ECONOMIC CLUB

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2011 Economic Outlook Breakfast
Summary

Robert Rasche, executive vice president and senior policy advisor for the St. Louis Federal Reserve Bank, was the featured speaker at the Economic Club's November breakfast meeting. The well-attended engagement was held at the University of Memphis' Holiday Inn. Business leaders were anxious to hear Rasche's take on the nation's current economic health in the face of the lingering recession. But the policy advisor's message was mixed, and touched on everything from the unemployment rate and rising concern over European debt to the effects the Fed's announcement of quantitative easing has had on the market.

Rasche's overall economic forecast could best be described as guardedly optimistic, with slow, very modest growth forecast for the coming year. Rasche stated that while the probability for a double dip in the economy was "very low," a consumer-driven recovery was also unlikely. Consumer buying of durable goods continues to remain sluggish.

"I think the economy will grow in the modest 2 to 3 percent range over the next year, but that won't do much to bring down the unemployment rate," he said.

Currently, the nation's unemployment rate hovers at about 9.5 percent. Rasche posted graphs comparing the 2007-2009 recession to other dips in the nation's economy over the past 50 years, pointing out similar parallels in drop offs as well as recovery times, as a way of reflecting a sense of normalcy in the current recession.

Rasche noted that American manufacturers were one of the harder hit sectors during this decline, shedding jobs that he stated will never be replaced. High-tech manufacturing is the one exception to this trend, the one area of growth for America's once mighty manufacturing base.

"We're entering into a post-manufacturing economy," said Rasche, "Just like when we entered a post-agricultural economy some 75 years ago.

"When we go through recessions, manufacturing employers never recover. At one time, every one job in three was a manufacturing job. Now it is one job in nine," observed Rasche. The recessions of 1973 and 2001 followed a similar trajectory, he noted, and after the economy flattened out after each dip, there was a significant loss in manufacturing employment. Many of these jobs were never regained, with businesses being shuttered altogether or labor jobs moving to overseas markets where work could be done for significantly lower wages.

Rasche said he is also doubtful that a consumer-driven rebound will occur very soon. Consumer spending continues to be sluggish, businesses remain reticent to hire new employees, and with the market correction, the real estate boom that drove the economy prior to 2007, is unlikely to happen again anytime soon.

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“The trend has been that more people have been using their houses as piggy banks. As their house value goes up, they take out a second home equity loan to do other things. The primary lending was access to home equity. Now, we have de-leveraging going on, the market is in retrenchment. We don’t see people financing second and third homes based on home equity.”

He also said the personal savings rate of consumers is significantly lower than it was during the 1980s but there has been a slight trend upward. An audience member asked if the artificial lowering of interest rates rewarded those who borrow versus those who save, a notion the policy analyst rejected.

From domestic issues, Rasche turned his attention overseas to discussing foreign markets and the looming concern economists share: the continued rise of Europe’s sovereign debt. Rasche noted that Ireland, Portugal, and Spain are poised to follow Greece into serious financial crisis, which could potentially destabilize the European market and the Euro. While he didn’t elaborate on the problems of Portugal and Spain, he did briefly touch on Ireland.

“Ireland’s banking system has collapsed,” he said, “since many banks are owned by the government and the country has experienced a huge crash in residential property values. Since banks held many of those mortgages, that has become part of the national debt. This presents a serious challenge for Europe and has the threat of going global.”

Finally, Rasche elaborated on the Fed’s recent announcement to jumpstart the nation’s sluggish recovery, again, by pumping billions of dollars into the economy. The move, called quanitative easing (and which had been dubbed by media and investors as QE2, since it comes on the heels of the Fed’s initial stimulus package), is aimed at getting the nation’s economy growing. Rasche worked to clarify the announcement of the central bank’s move to buy $600 billion in long-term Treasuries by emphasizing that it would be *up to* $600 billion, not necessarily that or more. Analysts had been anticipating the Fed’s announcement, projecting numbers between $500 million and 1 trillion. The purchase of long-term Treasuries will take place over the next eight months.

The bond purchase “is not much different than what has been done traditionally,” noted Rasche, “we’re just buying more.” He pointed out that when Ben Bernanke suggested this announcement was pending, long-term bond rates began to climb, which means the markets responded as economists and the Fed had expected. Since Bernanke’s speech, equity rates have gone up and the dollar is appreciating against the Euro and Yen, Rasche noted.
Once the floor was opened to audience questions, one speaker asked Rasche how the U.S. could grow their export business if manufacturing employment continues to decline. “The output and product has grown faster than the rest of the economy. With sustained output, I think that trend will continue,” he responded.

Another audience member asked why the FRC does not consider commodity prices when analyzing the economy (the speaker was referencing the trading prices of cotton or soy beans, some locally produced commodities). Rasche replied that commodities do get factored into the overall economic forecasts, but that alone, they don’t carry enough weight. “We shouldn’t focus on relative prices, we must let the market go where it will,” he said.

Finally, what happens if the Euro falls apart because of debt issues in the European nations? Rasche says there should be a good risk-management contingency plan in place “should the unthinkable happen. I don’t know that anyone has a plan but someone should be thinking about the unthinkable.”