

Fragile economy edgy

Malaise that began in late 2000 hasn't yet run its full course

By MICHAEL E. KANELL
mkanell@ajc.com

As the economy inches toward an elusive recovery, fears of recession again are growing.

Dismal numbers for February — job losses climbing, while consumer confidence and retail sales fall — have raised the specter once again that a halting recovery has reversed and the economy is accelerating into a slide.

A looming war only intensifies that worry.

"We are on very fragile footing," said economist Campbell Harvey of Duke University in North Carolina. "If uncertainty keeps going on and on and on. Or if the war starts and it's not a fast war — immediately I think the United States would go right back into recession."

That is assuming that it ever left and that a downturn now would be a "double-dip."

Certainly if job creation is the measure, the economic malaise that started in late 2000 has not yet come to an end, said Rajeev Dhawan, director of the forecasting center at Georgia State.

"Who said the recession was over? I never said that," Dhawan said.

Yes, the economy has grown — erratically, modestly — since late 2001. But payrolls have been shrinking and the pace has picked up.

New jobless claims again floated skyward, averaging 420,000 the past four weeks — levels usually seen only during recessions. Consumer confidence again dropped, according to the monthly survey by the University of Michigan: Confidence has not been this low since October 1992.

And retail sales slipped 1.6 percent in February, with signs of weakness in nearly everything except gasoline sales.

"Consumers are behaving like we are in a recession," said economist Mark Vitner of Wachovia Securities. "Not only are consumers cutting back but they are cutting back the most on discretionary purchases, such as cars, furniture, household appliances and clothing."

And if consumers act like it's a recession, they can make it so. Because it accounts for more than two-thirds of the economy, anything that dampens

INDUSTRY

Industrial production edged up 0.1 percent last month, slightly better than expected. Utilities and mining did well; manufacturing declined.

HOUSING MARKET

Mortgage applications leaped by 27 percent to a record high. Refinancing continues an unprecedented boom, but home purchases held steady.

FRAIL RECOVERY OR RECESSION REDUX

This week's economic data told the story of two economies. One is growing, albeit meekly. The other is accelerating into a ditch.

