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Tuesday, June 17, 2008

Brian J. O'Connor

Bubble bursts on the wealth effect



First there was the tech bubble, and it burst. Then there was the real estate bubble, and we all know how it's ending.

But before they blew, the "wealth effect" they each created gave us one decade-long consumer spending bubble that's popped, burst and completely imploded. That's perhaps the most serious threat to the U.S. economy, where 70 percent of activity comes from consumer spending.

Unless the financial geniuses and media cheerleaders who inflated the last two bubbles have another one on deck, the United States is facing a consumer-led economic downturn that hits everyone from General Motors and General Electric to Staples and Starbucks.

Credit fueled wealth bubble

Behind the temporary gains created by tech stocks like Pets.com and flipping condos like pancakes, the real driver of the wealth bubble was easy credit, cheap credit, and way-too-easy cheap credit.

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Now that the big carnival of credit has closed, consumers feel the pinch of not being able to borrow. Meanwhile, soaring prices for groceries and gas leave people feeling decidedly gloomy, according to surveys that find consumer confidence at a 28-year low.

But are they? After all, retail sales results for May were up twice as much as economists expected, and April sales rose, too. Don't be fooled: Many of those gains came from the \$50 million in economic stimulus checks received in May, as well as Americans being forced to grudgingly spend more for food and gas.

How long will decline last?

Some economists predict this decline will last much longer than expected, as free-spending consumers are forced to live within their means -- along with the companies that depend on their over-spending.

One factor, says Dean Baker, co-director of the Center for Economic and Policy Research, is that baby boomers on the cusp of retirement find themselves with less in stocks, thanks to the tech crash, and now with less home equity, too. Making up those losses before retirement could severely crimp spending, he says.

"At some point, we're going to see lower levels of consumption," says Baker.

Other analysts, such as Alex Rosaen, senior analyst at Anderson Economic Group in East Lansing, note that the basic level of consumer spending will support the economy.

"A small slice of our economy is dependent on that higher level of spending," Rosaen says. "But this is not a sign that the American economy is not going to have strong growth in the future. This is the hangover after the party, but you're not hung over forever."

The only thing everyone agrees on is that growth will slow and consumers will feel some pain. And waiting to find out just how long it'll last is creating our newest economic obsession: the anxiety bubble.

You can reach Money & Life Editor Brian O'Connor at (313) 222-2145 or boconnor@detnews.com.

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