



Is the Economic Recovery Sputtering to a Close?

Michael Mussa says the latest disappointing economic numbers indicate a slower pace of growth and a possible rise in unemployment, and that a return to recession cannot be ruled out.

Edited transcript, recorded August 20, 2010. © Peterson Institute for International Economics.

Steve Weisman: Is the recovery in the United States sputtering to a close? Michael Mussa, senior fellow at the Peterson Institute for International Economics, is here today with me, Steve Weisman, at the Institute to tell us how to interpret the latest numbers on the economy on August 20. Mike, thanks for joining me.

Michael Mussa: My pleasure. Well, recovery clearly has slowed down. I would say we're probably [going] along at 2 percent GDP growth or something like that this summer after being up around 4 percent in the late winter and early spring. And consistent with that, the data have been mixed with a generally subdued tone. The GDP report for the second quarter came in fairly low, thanks largely to a surge in imports, which was a little strange.

Employment growth has clearly slowed. We actually had to navigate an overall figure with the temporary census workers leaving their jobs. Unemployment claims are up, once again reaching half a million in the most recent measurement. But retail sales picked up a little bit in July from June; housing starts, while still very depressed, picked up again a little bit in July from June.

So it's a kind of mixed picture, the numbers you expect when the economy is still barely making headway. We may now see at this pace of growth that the unemployment rate, which has gotten down to 9.5 percent, may begin to pick up again.

Steve Weisman: Is there any chance that this can be reversed absent government action? And should anything be done to speed things up a little bit?

Michael Mussa: I think—actually usefully—the Congress, with a little bit of Republican support, finally did pass a modest increase in the amount of the stimulus package that will aid state and local governments. But they cut it about in half from what was, I thought, an excessive proposal by the House Democrats.

Steve Weisman: Remind me what the size of the package was.

Michael Mussa: It was about \$100 billion when you add in all the elements of the final package. In fact, the final package hasn't been passed yet, but various elements have been passed and it looks like it's going to add up to around \$100 billion in paying for extended unemployment benefits and additional aid to state and local governments and assorted other items.

Steve Weisman: So what is the economic growth outlook now for the third and fourth quarters?

Michael Mussa: We've got a little bit of information now on the third quarter, both from the carry-over from a fairly weak June and the numbers we've gotten for July and a little bit for August. And these suggest, I think, that we're still going to have positive growth but it's going to be again probably around 2 percent. It's virtually impossible that we have another surge of imports, which would be the source of difficulty, but domestic demand looks like its growth has slowed.

Steve Weisman: By the way, what did account for the surge of imports?

Michael Mussa: Those numbers tend to be highly volatile month to month. So for a considerable period of time we were benefited unusually by strong growth of exports, with imports lagging behind, and I think we had a quarter when imports began to catch up with the fact that inventories had been run down and other features. So that was, however, I think a one quarter phenomenon and I anticipate going forward that we probably will see import growth much slower since we had this one big bump up.

Steve Weisman: What is the outlook for the next year or two?

Michael Mussa: Chairman Bernanke says it's unusually uncertain. Forecasters always say it's unusually uncertain. I would say the best baseline guess is that we will continue to have a moderate-paced expansion looking ahead through 2011 and 2012. Housing has a long way to come back. We're barely producing enough new housing to replace the units that are being removed from the stock each year, at barely 600,000 new starts, and that's going to ultimately get back to 1.5 million, 1.6 million, 1.7 million—the question is how soon and how fast.

Automobile purchases have been running about 11.5 million versus 10 million last year, while we previously were running 16 million, 17 million. And the stock of automobiles is getting older and wearing out. So there [are] sort of some built-in things that are going to boost consumer spending and residential investment. And business investment spending for plant and equipment has been quite strong, helped by the strong export market.

Steve Weisman: So when you say moderate growth in 2011 and 2012, what does that mean? Does it have a prospect for reducing unemployment over the next year or two?

Michael Mussa: My forecast has been and remains a little more buoyant than the average, so I think we're probably going to get something like 3.5 percent growth next year. I think the consensus, the average forecast is now probably a little below 3 percent, which is barely enough to keep the unemployment rate from rising. And if growth were only 2 percent, then we probably would see the unemployment rate creep up.

So my expectation is it will fall slowly over the course of the next year to 18 months. I would say the average forecast would have it about stable, maybe modestly down say from 9.5 to 9 [percent]. And if we came out on the low side, then we could see the unemployment rate creep back up to 10. It's not a zero risk, but I think a double dip recession is not a high likelihood event—that is to say, another recession beginning within the next year. But it's not impossible.

Steve Weisman: So growth has to be pretty much in excess of 2 percent in order to have an impact on unemployment.

Michael Mussa: Yes, that we have sort of normal growth of the labor force plus the rise in productivity. Productivity growth slowed, actually it was reported to be negative in the second quarter but that also was probably a fluky phenomenon. But you've got to get output growing about 2 percent in order to be creating enough jobs so that the unemployment rate doesn't rise and you're able to employ the new entrants to the labor force.

Steve Weisman: Going into the fall campaign, obviously the stimulus program enacted in early 2009 is a big issue. Americans don't seem to think that it worked, if you read the opinion polls. What's

your opinion about whether the stimulus benefits from the stimulus seem only to have been temporary?

Michael Mussa: I think that about 75 or 80 percent of it was desirable. About \$600 billion will be spent by the end of this year, \$550 [billion] to \$600 billion—

Steve Weisman: Out of like \$750 [billion] or \$800 [billion].

Michael Mussa: Out of the official figure of \$787 billion.

But part of that was just continuing tax breaks that had been in effect for many years.

So that was never going to provide much impetus to recovery. It would have had a negative effect if you hadn't continued the fix on the alternative minimum taxes you want.

So that was never going to create the perception that we are generating new jobs. We're just avoiding a negative and there was about \$100 billion or a little bit more of that [for extending the Alternative Minimum Tax]. Then a large chunk was to pay for extended unemployment benefits.

The number of long-term unemployed has gone up partly because probably the benefits have encouraged the distribution of unemployment to be more longer term and less near term. But the only way you spend a lot of money on increased unemployment benefits is if unemployment is higher. So that part of the stimulus package was sort of designed never to produce the impression that we were generating a lot of jobs.

Steve Weisman: Right.

Michael Mussa: And the support for state and local government, which is substantial, I think desirably relaxed some of the fiscal pressure on state and local governments, but it certainly did not remove all of it. So they've had to make tough choices about which public services to retain, at what level. They cut about 1 percent of their total employment in 2009, which impresses me as probably about right. They would have had to cut 2 or 3 percent if they had not had additional financial assistance from the federal government. But again it's not that we were adding jobs. We were avoiding sharper reductions in employment and that's not sort of practically perceived as creative—

Steve Weisman: —stimulus.

Michael Mussa: So I think that the administration made a mistake in overselling the program. It talked about preserving or creating 3 to 4 million jobs. Well, preserving jobs is very difficult to perceive and I think also probably somewhat exaggerated. So they, I think got themselves into trouble by mischaracterizing what the program was likely to accomplish in terms of visible results.

Steve Weisman: The voters will have their verdict in November and you and I will talk a number of times before then. I always thank you for giving us your update.

Michael Mussa: Very good.

Steve Weisman: Thanks.

