

Alan Reynolds

THIS RECESSION IS NOT JUST A U.S. PROBLEM, not just about housing, and not just financial. Consider each point, in turn:

Germany, France, Italy, Japan, Singapore, and Hong Kong fell into recession in the second quarter (arguably *before* the United States and United Kingdom) when the price of oil rose as high as \$145 a barrel. This was no coincidence. Soaring oil prices raise the cost of production and distribution for many industries, and reduce *real* household incomes and therefore consumption.

In 1983, economist James Hamilton of U.C. San Diego showed that "all but one of the U.S. recessions since World War Two have been preceded...by a dramatic increase in the price of crude petroleum." By the year 2000 we had been through *nine* dramatic spikes in the price of oil, every one of which was soon followed by recession. Writing in the *Financial Times* on January 2, 2008, I suggested that "the U.S. economy is likely to slip into recession because of higher energy costs alone, regardless of what the Fed does" (and regardless of housing too).

Ten months later (November 8), the *Economist* noted that, "All three previous recessions came after housing booms and oil shocks." They were talking about the U.K., but could have been talking about the U.S. Yet housing slumps can be a consequence of recession rather than a major cause. The housing bust in places like Detroit and Cleveland was not preceded by a boom.

Aside from hot spots in California, Nevada, Arizona, and Florida, the American housing boom was less exuberant than many others. On December 6, 2007, the *Economist* revealed that housing prices had increased 102% over the previous decade in the U.S., but 144% in France, 159% in Australia, 190% in Spain, 213% in Britain, and 240% in Ireland.

When the U.S. economy began to contract in 2008, the biggest drop in housing starts was

behind us. Falling residential investment subtracted more than a percentage point from real GDP growth in 2006 and 2007, but only half a point in the second and third quarters of 2008. By the second quarter of 2008, home prices were lower than a year earlier in ten states, according to the Office of Federal Housing Enterprise Oversight (OFHEO), but higher in 26 states.

Unbearable increases in the world prices of oil and metals are a better explanation of the recession's geographical and industrial breadth, regardless of the added problems with housing and finance. And that, in turn, means falling prices of oil and metals are sowing the seeds for recovery in 2009—including a housing recovery.

What about finance? The November 10, 2008 issue of *Business Week* said, "Despite the government's best efforts, it may be 2010 before U.S. banks are willing to lend freely again." But bank lending was flat or down only between April and July of 2008. After that, the Fed's weekly H.8 report showed bank loans rising steadily from \$6.91 trillion in July to \$7.27 trillion by late October. The sudden bankruptcy of Lehman Brothers caused money market funds to shun commercial paper for the few weeks ending October 1, but nonfinancial commercial paper outstanding rose 9% in the following five weeks. Interest rates on interbank loans (Libor) came down too. Even if more credit was a sensible solution to excessive debt, the "credit crisis" has been exaggerated.

By the time of the U.S. presidential election, the multi-causal global recession was half over. Because unemployment is a lagging indicator, unfortunately, we won't hear that the recession has ended in 2009 until at least another few months have passed.

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