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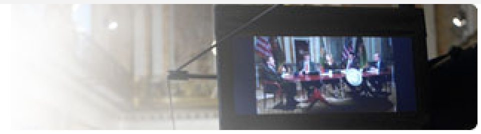

# Assistant Secretary for Economic Policy Alan Krueger Remarks Remarks to the Congressional Hispanic Caucus Institute

9/16/2009

**Introduction**

Thank you Maria (Contreras-Sweet). It is a pleasure to be on this panel this morning with Secretary Solis and Secretary Donovan, Representative Sablan and Representative Sanchez, and Doctor Hinojosa-Ojeda.

Today is the one-year anniversary of the failure of Lehman Brothers. Many analysts believe this is the event that set off the financial panic that brought the financial system to the brink of collapse and that leaves us today facing the highest overall unemployment rate in 26 years.

It is worth remembering the maelstrom of confusion and concern that erupted in the week after Lehman collapsed. A key money market fund announced that it would "break the buck," signaling to businesses and households alike that assets once thought rock solid could easily evaporate. The strongest financial institutions in the world moved dangerously close to collapse. Consumer and business confidence were shaken. The U.S. economy faced the 21st century equivalent of a run on the bank – and it was both real banks and unregulated institutions that functioned like banks that were facing electronic runs.

This financial fire quickly spread to the rest of the economy, with devastating consequences. The financial crisis wiped out $5 trillion of wealth in the last quarter of 2008. Declining wealth caused consumers to cut back on spending. Falling spending caused companies to lay off workers. Workers who lost their jobs -- and those who feared they might -- cut back even further on their spending, and the vicious cycle spiraled further out of control.

In January, when the Administration took office, the economy lost 741,000 jobs, single-family housing starts were at an all-time low, and we had more than one year's supply of unsold new homes on the market. In the last quarter of last year and first quarter of this year the economy shrank by 6 percent at an annual rate – its largest 6 month decline in 50 years.

Fundamentally, our economic crisis can be traced to an economy that relied too much on borrowing and not enough on saving; to a financial system that exploited regulatory gaps, eschewed transparency, and took on too much risk; and to public policies that allowed unsustainable imbalances to emerge. Economics is about the allocation of scarce resources, and our system was investing too little in human capital and public infrastructure and too much in unproductive activity. This environment was ripe for bubbles, and many developed -- the most important of which involved the housing sector.

**Main Body**

I'm happy to report that, thanks in large part to actions taken by the Administration, Congress and the Federal Reserve, the contraction in the economy appears to have abated and the recovery phase is beginning. The Financial Stability Plan, the Recovery Act, and other policies are playing a key role by boosting aggregate demand, supporting financial markets, and mitigating the effects of the housing market correction.

More than 80 percent of private forecasters in a recent survey believe the economy is now out of recession, with a consensus projecting real GDP to average between 2½ and 3 percent at an annual rate through the end of 2010. We've come a long way, but the economy remains fragile and unemployment is likely to remain unacceptably high for some time to come.

Just last week we got a look at some key indicators of the damage the recession has inflicted:

· Real median household income fell 3.6 percent to about $50,300 in 2008, the lowest level since 1997. For Hispanics, the percentage decline was even greater. Real median household income fell 5.6 percent to about $37,900.

· About 2.5 million more people fell below the poverty line in 2008, and the poverty rate rose to 13.2 percent, the highest level since 1997. Again, the increase in poverty affected Hispanics disproportionately, as 1.1 million more Hispanics fell under the poverty line 2008 and the Hispanic poverty rate rose to 23.2 percent.

The economic damage has been severe and widespread. So why are we hopeful that the economic storm is abating? In the second quarter of 2009, our broadest measure of economic growth, real GDP, posted its smallest decline in a year, falling by 1 percent at an annual rate. There are signs that spending in Q3 will be solid, and the stimulus measures proposed by the Administration and passed by Congress deserve much of the credit. To give an important example, the unprecedented modernization and extension of Federal unemployment insurance benefits launched by Secretary Solis have provided crucial support to those thrown out of work, both through benefit increases and extensions, and through provisions that help unemployed workers to continue their health insurance coverage.

The downturn started in the housing sector, so it is encouraging that recent data suggest that housing markets are stabilizing. To cite a few:

· Single-family starts are up for 5 straight months and are up more than 30 percent from February's record low (although they are still down about 75 percent from their peak in early 2006).

· New home sales are up a third (albeit from record-low levels) since January. New home inventories have been whittled down to their lowest level since 1993, and, relative to sales inventories are approaching more normal levels (a 7.5 month supply compared to a 5-6 month normal supply).

· House prices are down significantly from a year earlier, but in recent months prices have stopped falling and, in some markets, are actually rising.

· Here again, government policies deserve much of the credit. Under the leadership of Secretaries Donovan and Geithner, the Home Affordable Mortgage Program (HAMP SM) program, for example, is on target to meet its goal of starting half a million trial modifications for responsible homeowners by November 1 st.

