

Economist.com

OPINION
LEADERS**The world economy****The great American slowdown**

Apr 10th 2008

From The Economist print edition

The recession may not be as severe as many fear, but the recovery could take longer—and that is dangerous**Get article background**

AMERICANS are unaccustomed to recessions, particularly ones that involve shopping less. During the past quarter-century, the world's most powerful economy has suffered only two official downturns, in 1990-91 and 2001. Both were short and shallow. In 2001 consumer spending barely skipped a beat; a decade earlier it fell, but only briefly. Buoyed by rising asset prices and financial innovations that allowed ever more people to tap ever more debt, the collective American wallet has not snapped shut in almost two decades.

That may be about to change. Evidence is mounting that the economy has slipped into recession—and this time consumer weakness is to the fore (see [article](#)). The doughty American shopper is being pummelled by four things: the housing bust, the credit crunch, higher fuel and food costs and, most recently, a weakening labour market. The unemployment rate rose to 5.1% in March, while the private sector lost jobs for the fourth month in a row. Feeling poorer and with fewer people prepared to lend them money, consumers are cutting back: witness the slump in car sales. And seeing that consumer spending accounts for 70% of American demand, that hurts, especially when it is coupled with a collapse in the once mighty construction industry. The IMF now officially predicts an American recession in 2008; many at the Federal Reserve think output is contracting.

Shallow but lengthy: you could do a lot worse

There are two big questions about this downturn for America and the world: how long? And how deep? On

the second count, there is room for guarded optimism: although American recessions have usually sent the world economy into a funk, this time the slowdown need not be so severe—especially for the emerging world. The economic tests instead may come from the length of this downturn: an America that stays sluggish for several years could cause all sorts of problems.

That is not to imply that a severe global slowdown is out of the question. The IMF reckons that there is a 25% chance of the world economy growing by less than 3% in 2008 and 2009, the equivalent of recession, in its view. The origins of this crisis lie in the biggest asset bubble in history; financial markets have already suffered arguably their biggest shock for 80 years; and America is not the only developed economy suffering (Britain's housing market, for instance, is showing the same symptoms as America's—see [article](#)). But so far at least there is little evidence that the world economy is falling off a cliff.

The pace of job losses in America has been mild compared with previous downturns, and there are a couple of reasons to suppose it will stay that way. The first is the activism of American policymakers. Congress started throwing money at the problem early, and a second fiscal stimulus is already being discussed (alongside a bail-out for the housing market). The Fed has slashed interest rates, promised more cuts if the economy stays weak and—perhaps most important—sharply reduced the odds of financial-market catastrophe by extending its safety net to investment banks.

The second is the changing structure of the world economy. The dynamism and resilience of emerging markets mean that America does not matter as much as it once did. The IMF expects global growth to fall from 4.9% in 2007 to 3.7% this year—hardly catastrophic. Moreover, these foreigners can now do a bit to cushion the blow for Americans: already global demand, coupled with a weak dollar, is boosting American exports. Meanwhile, some losses from America's housing bust have been borne abroad, although not without pain.

With these props, America can avoid a deep slump, but don't expect a vigorous recovery. Spending will be supported by tax rebates in the second half of the year, but the hangover from the housing bust will linger much longer. Judging by the experience of other rich countries that have suffered financial crises spawned by housing busts, such as Sweden and Norway in the early 1990s, weak balance sheets will weigh on consumers' spending for years rather than months. The 2008 recession may be mild, but the 2009 recovery will be feeble.

Beware the slithering snail

If the world economy's biggest problem turns out to be America remaining snail-like for longer than most people expect, many will breathe a sigh of relief. Given the scale of the financial mess, it could be a lot worse. You can even argue that after five years of breakneck growth, a more sedate global expansion would be no bad thing: it would dampen inflationary pressures in the emerging world, and weaker domestic demand should shrink America's gaping external deficit—already down from above 6% of GDP to below 5%.

But that is about as far as optimism can take you. The main fear is that the rest of the world proves less resilient than now seems likely: commodity exporters, say, may rely on American demand less than they did, but are hardly cut off from it. The weak dollar also causes problems. Importing America's loose monetary policy will become harder to sustain for countries, such as the Gulf states, that peg their currencies to the greenback. They will need to let their exchange rates rise.

Politics too can do plenty of damage. A sluggish America next year will be a hard inheritance for the next president. With the budget deficit rising, big domestic reforms, such as expanding health-care coverage, will become more difficult; with a fragile economy, the Democrats, if they get in, may have to rethink their plan to roll back George Bush's tax cuts.

And do not forget populism and protectionism. Already eight out of ten Americans say their country is on the wrong track. A protracted malaise will spawn an angry search for scapegoats. Even though free trade is helping save Americans from a worse downturn, Mr Bush is struggling to get a trade deal with Colombia through Congress (see [article](#)): heaven help the Doha round. Meanwhile, the momentum to re-regulate financial markets and punish the oil industry, credit-card firms or indeed any other malefactors of great wealth will grow. The great American slowdown may be less calamitous than many people fear; but it is fraught with dangers.

Copyright © 2008 The Economist Newspaper and The Economist Group. All rights reserved.