Can We Talk Ourselves into a Serious Recession?
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The economy just missed sliding into negative growth the first quarter of this year and it appears likely to drop into a recession of no growth the next two quarters. The big questions are how deep will the recession be and how long will it last? Will it be an extended – two years or more -- and deep recession?

The answer to those questions depends as much on the media as it does on the underlying economic factors. George Soros has long promulgated the idea that people's beliefs and behavior affect the direction of the underlying economy. Even if you don't subscribe to Soros' reflexivity theory of economic behavior, psychology clearly plays a role in shaping our financial decisions.

The past six months have led to personal budget-breaking increases in oil and food prices. These price increases have had their strongest impact on those U.S. households with average -- $60,000 -- and below-average incomes. But they are not so severe as to force the majority of consumers to cut their expenditures radically. Yet, according to an April 4, 2008 New York Times lead article, more than 81 percent of the public is deeply concerned about their future well being, despite that fact that far fewer than 81 percent of all U.S. households are experiencing either mortgage or financial difficulties. This and similar reports of the worsening public economic mood, accompanied by headline predictions that there is worse to come, tend to reinforce and exacerbate wallet-closing behavior.

The current situation reminds me of a survey our firm did 20 years ago on attitudes towards multifamily residential landlords. At that time, there had been an increasing number of newspaper articles on unwarranted rental increases and other abuses by "greedy landlords." We were asked to undertake a survey to ascertain the attitudes of renters toward landlords. The survey was conducted with a sample of Bay Area residents residing in multifamily rental units. Renter respondents were asked first if they had very positive, positive, neutral, negative or very negative opinions of landlords in general.

At best, respondents indicated they were neutral in their attitudes toward landlords in general, but a majority held negative opinions. But when asked about their own landlord, the majority of the responses fell in the positive range. At first, the extreme difference in response was puzzling. But not when we considered that their responses were based on the assumption that they had a "unique" landlord who was unlike landlords in general.

A recent San Francisco Chronicle insert requested readers to contact the paper if they were experiencing significant problems in paying their mortgage. A more unbiased approach would be to conduct a Bay Area-wide survey with a sample of homeowners who have either lost their homes or are likely to in the near future, along with homeowners not experiencing financial difficulties. The survey would then obtain responses concerning the retail expenditure or shopping behavior of both groups.

The results of such a survey would present a reasonably accurate picture of the relationship between the housing constriction and the slowdown in retail sales. It would provide a basis for predictions about the near-term path of the retail expenditures that have constituted about 70 percent of economic activity.

Finally, you'd be able to report on whether and to what extent these reductions are based on these homeowners being bombarded by bad economic news.

I believe there is a feedback loop: bad economic news, a reduction in expenditures, predictions the recession has not bottomed out and is anticipated to worsen, further drawbacks of retail expenditures and so on.

This interaction between bad news and consumer behavior is not the sole or even necessarily the primary cause of consumers cutting back on their expenditures. Many, particularly those whose incomes fall in the two middle quartiles, are deeply concerned about the possibility of losing their jobs, facing cutbacks on hours or experiencing a major medical emergency if their health is not covered by employer insurance programs. The question is how much are these underlying anxieties exacerbated by the doom and gloom of media forecasts?

While no survey has verified either the existence or importance of this feedback loop, nevertheless the increase in the number of retail bankruptcies, such as Sharper Image and Linens 'n Things, and the decrease in retail sales are sufficiently significant to warrant testing the feedback loop hypothesis. It is important to ascertain the extent to which reductions in retail expenditures are in response to what these consumers are reading in the newspaper or absorbing from other media, whether TV or blogs.

As troublesome as the sub-prime mortgage situation is, of greater importance to our overall economy is the number of retail operations that are cutting back on store expansions or reducing their number of outlets. Retail bankruptcies ripple through the economy as suppliers and investors take a financial beating. This, in turn, is likely to lead to some suppliers going bankrupt. The reduction in the number of existing and future stores means a decrease in jobs and creates a reduction in the "multiplier" effect.

The unrelenting barrage of stories concerning the sub-prime mortgage mess, the cutback in consumer expenditures and their impact on the underlying economy is likely to continue to serve as a psychological catalyst increasing consumer anxieties.

The forthcoming governmental $1,200-per-household rebate may modify the amount of decrease in retail expenditures. That is, if the media's predictions of doom and gloom do not become self-fulfilling prophesies by frightening consumers into spending only a small portion or none of their rebate on delayed household and personal expenditures.