"The World Is Not Ending," Mount Kisco economist says

BY JERRY GLEESON
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David Levy, chairman of the The Jerome Levy Forecasting Center, sits in his office in Mount Kisco. (Ricky Flores/The Journal News)

David A. Levy, a third-generation economist, former rugby player, and chairman of The Jerome Levy Forecasting Center in Mount Kisco, offers some comfort to the average person attempting to make sense of the financial events of the past week.

"The World Is Not Ending" is the title of his essay in the latest issue of The Levy Forecast, the center's monthly newsletter.

Levy, 53, is a self-described optimist. But since Levy is also an economist, he felt it necessary to qualify the headline after he provided a copy of the newsletter to a reporter last week.

"It's not going to be too great, either," he said, a touch of regret in his voice.

Here is Levy's take on the historic proposal to buy up to $700 billion in Wall Street securities that are, to some uncertain degree, tainted by subprime mortgages.

The plan is essential to avoiding what Levy described as "a series of rapidly falling dominoes." The securities are providing reduced or no income because of the failure of the mortgages, and banks and other financial institutions need to unload them from their balance sheets.

It's not just because the securities aren't paying the returns their owners counted on; banks must mark down their value on their financial statements and when they do, it reduces the overall value of the banks. Bank regulators expect those values to remain at certain levels, and when they don't, the banks must turn to markets to raise capital.

Selling questionable securities at fire-sale prices, however, can reduce bank values even further. And in an environment where the asset side of balance sheets is falling, banks that aren't holding bad investments are more inclined to keep their cash and not lend it, as they commonly do, to other banks to finance short-term cash needs.

Markets already have seen sharp spikes in the past two weeks in overnight and other short-term lending rates. The system can grind to a halt in a manner that Levy likens to the Great Depression.

"These things build on themselves," he said. "This is not a time for laissez-faire. You cannot let the financial system break down."

Tighter Credit

Banks tend to operate at thin margins that have been stressed further in recent months by growing delinquencies in consumer loans, Levy said.

THE OUTLOOK ACCORDING TO LEVY

Here's how the Jerome Levy Forecasting Center in Mount Kisco sees the key issues, according to its most recent newsletter:

Economic growth
"The deterioration of economic conditions will accelerate in coming months, and the economy will likely decline through 2009."

Interest rates
"The federal funds target rate will fall to a fraction of 1% in 2009. Treasury bond yields will plunge to modern lows in this decade as intensifying recessionary and financial instability concerns fully displace inflation fears."

Employment
"The decline will persist well beyond 2009."

Corporate profits
"The downward profits trend is still fairly moderate and inconsistent, but it will steepen during 2008 and continue well into 2009."

Labor cost/earnings
"The weakening economy will turn the trend of compensation inflation downward; it may have already."

Prices
"The recession will bring disinflation and eventually, in all probability, modest deflation — with or without food and energy."

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Eventually, he believes, the reluctance to lend will affect consumers and businesses who have taken borrowing for granted for years. He sees some tightening already.

Levy, who lives in Waccabuc, said he was chatting recently with a neighbor who runs a manufacturing business. The neighbor was complaining that his bank was cutting back his credit line, forcing him to scout around.

Homeowners who count on credit cards to finance their monthly expenses may find themselves in the same situation if their lenders reduce their credit limits or raise already steep interest rates, Levy said. Car loans and home mortgages may also become difficult to obtain.

"This feeds back on the angst of the public," he said. "Individuals could really have a very rough time."

Levy concedes that finding a value for the securities the government plans to buy won't be easy. But he disagrees with the view that the hundreds of billions of dollars required for the effort will debauch the dollar or bury the United States in crippling debt.

Japan's debt level is nearly 200 percent of its gross domestic product, yet the world's second-largest economy hasn't seen its yen collapse. And America has gone through periods where it has seen far greater debt-to-GDP levels than it has today, Levy said.

Just after World War II, in 1946, the level of all publicly held U.S. Treasury debt as a share of GDP stood at 115 percent, he said. Today it's about 38 percent. Pushing that debt up to accommodate the current bailouts may drive the ratio to 50 or 60 percent, Levy said, and those levels will eventually come back down.

All that being said, what's in store for the public is going to be no day at the beach, Levy warned.

State and local governments will soon have financing problems of their own, since they are limited in the amount of funds they can set aside for bad times. And households have more debt than they can manage, a long-simmering trend that will take some time to unwind, Levy said.

Business profits will fall more sharply as consumers save more and spend less, he expects, and national employment will decline as well. Levy sees a U.S. jobless rate of more than 7 percent next year, maybe hitting 8 percent.

"It's not going to feel like much of a recovery for a while," possibly not until 2010, he said. He expects the Federal Reserve Board will begin lowering key interest rate targets next month.

A Better Answer

Levy's interest in economics has roots that go back 100 years, to 1908. That was when his grandfather, Jerome Levy, picked up a newspaper in New York City and read an account of presidential candidate William Howard Taft's appearance at Cooper Union.

Taft was asked by an unemployed member of the audience what he would do if he found himself without a job. In a level of candor noticeably lacking in campaigns a century later, Taft replied, "God knows. I don't."

Jerome Levy, who was 26 at the time and running his own wholesale business in Manhattan, thought there ought to be a better answer. A college graduate who had studied physics, Levy began to explore the subject of economics more closely. It led him to develop ideas about the role that profit plays in economics.

Jerome Levy wasn't one to run with the herd. Convinced in 1929 that the American economy was heading for a bad fall, he sold his business and his stocks well before the October market crash that ushered in the Depression. His economic ideas were embraced by his son, S Jay Levy and later his grandson.

The second- and third-generation Levys collaborated on a book published by Harper & Row in 1982. Entitled "Profits and the Future of American Society: A Dramatic New Perspective on Capitalism," it outlined their views in a clear and engaging prose that eludes most other authors laboring in The Dismal Science.

"It was not a best-seller," Levy said, "but it did come out in paperback, and there was a Korean edition of it." It drew praise from reviewers such as Jane Bryant Quinn ("Pioneering") and William F. Buckley ("Another nail in the socialist coffin.")

David A. Levy grew up in Chappaqua, played rugby at Williams College, and got an MBA at Columbia University. He worked as a market researcher before joining his father's corporate consultancy in 1978 and helping to publish the newsletter his father had started, Industry Forecast.

Now retired, S Jay Levy lives in Somers. The family started an economic institute at Bard College named after Jerome Levy. David Levy was named by President Clinton in 1997 to serve on a commission to study capital budgeting, and he has shared his opinions on "The Today Show," "The Jim Lehrer NewsHour," and CNBC.

The clients of the Jerome Levy Forecasting Center are hedge funds, mutual funds, banks and other businesses that are interested in "a different way of looking at the economy," Levy said. The center also

manages its own funds. Levy studies economic patterns over long periods of up to five years, rather than day-over-day or week-over-week trends.

The atmosphere is young and informal at the Levy center on the second floor of a South Moger Avenue office building near the village train station. Button-down shirts, no ties. Desks arranged in an open area so the staff can debate freely.

The economists range in age from the mid-20s to early 30s. Levy is not a fan of doctorates in economics; the process of obtaining the degree causes students to think in ways that make it difficult for them to recognize when patterns are changing, he said.

His clients have not been calling in a panic. Most are sophisticated about the issues. But many are surprised with the speed with which things are happening, he said. No one's ever seen gold jump $90 an ounce in one day, or the Dow move an average of 344 points over seven days, or crude oil move $25 a barrel in a few hours.

"The volatility is shocking to everybody," Levy said.

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