BusinessWeek

FACETIME January 7, 2009, 5:00PM EST

Columbia's Amar Bhidé and NYU's Nouriel Roubini

"When you have an integrated global economy…there are not many places to hide because markets [and economies] become correlated"

By Maria Bartiromo

A year from now we may look back on this column and thank heaven that not all of its grim predictions came true. But don't bet your kid's lunch money against Nouriel Roubini. A professor of economics at New York University's Stern School of Business and chairman of the consultancy RGE Monitor, Roubini in 2006 predicted the housing bust and an ensuing recession, among other on-the-money calls. And he says the worst is still ahead. Amar Bhidé, a professor of business at Columbia University, is a former McKinsey executive, a staff member for the commission that investigated the stock market crash of 1987, and author of the new book *The Venturesome Economy: How Innovation Sustains Prosperity in a More Connected World*. He, too, expects a trying year ahead. But beyond the black cloud hanging over America, he sees a country chastened and an economy strengthened by the ordeal.

MARIA BARTIROMO

Where are we right now in this economic slowdown?

NOURIEL ROUBINI

We are looking at the most severe U.S. recession in the last 50 or 60 years, both in terms of length and depth. Every piece of economic news that's come out in the last few weeks and months has been much worse than expected, from employment, holiday sales, capital spending by the corporate sector, the continued collapse of residential real estate, and a weakening even of the trade balance, so the rest of the world is also contracting.

You say we are looking at a deep and possibly multiyear recession in America; an additional 15% drop in U.S. home prices; painful recessions in Europe, Canada, Japan, and other established economies; a sharp slowdown in China, India, Russia, and Brazil; and possibly default by some emerging-market countries. Can anything stop this locomotive bearing down on us?

The only positive news I see is that the policy response, both in the U.S. and in other countries, is going to be quite aggressive. But in my view, that policy stimulus is going to have most of its effects in 2010. And the cost of issuing a huge amount of public debt will be trillion-dollar budget deficits this year and next, which eventually is going to have a crowding-out effect on private demand. So either we issue a huge amount of public debt to finance it, and that's going to push up interest rates, or we print a lot of money that eventually is going to be inflationary and again damaging to the economy. We have no choice but to have an aggressive policy response, but it's not a free lunch.

In a new article in *Foreign Policy*, you suggest that corporate earnings will shock any equity analysts still deluding themselves. Where will the Dow be at midyear?

I see it about 20% below current levels. Same for the S&P.

How many jobs do you think will be lost in 2009?

I expect job losses of at least 2.5 million.

How much confidence do you have in the new economic team that President-elect Obama has named?

I think folks like Tim Geithner, Larry Summers, and others are as good as you can get. But the problems they're facing are so vast that even the best economic team and the best economic policies are not going to start having an effect until the end of 2009 [or beginning of] 2010.

Do you think criticism of how Hank Paulson and his team have handled the crisis is fair?

It was a very tough situation, of course, but I think that the policy response by Paulson has been relatively confused, not credible, and inconsistent. So I give them a low grade in terms of performance.

As an investor, what do I do in this scenario?

Safe assets such as government bonds are the place to be until midyear when we see whether the fog of uncertainty clears in the direction of a recovery.

And keep as much of my assets as possible in cash for the near term.

Absolutely.

Are there any areas escaping this upset? Are there any places to hide?

Unfortunately, when you have an integrated global economy with trade and financial links, there are not really many places to hide because markets become correlated, and economies become highly correlated.

Do you see any positives coming out of this crisis?

The U.S. has been living in a situation of excesses for too long. Consumers were out spending more than their income and the country was spending more than its income, running up large current-account deficits. Now we have to tighten our belts and save more. The trouble is that higher savings in the medium term are positive, but in the short run a consumer cutback on consumption makes the economic contraction more severe. That's the paradox of thrift. But we need to save more as a country, and we have to channel more resources to parts of the economy that are more productive. And when you have too many financial engineers and not as many computer engineers, you have a problem.

What do you advise students coming out of school?

I think this country needs more people who are going to be entrepreneurs, more people in manufacturing, more people going into sectors that are going to lead to long-run economic growth. When the best minds of the country are all going to Wall Street, there is a distortion in the allocation of human capital to some activities that become excessive and eventually inefficient.

MARIA BARTIROMO

Nouriel Roubini paints a pretty dire picture of the year ahead. How deep and painful will this recession be?

