# U.S. recession: Things will get worse before they get better

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Economists at the University of Michigan confirmed today what many Americans already believe—that the nation is in the throes of recession.

And it's a recession that will bottom out in mid-2009 with only modest economic growth expected in 2010 and unemployment hovering above 8 percent throughout that year.

"The decline in employment that began at the turn of the year raised the specter of recession," said U-M economist Joan Crary. "Until the credit markets seized up, however, it appeared that the economy might squeak by with a 'growth' recession, enduring a period of job loss and very sluggish growth, but avoiding a full-blown recession. The financial crisis tipped the balance, curtailing economic activity and plunging the economy into a downturn.

"While the current financial crisis is an extreme event that has raised fears of economic collapse, we are not forecasting economic catastrophe but rather a recession that is best characterized as moderately severe. And that moderate severity stems from the early enactment of a significant package of fiscal stimulus measures, including infrastructure spending and tax cuts."

In their annual forecast of the U.S. economy, Crary and colleagues Stanley Sedo and Janet Wolfe predict that even with a significant fiscal stimulus package in place by early next year, economic output growth (as measured by real Gross Domestic Product) will fall by 1 percent in 2009 followed by a 2 percent increase in 2010—a relatively sluggish pace for the first full year of recovery.

What's more, the country will lose about 2.4 million jobs over the next year-and-a-half before starting to see significant employment gains in late 2010.

So, how does this compare to previous recessions? Crary and colleagues say that it falls in the mid-range of recessions over the past 35 years with regard to GDP, employment and the unemployment rate. It won't be as harsh as the recessions of 1974-75 and 1981-82, but it will be more severe than the 1990-91 and 2001 downturns.

In addition to significant job loss and declining economic output in 2009, a moribund housing industry—thanks to difficulties in the financial markets—will continue to plague America's economy, they say.

Housing prices will fall 14 percent this year and 6 percent in 2009. New housing starts will

reach a low of 836,000 units next year, but improve to 941,000 in 2010—still about 24,000 less than the current year and less than half the 2005 total of 2.1 million. Existing homes sales will continue to drop from nearly 5 million last year to 4.4 million this year and 4.15 million next year, before stabilizing in 2010.

"By any measure, the recent decline in home prices leaves us in uncharted territory," Crary said. "Changes in home prices from the same period a year earlier have rarely been negative and never as negative as those reported now. Prices will bottom out in late 2009 at more than 27 percent below their peak and then edge up by just 1 percent during 2010."

Like the prices and sales of homes, the sales of light vehicles will continue to plunge next year, the economists say. Sales of cars and light trucks will fall from 16.1 million last year to 13.3 million this year, before dropping to a 25-year low of 12.2 million in 2009. Sales improve to 13.6 million in 2010.

On the bright side, oil prices will stabilize at under $60 a barrel in 2009—down more than half compared to the cost in the second quarter of this year. The corresponding drop in gasoline prices from their summer 2008 peak implies a yearly savings of about $180 billion for consumers, according to the forecast.

The steep drop in the price of oil, along with moderate increases in food prices, will keep inflation unusually low next year, say Crary and colleagues. Consumer price inflation will fall from 4.2 percent in 2008—the worst rate since 1991—to 1.3 percent next year, before edging back up to 2.6 percent in 2010.

Finally, the U-M economists predict that the Federal Reserve will hold its policy rate steady during 2009 and with credit markets stabilizing, interest rates on Treasury notes and bills will remain stable next year. Rates for 30-year conventional mortgages are even expected to tick downward from 6.2 percent currently to 5.8 percent over the next two years.

"Overall, the outlook is extremely uncertain, but any improvement clearly hinges on the return of a functioning credit market," Crary said. "Fortunately, economic crises of this magnitude are rare. The contractionary shocks to the economy have been severe and widespread.

"We expect, however, that the set of policies put in place to address the crisis will be successful. The most effective tools for righting the economy involve a healthy dose of sustained fiscal stimulus, along with a monetary policy that leaves banks and other financial institutions poised to support the resulting pickup in economic activity."

The U-M forecast is based on the Michigan Quarterly Econometric Model of the U.S. Economy and compiled by the U-M Research Seminar in Quantitative Economics.

Source: University of Michigan