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The case for cautious optimism

Many economic forecasters see nothing but further sinking, but with a rising number - if not percentage - of people employed, there are grounds for optimism.

A worker assembles roof rafters at a construction site, in Portland, Ore. on Aug. 19. With employment continuing to rise, if slowly, some economic forecasters predict sluggish growth.

Rick Bowmer / AP / File

By David R. Francis / September 14, 2010

"Pouting pundits of pessimism."

Is that what those many economic forecasters, warning of a double-dip recession and deflation, amount to? Brian Wesbury, chief economist of First Trust Portfolios in Wheaton, Ill., thinks so.

Today's widespread gloom is "economic hypochondria," he writes in a blog. "This disease causes a person to think the worst about everything and anything that happens."

Apparently, the public isn't immune to the gloom. Nearly two-thirds of Americans – 62 percent – figure the economy has yet to hit bottom, according to a survey for Citi, the global financial services company.

No one knows for sure, of course. Economic forecasting involves a "lot of uncertainty," says William Poole, former president of the Federal Reserve Bank of St. Louis.

"It's all guesswork when you go forward," says Daniel Fuss, manager of the $19.2 billion Loomis Sayles Bond Fund.

Although neither one sees a vibrant economy immediately ahead, they don't expect a dip back into recession. They forecast sluggish growth.

The reductions in unemployment will be "far below what we need," predicts Mr. Poole, who is now a senior fellow at the libertarian Cato Institute in Washington.

Though regarded as a "monetarist," an economist who puts heavy emphasis on trends in the creation of new money, Poole says neither monetary policy nor fiscal policy can do much to pep up the economy at present. People and companies first have to pay down excessive debts, debts that were the major cause of the Great Recession in the first place, says Poole.

To provide an incentive for companies to use less leverage, he would like Congress to phase out corporations' tax deduction for interest from taxable income. He would also gradually shrink the federal tax on corporations from the current marginal rate of 35 percent to about 15 percent.

Poole suspects the current slow recovery is due largely to the uncertainty of business executives facing thousands of pages of new regulations in both the financial and health-care industries. It's an "enormous regulatory shock," he says. Before making a lot of new investments, they are waiting to see what happens with the new rules.

Poole is critical of proposals by both Democrats and Republicans to deal with the huge deficit.

Mr. Fuss, an executive with a superb record in running bond mutual funds, faces a different challenge. Having made lots of money for his investors with the fall of interest rates to record lows, he now has to avoid a big drop in the value of his funds when the economy eventually revives and interest rates start to rise again. (Existing bond prices fall when interest rates climb.)

When will the rebound come? The veteran mutual-fund manager doesn't expect the economy to get back to its prerecession peak until fall 2011.

As a precaution, though, he's shortening the average maturity of bonds in his portfolio and buying foreign securities. The latter involves the risk of shifts in foreign exchange rates. Nonetheless, Fuss finds good bond prospects in such places as Canada, Australia, and New Zealand. But not in Japan.

As for the direction of the US economy, the key indicator he follows is the absolute number of people working. That is still rising.

Given the current level of pessimism in the market, that qualifies as an optimistic outlook.

•David R. Francis *writes a weekly column.*