

U.S. could fall into recession if budget deal not reached soon, experts say

by Matthew Rusling

WASHINGTON, Nov. 29 (Xinhua) -- The U.S. economy could slip into recession if Congress does not agree on a budget deal with the White House to avoid the "fiscal cliff," U.S. experts warned Thursday.

A deal may yet come through, but at the moment the two sides are unable to compromise on taxes for upper income earners -- President Barack Obama argues they must pay their fair share while Republicans contend those in upper tax brackets drive the economy and taxing them will stunt growth and jobs creation.

Should the two sides fail to hammer out a deal by year's end, a spate of tax hikes are set to kick in that will cause many Americans to feel the squeeze in their paychecks, leading to a drop in consumer spending and another recession, experts said.

Barry Bosworth, senior fellow at the Brookings Institution and a former presidential advisor, said most of the models conclude that a large tax increase would trigger a relatively modest recession.

The Congressional Budget Office projects that the unemployment rate would rise to 9 percent -- it was 7.9 percent in October -- and the decline in GDP over 4 quarters would be about 0.5 percent, Bosworth noted.

"The full tax increase would be very large and the full budgetary effect is about 500 billion (U.S. dollars)," he said. "The effects would be quite immediate in the first quarter of 2013, and reach a peak in the last half of the year."

Consumers will begin to react immediately in the first quarter, although much of that would be reversed in future quarters if Congress hammers out a deal in the first part of 2013 that extends the tax cuts and eliminates spending cuts, Bosworth said.

"Even if they reach a deal, it will include a substantial amount of fiscal restraint in 2013 and 2014, so U.S. growth is likely to be low regardless of what they do," he said.

Andy Busch, global currency and public policy strategist at BMO Capital Markets, said negotiations are entering into a critical time frame.

While markets rallied significantly last week, they were shaken out of that mindset Tuesday when U.S. Senate Majority leader Harry Reid said he was disappointed over the pace of the negotiations and added there had been little progress, Busch said.

Democrats believe that winning the White House earlier this month has empowered them to raise taxes and cut deductions on the top two brackets while leaving entitlement programs untouched.

By contrast, Republicans believe retaining the House majority has empowered them to pass all of the sun setting tax provisions and then have a

larger deal on cutting spending, reducing entitlements and fixing the tax code to promote growth, Busch said.