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St. Louis Fed chief gives gloomy forecast

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St. Louis Federal Reserve Bank President James Bullard sees two possible courses for the economy - a mild recession at worst or a prolonged downturn.

Pin him down and he leans toward the first of the options he described for members of the Economic Club of Memphis on Tuesday night.

"Hopefully, we'll get the benign outcome," Bullard said after the speech.

His talk came before the latest Beige Book report from the **Fed** on Wednesday showed business conditions in September deteriorated in the **St. Louis** bank district, which includes the Memphis area.

Manufacturing, services, home sales and bank lending declined while commercial construction, retail and vehicle sales were flat.

Bullard conceded forecasting was hazardous because the economy "has taken many twists and turns I didn't expect."

"If we can get the financial markets to calm down, if housing stabilizes early next year, and we get the opaque assets (mortgage backed securities, etc.) taken care of, we could have flat growth or a milder recession."

It's too early to know which of Bullard's scenarios might become reality, said Dr. John Gnuschke, director of the Sparks Bureau of Business and Economic Research at University of Memphis .

"In the face of recession, consumers and businesses are pulling back and that probably means at least a mild recession," he said. "The supply of money has been improved over the last few days, but that doesn't mean the demand for money will improve."

If people buy heavily in the holidays, that could make for a mild downturn, Gnuschke said. But if U.S. economic woes spread worldwide, we may see Bullard's severe downturn threat develop, he said.

Bullard said some of the largest uncertainties - the fate of investment banks, mortgage marketers Fannie Mae and Freddie Mac - are in government conservatorship.

At the core of the problems is housing. Bullard said he believes home prices are close to bottoming out. The Case-Shiller Home Price Index is at about the same level now as it would have been if it had grown at the same rate as Gross Domestic Product since the 2001 recession, he said.

While he's not a fan of government intervention, Bullard conceded a process including firing failing companies' CEOs, letting firms go out of business and merging the weak with the strong wouldn't work in the current situation.

Nor did he put much stock in the effect of the latest short-term rate cut by his employer, the **Fed**.

"It doesn't do that much to address the problems we're facing," said Bullard, who sits on the , but doesn't have a vote.

"Interest rates were already low," he said.

But, Gnuschke said rate cuts are as much psychological as economic.

"In this time period, we need a strong policy to convince people there is not going to be a protracted downturn," he said.

- David Flaum: 529-2330

Eighth District Federal Reserve Beige Book findings

Business conditions: Continued to deteriorate in September

Manufacturing: Continued decline because of weak product demand, rising production costs

Services: Slipped, especially in medical, information, financial and trucking

Retail sales: Volume constant but customers switched to lower priced products

Auto sales: Mostly flat except for dealers with customer incentives, rebates

Homes: Through August, home sales in Memphis were 20 percent less than in 2007 and single family construction permits declined 57 percent

Commercial construction: At least one Memphis contractor reported record commitments; industrial vacancy rate was stable because of lack of new building

Banking: Lending by district banks dropped 1 percent in the mid-July to mid-September time frame

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