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# Economy Watch



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Martha C. White, NBC News contributor - 34 days

## Fiscal cliff showdown already damaged economy



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### 'Dysfunction and Polarization' Distract Investors

12/31/2012: "At best we'll get a stop-gap micro-deal," said Mohamed El-Erian, PIMCO CEO & co-CIO, explaining how falling off the "fiscal cliff" will impact markets.

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Even though the eleventh-hour wrangling among lawmakers yielded a solution to the worst-case fiscal cliff scenario, some say the damage has already been done.

"I think we have seen effects of the uncertainty over the last few months, intensified over the past few weeks," said Alice Rivlin, senior fellow in economic studies at the Brookings Institution. "Companies and banks have a lot of cash, but they're not investing. ... It may partly be because they don't think the

aggregate demand is there but it might also be the uncertainty” over the prospect of rising tax rates and cuts in government spending, she said.

**An agreement to stave off the harshest and most immediate consequences of the fiscal cliff won approval** in the House late Tuesday. President Barack Obama said he would sign the law, the battle over which foreshadowed more fights with Congress over spending.

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Following a day of hectic wrangling on Capitol Hill — where the prospects for passing the bipartisan, Senate legislation regarding the fiscal cliff hung in the balance for much of New Year's Day — the House voted 257 to 167 to pass the belated compromise measure over the objections of many conservative Republicans.

Last Thursday, the Conference Board's monthly Consumer Confidence Index posted a second consecutive decrease, this one much larger than its November drop. Although Americans are more upbeat about business and jobs conditions today, their outlook for the next six months is gloomier. More people in December said they expect fewer jobs, lower income and worsening business conditions in six months.

“Consumers’ expectations retreated sharply in December... The sudden turnaround in expectations was most likely caused by uncertainty surrounding the oncoming fiscal cliff,” director of economic indicators Lynn Franco said in a statement.

“The recent numbers in retail sales for this holiday season have been dismal; well below expectations,” Mitchell Goldberg, president of ClientFirst Strategy Inc., said via email. “The consumer has very quickly come to an understanding how the fiscal cliff could potentially impact him or her.” There’s evidence that the expectation of a rocky first half of 2013 is throwing a wet blanket on consumer spending. After a strong Black Friday, holiday spending failed to keep up its momentum. The MasterCard Advisors SpendingPulse said holiday sales grew less than one percent from 2011.

What’s so frustrating to economists is that, absent the cliff standoff, a slew of recent economic indicators all give reason for optimism. Real GDP increased at an annualized rate of just over 3 percent last quarter, and data on housing, spending, employment and corporate earnings have been steadily inching higher.

The improvement isn’t as far or as fast as anyone would like, but Kaufman said the country has reached the point where most consumers were starting to relax and worry less about their jobs and their financial security; that is, until the cliff became front-page news.

The biggest danger is that the country runs headlong into the still-unresolved issue of the debt ceiling. Dean Baker, co-director of the Center for Economic and Policy Research, said if it happens, it’s “definitely affecting spending.” Consumers would buy fewer durable goods, cars and other big-ticket items, and pare back discretionary spending on items like restaurant meals and vacations. Mohamed El-Erian, CEO of Pimco, **told CNBC** businesses were confronting a “new normal [of] sluggish growth and persistently high unemployment and concerns about debt and deficits.” El-Erian referred to an “uncertainty premium” curbing corporate investment and hiring.

Affluent Americans, whose spending helped lift the economy out of recession a few years ago, would be especially sensitive an extended period without a deal, said Daniel Hamermesh, an economics professor at the University of Texas. In the face of a volatile stock market and uncertainty over how much they’d owe in taxes, wealthy consumers would keep their wallets shut.

“The debt ceiling, to me, is the bigger problem,” Kaufman said. If the situation gets down to the wire as it did last year, “The market’s definitely going to have conniptions again.” Companies can anticipate and adjust to negative market conditions, he said, but only if they know what those conditions are. “The problem is, right now they don’t know the rules.”

NBC News' Michael O'Brien contributed to this report.

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