

## **What is Government Doing About The Worst Recession Since 1930? – Part I by Gary D. Halbert**

We are witnessing the most aggressive government intervention into the US private sector in history, and I am not simply referring to President Obama's massive \$825 billion so-called "stimulus" package passed last week by the House of Representatives. As we will discuss as we go along, there are also plans in the works to borrow and spend **trillions more**, which will result in the government owning even more of the private sector, starting with the banking system.

We should all recognize that President Obama and most of the politicians who control in Congress have no problem whatsoever with the government owning (and eventually controlling) much of the private sector. What we are, and will be, witnessing is unprecedented and is being planned under the guise of the economic and financial crisis, when in fact there is a much larger political agenda ongoing now that the Democrats have control of the White House and the Congress.

Speaking of the economic and financial crisis, the US recession continues to deepen as does the global economy. The Commerce Department reported that US GDP slumped at an annual rate of 3.8% in the fourth quarter. Most of the other economic reports of late have also been on the negative side. Most forecasters now predict that first quarter GDP will also be down at least 3-4%. Let's look at the latest data and some forecasts of what lies ahead for 2009.

Following that, we will examine the latest \$825 billion stimulus package that was passed by the House. While initially touted as a way to jump-start the banks and unfreeze the credit markets, the final bill is loaded with pork-barrel spending and has nothing for the banks. Following that, we will discuss new government plans totaling **\$1-2 trillion** to bail out the banking system. There is so much to talk about, I don't know where to start, but let's begin with the economy.

### **The Recession Continues to Deepen**

As one analyst put it, there is still no light at the end of the tunnel for the US economy, which officially entered this recession in December 2007 (with the benefit of hindsight). As noted above, US Gross Domestic Product fell at an annual rate of 3.8% in the 4Q, the largest quarterly decline since 1982. The latest GDP number was not as bad as pre-report expectations, but it does reflect the reality that holiday retail sales plunged over 8% in December according to MasterCard.

The Consumer Confidence Index dropped to another all-time low in January, falling to a reading of 37.7, down from 87.3 one year ago. Consumers remain very pessimistic about the state of the economy and about their earnings. Those saying business conditions are "bad" increased to 47.9% from 45.8% in December, while those saying business conditions are "good" declined to 6.4% from 7.7% in December. These are the lowest readings since the Consumer Confidence Index has been in existence.

In what was initially thought to be a bright spot, the Conference Board announced last week that the Index of Leading Economic Indicators (LEI) rose 0.3% in December. However, the Conference Board was quick to point out that the increase in the LEI was almost entirely due to the large surge in the money supply in December. The economic component of the LEI was actually down -0.5% in December. The LEI has declined for the last seven months in a row.

The unemployment rate rose more than expected in December, to 7.2%, when every state in America saw its unemployment rate rise. The nation lost approximately two million jobs in the last four months of 2008 alone. At the rate major layoffs are being announced, the unemployment rate could approach 9% by the end of the year. [Some analysts are projecting 10% to 12%].

On the manufacturing side, most reports were worse than expected. The ISM Index fell to 32.4 in December, down from 36.2 in November, and worse than pre-report estimates of a decline to 35.4. This morning, the ISM Index for January showed a modest increase to 35.6, which was higher than expected. But keep in mind that any figure below 50 indicates an economy that is contracting.

Industrial production fell 2.0% in December, twice the pre-report consensus. Durable goods orders fell 2.6% in December following a decline of 3.7% in November. Factory orders plunged 4.6% in November (latest data available).

On the housing front, there finally were some encouraging reports. Sales of existing homes rose 6.5% in December to an annual sales pace of 4.74 million units according to the National Association of Realtors, although the NAR noted that many of the sales were “distressed sales” in an effort to avoid foreclosure.

Thanks to the unexpected home sales increase, the inventory of homes for sale decreased 11.7% in December to 3.68 million units. That represents a 9.3-month inventory of unsold homes at the current pace of sales, down from an 11.2-month supply in November. The median home sales price fell to \$175,400 in December, which was down 15.3% from the same period in 2007.

New home sales, on the other hand, fell more than expected in December to approximately 331,000 units. Housing starts fell more than expected in December to approximately 550,000 units – this is actually a good thing. Building permits also fell more than expected in December to approximately 549,000 units, also a good thing from an economic standpoint, though not so good if you are or work for a builder.

