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America's Economy Will Rebound From Attacks

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As we mourn the loss from last Tuesday's tragic events, attention is also turning to their effects on our economy. The president has made clear his intention to respond to the attacks. At the same time, he has provided leadership to ensure the smooth functioning of the economic underpinnings of the nation.

The terrorist attacks affect us in many ways. Yet over the medium to long term, last week's events do little to alter the fundamental strength of the economy. The key to economic prosperity is long-term productivity growth, which remains strong. A recent survey of the National Association of Business Economists showed that nearly two-thirds of respondents estimated the long-term productivity growth rate between 2.0% and 2.5%.

However, much more attention will likely be focused on the events of the next few days and weeks. Most equity markets are scheduled to reopen today (trading in government securities commenced last Thursday). Overseas markets have reacted adversely to the tragedy in relatively thin trading. No doubt resumption of trading in the U.S. will help resolve the uncertainty from closed markets.

Attention paid to financial markets in the aftermath of the bombings is well placed, as financial market disruptions can raise the cost of consumer and business credit. Fortunately, well-coordinated actions by the administration, the Securities and Exchange Commission and especially the Federal Reserve will serve to blunt the effects of financial market-making dislocations. The Federal Reserve, in particular, is open and operating. The discount window is available to meet liquidity needs, and regulators have encouraged financial institutions to remain sensitive to their customers' situations. Finally, the president has already taken action by putting the full resources of the federal government behind efforts to open and restore our financial nerve centers.

While many commentators have focused scrutiny on the infrastructure for financial transactions, some have emphasized transportation infrastructure dislocations. Despite its key role in the tragedy, the physical infrastructure of the nation's transportation system is essentially unaffected and remains in place. Disruptions of air transport are transitory, and may be offset at least in part by the greater use of the rail and trucking networks.

Finally, we have seen a modest reaction in world oil markets to the events of Tuesday. While there have been scattered reports of retail price rises, there appears to be no underlying support for a sustained rise in the price of energy, and one would expect these speculative events to subside. Thus, upon reflection, there is little reason to expect serious interference in the ability of U.S. business and markets to meet the economy's needs, even in the short run.

If so, then what should one expect about the prospects for near-term growth? If one can think back to only last Monday, private forecasters were expecting the economy to move to faster growth by the end of the year. Growth in the gross domestic product was predicted to increase to 2.6% in the fourth quarter, rising to more than 3% next year, according to the September blue chip consensus.

While the very short-term economic outlook may be adversely impacted by the terrorist attack, how have things changed going forward? On the international front, very little. There was scant prospect of help from the slowing world economy, and this remains the case. America will return to faster growth on the basis of domestic factors.

Domestically, there is never good news in a disaster, but the president and Congress are united in their goal of providing the funds necessary to address the needs of state and local governments, communities and businesses for their disaster-related expenses. One can anticipate as well new spending in the aftermath of these events. As in events such as hurricanes or earthquakes, there will be purchases associated with the rebuilding of communities. In short, these actions by the government will not be a drag on short-term growth.

As we are aware, some firms have been tragically affected by the events. From an economywide perspective, however, the effects on corporate investment appear limited. There may be some declines in profitability due to the insurance losses, but the effects of these losses on the economy as a whole are not likely to be large.

In addition, the events may make the cost of business transactions rise somewhat in the short run, but without a dramatic impact on profits in the long term. When the week began, most private forecasters were waiting for an investment rebound later this year or early next year. They may still be waiting, but the bad news last week should not slow it down.

Finally, consider the all important question of consumer confidence. Americans are uniquely equipped to stare adversity in the face and move forward. To date American households have done just that -- in narrow economic terms -- as the remainder of the economy slowed. Absent further real news on employment or prices of goods and services, one would expect consumers to stay the course, as the most recent retail sales data suggest.

In short, there is no reason to revalue radically the activities of the American economy. Short-term supply disruptions are real but appear to be contained and transitory. The near-term outlook for economic activity remains largely the same. With the efforts of the president and federal agencies, one can expect functioning financial markets, and these will likely show no change in the cost of capital or the premium to risky equity investments.

Despite last Tuesday's attacks, America's economic and financial institutions are up and running. The terrorists chose the targets of their heinous acts to sow fear and economic disruption. We must see that they fail on both counts.

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