Financial market conditions are also improving.

· In retrospect, the SCAP--or "stress test" program--was a key turning point that promoted banking sector transparency and spurred financial institutions to raise substantial amounts of capital in private markets. The financial system is now beginning to operate on its own again: Ba nks rescued by public dollars have repaid more than $70 billion of the capital we committed, with interest.

· The level of the stock market has jumped nearly 50 percent since early March, and is up more than 10 percent so far this year (after falling nearly 40 percent last year). The rise in stock prices has provided some needed relief to corporate and household balance sheets. Total stock market capitalization has risen by about $3 trillion since early March.

In the typical recovery, financial markets recover before GDP, and GDP recovers before jobs. So far, this recovery is following that familiar path, despite the severity and longevity of the recession.

In my view, we will not have a real recovery until the U.S. is creating enough jobs for the expanding labor force. We are still sustaining unacceptably high job losses. Job losses so far in Q3 are running about 250,000 per month, which is roughly half the pace of decline in Q2, but any jobs report that begins with a negative sign is disappointing.

The unemployment rate, which typically lags GDP growth, is at 9.7 percent, a 26-year high. Private forecasters and the Administration expect unemployment to increase into early next year, with the rate peaking at 10 percent before starting to gradually come down in the second half of next year.

**Hispanics and the Current Recession**

The recession has hit Hispanic workers particularly hard. In December 2007, the peak of the previous expansion, the overall unemployment was 4.9 percent and the unemployment rate for Hispanics was 6.2 percent, a gap of 1.3 percentage points. In August, the overall unemployment rate hit 9.7 percent while the Hispanic unemployment rate rose to 13 percent. In total, the Hispanic unemployment rate has risen 6.8 percentage points, while the overall rate is up 4.8 percentage points. The gap between the overall unemployment rate and the Hispanic unemployment is now about 3 percentage points. That is about what the gap averaged in the 20 years between 1975 and 1995, before the roughly 10-year period when the gap between the overall unemployment rate and the Hispanic unemployment rate narrowed to almost half a percentage point.

The distribution of employment across industries helps to explain why unemployment has risen more for Hispanics than the rest of the population. Hispanic employment is more concentrated in industries that have been hit especially hard in this recession. Hispanic workers are more than twice as likely to work in the construction industry as are non-Hispanic workers. Hispanic workers are also nearly twice as likely to work in the "Food and accommodation" industry as non-Hispanic workers. The contraction in these two sectors partly explains the greater rise in the unemployment rate for Hispanic workers than for other workers.

What will be next for both the overall unemployment rate and the Hispanic unemployment rate? There is a strong consensus that the recovery in the overall unemployment rate will be slow; private forecasters and the Administration see the overall unemployment coming down to between 9 ½ and 10 percent at the end of 2010 – about where it is right now. That's partly because most forecasters do not see a sharp recovery in demand, and partly because it just takes time for unemployment to fall, even if demand rises more rapidly. Bear in mind that after the 2001 recession officially ended the overall unemployment rate continued to *rise* for another 19 months -- over a year and a half – and it did not fall below the level it reached at the *end* of the recession until nearly three years later.

With respect to the Hispanic unemployment rate, I should confess that I tried to answer a forecasting question once before, and my track record is not impressive. Like much of economics, the reasons for my failure are interesting. During the 2001 recession, Jon Orszag and I did a study for the Pew Hispanic Center that we called "Hispanics and the Current Economic Downturn: Will the Receding Tide Sink Hispanics?" In that study we looked at how the Hispanic unemployment rate had recovered in previous recessions and applied the time pattern to the then-current 2001 recession. We predicted that the unemployment rate for Hispanics would not fall to its pre-recession level (6.2 percent) until March of 2008.

As it turned out, happily, our forecast was far too pessimistic--the Hispanic unemployment rate fell below 6.2 percent in early 2005, about 3 years ahead of our prediction. By comparison, the overall unemployment never fell back to the pre-2001 recession level. The rising tide of the economic recovery following the 2001 recession apparently lifted Hispanic economic fortunes, rather than sinking them -- partly because the housing boom lifted Hispanic employment. I think we have learned that the boom-and-bust cycle has been magnified for Hispanic families.

At long last, the storms of the recession of the last two years appear to be breaking. The first priority of the Administration has been to foster an overall economic recovery by boosting aggregate demand, easing the housing market correction, and supporting family incomes. It is also crucial to ensure that the financial sector will not be a source of instability in t he future. As President Obama said yesterday, a return to n ormalcy in the financial sector "cannot lead to complacency." This is why the Administration proposes creating a new Consumer Financial Protection Agency, closing regulatory gaps, and providing the tools necessary to resolve failing financial institutions that pose risks to the entire economy . Finally, and equally importantly, we must make the needed investments in public infrastructure and education to build a firmer foundation for sustainable economic growth that benefits all Americans.