The Economy Looks Like "L"

Just when the headline news about the economy was beginning to look good and the talking heads were beginning to sound good, along came a barrage of bad news that was so bad that it couldn't be covered up. Gallup began with the news that in January nearly 20 percent of the U.S. workforce "lacked adequate employment", which was worse than the numbers reported by the Labor Department. According to Reuters, these "findings appear to paint a darker employment picture than official U.S. data," with about 30 million Americans "underemployed." And Gallup misses the mark by at least 2 percent, according to John Williams of ShadowStats.com.

On top of those numbers, consumer confidence fell sharply in January from an anticipated 55 to a disappointing but probably realistic 46. A reading of 90 or better indicates a healthy economy. But a closer look even at "the numbers behind the numbers" shows that the "current conditions" index dropped to a level not seen since 1983, 27 years ago. According to the Associated Press, this "raises concerns about the economic recovery." Lynn Franco, director of the Conference Board Consumer Research Center, put it gently: "The combination of earnings and job anxieties is likely to continue to curb spending. Consumers remain extremely pessimistic about their income prospects."

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"Likely" is hardly the word to use. Gallup announced that those "underemployed people spent 36 percent less on household purchases than their fully employed neighbors in January." With the consumer responsible for 70 percent of the nation's GDP, and one out of five either mostly or totally out of work, it's no wonder that confidence is in the dumper. Gary Thayer, chief economist at Wells Fargo Advisors, agrees: "Shoppers are going to wait until things get better."

And when is that likely to happen?

The Case/Shiller index of housing prices staged "the most dramatic turnaround that we've seen in our data all the way back to 1987." But the January data show that turnaround "has fizzled and housing is [now] in a holding pattern." Fizzle is synonymous with "sugar high", which the housing market has enjoyed ever since the government began giving tax credits to people buying homes. But those programs are coming to an end, and reality in housing is kicking back in.

Yale Professor Robert Shiller cited a "particular worry about rising mortgage defaults," reflecting the fact that foreclosures are continuing at record pace, and banks own a huge amount of repossessed properties that have yet to be put on the market. They too are "waiting for the things to get better." Standard and Poor's rating service anticipates that "a full 37.5 percent of [option ARMS] that were written in 2007…will eventually go bad."

And since most of those "resets" take place three to five years out, "the brunt of the impact [of those defaults] has yet to be felt. These resets have been addressed here and here on this website and are finally being looked at seriously by the popular cheerleader press. For example, *Time* magazine asked rhetorically "How worried should we be? Perhaps very." They looked at a recent study done by Amherst Mortgage and concluded that "$10 billion worth of option ARMS will reset higher each month" by the middle of next year.

> The problem with option ARMs begins with the fact that people who took out these loans were given the chance to make ultra-low payments for the first few years — and many of them did exactly that. Borrowers, mostly middle- and upper-class with good credit scores, were allowed to make payments that didn't even cover the interest owed (let alone the principal), with the understanding that payments would spike later on to make up for the shortfall. That allowed people to buy bigger, more expensive houses than they would have been able to qualify for otherwise. Plenty of families banked on rising incomes and an ability to sell their house as ways to deal with such loans in the long term — plans that the housing crash and recession in many cases foiled.

Time examined one Option ARM loan, a 40-year loan written in 2007 in the amount of $465,000. The initial monthly payment was $1,260, but jumped [due to a cap on the amount of negative amortization that was allowed] to $1,354. It reset two years later with the monthly payment more than doubling to $2,806. No wonder the homeowner walked! According to Diane Westerback, the managing director for Standard and Poor's, "Some of the damage has already been done, but the loss projections [into the future] are increasing."

Such bad news has its ripple effect, which was reported on Tuesday, with the announcement that another 700 banks failed during the last quarter of 2009, the highest level since 1993.

And of course it's all the fault of Congress, according to Reuters, because government programs designed to "boost employment" have been "frustrated by a partisan rancor in Congress." Of course, promises by President Obama that the economy would be back on track, and that employment would never rise above 8 percent due to his "stimulus" programs, have all disappeared over the back fence. And so, as true Keynesians, since the first, and the second, and the third "stimulus" packages didn't work and haven't worked, what is needed is another one!

Common sense economists, although few in number, have been proposing the most sensible thing to "do", to stimulate the economy, is to cut taxes 30 percent across the board, and stop meddling. That would allow taxpayers to keep more of their own money, and allow them to make their own decisions about how and where and when to spend, or invest, it. As often quoted here before, Austrian School economist Henry Hazlitt had the answer about what to do: "Stop the Remedies!"

Left alone, the economy will come back as individuals are free to make their own plans without interference and uncertainty. With continued government programs and packages and "solutions", however, the economy certainly won't look like a V, and it isn't likely to look like a W. It's more than ever likely to look like "L."

Photo of unemployment line during the Great Depression: AP Images