

## Forecasts and Trends

by Gary D. Halbert

The Commerce Department estimates that third quarter Gross Domestic Product slowed to an annual rate of only 1.6%, down from 2.6% in the second quarter and 5.6% in the first quarter. The latest GDP report was well below expectations, as well as the consensus view that the economy will grow by around 2.5% in the second half of this year. Other economic reports released over the last month were mixed but generally confirm that the economy is slowing a bit more than expected; however, I continue to believe we will avoid a recession, and that the economy will rebound this year.

Of course, a lot depends on the housing market, which weighed heavily on the latest disappointing GDP report. Home prices continue to fall in many parts of the country, and the inventory of unsold homes continues to rise. Expect this to continue for a while longer. I continue to believe the housing market is in a correction rather than a major bust.

The latest disappointing GDP report makes it much more likely that the Fed is finished raising interest rates, and that we should expect the Fed to begin cutting rates early this year. The Bank Credit Analyst continues to predict that we will see several rate cuts this year, which will contribute to an economic rebound in the second half of 2007. The bond markets have rallied strongly on the news that the economy is slowing.

The stock markets have continued to rise, not only in the US but also globally, in spite of negative economic reports and despite the fact that the Democrats regained majority control of the House of Representatives. I continue to believe we are overdue for a downward correction in the equity markets, but that remains to be seen. In any event, risks are rising and volatility is likely to remain quite high in the equity markets.

### Economic Growth Looks to Slow a Bit More

Regular readers of this column know that I have been predicting a slowdown in the US economy since the early part of last year. But I have also predicted that a recession is not the most likely scenario, and that the economy is likely to rebound in the second half of 2007 if not sooner. As always, the gloom-and-doom crowd, and their accomplices in the mainstream media, continue to predict an economic recession, or worse.

The latest economic reports have been mostly on the negative side. As noted, the government reported that third GDP was up only 1.6% (annual rate), well below the 2.6% in the second quarter and 5.6% in the first quarter. The housing slump weighed heavily on the economy in the third quarter.

The latest numbers on housing were mixed. Housing starts surprised on the upside in September, while home building permit applications were lower than expected. Existing homes sales for September were down 1.9%, in line with expectations. The median sales price for existing homes dropped for the second month in a row to \$219,800. On the bright side, new home sales rose 5.3% in September, well above expectations. Overall, the housing slump continues, but so far it has not turned into the bust that so many have predicted.

### Fed Leaves Rates Unchanged

The Fed Open Market Committee voted to leave interest rates unchanged for the third time on October 25. The Fed's last policy meeting of the year is scheduled for December 12, and Wall Street is hoping for a cut in the Fed Funds rate at that time.

On the inflation front, wholesale prices fell sharply in September (-1.3%), led by plunging oil prices. It was the largest monthly decline in over three years. The Consumer Price Index also fell 0.5% in September. However, the "core rate" (minus food and energy) still rose 0.4% for wholesale prices and 0.2% for consumer prices. As we have discussed often in the past, the Fed is believed to focus much more on the core rate of inflation rather than the headline numbers. Since the core rate is still above the Fed's target, the Fed left rates unchanged on October 25, rather than opting for a cut. BCA continues to believe that equity prices will trend somewhat higher over the next year or so but not without some potentially scary downward corrections along the way. I will not be surprised if we see a downward correction in the equity markets ahead as the latest economic data and the election results sink in. For all these reasons, I believe the risks in the equity markets are increasing, just at the time that large numbers of investors are pouring back into the markets. What else is new?

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