The US Economy after September 11th. Decline or Rapid Growth?

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On a common Tuesday, September 11th music on my favourite radio station was interrupted by a special news block, which reported that an airplane tore into the one of the twin-towers of the World Trade Centre in New York. My first thought was about dramatic weather conditions that could have led to such a terrible accident. I couldn’t even imagine that it might have been a terror act or something like that. In some minutes together with millions of people all over the world I was watching views of the catastrophe on TV and couldn’t believe my eyes. If I hadn’t heard about this before, I would have definitely thought that a new Hollywood movie was on. The understanding and feeling of what had happened and of the scale of this came only after some hours of embarrassment and shock…

But business and economic spheres can’t afford hesitation and delay. On this day ruined not only the walls of the World Trade Centre, but also, which is much more important for the economy, the assumption of the USA being a standard of stability, trust and prosperity. Businessmen, investors and brokers recognised that the faster they reacted, the more they benefit (or probably the less they lose) in the situation. Market response was immediate. Words of Alan Greenspan, chairman of the Federal Reserve, illustrate it: “Greater uncertainty for business and consumers hits economic activity, at least in the short term”.

Already since the beginning of the year 2001 economists have been arguing about whether the economy of the United States was declining or not. The situation, indeed, was not very obvious because of a number of attempts of the Federal Reserve to stimulate the expansion by cutting the interest rate. Today, however, practically all of the specialists say that the American economy is in recession. Now there is no common view on how long and how deep the recession will be and how to evoke the recovery. To illustrate this I want to note that one group of economists believe that cause of this recession is not terrorism, but rather the economic and financial imbalances that built up during the late 1990’s, and that the incident of the September 11th was only a jolt to aggravating the situation. Firms overinvested and overborrowed due to inflated expectations about future profits. Households borrowed heavily too, believing that share prices would rise forever. Thus, it will take time to bring consumption, investment and loans to their natural rates. Despite this, there is also a point of view that the events of September 11th have made a V-shaped recession and recovery more likely: a swift slide down one slope, sufficient to propel the economy up the next. Now it is high time to consider facts, mainly statistical, which are important in the analysis. It’s better, to my mind, to begin with the pessimistic prognosis.

Economic data published since September 11th have, not surprisingly, been gloomy. America's industrial production fell in September by 1%. That was its 12th successive month of decline, the longest unbroken fall since 1945. The current manufacturing activity had plunged to its lowest level since February 1991. The 5.8% output loss of the past 12 months is already greater than in the recession of 1990-91. Retail sales also fell in September, by 2.4%, consumers cut back their spending in September by the largest amount in nearly 15 years. To cope with sagging sales, manufacturers have sharply cut back production and shed workers. The nation's unemployment rate leaped from 4.9% in September to 5.4% in October, the biggest one-month jump in more than 21 years. This is the highest unemployment rate since December 1996. 415,000 jobs were eliminated during the month, which represented the biggest cut in payrolls since May 1980. Manufacturing, airlines, travel agencies, hotels, retailers were among those suffering big losses. ''Companies are in survival mode and they are cutting jobs to control costs,'' said economist Ken Mayland of ClearView Economics. ''The tragic events of September 11th and their aftermath probably tipped the economy into recession. People are waiting for the other shoe to drop.'' There is one more indirect evidence of the tough state of staff policy in American companies: many of them are planning to cancel traditional Christmas Parties due to their poor financial condition.

Thus, according to the GDP report of the government, the economy contracted in the third quarter.

Even with a mild recession in America, then, this could still turn out to be the most severe world recession since the 1930s. (Such a recession is commonly defined as annual growth of less than 2%.) Global growth is predicted to be average 1.5% in 2001 and 2002, its slowest two-year period during the past 50 years. This increases the risks for America, because contracting trade can amplify a recession. Last year the volume of world trade grew by 13%, this year growth may fall to zero. When nominal GDP growth falls so low, central banks have less scope to use monetary policy to boost demand, profits grow more slowly than expected by stockmarket investors, borrowers find it harder to repay debts.

There is also one factor, which some specialists consider to be one more evidence of weakening economy: profits of confectionery companies grew this year by 15%. Statistics say that this is often an indication of recession, as many people can’t satisfy their luxury wants any more, but consuming larger amounts of sweets, which are comparatively cheaper.

In addition with the wide-spread view that the country has entered its first recession in a decade, analysts are predicting that inflation pressures, which have been moderating for a year, will retreat further, especially in the area of wage pressures, as the surging unemployment rate dampens workers' demands for salary increases.

Economists are afraid of that continued fallout from the attacks, worries about anthrax in the mail, tumbling consumer confidence and rising unemployment, will keep consumers tightfisting, further weakening the economy.

But let us now switch to the more optimistic prediction as many economists still reckon that America's recession will be brief and mild. They predict that GDP of the USA will decline till the second quarter of the year 2002, then will start to recover with quite a strong growth, by 3-4%. If the prognosis turns out to be right, it will be one of the shortest and mildest recessions on record. And there are three main reasons to believe in it:

1. It is argued that firms have already made steps to cut back unwanted inventories and overcapacity.
2. In contrast with three previous recessions, oil price has fallen.
3. America benefits much from monetary and fiscal policy. Interest rates have been cut ten times this year, including three reductions after September 11th, to their lowest level since the early 1960’s. President Bush, meanwhile, wants Congress to quickly pass a package aimed at stimulating the economy through new tax cuts, increased government spending, emergency relief, which could amount to 1.5% GDP – the biggest fiscal boost in one year since 1975.

Indeed, the US economy had an advance in October, largely thanks to zero interest-rate financing for new cars. The value of retail sales climbed by 7.1%, the biggest increase ever. Sadly, retail sales dropped back next month, as the effects of the incentives ran out. But even not taking into account cars, retails sales rose by 1% in October.

Besides also in October the US dollar reached a 3-month high against the Euro due to new hopes for a revival of consumer demand.

The hope that America's recession will be mild appears to have helped share prices to recover worldwide. Many stockmarkets have almost regained their levels on September 10th. Main indexes - Nasdaq, S&P 500, DJIA - are edging up, though in comparison with December 31st, 2000 they are respectively 23%, 13.6% and 8.9% lower. Considering Commodity Price index change on October and on the whole year we face practically the same situation: change of Industrials index on one year is -15.7% and on one month +2.7%, change of Food index -2.7% and +3.0% respectively. The same applies to other commodities as well as for all items.

This might signify that gradual boosting of the Economy in the last quarter of this year and in 2002 will compensate for the sharp slump in September and the recession will be left behind.

As for me I believe in the USA. There is one common feature of Russian and American folks I can distinguish and admire, it is that in the most dramatic moments each nation unites and in spite of all obstacles, troubles and difficulties overcomes the crisis. This has been proved not once in course of history of both countries (not without any exceptions, of course).

There are many reasons for a sharp decline in the US economy, but some factors that could amplify its recovery and further growth also exist. Both “for” and “against” were presented above and at the first glance the pessimistic anticipation seems to predominate. But still I can’t forget about this “nation spirit” – an unexplainable component, i.e. the so-called X-factor of success in the most unfavourable conditions. Although, by the way, I may think so under the influence of the American standard of well-being. But still taking into consideration this as well as all other optimistic forecasts, I am inclined to believe that the recession will not last for a long time and may, on the contrary, stimulate the following rapid pace growth.

List of resources used in preparing the report:

1. www.economist.com
2. www.usatoday.com
3. www.reuters.com
4. The Economist, November 17th, 2001.