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Is a Recession on the Way?

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Economists and politicians can debate all they want about whether the nation is sliding into its first recession in nearly seven years. To Chuck Rizzo, the picture is clear.

Rizzo was recently laid off from his customer service job at a homebuilder in Sarasota, Fla. His grocery bill is higher nowadays, and he can barely afford his mortgage payments.

"Everything has gotten tremendously more expensive," said Rizzo, 45, who is married with a 15-year-old daughter. "We don't go out to dinner now. We don't take vacations. We've had to make a lot of adjustments to our lifestyle."

Whether an actual recession is on the way — or already here — U.S. consumers and businesses are being increasingly squeezed by a downturn that threatens to spread the pain being felt everywhere from the gas pump to the unemployment line.

The official designation often comes long after the recession itself begins. Experts note that the point at which the "R-word" is triggered is mostly an academic debate.

"That's not going to make a great deal of difference to people's economic well-being or their pocketbooks," said Frank Lichtenberg, professor of business, finance and economics at Columbia Business School in New York.

"The idea that if you're on one side of the line you're in a recession and if you're on the other side you're fine — that's not really the case," he added. "Clearly, we are in a very difficult period."

In the last recession, in 2001, investors took the biggest hit from collapsing technology stock prices. This time, consumers may bear the brunt of the pain as rising inflation and sky-high energy prices boost daily living costs uncomfortably.

The current slide started when the housing market, pumped up with the help of loans that were easier than ever to obtain, went from boom to bust. The real estate and home construction markets collapsed, loan defaults and foreclosures proliferated and damage has continued to spread through the nation's financial system.

The double punch of a punctured housing market and oil that topped $100 a barrel has slowed the growth of the world's largest economy to a crawl, and tightening credit and other worrisome trends may well make things worse in 2008 before they get better.

The question now: How bad will it get?

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There is little consensus on the consequences if a full-blown recession — defined as an outright contraction of economic activity and employment lasting at least six months — develops.

The effect will depend in part on how aggressively the Federal Reserve keeps cutting interest rates and whether Democrats controlling Congress can reach quick agreement with President Bush on an economic stimulus plan. But experts warn that even quick action from Washington now could be too late.

One potential scenario, built from precedent, recent corporate developments, economic indicators and interviews with economic and business experts:

Consumers will continue to pull back, with troublesome results for retailers and companies. Housing prices, which have fallen an average of 8 percent nationwide and as much as 40 percent in some markets since peaking in 2005, will drop for another year or so.

Unemployment could climb another two percentage points to 7 percent, which would be the highest in 16 years and leave another 3 million Americans out of work. And stocks could keep dropping.

For some, tougher times may mean opportunities. House-hunters with cash on hand and respectable credit scores will likely be able to take advantage of cheaper prices. Hardware stores and auto parts retailers tend to see sales rise when more cash-conscious people attempt their own home improvements and hang on to cars longer. Foreign investors may find U.S. assets more affordable as prices drop, especially if the dollar continues to weaken.

Overall, however, it is a picture with far more losers than winners.

"All of us are going to feel the pain to a greater or lesser degree," Lichtenberg said.

And the outcome could be gloomier still if the nation's banks and brokerages can't recover quickly from heavy losses incurred in the collapse of the subprime mortgage market, resulting in a prolonged credit squeeze — or if the dollar goes into freefall and global investors lose faith in the U.S. economy.

"It's not hard to get to dark places once you're in a recession," said Mark Zandi, chief economist at Moody's Economy.com.

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Americans are clearly spooked by the current prospects of the economy. Consumer confidence sank to the lowest level in at least six years this month, according to the RBC Cash Index, amid growing worries about jobs, energy bills and home foreclosures after the unemployment rate rose to a two-year high of 5 percent in December.

Consumer spending, which fuels a majority of the economy's output, has slowed dramatically in recent months, as was evident in the unexpected 0.4 percent slump in December retail sales reported by the government on Jan. 15.

Carl Steidtmann, chief economist at Deloitte Research, this month forecast an actual decline in same-store sales this year at the nation's retailers — the first since the recession of 1991.

Affluent shoppers have joined low- and middle-income consumers in pulling back, so corporate results have suffered everywhere from upscale jeweler Tiffany & Co. and Saks Inc. to Sears Holdings Corp.'s Sears and Kmart stores.

And more people are having trouble paying their bills. AT&T said recently it's disconnecting more phones because of delinquent customers, and American Express Co., whose customers are generally affluent, said it expects slower spending and more missed payments on credit cards throughout 2008.

As Americans feel the pinch — with food and fuel costs rising and jobs becoming harder to find — they're heaping more debt onto credit cards. Balances surged through last fall, Federal Reserve figures show.

And anecdotal reports suggest they are paring where they can — putting off a teeth-whitening, perhaps, or trying to wring a few thousand more miles out of an old car before trying to replace it.

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On the business side, financial services companies have been battered at the front edge of the gathering storm.

Merrill Lynch & Co. and Citigroup Inc. reported $20 billion in fourth-quarter losses between them earlier this month as the corporate earnings season opened with a flood of red ink. Banks, brokerages and insurers announced staggering write-downs, largely due to bad subprime mortgage bets.

They also added to the jobless ranks. Citigroup said it had slashed 4,200 jobs as it braces for more consumer-related trouble and mortgage lender IndyMac Bancorp Inc. cut its work force by 24 percent, laying off about 2,400 employees as it tries to weather the housing slump.

