

What Does the Future Hold?

By John V. Kamin

How do you know when you're in a recession? Can just anyone say, "We're in a recession" or does there have to be some particular evidence? After all, incumbent politicians would say, "No recession", while election candidates would say, "Deep recession".

The NBER (National Bureau of Economic Research) in Cambridge, Massachusetts, is the official arbiter of recession calls. Their definition of recession is two consecutive quarters of downturn in GDP (Gross Domestic Product – total output of goods and services in the USA). The problem? By the time two quarters (six months and one month late doing the statistics) have passed, you are already at least seven months into a recession before NBER tells you it's a recession! You are looking backward seven months to see two quarters of negative growth in GDP. It's like trying to drive by looking out the rear window.

By the time most businesses are at least seven months and perhaps 12 months to 18 months into recession, it's too late for them to make quick adjustments to: make profits, save jobs, re-jigger borrowings, budget spending and other strategies.

Therefore, businesses and individuals (and you) need some other indicators that are faster, that tip you off ahead of time when the economy is sliding into recession.

Helpful Indicators – Red Flags

Your Forecaster Economist monitors many indicators for precise sooner recession warnings, some of which you probably haven't heard of.

Take the very low unemployment rate. It got down to 4.5% during the recent boom ending early 2007. But now, it's heading upward to beyond 5%. During a recession, the unemployment rate may reach 6% or higher.

Two other indicators to alert you are building permits and house construction. The normal rate for new house sales is 1.6 million new homes per year. But by November 2007, the monthly rate of new home sales fell to 1.19 million per year annualized - a much lower rate.

Much is due to tightened bank lending in the midst of the subprime mortgage crisis. Since homes are bought mostly with borrowed money, with few exceptions, when lenders tighten as they have for the latest two quarters, people find it difficult to borrow the money to buy homes.

One interesting advance indicator is building permits. Permits have been falling. Another industry indicator is listings. Supplies of homes for sale have increased from two months inventory to 11 months inventory, based on current home sales; a supply GLUT.

Repos and Foreclosures

You can also watch foreclosure rates as lenders struggle to limit them. For example, in Las Vegas metro, condos are overbuilt and there are many "walkaways". These mostly are folks who put down little or no money and just walked away from their small deposits when promised condo construction required more, but the market turned south. They just "let it go".

Flippers, Dippers and Speculators

Miami overbuilding and foreclosures quickly became apparent. Then, when condo owners and homeowners tried to resell, price-cutting occurred. Atlanta tanked.

Sellers who couldn't resell decided to RENT OUT their properties to compete with existing rentals, such as apartments, which sabotaged the rental markets. Flippers wanted to rent out those homes when unable to resell, so they could continue to make their mortgage payments, especially the speculators and flippers, when the 2007 market boom turned to 2007 bust. Condo

flippers had counted on (assumed) a perpetually rising market. Instead, what they got was a normal real estate boom/bust cycle that they hadn't planned for! Many tried to refinance just as the banks and other lenders tightened up on loan qualifications. When over spenders wouldn't borrow money in Miami, many more foreclosures were the result.

Wheels and Deals Tip-Off

Another common recession indicator is to watch the rate of new car sales and compare it to previous years. As you enter a recession, car sales usually fall off (sometimes off a cliff).

VALUABLE TIP: Watch for manufacturers who offer multi-\$1,000s rebates if you'll just please buy a new car or perhaps two to five years of 0% interest financing or other incentives.

Car makers tried during 2007 to get away from large rebates, large discounts, 0% financing as sales picked up a bit. But now, they're declining again.

FORECAST: GDP for 4th Quarter 2007 figures to be released soon, will show an annual growth rate of less than 1%, getting close to the recession definition.

The Missing Money – Builders' Nightmare:

The Noose Tightens!

The glut of new homes for sale at high prices can't be bought up by new homebuyers until lenders free up the borrowing.

But that's precisely the opposite of what many traditional lenders are trying to do, instead of stepping up lending to prospective borrowers, they're tightening qualifications. Some lenders have quit making subprime loans altogether, others have put many strings on new conventional loans. Lenders are tightening the noose on prospective homebuyers, which tends to drive builders nuts. Even though building permits have not fallen super-fast, many of those construction projects will be cancelled, even though permits already have been applied for, due to reluctance in the lending market.

