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The Great Recession of 2008?

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It probably won't happen, says DIANA FURCHTGOTT-ROTH, and even if it does, we may not know until 2009.

The prospect of a 2008 recession is the talk of Washingto Alan Greenspan recently estimated the likelihood at 50 percent. Hundreds of financial experts and economists have weighed in with opinions ranging from "certain recession" to "definitely no recession." Whose prediction is right?

The old saying goes that economic forecasters were invented to make meteorologists look accurate. Whe the weather reporter predicts rain, one can look outside to see if the forecast is correct. But when an economist predicts a recession, the only verification is the opinion of other economists.

The federal government is our official source of information about unemployment, inflation, and thousands of other economic indicators. The informal definition of a recession is two consecutive quarte of negative economic growth. However, it is common practice to leave the determination of a recession t a committee of economists at the National Bureau of Economic Research (NBER), a private organizatio of academic economists.

Unlike rain, no one can be sure when a recession has begun, or when it has ended. The NBER designates the beginning of a recession months after it has started and designates its ending months (or sometimes years) after it has ended. It measures business cycles on a monthly basis and classifies the period betwee the peak and trough of a cycle as a "recession." The NBER has reviewed historical and current economic data to designate 33 American economic recessions since 1854; the most recent one lasted from March 2001 through November 2001. But it wasn't *until* November 2001 that the NBER pinpointed March 200 as the beginning of the recession; and it wasn't until July 2003 that it determined precisely when the recession had ended.

Whether or not there is a 'recession' in 2008 will depend both on actual economic activity and on the subjective judgments of the National Bureau of Economic Research.

One might infer that the U.S. economy was expanding consistently before March 2001 and then contracting consistently until November 2001. But economic data from the federal government's Bureau of Economic Analysis reveal a much different picture. The economy contracted in the third quarter of 2000, the first quarter of 2001, and again in the third quarter of 2001. But it expanded in the fourth quarter of 2000 and the second quarter of 2001. In other words, there was choppy economic performanc throughout both years. If one defines a recession as two consecutive quarters of negative growth, then nc recession occurred.

So will there be a recession in 2008? The NBER usually waits several months before designating a recession. So if a recession were to begin in January 2008, the NBER might not announce it until the summer or fall. If a recession began next summer, it might not be identified as such until early 2009.

Some experts believe that a credit shortage will tip the economy into negative growth. The credit crunch has indeed caused havoc in the financial and real estate sectors, and the Federal Reserve reacted last wee by lowering interest rates by a quarter of a percentage point. Columbia Business School economist Charl Calomiris, a visiting scholar at the American Enterprise Institute, believes that the Fed's actions thus far have been appropriate, but that further loosening of the money supply may not be necessary. Calomiris sees the housing finance shock as small relative to the total economy. Although subprime mortgage losse will probably range from $300 billion to $400 billion, housing prices are not collapsing.

The most precise measure of change—the Office of Federal Housing Enterprise Oversight (OFHEO) inde comparing sales prices of the same houses over time—declined by 0.4 percent in the third quarter of 20(the first quarterly decline in 13 years. Yet prices were still 1.8 percent higher than they were a year ago. Although Calomiris recognizes that further declines are likely, he thinks they will be concentrated in certain regions, and likely will not exceed an average decline of 5 percent nationally, as measured by the OFHEO index.

Others, such as American Enterprise Institute resident fellow Desmond Lachman, a former strategist at Smith Barney, believe that the Fed did not go far enough. Lachman sees a much larger financial crisis in the making and reckons that the ongoing housing bust runs a risk of aggravating that turmoil. Like Harvard professor Martin Feldstein, he says the Fed needs to be more aggressive in responding to the credit crunch if a serious economic slump is to be averted.

"We clearly have had a major house price and credit market bubble between 2000 and 2006 that is now the process of deflating at a time that oil prices are at $90 a barrel," Lachman explains. "House prices ha already started to decline and could very well decline by 5-10 percent a year over the next few years, whi will erode the underlying collateral of bank mortgage lending."

The Fed may have been prudent in lowering rates on December 11th, but it was clearly unprepared for th inflation figures that were released by the Bureau of Labor Statistics on December 13th and 14th. Both th producer price index (PPI) and the consumer price index (CPI) increased by far more than expected. The PPI jumped by 3.2 percent in November and by 7.2 percent over the past year. The CPI rose by 0.8 perce last month and by 4.3 percent over the past year. These numbers may stoke inflation fears and dissuade the Fed from pursuing more rate cuts.

Other economic remedies, such as tax relief, are available to stimulate the economy and prevent a recession. Lawmakers could make the Bush tax cuts permanent, or they could even pass new tax cuts, as several Republican presidential candidates have proposed. The prospect of higher taxes after 2010, whe the Bush tax cuts expire, has had a dampening effect on current investment.

On balance, it is not likely that the United States will experience a recession in 2008. Most economic forecasters expect growth to continue in the 2.5 percent range. Employment and personal income have remained strong through October and November of 2007, so consumption spending should continue, buoying the economy. The weak U.S. dollar makes American exports more competitive, thereby fueling economic growth and employment. Even if the economy dips in 2008, its slowdown may not last the requisite "several months" to be designated a recession by the NBER.

In other words, whether or not there is a "recession" in 2008 will depend both on actual economic activi and on the subjective judgments of the NBER. Neither is easy to predict, and an inaccurate forecast toda will not be proved false for 12 months or more, by which point it will have been long forgotten.

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