

Fed cuts rates again with US recession "no longer in doubt"

Nick Beams
3 October 2001

The US Federal Reserve Board has again cut interest rates by half a percentage point in what is becoming an increasingly desperate attempt to boost the US economy and stave off a global recession. The cut, the ninth so far this year, takes interest rates to their lowest point since 1962.

In its explanation of the decision, the Fed's open market committee (FOMC) said the September 11 terrorist attack had "heightened uncertainty in an economy that was already weak." And the rate cutting is not over, with the FOMC warning that "the risks are weighted mainly toward conditions that may generate economic weakness in the foreseeable future."

The Fed's move came as economic forecasters made it clear that the economy would move into recession if it were not already there. A University of Michigan report indicated that consumer confidence plunged in the last two weeks of September and suggested that consumer spending would fall through the start of 2002. In a statement on the results Richard Curtin of the University of Michigan said: "A recession is no longer in doubt. The only issue is how long the downturn will last."

For the first time a member of the Bush administration has used the word "recession" to describe the state of the US economy. In testimony to the Senate Budget Committee, Glenn Hubbard, chairman of the Council of Economic Advisers, said the "supply shock" consequences of the terror attack would reduce the growth rate of gross domestic product in the third and fourth quarters and "increase significantly the likelihood that the economy is in recession."

In a survey of the impact of the September 11 shock, *BusinessWeek* magazine warned that it would flow across the economy. "It's no secret that the terrorist attacks of Sept. 11 devastated airlines, insurers, travel agents, and stockbrokers. But that may just be the beginning. It's becoming increasingly clear that the damage will extend across almost the entire spectrum of US businesses, from energy and manufacturing to technology, retailing, and autos. Even before the attacks, 2001 was shaping up to be a

terrible year for corporate profits. Now, earnings threaten to show 'the sharpest drop we've ever seen' in the postwar era, warns David A. Wyss, chief economist for Standard and Poor's Corp."

The warnings of sharply reduced global growth are also coming thick and fast. As *BusinessWeek* put it: "Economists, who make their best guesses based on the evidence at hand, are lopping anywhere from a half-point to two percentage points off their 2002 growth forecasts for the US, Europe, and East Asia." But the downturn could be more severe.

On Monday the Reuters Eurozone Purchasing Managers' Index of manufacturers hit the lowest level in its four-year history. However, according to David Brown of Bear Sterns in London, the worst was not over. "The euro zone downturn is going to deepen before we see any chance of recovery," he said.

The gloomy forecasts for Europe were underlined by the Swissair announcement that it was filing for bankruptcy—a move that could signal the start of major problems for other European airlines.

According to Ignazio Visco, chief economist for the Organization for Economic Co-operation and Development—the group comprising the 30 richest industrial nations: "Growth in the second half of this year will be negative in the US—the sign of recession—and very low in the EU. There will be global stagnation during this period."

The Japanese economy, already in recession, is going from bad to worse. The Bank of Japan's Tankan survey of the economy showed that business confidence at large manufacturers was running at minus 33 last quarter compared to minus 16 for the previous three months. This was the third successive quarter for which results had been negative and worse than economists had been predicting. The gloomy outlook was underscored by figures showing that industrial production in August declined at the fastest annual rate since the 1973 oil price shock.

As the US and global downturn deepens there are warnings that the events of September 11 will mark a major turning point and not merely a one-off shock whose effects

will rapidly pass.

In a recent analysis, Morgan Stanley chief economist Stephen Roach wrote that while many people in financial markets, business circles and Washington were still clinging to the notion that the economy would soon revert to the growth norms of the latter half of the 1990s, he believed that “the United States is at a key secular juncture, with the growth norms of the next five years likely to fall well short of those of recent years.”

According to Roach, as a result of the financial bubble, the US economy has been left with “a serious array of structural imbalances” including “a massive current account deficit, a huge capacity overhang, a record shortfall of personal saving, and a worrisome buildup of household debt.” Because of the “excesses” of the late 1990s, the US would face “powerful headwinds for years to come.”

A graphic warning of the situation confronting the US economy was contained in a major article by *New York Times* columnist and professor of economics at Princeton, Paul Krugman, published last Sunday under the title “The Fear Economy”.

Krugman began by pointing out that “the economic repercussions from the World Trade Centre disaster, unnerving as they are, would soon fade out if the economy had been strong to begin with. ... The point is that even before the attack, our economic condition was looking unusually precarious.”

According to Krugman, in order to understand the economic risks that the US economy may now be facing it was necessary to look back to the Great Depression of the 1930s and the difficulties of modern Japan.

“The history of the United States economy since World War II inspires at least a mild sense of complacency about the risks of economic downturn. The defences in place against any repeat of the Great Depression have held very well. And if our own history were the only evidence at hand, I and many others would probably feel quite at ease about the current situation. But we are not the only advanced economy that has had to face economic stress, and others have not fared so well.”

He pointed out that in the 1980s Japan had the most dynamic economy in the advanced world, but then came a recession in the early 1990s from which Japan has never really recovered, with the past 10 years amounting to a “sort of slow-motion depression.”

“I wish I could say with confidence that Japan’s dismal experience is of no relevance to the United States. And certainly our nations are very different in many ways. But there is a distinct resemblance between what happened to Japan a decade ago and what was happening to the US economy just a few weeks ago. Indeed, Japan’s story reads

all too much like a morality play designed for our edification.”

When the US developed a stock market bubble in the latter half of the 1990s, there were warnings that this could lead to a Japanese-style collapse. However those warnings were overshadowed by claims that the economy was resilient and that if a slowdown did come it would be countered by action from the Federal Reserve.

“By Sept. 10, however, the Fed had already cut rates seven times, and it was still hard to see where a recovery would come from. Indeed, some business economists had started referring privately to the Fed chairman as ‘Greenspan-san.’ Business investment was still falling, because corporations clearly invested way too much back when optimism was the rage.”

Krugman said that while he did not believe the US was at imminent risk of following Japan into deep slump, it could experience a “prolonged period of stagnation.”

“Here’s my nightmare: America’s recovery from its current slump, whenever it comes, is tentative and short-lived, because the business investment that drove our boom in the 1990s remains stagnant. Eventually the housing bubble bursts and we have another slump; then we have another weak recovery, this time driven by deficit spending, but that, too, fades out. Eventually we look around and realize that it’s 2009, and the economy still hasn’t fully recovered from the slowdown that began at the end of the previous decade.”

He concluded by pointing out that, while it has become a cliché to say that “everything is different now,” he was worried by the prospect that “some things may be the same—the same as they were here in the 1930s, the same as they have been in Japan for the last 10 years.”



To contact the WSWS and the
Socialist Equality Party visit:

wsws.org/contact