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A Nation of Exaggerators
Quit Doling Out That Bad-Economy Line

By Donald L. Luskin

"It was the worst of times, and it was the worst of times."

I imagine that's what Charles Dickens would conclude about the current condition of the U.S. economy, based on the relentless drumbeat of pessimism in the media and on the campaign trail. In the past two months, this newspaper alone has written no fewer than nine times, in news stories, columns and op-eds, that key elements of the economy are the worst they've been "since the Great Depression." That diagnosis has been applied twice to the housing "slump" and once to the housing "crisis," to the "severe" decline in home prices, to the "spike" in mortgage foreclosures, to the "change" in the mortgage market and the "turmoil" in debt markets, and to the "crisis" or "meltdown" in financial markets.

It's a virus -- and it's spreading. Do a Google News search for "since the Great Depression," and you come up with more than 4,500 examples of the phrase's use in just the past month.

But that doesn't make any of it true. Things today just aren't that bad. Sure, there are trouble spots in the economy, as the government takeover of mortgage giants Fannie Mae and Freddie Mac, and jitters about Wall Street firm Lehman Brothers, amply demonstrate. And unemployment figures are up a bit, too. None of this, however, is cause for depression -- or exaggerated Depression comparisons.

Overall, the pessimists are up against an insurmountable reality: In the last reported quarter, the U.S. economy grew at an annual rate of 3.3 percent, adjusted for inflation. That's virtually the same as the 3.4 percent average growth rate since -- yes -- the Great Depression.

Why, then, does the public appear to agree with the media? A recent Zogby poll shows that 66 percent of likely voters believe that "the entire world is either now locked in a global economic recession or soon will be." Actually, that's a major clue to what started this thought-contagion about everything being the worst it has been "since the Great Depression": Politics.

Patient zero in this epidemic is the Democratic candidate for president. As it would be for any challenger, it's in his interest to portray the incumbent party's economic performance in the grimmest possible terms. Barack Obama has frequently used the Depression exaggeration, including during a campaign speech in June, when he said that the "percentage of homes in foreclosure and late mortgage payments is the highest since the Great Depression." At best, this statement is a good guess. To be really true, it would have to be heavily qualified with words such as "maybe" or "probably." According to economist David C. Wheelock of the Federal

Reserve Bank of St. Louis, who has studied the history of mortgage markets for the Fed, "there are no consistent data on foreclosure or delinquency going all the way back to the Depression."

The Mortgage Bankers Association (MBA) database, which allows rigorous apples-to-apples comparisons, only goes back to 1979. It shows that today's delinquency rate is only a little higher than the level seen in 1985. As to the foreclosure rate, it was setting records for the day -- the highest since the Great Depression, one supposes -- in 1999, at the peak of the Clinton-era prosperity that Obama celebrated in his acceptance speech at the Democratic National Convention late last month. I don't recall hearing any Democratic politicians complaining back then.

Even if Obama is right that the foreclosure rate is the worst since the Great Depression, it's spurious to evoke memories of that great national calamity when talking about today -- it's akin to equating a sore throat with stomach cancer. According to the MBA, 6.4 percent of mortgages are delinquent to some extent, and 2.75 percent are in foreclosure. During the Great Depression, according to Wheelock's research, more than 50 percent of home loans were in default.

Moreover, MBA data show that today's foreclosures are concentrated in that small fraction of U.S. homes financed by subprime mortgages. Such homes make up only 12 percent of all mortgages, yet account for 52 percent of foreclosures. This suggests that today's mortgage difficulties are probably a side effect of the otherwise happy fact that, over the past several years, millions of Americans of modest means have come to own their own homes for the first time.

Here's another one not to be too alarmed about: Obama is flat-out wrong when he frets on his campaign Web site that "the personal savings rate is now the lowest it's been since the Great Depression." The latest rate, for the second quarter of 2008, is 2.6 percent -- higher than the 1.9 percent rate that prevailed in the last quarter of Bill Clinton's presidency.

Full disclosure: I'm an adviser to John McCain's campaign, though as far as I know, the senator has never taken one word of my advice. He's been sounding a little pessimistic on the economy of late, too. And to be fair, he isn't immune to the Depression-exaggeration virus, either. At a campaign news conference in July, my fellow adviser Steve Forbes warned that Obama was seeking "the biggest tax increase since Herbert Hoover and the Great Depression." Factual? Almost certainly not.

