

Odds Are ...

Experts Say the Nation Will Likely Skirt a Recession, but All Bets Are Off

By GEORGE O'BRIEN

Michael B. Katz weighs in below.

Michael Goodman is the managing editor of *MassBenchmarks*, a quarterly review of the state's economy published by the Donahue Institute at the University of Massachusetts.

He's hard at work on the latest issue, which will take a comprehensive look at casino gambling and its potential impact on the Commonwealth's economy — and society in general.

There's a touch of irony in all this because, as the calendar turns the page to 2008, regional and national economists are sounding a bit like odds-makers as they speculate on whether the nation will fall into a recession, and, if so, how long and deep it will be.

"If I were a gambling man, which I'm not," said Goodman, who is also current president of a group called the New England Economic Partnership, or NEEP, which produces semiannual economic forecasts for the six New England states, "I'd say that growth slows down over the next several months, but we're *not* going into recession in Massachusetts."

At least not in the technical sense of that word — 'recession' is defined as two consecutive quarters of negative growth in gross national product, he said, noting that the less-rigid definition of the r-word (a period of reduced economic activity) will likely lead to considerable debate as to if and when the country slides into a recession.

"I'd say the odds are about 70-30 that we won't go into a recession," he continued, noting quickly that there are a number of factors that would make betting on what will happen next year a risky proposition. These include the ongoing and deepening

subprime lending crisis, which is being compared in some circles to the savings-and-loan debacle of the 1980s in terms of its potential consequences to the national economy, as well as an accompanying credit crunch, soaring energy costs (there is persistent speculation that gasoline

Which is unfortunate, said Dave Glidden, regional president of TD Banknorth, because area banks have plenty of money to lend and, in the case of some institutions that recently went public and raised tens of millions in fresh capital, more money than they could ever hope to lend.

factors listed above make projection-making a real crapshoot.

Betting the House

While some economists are shying away from the word 'recession' when projecting ahead to 2008, they have some other terms to convey a less-than-rosy outlook.

"Things are definitely going to feel sluggish by next spring," said Robert Nakosteen, an Economics professor at UMass, who also used 'stagnant' and 'soft' as he discussed the national economy and what might happen with it in the months ahead. This sluggishness will be a byproduct of several factors, including a general tightening up on credit (more so nationally than in the Bay State), falling property values, higher energy costs, and a resulting decline in confidence on the part of both consumers and business owners.

"When home values decline, people simply feel less affluent," said Nakosteen, borrowing an industry term — the so-called 'wealth effect' — to explain why spending declines. "When people don't feel they can use their house as a piggy bank, that always reduces the amount of consumption spending."

Looking back to the third quarter of 2007, Goodman said it was stronger than most projected it would be, with growth approaching 5% when compared to the year prior. To give all that back and then experience negative growth by early next year would be a big — but not unprecedented — fall, thus leading many to stop short of predicting recession.

"There's still a lot of strength in the U.S. economy," he explained, predicting slower growth, perhaps 2% or so for at

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may reach \$4 per gallon), and the remarkably weak dollar, which brings a number of benefits so long as it doesn't fall too low.

And then, there's the all-important matter of confidence, among both consumers and business owners, and this intangible will be a function of many of those other factors.

Summing them all up in relation to what he's seeing and hearing, Mike Katz, an attorney with the Springfield-based firm Bacon & Wilson who specializes in bankruptcy and finance, said many people have grown wary of spending and are in a state approaching semi-paralysis.

"Many people seem to be overwhelmed by uncertainty," he explained. "They don't know when and how to decide on such things as making big purchases, selling their house and trading up to a bigger one, refinancing their house ... they just don't know when to jump in the pool. It's a crisis of confidence."

This is especially true on the commercial side of the ledger, he said, noting that an already-highly competitive market has become even moreso as a crowded field of players vies for less business.

But while there are many question marks concerning 2008 — "muddled" was the word Glidden used to describe the picture for '08 — there are some bright spots concerning the present and (potentially) the future tenses, he said.

"It's easy to put on the gloom-and-doom hat," he told *BusinessWest*, "but there are some are some positive things happening in this region. There is some job growth, and many companies, especially manufacturers, are making investments in their businesses."

In this, our annual 'Economic Outlook' issue, *BusinessWest* takes a look at what several experts foresee happening in the months ahead, and why the many

least the first few quarters of '08. "Clearly there are uncertainties and a lot of imminent weakness, but on the strength side, the weakness of the dollar has been an extraordinary advantage to our exporters and our manufacturers.

"Meanwhile, the weak dollar makes the U.S. quite a bargain," he continued, "for people who would purchase the goods we make or people who are interested in making investments in corporations or real estate or deciding where to expand; the U.S. as a business location is looking like a very good bargain these days."

