



The Recession of 2016

BY RICHARD W. RAHN

CENTRAL BANK BUNGLES, OIL PRICE FLUCTUATIONS AND OVERREGULATION INDICATE CONTRACTION

There will be a recession in the United States and much of the rest of the world in 2016. After reading the above sentence, you should be thinking, what possibly could the writer know that the International Monetary Fund, the Federal Reserve and the Obama administration do not know given all their resources and all of their professional economic forecasters?

If one looks at the forecast record of the IMF and the Fed over the past several decades, one will not find any case in which a year of positive growth was followed by a year of contraction in which the IMF or Fed anticipated the recession in April of the growth year. Given the evidence, economic forecasting is far from an exact science, and forecasters and model-builders have much to be modest about. In fact, I do not know for certain that my opening sentence is true or not, but the following is my case for why my assertion is more likely to be true than the various official forecasts.

Central banks, including the Fed, the European Central Bank and the Bank of Japan, as a result of their low-interest rate policies and selective financial asset buying, have replaced the free market in determining credit allocation. That is, their policies have subsidized government debt and borrowings by major

corporations, all at the expense of smaller and more entrepreneurial organizations that are the major job creators. Economists who I respect have estimated that this misallocation of credit has cost the United States perhaps 1.5 percent gross domestic product growth for each of the last several years, which would explain much of the slow-growth economy.

Historically, it is known that most recessions, including the Great Recession, were caused by mistakes in monetary policy, which were often reinforced by bad tax and regulatory policies and not by “greedy bankers and businesspeople.” Once every several years, bankers and businesspeople do not suddenly become greedier, but government policymakers do make big mistakes and reinforce crony capitalists.

The job of the Fed has been described as to “lean against the wind.” But to do so, one has to know which way the wind is blowing, and the people in regulatory agencies have no more insight into this (and usually less) than participants in the market who have their own money at stake. The growing amount of financial, labor and environmental regulation is slowly strangling the economy. Some of these increasing costs have been offset by the drop in oil prices, but that is about to end.

The Obama administration seems to be determined to kill most fossil fuels while totally disregarding the impact on economic growth and jobs. Just last week, it declared it would no longer sign leases for coal mining on federal lands. The president talks compassion but has left much of the Appalachian coal country an economic and human wasteland, and it is getting worse.

The number and uncertainty of all the new financial regulations are obscene. The regulations stemming from the Dodd-Frank bill alone have now exceeded 19,000 pages, much of it written in bureaucratic gobbledygook, ensuring that financial institutions can never know whether or not they are in compliance — and making it impossible for smaller institutions to digest. The new rules on international financial transfers and accounts are shutting down much productive investment and commerce. One of wiser economists, David Malpass, who has extensive high-

level Washington and Wall Street experience, has been detailing and warning about the increased regulatory drag. He sees no letup but, in fact, an acceleration in the destructive regulations emanating from the Obama administration, which may totally offset any positives.

A number of the mistakes made before the Great Recession are being repeated because policymakers chose to learn the wrong lessons. Ads are now being run in Miami and other places again for courses on how to “flip houses,” which is one of the ways so many people got into trouble a decade ago.

There is no longer a major growth engine in the world to bail everyone else out. Growth will probably continue to slip in China. Japan and Europe are stagnant at best, and the big oil-producing countries are running out of money to buy goods and services from the rest of the world.

The drop in oil prices has been good for consumers, but that benefit has been more than offset by a rise of the price of medical insurance owing to Obamacare. It is estimated that to meet present global oil demand, a price of \$40-50 per barrel will be required once current inventories are worked off and marginal wells are shut down. Russia and Iran desperately need a higher price of oil, and the best way of achieving that is to have some of Saudi Arabia’s production turned off. There are a number of benign and not-so-benign ways that can happen.

Well before the end of this year, the price of oil will rise. That, combined with ever-increasing regulatory costs, the continued misallocation of credit by the central banks, and the China slowdown, will mean negative economic growth for the United States and many other countries.

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