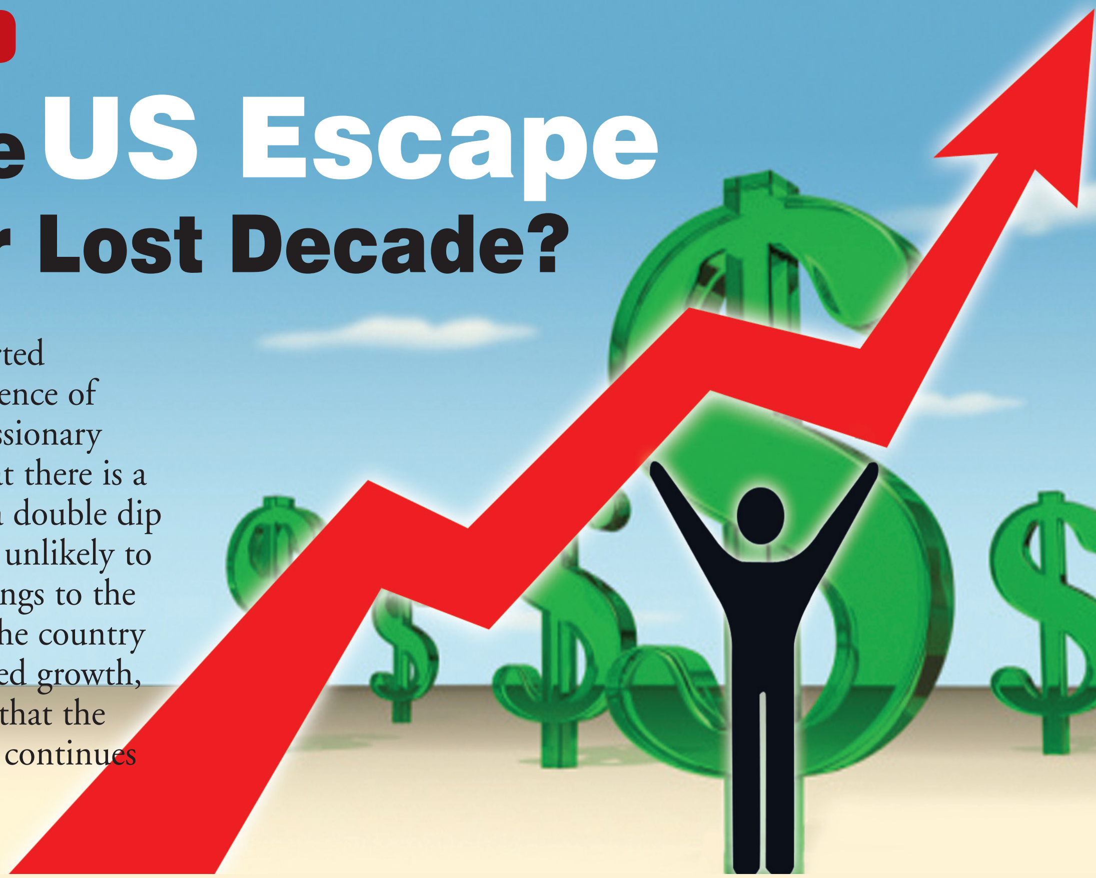
Special Report

Can The US Escape Another Lost Decade?



While many have started celebrating the emergence of the US from the recessionary phase, the truth is that there is a greater possibility of a double dip what with consumers unlikely to loosen their purse strings to the extent that will take the country to the path of sustained growth, not to forget the fact that the employment scenario continues to remain bleak

With the first decade of the new millennium coming to an end, the big news is that the US has technically come out of one of the worst recessions since the Great Depression. At a relative level, this may be one of the worst recessions ever recorded. The uniqueness of this recession lies in the fact that unlike the previous recessions, which mostly saw the inventory-led boom bust cycle playing out, this recession saw the US financial system plunging to its nadir. For this, however, while a majority of the blame goes to the financial whiz kids (a euphemism for thugs on the loose), the regulators also need to take a lot of blame for failing to take appropriate action at the opportune moment.

Despite clear faults in the system, the runaway assets' prices backed by the obscene expansion of the opaque derivative products were used by the regulators to justify that as a success story of their own policy acumen. And, when the bubble burst, asset prices collapsed. The last trading day of the year saw the Dow close at 10,428.05, down by 9.3 per cent (despite a major recovery from its March low, which is not necessarily backed by the economic fundamentals) as compared to its closing value of the previous decade i.e 11,497.12. This was the first time ever since the Great Depression that the Dow actually posted a loss during a decade.

This decade also experienced two recessions, one in 2001 (lasting for 8 months) and the other in 2008 (lasting for 19 months). This has happened for the first time after the decade of the 50s. Not surprisingly, the economy expanded the least (in real terms), leaving aside the decade of the Great Depression. Even after the 5.7 per cent annualised growth in the fourth quarter of 2010, US' real GDP would expand by less than 21 per cent during the decade - and this, despite a substantial improvement in productivity. Looking at it, the last decade can be termed as a lost decade for the US economy. There was virtually zero job creation (less than 4,00,000 jobs have been created) during this period.