### **So, How Deep & How Long?**

The truth is, no one knows for sure how long this recession will last or how bad it will get. As noted earlier, most forecasters are predicting that GDP will fall by 3-4% in the first quarter. Among the analysts and forecasting groups I read and respect, there are basically two camps. One camp believes that the recession will get worse, perhaps

considerably worse, the credit markets will remain very tight all year, and that a mild recovery will not begin until sometime in 2010.

The other camp is less pessimistic and believes that the economy will begin a slow recovery and the credit markets will unfreeze in the second half of this year. Most in this camp believe that the vast sums (trillions as we will discuss below) the government and the Fed are throwing into the economy will fill the void left by contracting consumer spending. Some in this camp are optimistic that the unexpected upturn in existing home sales in December will have marked the bottom of the housing slump.

Personally, I have been leaning more toward the first camp. However, as we will discuss in the pages that follow, if the Treasury and the Fed are prepared to throw an additional **\$1-\$3 trillion** of liquidity into the economy, perhaps the outcome is somewhere between the two camps noted above. In either case, we will not be out of this recession any time soon.

### **Multi-Trillion Dollar Bailouts in the Works**

As I noted earlier, I do not wish for this article to be considered a political piece, but there are some political realities that sophisticated investors must consider. The question for me is where to start. I choose to start this discussion with a quote from President Obama's Chief of Staff, **Rahm Emanuel**, shortly before Obama took office.

Rahm Emanuel, who was a senior political advisor to former president Bill Clinton, and most recently a member of the House of Representatives from the state of Illinois, is one of the most powerful (and foul-mouthed) members of the liberal Washington elite. Interestingly, Emanuel supported Hillary Clinton in the campaign, but Obama picked him as Chief of Staff anyway.

As President Obama's Chief of Staff, Emanuel is essentially the second most powerful politician in Washington. Mr. Emanuel stated the following to the Wall Street Journal after Barack Obama named him as Chief of Staff prior to his inauguration (read carefully):

***“You never want a serious crisis to go to waste. What I mean by that is that you have an opportunity to do things you could never do before. Things that we had postponed for too long, that were long-term, are now immediate and must be dealt with.”***

Let me interpret this political message that Emanuel unintentionally stated: ***We are in an unprecedented financial crisis that will pave the way for the implementation of the liberal policies that we believe in, including things that the American people would not otherwise tolerate.*** And some of those things are now in the pipeline as I will elaborate below.

You have no doubt heard about President Obama's estimated \$825 billion “stimulus” package that was passed by the House (with not a single Republican voting yes). As you

probably also know, that “stimulus” package was loaded with pork-barrel spending that, during the campaign, Obama said he would not tolerate.

What you probably do not know is that Obama has an additional stimulus plan to recapitalize the banks and financial institutions that could total \$2 trillion or more, and will mean that the government gains substantially more equity ownership of the major banks and financial institutions, as well as others.

Should President Obama run into problems financing these huge bailout initiatives, the Federal Reserve has let it be known that it stands ready to purchase a trillion or more in long-term bonds in order to keep interest rates low and keep the credit markets from seizing up, according to recent statements from his new Treasury Secretary, Timothy Geithner.

We will look in more detail at Obama’s breathtaking plans later in the article, beginning with the latest \$825 billion “stimulus” package passed by the House. Then we will look into the potentially \$2 trillion rescue package for the banks and the possibility that the Fed will be buying hundreds of billions of Treasury bonds, if needed.

### **Obama’s \$825 Billion “Stimulus” Package**

Unless you are politically tone-deaf, you know that President Obama has proposed another so-called ‘economic stimulus package’ of approximately \$825 billion, on top of President Bush’s \$700 billion “Troubled Asset Relief Program” (TARP) last year, of which only approximately half has been spent so far. Obama will now get to decide how the other half is spent.

Oh, and let’s not forget the additional \$800 billion that the Fed intends to spend in an attempt to further unfreeze credit markets for homebuyers, consumers and small businesses. Never mind that the Fed’s plan aims to do the very things that Secretary Paulson initially planned for TARP – buy up troubled mortgage securities – but then said there were better uses for the money.

Many analysts have argued for several months now that Bush’s TARP program was not enough to keep our nation’s largest banks afloat, and that much more in the way of rescue funds would need to be made available by the Treasury. Plus, most analysts also agreed that any such new stimulus package should include tax breaks and incentives to get consumers spending again to revive the plunging economy.

