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It's Not as Bad as You Think

How would you describe the current state of the economy? According to the June 2008 Consumer Confidence Index, a measure of how Americans feel about the economy, only 11.5% of Americans think business conditions are good, the fifth lowest rating since the index was established.¹



Falling real estate values and rising gas prices may make it seem as though the economy is in terrible shape, but economists say that conditions may not be as bad as we think. Consider another time in U.S. history when consumer confidence was this low: In May 1980, the unemployment rate was 7.5% and inflation was a whopping 14.4%.^{2,3,4} These conditions were far worse than in May 2008, when unemployment was a much lower 5.5% and inflation was 4.2%.^{5,6}

So why do things seem so difficult now? It may be a matter of perception.

Close to Home

Ronald Reagan once remarked that a recession is when your neighbor loses his job and a depression is when you lose yours.⁷ In other words, the more a problem affects you, the worse it seems. Take the real estate market. One reason for low consumer confidence could be because more people own homes than own stocks directly, so a decline in real estate values affects more people than a comparable decline in stock prices.⁸ Yet weak real estate prices don't necessarily equal a weak economy. More Americans own homes than ever before, and more than 94% of American homeowners pay their monthly mortgage obligations.⁹

Similarly, rising gas prices may cause immediate pain for just about everybody, but they are a far less serious indication of economic weakness than, say, a significant rise in the unemployment rate. When gas prices go up, everyone feels it. But if the current unemployment rate of 5.5% were to rise to 7.5%, only 2% of the population would feel the immediate pain, yet the long-term implications for the economy could be far more alarming.

Gross Domestic Progress

Economists look at gross domestic product (GDP) as an important indicator of how the economy is faring. GDP is the sum of goods and services produced in the United States. When GDP increases, the economy is said to be growing. As a rule of thumb, when GDP shrinks for two consecutive quarters, it is a sign that the economy could be in a recession. Although several pundits started telling us, more than two quarters ago, that the economy was almost certainly in a recession, GDP has continued to grow, albeit more slowly than during the past several years.¹⁰ This is not to say that GDP will continue to grow indefinitely. Sooner or later it will shrink as part of the normal business cycle, although over the course of history, U.S. recessions have generally gotten shorter and less severe.¹¹ Rather, it's useful to note that GDP continued to grow despite widespread fears that the economy was in a recession.

Media Coverage

It's the news media's job to tell us when things go wrong, but they are far less enthusiastic about reporting when things go right. Add in this year's wall-to-wall campaign rhetoric, in which some candidates have an incentive to point out what's going wrong and ignore what's going well, and it would be easy to think that the economy is spinning out of control. However, much of the broader economic slowdown was caused by a crisis in the financial sector, which looks terrible in news reports but may not be as serious as some Americans have been led to believe.

Our memories also play a role in shaping our expectations. The painful economic conditions of the late 1970s and early 1980s were too long ago to influence most people's perceptions. There have been only two short recessions since 1990.¹² As recently as a decade ago, gasoline was less than \$1 per gallon. As Americans, we've grown accustomed to a solid, stable economy. When something goes amiss, it can seem serious because it's in sharp contrast to our experiences.

There is no doubt that our economy is in a rough spot right now. But it's important not to lose perspective or let short-term events sway you from pursuing your long-term goals. For more information on how to best pursue your goals in light of today's market, contact **Jason M. Woodward, J.D.** today at (603) 264-7550 or financialattorney@gmail.com.

1) The Conference Board, 2008

2, 3, 5, 10) Haver Analytics, 2008

4) Thomson Financial, 2008 (consumer price index for the period 5/31/1979 to 5/31/2008)

6) Bureau of Labor Statistics, 2008

7) Brainyquote.com

8) *The Washington Post*, June 18, 2008

9) *Investor's Business Daily*, March 25, 2008

11, 12) National Bureau of Economic Research, 2008