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Obama Channeling Reagan Needs 5 Quarters of 7% GDP Growth Surge

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By Michael McKee

Aug. 27 (Bloomberg) -- President **Barack Obama**, like **Ronald Reagan**, has decided to keep a Federal Reserve chairman after what at the time was the longest recession since the 1930s. Unlike Reagan, Obama probably won't get a strong recovery, or the political boost that it brings.

Under Fed Chairman **Paul Volcker**, the economy grew at a more than 7 percent annual rate for five straight quarters following the 1981-1982 recession. Reagan, after reappointing Volcker in 1983 and declaring "it's morning again in America," won 49 of 50 states in the following year's election.

Obama is putting his trust in **Ben S. Bernanke** ahead of time, nominating him to a second four-year term even though the recession isn't officially over. Growth is forecast to average just 2.2 percent over the next year, according to a Bloomberg News survey of economists this month.

"It's going to be much, much tougher to jump-start the economy now," said **Stephen Roach**, chairman of Morgan Stanley Asia in Hong Kong, who in 1983 was in the first year of his career as a Wall Street economist. "It's a totally different dynamic playing out today in our post-bubble, overly leveraged world."

Obama praised Bernanke for "bold action and out-of-the-box thinking that has helped put the brakes on our economic freefall" in nominating him Aug. 25, and went on to discuss his plans to overhaul health care and promote clean energy. Spearheading that agenda is **Lawrence Summers**, director of the White House National Economic Council, who worked as an adviser in the Reagan White House in 1983.

Congressional Elections

There's little more that Bernanke and Summers can do to deliver additional fiscal or monetary stimulus before the 2010 congressional elections with **interest rates** already near zero and the budget deficit projected to rise to a record $1.6 trillion this year, economists say.

"The results of the mid-term election next year will be critical in terms of Obama's ability to push through his programs," said **William Poole**, former president of the Federal Reserve Bank of St. Louis, who was a member of the Council of Economic Advisers in 1983.

The economy contracted by 3.9 percent during the latest recession, which started in December 2007, more than the 2.9 percent decline of 1981-1982.

Even the most optimistic member of the Fed's policy-making Open Market Committee predicts growth of no more than 4.6 percent two years from now, in 2011, when **unemployment** will finally fall below 9 percent.

Withdrawing Stimulus

Bernanke must worry about withdrawing stimulus to avoid reigniting inflation after doubling the Fed's balance sheet to more than $2 trillion, said **William Niskanen**, a member of Reagan's Council of Economic Advisers.

"Bernanke is going to have to take money out of the economy," Niskanen said. That was a problem Volcker didn't face.

Consumer spending will remain anemic, economists say. Personal incomes, which rose through the 1981-1982

recession, have fallen 1.7 percent since the current slump began. From a peak in the second quarter of 2006, average home **prices** are down more than 30 percent, removing a potential source of cash for consumers.

"It's a rather worrisome situation," said **Lyle Gramley**, senior adviser to New York-based Soleil Securities, who was a member of Volcker's Fed board of governors from 1980 to 1985. "What we need now is a lot of prayer."

Credit Crunch

Americans who are willing to borrow and spend are finding it harder to get credit. The Fed reported last week that banks continued to tighten standards on all types of loans in the second quarter, and expect to maintain strict lending criteria until at least the second half of 2010.

"We didn't have the kind of credit-crunch problems we face this time," Gramley said. "Credit markets are still a long way from being healed. We don't have the willingness to lend you need to get recovery."

Austan Goolsbee, a member of Obama's Council of Economic Advisers, said one of the top priorities for the administration and the Fed is finding a way "to reignite the credit markets so we can get businesses able to access credit and banks lending again."

The situation was different under Volcker, who waged war on inflation by raising Fed's benchmark lending rate to 20 percent in early 1981, pushing the unemployment rate up to 10.8 percent in the process and risking a political backlash.

'Explaining Why'

"I spent a lot of time writing members of Congress, explaining why we had to do it," said **James Glassman**, a senior economist at JPMorgan Chase & Co. in New York who worked at the Fed from 1979 to 1988.

By 1983, Volcker had won his battle. Annual consumer price inflation had collapsed to 2.5 percent in July 1983 from 14.8 percent in March 1980. The central bank was lowering interest rates. Reagan had signed a 25 percent across-the-board tax cut. Unemployment was falling.

Reagan announced Volcker's reappointment on June 18, 1983. Three weeks later, the National Bureau of Economic Research declared the recession had ended the previous November after 16 months -- matching the duration of the 1973-1975 slump as the longest since the Great Depression.

"There was a feeling that we would have a V-shaped recovery with strong GDP growth," recalled Niskanen, who is now chairman emeritus of the **Cato Institute** in Washington, a policy research group. "We were not discouraged by the conditions. Reagan was almost incurably optimistic."

His optimism was well placed. The economy took off, growing by 5.1 percent in the first quarter of 1983. Growth reached 9.3 percent in the second quarter of that year and averaged 7.9 percent in the following 12 months.

"Once the economy started soaring we moved ahead in the polls and never looked back," said **Ed Rollins**, Reagan's 1984 campaign director.

"Obama will stay popular," Rollins said. "But if we're still talking about the economy two years from now it's going to be very difficult for him."

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