But at least Forbes wasn't dissing the economy -- he was dissing Obama. And Obama's infection by the Depression-exaggeration bug goes way back. His first outbreak came on Oct. 2, 2002, in his famous speech opposing the invasion of Iraq, delivered when he was an Illinois state senator. He said that the invasion was "the attempt by political hacks like Karl Rove to distract us from" a litany of economic troubles including "a stock market that has just gone through the worst month since the Great Depression."

Quite an exaggeration. When state senator Obama made that remark, the Standard & Poor's 500 had just dropped 11 percent for the month of September 2002. But stocks dropped twice that much in October 1987. Since the Great Depression, the stock market has had bigger one-month drops on four occasions. Obama's pessimism on stocks then happened to be as ineptly timed as it was factually incorrect. Exactly one week later, stocks hit bottom, and over the next five years the S&P 500 more than doubled, surging to new all-time highs.

So much for Obama's hyperbole about our terrible economy. But what about the media's?

A housing "slump," a housing "crisis"? A "severe" price decline? According to the latest report from the National Association of Realtors, the median price of an existing home is up 8.5 percent from the low of last February. And according to the U.S. Census Bureau, the median price of a new home is up 1.3 percent from the low of last December. Home prices may not be at all-time highs -- and there are pockets of continuing decline in some urban areas -- but overall they've clearly stopped going down and have started to recover. So why keep proclaiming a "crisis" after it's over?

"Turmoil" in the debt markets? Sure, but we've seen plenty worse. According to the FDIC, there have been a total of 13 bank failures in 2007 and so far into 2008. There were 15 in 1999-2000, the climax of the Obama-celebrated era of Clintonian prosperity. And in recession-free 1988-89, there were 1,004 failures -- almost an order of magnitude more than today. Since the Great Depression, the average number of bank failures each year has been 94.

Despite highly publicized losses in subprime mortgage lending, bank equity capital -- the best measure of core financial strength -- is now $1.35 trillion, more than the $1.28 trillion level of mid-2007, before the "turmoil" even began.

Financial market "crisis" and "meltdown"? Yes, from all-time highs last October, the S&P 500 has fallen 20 percent. But that's nothing by historical standards. Stocks have often fallen more than that over comparable spans of time. They fell more than twice that much in 1974 -- which was truly the worst drop since the Great Depression. Even the present 20-percent loss isn't what it seems. The damage has been heavily concentrated in the financial sector -- banks, investment firms and mortgage companies. If you exclude that sector, stocks are off 14.8 percent.

Some economic indicators -- export growth and non-defense capital goods orders such as industrial machinery, for example -- are running at levels associated with brisk expansion. Others are running at middling levels, such as the closely followed Institute for Supply Management manufacturing index. But it's actually difficult to find many that are running at truly recessionary levels.

There have been 11 recessions since the Great Depression. And we're nowhere close to being in the 12th one now. This isn't just a matter of opinion. Words -- even words as seemingly subjective as "recession" -- have meaning.

In a new working paper, economist Edward Leamer of UCLA's Anderson School of Management shows that changes in the unemployment rate, payroll jobs and industrial production almost precisely explain every recession as officially determined by the National Bureau of Economic Research. At present, only the unemployment rate exceeds the recession threshold. The other two factors are far from it. According to Leamer's paper, we'll only fall into recession "if things get much worse."

This would suggest that anyone who says we're in a recession, or heading into one -- especially the worst one since the Great Depression -- is making up his own private definition of "recession." And probably for his own political purposes.

McCain campaign adviser and former U.S. senator Phil Gramm was right in July when he said that our current state "is a mental recession." Maybe he was out of line when he added that the United States has become "a nation of whiners." But when it comes to the economy, we have surely become a nation of exaggerators.

Yet Gramm was pilloried for his remarks, and McCain had to distance himself from his adviser by joking that in a McCain administration, Gramm would be ambassador to Belarus. What does it say about our nation that it has become political suicide to state the good news that our economy is not in recession?

Whatever the political outcome this year, hopefully this will prove to be yet another instance of that iron law of economics and markets: The sentiment of the majority is always wrong at key turning points. And the majority is plenty pessimistic right now. That suggests that we're on the brink not of recession, but of accelerating prosperity.

Maybe this will turn out to be the best of times -- at least since the Great Depression.

Mr. Luskin is chief investment officer of Trend Macrolytics LLC.