AMAR BHIDE

For some people, extremely painful. For almost everyone, anxious. But I think most people will come out of it fine. In a book I wrote in 1999, I said: "We're in the middle of an Internet bubble, and it's all going to blow up, and it's all going to come to a bad end." After a dinner talk I gave, I was taken aside by a Merrill Lynch broker, and he said: "Look, you may well be right, but nobody became rich in America being a pessimist." And he was dead right. The Internet bubble did blow up, and some people lost their shirts, but the overall process of economic growth and increased prosperity stayed in place. People will redouble their efforts to be more innovative and efficient.

So you're saying economic weakness is going to inspire more innovation, and at the end of the day, positive things will come out of this crisis?

It's going to be positive in two respects. One is that [recession] is often a stimulus for the adoption of new technologies. The decade of highest productivity growth in the 20th century was the 1930s. In the 1930s a lot of technologies developed in the 1920s were put into use because people were looking for any angle to improve their productivity. The personal computer revolution took off in the early 1980s when we had a really lousy recession. I think we're going to see an awful lot of innovation in the health-care sector because people will be driven to cut costs. So right under our noses a great boom could be taking place that in the long run revolutionizes health care for everyone. And that will have a much more lasting impact on the economy than whether the recession lasts a few months more or less.

You have talked about past recessions being real opportunities for business. But in past recessions, wasn't business able to get lending? And doesn't the tightness of the credit market today inhibit some opportunities?

Typically not. Most new innovations are started without access to credit in good times or bad. Microsoft (MSFT) was started without any access to credit. It's only in crazy times that people lend money to people who are experimenting with innovations. Most of the great businesses today were started with neither a lot of venture capital nor with any bank lending until five or six years after they were [up and running].

One of the points Roubini makes is that American consumers have lived beyond their means and now are starting to save. But he says over the short term, that could deepen the recession. One of the points you have made is that history shows Americans don't shy away from smart consumption even in tough times. What are some of the examples of that?

As we speak, people of middle to low incomes are buying iPhones, and they're buying them smart because they're buying them to use as substitutes for computers. Many macroeconomists just think of consumption as one big lump of stuff. In fact, it's a whole bunch of things, some of which are good for the economy in the long run and some of which are less good. So I think we'll see a cutback in the kinds of things people consider dispensable. They may eat out less. They may not trade up to a larger home. But history suggests there will be no cutback in the consumption of the kinds of new technologies and products that ultimately make the economy grow.

How will America be positioned in terms of global competitiveness when it emerges from this recession?

One of the few things I agree with Paul Krugman about is that competitiveness is a dubious notion. One can talk about competitiveness in the Olympics, but competitiveness in terms of economic growth puts things in completely the wrong frame. We are living a world where there is going to be, in the long run, more prosperity in more parts of the world. As prosperity increases in more parts of the world, the U.S. share of world GDP will decline, and that is a good thing. But in the next couple of years, we could completely mess this up and go in the direction of socialism. We could go crazy with these stimulus packages and destroy the free-enterprise ethos that has sustained innovation for the past several centuries. I would rather have a slower recovery than try to accelerate the process and destroy the foundations of the free-enterprise system.

You don't agree with the current stimulus ideas?

I am deeply skeptical. I certainly thought [the Troubled Asset Relief Program] was a terrible mistake. I have enormous confidence in the institutions of America, and I hope they will override the mistakes individuals make. But this whole business of TARP reminded me a lot of the WMD business in Iraq: "Oh my God, just trust us. There are these WMDs, and unless you give us the authority now and right now to bomb them, disaster will befall us all." Giving Wall Street or Detroit or the banks money with virtually no personal accountability erodes the legitimacy of the system. Ultimately, the great strength of this economy is the belief that the game is not rigged, that we can all get ahead if only we try harder. The destruction of that belief could be an awful consequence of this desperate shoveling of money.

Consumer confidence is down, 401(k)s are decimated, people are losing their jobs. What are the most hopeful signs that you see amid the gloom?1...

We have a more innovative society than at any time in history. There are people looking for opportunities, and they will lead us out of this. Anyone who thinks that's going to happen overnight or without pain is delusional. Anyone who thinks that this is a bottomless pit is crazy, too.

Maria Bartiromo is the anchor of CNBC's Closing Bell.