But not everyone believes the nation can avoid recession. "I'll eat my hat if we're not in one by very early next year," said Michael Meeropol, an economics professor at Western New England College. He told *BusinessWest* that a confluence of factors, especially the credit crunch that will impact many regions of the country, will put the country into a recession, probably sooner rather than later.

Whether there is a recession or not, things are almost certainly going to continue getting worse before they get any better, and the main reason for this is the sub-prime lending crisis and its many tentacles, said Nakosteen, listing impact on credit availability, housing construction and other types of building, the many housing-related business sectors, and even real-estate brokers, an often-overlooked constituency that will invariably suffer, with many leaving that profession at least temporarily.

With all of these factors, the impact in Massachusetts will be less serious than in other parts of the country, and much less so than in the states hit hardest by the mortgage crisis — Florida, California, Texas, and others, he continued. Part of the reason for this is that there were fewer sub-prime mortgages written here, but in other cases, like housing construction, the Bay State simply has less to lose than other

regions of the country that had been experiencing strong residential growth.

"We don't really have a housing construction industry to get hurt by this in a big way," he explained, "because it's really hard to get any housing built here, and many contractors are not dependent on the housing market."

Confidence Men

But the mortgage crisis has impacted the Pioneer Valley, and it will continue to do so, said Katz, noting that there have been record numbers of foreclosures over the past year, and this trend will likely continue despite a host of programs and legislative measures — some of which he described as "smoke and mirrors" — designed to help people stay in their homes.

He said he has seen a steady rise in the number of people who are behind in their payments and concerned about not knowing what to do.

In some cases, it is adjustable-rate mortgages hitting numbers that the buyer didn't anticipate and can't handle, he explained, but in many others, it's simply a matter of people buying more house than they could afford under any scenario.

"People are sometimes lulled into, or talked into, taking out these low mortgages," he said. "And the reality is that even if the rates were brought down significantly below market, they still couldn't afford the house because they just don't have the income."

Katz said he's seen a number of people just walk away from their homes without putting up a fight — something that members of previous generations wouldn't think of doing. "People are just giving up, saying 'this isn't working, it's not economically viable.'"

Meanwhile, for those who are relatively comfortable economically, there is that matter of confidence, or lack thereof, that casts a sizable shadow over the economy.

Indeed, as he talked about the

prospects for 2008, Goodman said there are myriad statistics pointing toward consumer caution and a decline in overall confidence — and some anecdotal evidence as well.

"I was talking with a community banker who told me he has a few customers he always looks to for signs on which way the economy is going — and one of them is a tire dealer," he told *BusinessWest*. "Business was good at the tire store, but the owner knew that this wasn't really a good sign — people were replacing their tires and not their cars."

There will be other, similar indicators in the months ahead, he said, predicting that fewer people will be trading up to bigger homes, buying vacation homes, adding pools, or investing in most other big-ticket items, simply because they are uncertain about the immediate future.

"When people are confident in their own financial status, they're less risk-averse," he said, adding that the opposite is also true.

The extent to which spending declines will go a long way toward determining whether the country slides into a recession — and how long it might last if that occurs, said Goodman. And there are a number of factors that will go into that equation, starting with the wealth effect.

"You feel more prosperous when you're wealthier on paper and you feel the value of your home is going up," he said, noting that this phenomenon is reflective of everything from the value of one's home to the number on the retirement account statement. "When you're feeling more prosperous, you might put an addition on your house or buy a second home, which many people did a few years ago. Now, those people are very, very nervous, and they're trying to sell their second home and get out alive."

Energy prices are another variable. "Every additional dollar that goes into heating your home or putting gas in your tank is one

less dollar that you might spend on something else," Goodman explained, adding that if spending declines markedly, retailers will have to respond with some incentives. "I would expect some pretty good sales."

Katz said a combination of factors, including the recently schizophrenic stock market, is leaving many people struggling to decide just what to do with their money.

"Let's say you get a bonus this year ... what are you going to do with it?" he asked rhetorically. "Are you going to put in savings, where you're earning next to nothing in interest? Are you going to put it in the market after you lost x percent last month?"

"Most people are going to wind up buying something they think they need, or they're going to park it in the bank and earn very little in interest, because everyone's afraid," he said, adding that this fear may be the biggest factor facing the economy next year.

Dicey Situation

If the nation does happen to slide into recession, Goodman predicts that it won't be for long, and that the downturn will not be very deep — at least in Massachusetts and especially in the Pioneer Valley. That's because, historically, this region doesn't enjoy the economic highs seen in Boston and other areas, but nor does it experience the real lows that also visit those places.

"It represents a missed opportunity during the up times," he said of the area's relative flat-line growth pattern. "But it's a bullet dodged during the down times; there's generally slow, steady growth here, and it's a fairly stable economy — the Western Mass. region will ride this out without any major incidents."

That's one bet he's apparently willing to take. ♦

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