

## The Economy Is Heading the Wrong Way

THE EDITORIAL BOARD

At first glance, the latest economic growth report, released Friday, appears to show the economy revving up. In reality, the economy is either stuck in low gear, or worse, slowing to a stop as budget cuts harm not only the users of overstretched government services but the overall economy. This precarious situation urgently calls for more federal spending, not less, though that message has been lost on Congress.

From January through March, the economy grew at a modest annual rate of 2.5 percent, compared with a measly 0.4 percent in the last three months of 2012. That seems like a big jump, but it was less than economists expected and does not alter the big picture. Since the recession ended in mid-2009, quarterly growth has averaged around 2 percent. Every acceleration from that pace has inevitably petered out, which is why unemployment is high and pay is low nearly four years into what is officially an economic recovery.

Worse, there are signs in the latest report of a renewed slowdown. Excluding inventories, which tend to artificially depress growth in some quarters and raise it in others, growth in the first quarter of 2013 was only 1.5 percent, compared with 1.9 percent in the fourth quarter of 2012 and 2.4 percent in the third quarter.

Underneath it all is the fiscal drag from ill-advised and ill-timed austerity measures. With the expiration this year of the payroll tax break, personal income declined sharply last quarter, forcing consumers to draw on their savings to support their spending. That is unsustainable, presaging weaker consumption in the months to come and, with it, weaker overall growth.

At the same time, cutbacks in government spending took a big chunk out of growth, reflecting, in part, the onset of automatic budget cuts under the sequester. The hit from lower public spending will only intensify in the quarters to come as the sequester takes full effect, threatening to push growth below its already paltry 2 percent average.

There is a tendency, in the gloom, to look for bright spots. Housing, for example, showed continued growth in the first quarter, but it was more than offset by the drag from cuts in government spending. If overall growth remains sluggish or even slows down, that could overwhelm the housing recovery, because the pace of home sales is inseparable from the pace of the economy. Without enough growth to power jobs and pay, potential homeowners will simply not have the income and credit profiles to buy.

Lack of demand is also bound to take an increasing toll on corporate earnings, which also have been a bright spot. Already, some prominent companies, including I.B.M. and Caterpillar, have reported disappointing results, a reflection of waning demand not only in the United States but in recessionary Europe and in China, where growth has been below expectations. The longer and more widespread the weakness is, the less faith investors will have in the ability of the Federal Reserve to engineer a rebound. The real danger in the Fed's efforts to revive the economy is not that its actions will cause inflation - of which there is no evidence - but that they will fail to revive the economy by any meaningful measure, denting investor confidence and, in the process, the stock market.

That is not to blame the Fed. For years, Congress and the Obama administration have been working at cross-purposes to the Fed, as strategies to cut the budget have taken priority over strategies to increase growth, jobs and pay. Republicans have insisted on austerity for ideological and political reasons. The administration has done better by adding new taxes and investments to the cuts, but the reductions are still deep and damaging. The budget fights have endured even as the intellectual arguments for near-term deficit reduction have collapsed. They have endured even as the economies that have enforced budget cuts most strenuously have contracted, notably in Britain and in much of the rest of Europe. And they endure even as the United States remains impaired by fiscal wounds that are, unfortunately and undeniably, self-inflicted.

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