Respected economist says recession is likely over

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MOUNT KISCO - The long recession is likely over now, but don't get too hungry yet, says David A. Levy, director and chairman of the Jerome Levy Forecasting Center here in this Westchester County village.

Get ready for a long recovery, and one that's not going to be a picnic. And for heaven's sake, no more bingeing out there.

It was such financial excesses that built up to create the blowup of one year ago, starting with the Lehman Bros. bankruptcy on Sept. 15 followed by a variety of massive government interventions.

That federal deficit spending, though controversial, is the main prop holding up the economy now and will likely be needed for some time to come, Levy said.

Levy was interviewed on the anniversary of the Lehman crash and was asked for some projections of the times ahead.

The institute's business is making forecasts for its subscribers, and they have often been quite accurate.

In March 2007, the institute said U.S. housing prices had a drop in store of 30 to 50 percent. Dutchess County's average housing price fell nearly 30 percent from the high point of May 2007 to the low of March 2009.

Some key predictions:

• Recession: Probably over, but that's not the only problem. We still have a "contained depression" caused by years of being on a debt binge, a condition that impairs the economy's ability to grow. Recovery could fail as early as next year.

• Jobs: No quick recovery. Though the economy is picking up, "unfortunately, it's not going to translate into job creation in the next few months." The plunge is slowing, though.

• Federal deficit: "It's going to be extremely difficult to reduce the deficit without hurting the economy."

• Interest rates: Not going up anytime soon. Bond yields will trend down, contrary to what many economists think, because the collapse in private borrowing outweighs the increase in public borrowing.

• Inflation: "Inflation is not going anywhere, either, except down."

• Stocks: No real conviction here, but "conditions are not conducive for the stock market," and therefore "I would not want to expose myself to the market too much."

• Housing. "I think the worst leg is over but I don't think the whole problem is over." Buy a home only to live in, not as an investment now, he said.

• Mortgage rates will stay low, perhaps fall.

In the current issue of The Levy Forecast, out today, the institute notes: "Home prices remain out of whack with the population's ability to support them, especially given the oversupply of houses and the mountain of bad debt."

Levy's longer-range outlook is not so dour, and he believes the nation will emerge to compete well on the international stage.

The U.S. has advantages that are hard to duplicate. China, for example, does not have such a long history of economic stability and lacks the kind of legal institutions and traditions for dealing with disputes.

In fact, he said: "I'm extremely optimistic about U.S. prospects in the long run."

A forecasting history

Levy's approach to economics runs in the family, literally.

His grandfather, Jerome Levy, developed a novel analysis of macroeconomics that looks at overall money flows in the economy, with particular attention to profits.

"Profits are essential to how any economy operates," David Levy said.

"Profits do vary enormously, and they have a tremendous influence on what businesses can do," he said.

For example, business profits overall have been quite weak and, thus, job destruction and noninvestment prevail.

"We've had a collapse in the private economy's ability to generate its own profits," Levy said.

The problems of inflated asset values tumbling while debts are rising has left the economy's "balance sheet" in trouble, just as it has in many businesses and in many households where income isn't enough to take care of debt obligations.

"The extent of the downward forces, I think, are still underestimated," Levy said.

"The problem is that this balance-sheet correction is not something that gets taken care of in one recession," Levy said. "It's going to take a number of years, and maybe something more on the order of a decade, to work these problems out. That doesn't mean we're going to have one continuous recession; we're not. In fact, we're probably, more likely than not, out of the recession now and starting a very feeble recovery."

Levy said: "We think there are a lot of risks in 2010."

There is a job-creation problem, he said. Curing the recession isn't enough, because many employers still shoulder a deeper balance-sheet problem, one of shrinking balance sheets that they must fix.

A healthy balance-sheet expansion, Levy said, "is a necessary process for a private economy to generate profits."

Small and medium businesses are in "a real crisis," Levy said. "The lending environment is extremely difficult."

Levy said profits recovered slightly in the last two quarters and likely will do so for the third.

Leaning on the deficit

His explanation for this return to profit is startling in light of the the controversy over federal budget deficits caused by government efforts to rescue sectors of the economy, ranging from bank bailouts to the stimulus act.

"In this case the government deficit is so large that it's actually entirely accounting for the profits generated in the economy at this time," Levy said.

"By the government spending so much money, it's enabled businesses to generate some profit," Levy said.

Reacting to that, David Kennett, a professor of economics at Vassar College in Poughkeepsie, said: "I'm not sure there's a mechanical relationship between the two," but he added: "A lot of the objective was to stimulate the capitalist system in such a way that the profits would be rejuvenated."

Kennett agreed "we really did need a very major stimulus to get us going again."

But the growing deficit worries many.

The Congressional Budget Office estimated in August the deficit for 2009 will hit $1.6 trillion, about 11.2 percent of Gross Domestic Product, a measure of the whole economy.

The response then from House Republican Leader John Boehner of Ohio was: "The $9 trillion question is when will the White House do more than just pay lip service to tackling these jaw-dropping deficits that threaten our economic stability? Piling more and more debt on future generations while massively increasing federal spending is not a response."

Levy's view is the nation has managed such high debt loads temporarily and can do so again.

"We're not going to be able to remove our reliance on the federal government for a long time," Levy said, comparing it to life-support systems for a critically ill patient.

Talking about reducing federal budget deficits, he added, "is not going to be helping."