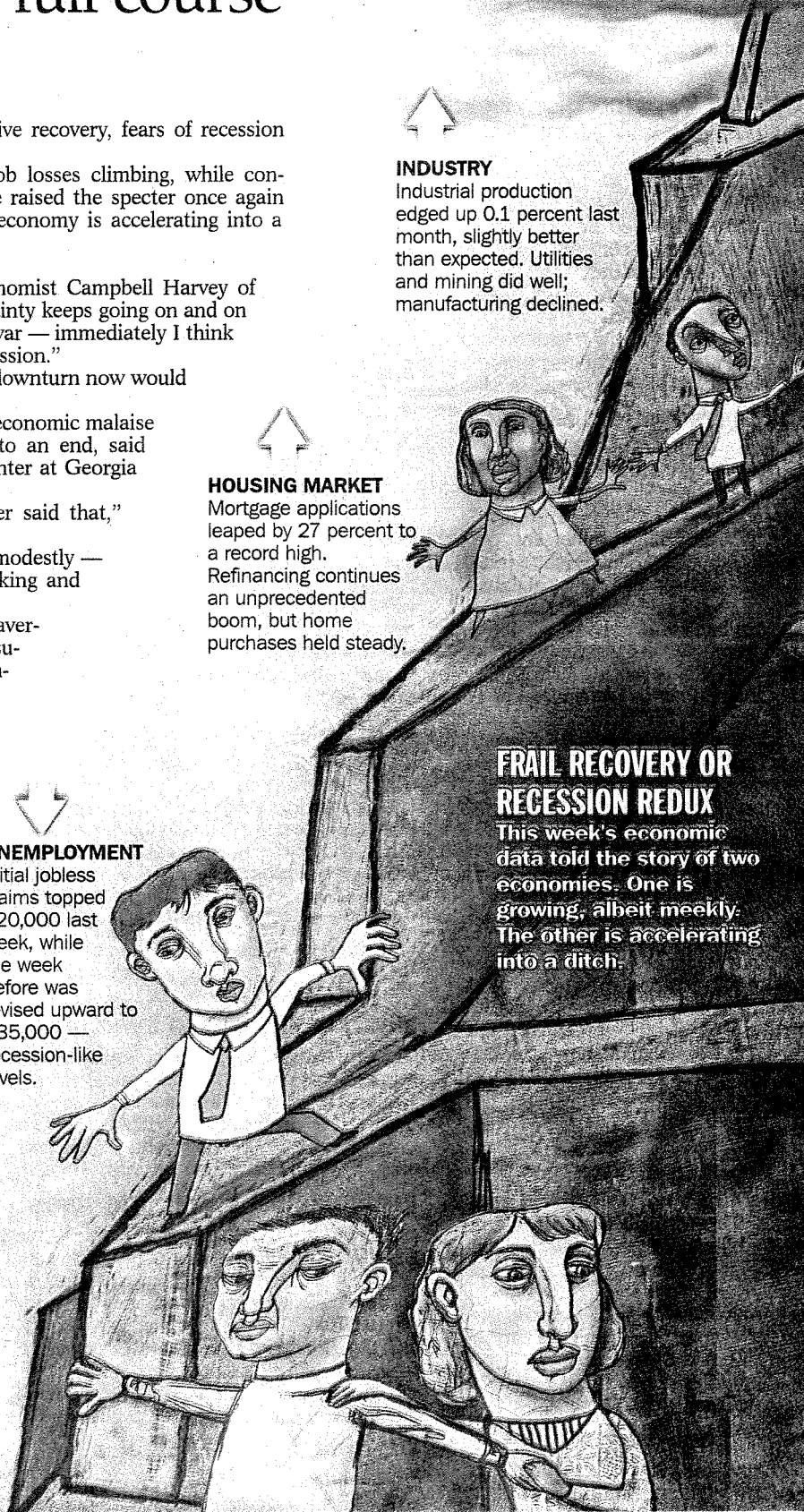
UNEMPLOYMENT

Initial jobless claims topped 420,000 last week, while the week before was revised upward to 435,000 — recession-like levels.

CONSUMERS

Consumer confidence crashed to its lowest level since October 1992. Retail sales took their largest fall since September 2001.

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Fragile economy remains mired in a malaise

► Continued from F1

consumer spending could spin the economy into a ditch. Energy price hikes have already trimmed consumer buying power. That is no reason to despair, Vitner said.

"Can consumers increase their borrowings even more? We think so," he said.

Don't count on it, countered Dmitri Papadimitriou, president of the Levy Institute. Debt paid for the 1990s boom, but nothing similar can happen now, he said.

"Personal-sector debt burdens remain extraordinarily high," he said.

The most urgent of the economy's troubles right now are oil and war — two fears that are deeply intertwined. Arguments over the future hinge on whether those

plagues are root afflictions — or just the most obvious.

For every \$5-a-barrel rise in oil prices, the economy sheds 1 percent of growth, Dhawan said.

"But this is not a fundamental problem. It is a situational problem," he said.

And the situation is about to change, Dhawan said.

Oil prices have flirted recently with \$40 a barrel. But trades on the futures market endorse the idea that oil will be back to \$25 a barrel by year's end — and dropping prices put money back in American pockets, said Richard DeKaser, chief economist for National City Corp.

So is it all about war?

It might happen or maybe not. It might be short with few U.S. casualties, but then again, it could be brutal, bloody and

costly. It might send oil prices through the roof, but then again, experts don't think so. And what about North Korea?

Uncertainty is rampant.

The nation is simply not in bad shape, Duke University's Harvey argued. Instead, anxiety about combat has frozen business spending and chilled consumer attitudes, he said.

"If you have a peaceful or quick resolution, this economy could take off," Harvey said.

The stock market — considered a leading indicator for the economy — should indeed get a bounce from a short war, said economist Peter Rousseau, an economic history specialist at Vanderbilt University in Tennessee.

But it might be brief, he said.

Like the terror attacks of 2001, the fall of France in 1940

raised the possibility of a radically different, much more frightening world. The stock market fell and kept falling.

"The fall of a major Western power had an immediate effect on the psyche," Rousseau said. "And in real terms, it took until 1945 for you to get your money back."

America still hasn't worked through the spectacular over-investment of the 1990s, argued Stephen Roach, chief economist for Morgan Stanley. With manufacturing still operating at only 75 percent of its capacity, companies are not likely to start investing soon, he said. Optimism that a war — a quick war — will spur growth "may well be one of the biggest myths."

Instead, recession odds are high — and rising, he said.

But maybe neither war nor the boom's hangover are the real key to the economy.

"I think the war is something of a sideshow," said economist James Bradfield of Hamilton College in New York. "The likely effect of a war is substantially less important than the lack of confidence among consumers and investors."

Economists often discount surveys, arguing that consumers do not always spend the way they say they feel. But the plunge has been dramatic — and has gotten worse with rising threats of war.

"If confidence erodes, we are in trouble," he said.

One of the worst domestic threats to the economy would come with a stall-out in what has been the engine of salvation — housing.

Slam that into reverse and the economy would shudder.

Purchases, refinancing and home equity loans accounted last year for more than \$700 billion of the nation's \$10 trillion economy. Moreover, home-building props up construction, while buying often ripples into purchases of furniture.

All of it helps the economy.

Roughly \$266 billion was "taken out" of homes in cash last year, nearly three times that of 2001, said economist Asha Bangalore of Northern Trust Co.

While new home sales took a steep fall in January, the dip was far outweighed by record sales in existing-home sales.

Sales are still strong. So, why worry? Because more declines are coming, said economist Celia Chen of

Economy.com.

Low mortgage rates have kept the housing engine humming so far.

Much of the credit is given to the Federal Reserve, which has slashed short-term interest rates to 1.25 percent.

That leaves little room to cut. Still, the Fed could use its remaining ammunition to give the economy one more push — although it might wait for war before moving. The Fed's elite committee meets next week, and a growing number of investors are betting that the Fed will move again.

Fed Chairman Alan Greenspan recently told Congress that the economy didn't need a jolt of government spending. Fear of war is the economy's albatross, he argued.

But the once unquestioned chairman now finds his judgment rejected from both left and right.

Doubt is a poisonous cocktail — and Greenspan underestimates its potency with “a remarkably complacent view,” said John Makin, resident scholar at the American Enterprise Institute.

“I cannot gauge the impact of geopolitical tensions on the state of the economy, but neither can Greenspan or anyone else.”