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The case for a quick recovery

Some economists think that because the current downturn has been so sharp, that sets the stage for a stronger and faster rebound than many now expect.

By Chris Isidore, CNNMoney.com senior writer
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NEW YORK (CNNMoney.com) -- There is no debate that the U.S. economy is in terrible shape at the moment.

Nearly [2.6 million jobs were lost last year](#), with the majority of them coming in the final four months of the year. And some economists are forecasting as much as a 5% to 9% drop in economic activity during the fourth quarter, which could be the biggest drop in 50 years.

But some economists are starting to believe that there could be a much stronger and quicker recovery than is now widely expected.

They say that the sharp drop in production and inventories during this recession will force businesses that are now busy cutting back to quickly ramp up production once the economy starts to improve.

The crisis in financial and credit markets sparked by the Lehman Brothers bankruptcy in September caused businesses to slam the brakes on production much harder than justified by reduced demand alone, according to Joseph Carson, chief economist at AllianceBernstein.

"We were producing 2 million tons of steel a week prior to Lehman. Now we're producing 880,000 a week," Carson said. "The economy has slowed, but it has not fallen by half in the last three months. This kind of significant inventory liquidation is exactly why recoveries take place."



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Many also believe that the significant steps being taken by the Federal Reserve and Congress to spur the economy will kick in later this year. That stimulus, coupled with low energy prices, could cause a jump in economic activity.

A V-shaped recovery?

This kind of recovery is known as a V-shaped recovery, because a chart of economic activity would look like the letter V: a steep decline followed by a quick and strong turn around.

"Generally the sharper the recession, the sharper the recovery," said Lakshman Achuthan, managing director of the Economic Cycle Research Institute.

Achuthan said he is not yet ready to call the bottom of the current economic downturn. But he said his firm's weekly index of leading economic indicators has been ticking higher in recent weeks, suggesting that the economy may finally be close to the bottom.

He added that when things start to show signs of improvement, the economy could well be helped by pent-up demand from consumers who sharply curtailed purchases in recent months.

"Consumers have been on strike," he said. "They've been holding off buying things that they don't absolutely have to have."

Of course, hopes for a quick turnaround are still faint. There are many economists, including staffers at the Fed, who worry that there will be, at best, a modest pick-up in activity later this year and continued job losses continuing into 2010.

According to a plan released by the economic team of President-elect Obama over the weekend, the incoming administration believes the unemployment rate will continue to rise through the third quarter of this year, and top out at 8% -- even if the economic stimulus plan it is proposing passes.

Or a U-shaped recovery?

And some economists who believe there will be a sharp recovery aren't sure it will take place anytime soon.

"We're eventually going to get a strong recovery. We just can't forecast with any degree of certainty if it will be in the second half of the year," said Ed Yardeni, president of Yardeni Research, an independent market research firm.

He added that the recovery could wind up looking more like a U, i.e. the economy hovers around the bottom for awhile, than a V.

Yardeni said everything will have to go right to bring any type of recovery in 2009, including quick passage of effective stimulus by Congress and an unfreezing of the credit markets.

He added there is some evidence of improvement in the economy, including narrowing credit spreads and lower mortgages rates. But it may be too little, too late for a turnaround this year.

"Right now there's more going wrong than going right," Yardeni said. ■

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