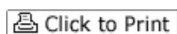




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What shape is the economic recovery in: U, V or W?

By Paul Davidson, USA TODAY

With the launch of an economic recovery all but certain this year — many experts say it's already begun — the debate among pundits has turned decidedly alphabetical. In other words, what letter will the rebound resemble — U, V or W?

Typically, sharp downturns like the current one yield equally rapid, or V-shaped, upswings. But the worst recession since the [Great Depression](#) has been anything but typical, with housing and credit markets devastated. In a USA TODAY survey, 63% of economists said the recovery will be slow and gradual, or U-shaped.

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Yet 37% said it will be moderate or fast. And a smattering of experts say the rebound will look like a W, with a precarious economy sliding back into recession before turning around for good. USA TODAY presents the case for each scenario:

WHY IT'S A U-SHAPED RECOVERY: A sharp downturn followed by a slow and gradual rebound.

Most economists, including [Federal Reserve](#) Chairman [Ben Bernanke](#), predict a slow and gradual upturn. To be sure, the telltale recovery signals have been flashing green lately. Factory output and new orders grew last month at the fastest pace in two years. The government's cash-for-clunkers program has lit up a moribund vehicle market.

And with inventories of stores and manufacturers depleted, factories must soon ratchet up production just to restock.

But most experts say the recovery will be muted, largely because consumers are in no mood to open their wallets. They've lost \$13 trillion of wealth in the recession's housing and stock market crashes and appear determined to sock away any extra cash they have, says Mark Zandi, chief economist of Moody's Economy.com. The savings rate jumped to 5.2% in the second quarter from a low of 1% before the crisis. Consumer spending accounts for 70% of the economy.

Meanwhile, the 9.4% jobless rate is keeping consumers "focused on necessities like food" and medicine, says [Sung Won Sohn](#), economics professor at California State University.

Two underpinnings of a robust recovery — the housing and auto markets — are suffering from deep-seated problems that won't soon fade. About 1.8 million in excess housing units built during the real estate bubble ensure a tepid rebound in housing starts, Zandi says. Foreclosures continue to rise. And vehicle sales have been hampered by a credit crisis that's made it tough for consumers and businesses to get loans. It will take time for banks to feel comfortable lending again. While the cash-for-clunkers program has juiced sales lately, that will mean fewer sales next year, Zandi says.

"It's hard to see how the economy can get going if people and businesses can't borrow money," Zandi says. He predicts anemic growth of 1% to 2.7% over the next year.

WHY IT'S A V-SHAPED RECOVERY: Dramatic tumble produces a similarly sharp upswing.

Despite unusual obstacles in the housing and credit markets, some economists say traditional economic dynamics should still win the day, with the steep downturn producing a sharp rebound. Or at least a moderate one.

Businesses have cut their workforces far more than falling customer demand required in an effort "to get ahead of the curve," says Ken Mayland, president of ClearView Economics. "They're beyond lean, they're understaffed," he says. "They'll have to start re-employing people faster than in past recessions" just to restock.

Rising employment should boost consumer spending.

Also, despite the massive drop in household wealth, the S&P 500-stock index is up 47% since its early March nadir. That should embolden consumers to open their pocketbooks wider than some predict, says Dean Maki, chief U.S. economist at [Barclays Capital](#). So while Maki says the savings rate will stay high, that shouldn't prevent consumer spending from rising at least moderately as well. Another boost to spending will come from incomes lifted by growing production and a housing construction rebound, he says.

Some optimists point to more basic economic principles. Consumers have been putting off purchases of everything from cars to appliances, leaving a storehouse of pent-up demand, says Chris Rupkey, chief financial economist at Bank of Tokyo-Mitsubishi. The population continues to grow 1.1% a year. And the positive economic news, along with rising stocks and gas prices that have fallen from their \$4-a-gallon peak, should buttress consumer confidence, Rupkey says. The economic stimulus will likely provide an additional bounce when most of the money is spent next year, optimists say.

The economy "is kind of like a beach ball underwater," Rupkey says. "It wants to bounce back."

What's more, automobile and housing sales have fallen so low that a return to even modest levels would mean a 10% to 20% increase and a V-shaped upswing, Mayland says. He projects the economy will expand at a fairly vibrant 4% clip in 2010, with unemployment peaking later this year.

Banks are still tightfisted. But Maki says the recovery will likely be driven by higher-income households and businesses "that don't need credit or are still able to get it."

WHY IT'S A W-SHAPED RECOVERY: Recovery cut short by recession, then a second rebound.

A small group of experts believes the nation will endure an unusual W-shaped, or "double-dip," recovery in which the economy falls back into recession before growing again.

That's what happened in the early 1980s when the economy soared the first few months of 1981 following a recession, before the Federal Reserve raised interest rates to head off inflation. That put the brakes on the recovery, setting off another, more severe downturn.

Steve Hanke, professor of Applied Economics at [Johns Hopkins University](#), predicts a similar pattern this time. Besides keeping a key interest rate near zero, the Fed is spending \$1.75 trillion to buy government securities in a bid to keep mortgage and other loan rates low.


The massive liquidity, plus rising commodity prices, will increase inflation, says Hanke, who is also a fellow at the conservative [Cato Institute](#). Meanwhile, Hanke believes the central bank will be loath to raise interest rates to stave off inflation in 2010, because doing so could tamp down what he says will be a weak recovery in an election year.

As a result, he says, the Fed "will wait too long" and then be forced, perhaps in 2011, to raise interest rates sharply, sending the economy back into a tailspin.

[Wells Fargo](#) economist Mark Vitner also believes a W-shaped recovery is possible, but for a different reason. The economy, he says, should grow at a fairly robust 3.4% in the third quarter as manufacturers boost output to replenish stocks. But he says it will likely hit a wall in the first quarter, with little customer demand to keep production up, higher state and local taxes that crimp spending and the expiration of the cash-for-clunkers program. Vitner thinks the economy will slow to a 1.8% crawl in the first quarter but could actually shrink before mounting a second, tepid recovery.

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