The hardest-hit occupations in terms of recent job losses include real estate brokers, financial services sales agents, loan counselors and public relations specialists, recent government figures show.

Automakers are suffering, too, as consumers hold back. U.S. new car and light truck sales fell by 415,000 vehicles or 2.5 percent, to 16.1 million last year, according to Ward's AutoInfobank, and could drop toward 15 million in a recession.

Other industries, including airlines, may also be vulnerable to big cutbacks ahead.

The downturn also is taking a toll on city governments because revenue from property taxes will decline along with home values.

In Cleveland, an epicenter of the foreclosure crisis, the city has demolished 1,000 abandoned homes in the past year that had become targets for vandals, in order to save money on policing those neighborhoods. Most of those homes had been financed with subprime mortgages.

Small businesses are also feeling repercussions and reporting that conditions are soft as customers cut back.

In Sedona, Ariz., some galleries and restaurants have closed because tourists are spending less, said Mary Schnack, whose business Up From The Dust sells imported jewelry, purses and home decor made by women in developing countries.

Schnack said her sales were way down during the holiday season as customers bought items only as gifts, not for themselves.

"It's the first sign like this," she said. "They don't say it's because the economy is bad, but I know that's the reason."

There are winners among small businesses, too: Some companies that sell software that helps other businesses cut costs are seeing stronger sales.

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Global consequences are certain if American consumers cut back for long. U.S. consumer spending has played a key role in world economic growth in recent years.

But the global economy remains the wild card in this downturn. Analysts say other economies around the world could help brake the downturn in the United States, with demand from China and India potentially cushioning the blow.

"We've never been through a recession when we've had a global economy" to this extent, said Muriel Siebert, a Wall Street veteran and head of discount brokerage Muriel Siebert & Co. "This is the first time there could be some counter-balancing forces."

Occurring about every six years, the 10 U.S. recessions since World War II have lasted from eight to 16 months and seen the level of real gross domestic product decline by an average of 2 percent.

The most severe in the postwar era was from November 1973 to March 1975, prompted by an Arab oil embargo. Inflation ran into double digits and stocks tumbled 25 percent during the recession and lost nearly half their value during the entire down cycle.

In the current case, economists see more parallels with another oil-related recession — that of 1990-91. In those years, oil prices soared after Iraq invaded Kuwait, bad real estate loans hurt savings and loans and banks, and the Federal Reserve was criticized for not acting quickly or boldly enough.

Diane Swonk, chief economist at Chicago-based Mesirow Financial, says anecdotal reports from small businesses today are significantly more upbeat than they were in previous recessions.

"Small businesses still have access to credit, are hiring and remain cautiously optimistic about their prospects for 2008," she wrote in a Jan. 11 report.

And unlike the 2001 recession, the technology industry has held up surprisingly well through recent economic turmoil. But even that resilience is now being tested. Earlier this month, chipmaker Intel Corp. missed Wall Street's profit and sales expectations, stirring fear in the markets that other tech giants could tumble.

Another surprise: McDonald's Corp., typically a winner in a downturn with its low-priced restaurants, could be a loser if an early indicator proves true.

While the fast-food chain has yet to release December same-store sales, a survey of McDonald's franchisees by restaurant stock analyst Mark Kalinowski released last week suggested sales were at their lowest level in at least six years.

That type of unexpected development helps explain the wide range of opinions on how deep a dive the economy might take.

At the dark end of the spectrum is the extremely bearish Peter Schiff, who has been right with some gloomy forecasts about housing and oil prices in the past.

Schiff, who runs the investment firm Euro Pacific Capital Inc. in Darien, Conn., foresees the worst recession since the Great

Depression, with double-digit unemployment, double-digit interest rates and double-digit inflation. That would mean at least a twofold increase in those key indicators.

"You're going to see the basic cost of living, food and energy get so high that that's all they're going to be able to afford," he said.

With the U.S. economy's record of resilience, most experts would characterize his prediction as alarmist. Merrill Lynch's economists believe the recession has started and will be over by midsummer.

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Steps proposed in Washington might help revive economic activity and assuage worries.

The stimulus package put forth by President Bush on Friday consists of as much as $150 billion worth of tax relief, including tax rebates of up to $800 for individuals and $1,600 for married couples. The White House also favors tax breaks for business investment, while Democratic congressional leaders are pushing smaller rebate checks and more aid for food stamp recipients and the unemployed.

But at least for the immediate future, Americans will have to ride out the economic turbulence without extra government help.

Besides cutting back his family's spending, Rizzo is putting in 13-hour days, seven days a week after pursuing a long-held dream and opening a fiery foods store last month. Early sales were strong but have "crashed" in January, and he's worried about the economic trends.

"I just hope our economy gets better under our new man Bernanke who took (Alan) Greenspan's place," he said. "You've got to wonder if he's making the right calls."

Scot Herrick and his wife knew their jobs at Washington Mutual Inc. were at risk because of the mortgage lending crisis, but getting pink slips from the nation's largest savings and loan on the same day just before Christmas was still a shock.

Herrick, 53, who was a technology manager for WaMu in Seattle — and who, ironically, offers career advice on his Web site, CubeRules.com — thinks the credit market will stabilize by the end of the year and expects to find another job sooner than that.

Just in case, he and his wife, Kate, gradually banked a year's take-home pay as they saw trouble building.

"We'll be fine until well into summer," he said. "Maybe by fall we'll panic."

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