As a result, many of these same analysts welcomed the idea of the additional \$825 billion Obama requested. That is, until they saw how Obama planned to spend the money. Most analysts figured that the \$825 billion would go to banks in the form of loans or other capital injections, and to consumers in the form of tax cuts, rebates or other tax incentives to put money in their pockets.

But when the Obama administration finally released the substance of the \$825 billion stimulus package, most analysts were shocked. The latest enormous stimulus package is

**loaded with pork.** Around two-thirds of the \$825 billion is liberal pork-barrel spending, with little for infrastructure rebuilding; only around one-third is tax cuts and credits for consumers; and there is nothing in the bill for helping the banks.

Remember, this was Obama's proposal. The House tweaked it a little, but not much in the end. The plan passed by the House totaled \$819 billion, with only \$275 billion for tax cuts and a whopping \$544 billion in new spending programs as outlined below. The Senate, which has yet to vote on the bill, as of this writing, reportedly has plans to increase it to approximately \$900 billion. For discussion purposes below, I will simply refer to it as the \$825 billion stimulus package.

As reported last week, the spending components in Obama's plan include an estimated: 1) \$92.3 billion for education, labor, etc.; 2) \$88.9 billion for Medicaid to help out state budgets that are in the red; 3) another \$79 billion for states that are running budget deficits; 4) \$59.5 billion for transportation and urban development; 5) \$48.9 billion for the Energy Department; 6) \$27 billion for the Agriculture Department; and 7) \$15 billion for the environment – just to name a few.

If your blood is not already boiling, get this. Obama's \$825 billion bailout also includes over \$5 billion that is targeted for low-income housing assistance organizations that prominently includes Chicago-based ACORN, which is really a political group that Obama worked for in his early days after law school. ACORN could be a big recipient of this money, even though it is under federal investigation for voter fraud. Hmmm.

As you can see, the bulk of Obama's \$825 billion stimulus package is targeted toward government agencies – not consumers or banks – and is estimated to result in at least 600,000 new federal employees. So Obama's first major legislative initiative – supposedly a stimulus package to jump-start the economy – is a bloated spending package to increase the size of government, with only about one-third going directly to help consumers.

The Democrats in the House were surprised initially at the makeup of the bill, but quickly passed it with few changes. As you have likely heard, Obama's giant "stimulus" package was voted against by every Republican in the House of Representatives and even a number of Democrats. Assuming the Senate passes it (or something even larger) in the next week or two, it will soon become the law of the land.

Making matters worse, precious little of the spending and tax breaks will occur in 2009. According to the Congressional Budget Office, only approximately \$93 billion of the \$825 billion will be spent in fiscal 2009, the time we need it most, and only approximately \$225 billion would be spent in fiscal 2010. The balance reportedly doesn't get spent until after that time, when we should be out of the recession.

Instead of giving the economy a "**targeted, timely and temporary**" injection as Obama had promised, the plan has been larded with spending on existing social programs or hastily designed new ones, with much of it permanent - and not enough of it likely to

create new jobs. The Obama administration says that it wants 75% of the money to “*spend out*” within 18 months. But the Congressional Budget Office estimates that, under the House bill, only 64% of the spending and tax cuts will hit the economy by 2011.

Also troublesome is the likelihood that the bill will become a vehicle for new protectionism policies. The House added “*Buy American*” protectionism provisions for iron, steel and textiles, and the Senate seems bent on expanding the list of products. The Obama administration seems unconcerned about the danger these measures pose. The protectionism provisions insisted on by the Democrats could undo whatever measured job creation the stimulus plan achieves by provoking US trading partners to reduce purchases of American-made goods.

And finally, there is the question of whether or not these large new amounts of spending will be counted toward the “baseline budget” for all of the government departments receiving funds under Obama’s \$825 billion spending plan. For example, will the \$92.3 billion going to education, labor, etc. mean that their baseline budget going forward is permanently \$92.3 billion higher?

The \$825 billion stimulus plan is supposed to be a “one-time” expenditure. But we will have to wait and see if this is true, or if all the departments getting this new money will try to say that their budgets should be increased by that amount permanently in future fiscal years. In Washington, it is easy to give money away, but it is next to impossible to scale it back. *[Next month we’ll cover Obama’s next “Big Bang” bank bailout and how we are going to pay for all of this!]*

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