The Federal Reserve is trying hard to get banks to loan more money on homes to soak up the excess supplies and to enable troubled borrowers to refinance, but it isn't working very well. Not yet. It's like pushing on a string. Lenders are still tightening, not loosening.

Can You Have Inflation

During Recession?

Sure you can. Gas prices, which affect all transport prices, are still at high levels and tied to the price of oil. They go up.

Health care costs, insurance costs and tuition are being raised. Efforts to introduce competition to hold down health care costs have so far been unsuccessful. Car makers plan to raise prices 1.5% on 2008 models. Grains for feeding livestock and people are going up as more acreage is dedicated to raising corn, to produce ethanol, to burn in cars. Your morning Cheerios are becoming so high priced that it's not very cheery.

We could find a huge number of other examples of rising prices pre-recession and during recession. For example, many manufacturers and merchants who have been eating cost increases for a couple of years use a slowdown in sales to raise prices and raise delivery charges. When was the last time you saw the Post Office reduce postage charges, recession or boom? When postal rates go up, so do private delivery charges (UPS, DHL, Brinks, FedEx, others, trucking services and rail rates).

Stagflation

Continuing inflation during recession is called "stagflation" (stagnation plus inflation). It's a common phenomenon. That is the forecast.

LEI = Excellent Advance Indicator

One advance indicator of changes in the economy that this economist gives estimated reliability to is called the LEI, Index of Leading Economic Indicators. LEI seeks to forecast business activity six to nine months ahead. LEI is a composite of some six other indicators and is published monthly.

What I Look For

Three consecutive downturns in LEI will usually indicate a recession soon ahead. Sometimes you will have two or three downturns, then a brief one month upturn then another downturn. LEI is not perfect, but it's pretty good. I've used it for one half-century to call turns in the economy along with many other indicators.

LEI can also indicate upturns in the economy. When LEI starts booming upward more than three months in a row, strongly, you can be pretty sure of strong growth ahead.

Looking into the economic future is a science, but it's not a perfect science. The Science of Economics is defined as "the study of the production, distribution and consumption of goods and services".

Forecasting has improved greatly over the decades, with better info, faster info and more reliable statistics. Working against sound forecasting are politics and political changes, creeping inflation, hidden deals at leadership levels, manipulation of statistics (such as trading headline CPI, Consumer Price Index, for lower CPI by excluding food and energy consumed by everyone, etc.), FRB manipulation of interest rates, going against a free market economy and many other factors. It is not unusual for economists seeking to forecast to be juggling 24 to 36 different factors and their relative strength or weakness to come up with a single forecast for more than 50% accuracy! But that's our training, our education, our experience and our job. This is not a complaint, just a brief outline of what's involved.

If economics weren't complex, everyone would be a good forecaster and there would be no need for the Forecaster Moneyletter. Unfortunately, many people, from salespeople to leaders to politicians, have a hidden agenda. They often "spin" and use purposeful misdirection and seek to manipulate free market forces, which are at work all at the same time.

Economists can sort out inaccurate statistical data; given time and resources or spot irrational behavior (e.g. Alan Greenspan's "irrational exuberance" advanced call). But they often can't **do** anything about errant policies or politics except shed light on what's happening now, expose, forecast and predict what's likely to happen in the near future, the medium term and the far-out future.

Example: Let me ask you a couple of questions. What do you think the price of oil will be 50 years from now? How about the price of a new car in 2058, say the updated version of a Chevrolet Suburban, basically a wagon on a truck body? (I often use a Chevrolet Suburban as a yardstick since I've been watches prices thereon for four decades and though new models are updated and restyled, it's basically the same concept vehicle.)

What do you think the price of gold will be in 50 years – 2058? How about the price of a four bedroom, two bath, 1,500 square foot to 2,000 square foot home in the major metro job areas: Boston, NYC, Philly, Chicago, San Francisco, Los Angeles and San Diego?

I expect the USA population to double from 300 million to 600 million by 2058 to 2063 in the medium-term and long-term trends ahead plus creeping inflation next 50 years. Ignore useless statistical aberrations.

Make time for you, not against you. Here at the Forecaster, we try to do our best to help so that you can benefit!

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