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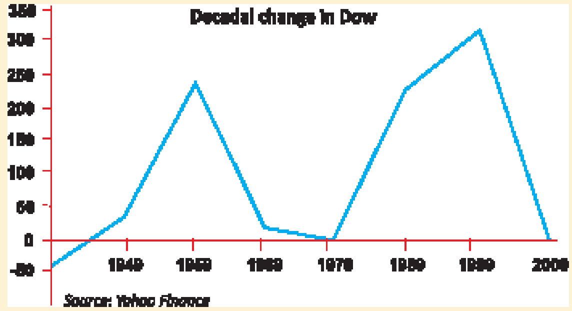
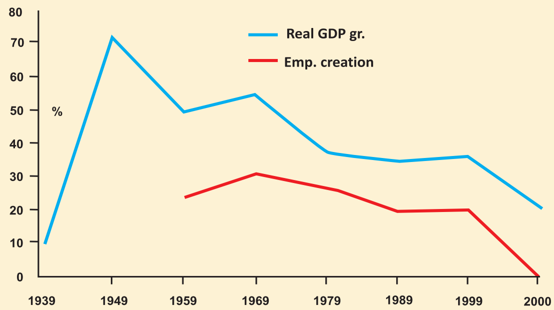
Not surprisingly, the US consumers were highly affected. During this decade, the inflation-adjusted median household income dipped for the first time, while the consumption binge that the US households indulged in (since the baby boomer generation entered the fray) led to their debts skyrocketing. With house prices falling and equity prices down, the wind has been knocked out of their sails. Going forward, how do things look for them? Not very good, I am afraid. During the last decade, more than 14 million people entered the labour force, but less than 4,00,000 jobs were created. In all, in the latest recession itself, approximately 8 million jobs were lost. Assuming another 14 million people enter the labour force in the current decade, the US would still need to create about 22 million jobs during the current decade to peg back the unemployment rate to around 5 per cent, which would be an ideal level.

This to me is going to be highly difficult. Looking back at the past decades, only in the decade of the 90s did the US add about 21.7 million jobs and during that decade, the economy grew at a CAGR of above 3 per cent. Around 3.1 per cent, to be precise. In the current decade, this is going to be a long shot, especially with the current potential growth rate being around 2.3 to 2.5 per cent. Fact of the matter is that the growth of the US economy is crucially dependent on the stimulus. And, despite the stimulus, the severely downward revised Q3'09 US GDP clocked a mere 2.2 per cent annualised growth. Given that the recession was officially declared to have ended in July, the growth rate was way below what it should typically have been at the end of the recession, especially long lasting ones.





Source: Bureau of Economic Analysis (BEA) and Bureau of Labor Statistics (BLS)

In the last six decades, the average first quarter post recession growth (for recessions lasting 10 months or more) has been 6.3 per cent. The Q3'09 GDP growth rate is about a third of that, and that too under the steroidal influence (as per some estimates, the influence was to the tune of 90 per cent) of the stimulus package. In fact, as per a report by the White House economists, the USD 787 billion economic stimulus package was responsible for keeping between 1.5 million and 2 million jobs in the economy through the end of 2009. Forget about the V-shaped recovery, which is what the stimulus was expected to bring about. There is, in fact, a greater possibility of a double dip recession. Contrary to many beliefs, the US consumers are unlikely to loosen their purse strings to the extent that will take the country to the path of sustained growth and the technical rebound that is expected on the back of inventory adjustment would soon give way to a dip as demands would fail to match expectations. There are many reasons as enumerated below.

The US would continue to experience a fairly high level of unemployment for a pretty long period of time. The most optimistic assumption of job growth in 2010, for example, is of 1.4 million on the back of inventory rebuilding. But even that pales in comparison to the need to create 8 million jobs lost during the recession and another average annual new addition of 1.4 million people to the labour force. One of the key issues holding down job growth is a growing disparity between small and large businesses. The National Federation of Independent Business released a report recently which showed another decline in small business optimism.

While the big banks and large corporations that have access to capital markets have been the biggest beneficiaries of the Fed's emergency programmes and low rates, small businesses (which employ nearly half of the US work force) have had a harder time accessing credit. Tighter standards on home equity loans and credit cards have hindered tiny operations. The Fed's latest survey of economic conditions nationwide, the so-called beige book, highlighted the continued weakness in the sector. In fact, according to a report by Global Entrepreneurship Monitor, the US saw a 14 per cent decline in entrepreneurs starting a new business.

It is not just the unemployment but the consumers are going to be much more cautious after taking a massive hit to their net worth. Even with the stock market rebounding, one can hardly get a sense of rebound in consumer sentiment. In fact, the survey results were to the contrary. And with unemployment level expected to remain elevated for a fairly longish period of time, consumers will continue to remain cautious. Additionally, with banks tightening lending standards and credit card limits reset downward quite heavily, the urge and ability to spend will remain muted. More importantly, the consumers are still highly leveraged. At about 128.1 per cent debt/net worth ratio, there's not much room for pushing this further.

Agreed, with net worth falling, the level looks somewhat elevated. But make no mistake since lower net worth is not the culprit but the high debt level is. The last decade saw the consumer leveraging levels rise ever so alarmingly, even though the net worth was rising at breakneck speed, on the back of skyrocketing house prices and rising stock markets. Even of late, while the house prices remain low, the stock markets have recovered quite well since March last. The problem is that during the last decade, when the US consumers were merrily building up their leverage to consume, the real interest rate levels were virtually zero.

Now, with budget deficit close to 10 per cent of the GDP and total debt close to 90 per cent (with debt held by public at 60 per cent) and the deficits slated to rise dramatically (in the next five years, the debt held by the public itself is slated to cross 100 per cent), inflation is going to rear its ugly head sooner, rather than later, which would necessarily lead to rising rates. And, when the cost of servicing debts starts to go up, the consumer would be faced with an ever-reducing pie of their income that can be used for consumption. Many would be facing their own Minsky moment and start defaulting. The bottom line: consumers are unlikely to loosen their purse strings that would be ever so vital for the US economy to start growing again at a healthy pace. Essentially, while the current decade may not exactly be a lost decade (though that cannot be ruled out totally), there would not be much to cheer either.

(Views are those of the author. Author's website: http://kunalsthoughts.weebly.com)