

The Economy in Perspective

Summertime (and the livin' is easy) ... It's hard to get excited about U.S. economic conditions when we are headed for vacation, in the middle of vacation, or nearing the end of vacation. Now is the time for highway construction, long lines, and pulp fiction on the beach; hardly the time for deep thoughts about record car sales, the employment cost index, or the Japanese banking system. Some might be curious, but all it takes to stifle their interest is a reminder that last summer they were worrying about the collapse of Asian financial markets, and to what avail? They've seen *Jaws* and they're still swimming.

Not that there are no circumstances to worry about. Demands on the U.S. economy could continue expanding so vigorously as to initiate accelerated inflation. Not only is inflation itself harmful to the economy, but the Federal Reserve could overreact to the threat and cause an economic downturn. Or the Federal Reserve could *not* react to the threat, allowing inflation to drift up gradually until it had to respond, then overreacting to the reality and causing an economic downturn. Or the economy could slow of its own accord, raising a threat that the slowdown would eventually develop into an economic downturn. People who are predisposed to worry about downturns can find plenty of places to look.

Then there is the federal budget debate. We could worry that the \$1 trillion budget surplus projected to accumulate in the next decade will fail to materialize. This would become even more relevant if the economic downturn aficionados prove correct. We could fret that the tax cuts under consideration will not leave much room for outright debt reduction (interest on the debt comprises a healthy chunk of current federal outlays). We could fret that the spending proposals under consideration will not leave much room for debt reduction either. Debt reduction, after all, should lower interest rates and boost our capacity to deal with future spending needs such as Social Security and health care reform.

Even with all the worrying we have already done about it, we could stew some more about the stock market. Equity values remain high relative to current earnings, suggesting that future profits will stay strong and even strengthen further. Income from capital gains, along with additions to wealth generated by unrealized capital gains, has fueled consumption spending. Should we worry that if the stock market merely levels

out, then consumption spending will slow, perhaps causing an economic downturn? And what if—what if—the market should actually drop precipitously and not bounce back? Wouldn't the consequences be unspeakably horrible? Clearly, we would be justified in fearing an economic downturn under those circumstances.

And if we don't have enough domestic worries, surely there are foreign problems worth wringing our hands over. Japan, for example. The Japanese economy still lies fallow, despite several years of remedial policy plowing. Surely national output will sprout anew, but when—and at what cost to the financial system and the government? What if the government is no longer willing or able to engineer a smooth workout of the bad debts on the books of Japanese financial institutions? And what if Japan's economic problems, left to fester, result in China's ascendance as the premier economic power in Asia? Like Japan, China runs substantial trade surpluses with the United States and it brings additional political issues to the table. Shouldn't we be worried about all of this?

And let's not forget Mexico and the rest of Latin America. Can we be sure the tumult that beset the region last year has really been calmed? Shouldn't we be concerned if Argentina doesn't abandon its currency in favor of the U.S. dollar? Shouldn't we be concerned if it does? Mexico faces a presidential election next year; if there ever was an event to worry about, surely this is one. Won't there be trouble no matter what happens?

If the rest of the world continues to limp along behind the United States, won't we eventually be dragged into a worldwide slump? If the rest of the world recovers its health, won't the U.S. economy be at risk of inflation? And if everything remains the same for a while longer, won't the inevitable (whatever that may be) only be postponed, but not prevented?

We're agreed then, that there is more than enough to worry about. One cannot listen to the financial press most days without concluding that storm clouds lurk just beyond the horizon of our sunny economic sky. But when you close your eyes and swear you smell barbecue sizzling on the grill and hear the rhythm of steel-drum music pulsing through a saltwater breeze, you can be forgiven a brief period of euphoria. Deep down inside, you can't forget that life's a beach.