FORECAST & TRENDS
The Economy – More Signs of Recovery
by Gary D. Halbert

We have seen considerably more positive signs than negative over the last month. Let's begin with the ISM manufacturing index which rose sharply to 52.9 in August, up from 43.4 in July. It is the highest reading since June 2007. A reading above 50 in the ISM index indicates that the economy is recovering. The ISM "new orders" index jumped 9.6% in August to 64.9, which confirms that inventory rebuilding is intensifying, albeit from very depressed levels.

Unfortunately, the rise in consumer confidence that began in the spring has not translated into significantly higher consumer spending. Retail sales in July fell 0.1%. Personal consumption expenditures, another measure of consumer spending, were up only 0.2% in July. Most Americans are still very concerned about the economy, and many are choosing to save rather than spend. The Commerce Department reports that the personal savings rate rose to 5% of disposable income in the second quarter, the highest rate in over a decade.

On the housing front, there was some good news in the last month. Pending home sales rose 3.2% in July following a gain of 3.6% in June. Actual sales of existing homes rose 7.2% in July to an annual rate of 5.24 million units. Sales of new homes rose 9.6% in July, the largest monthly gain since February 2005. Much of the increase in home sales in recent months is attributed to the up to $8,000 in tax incentives for first-time home buyers; yet no one knows what will happen when this stimulus program ends later this year.

The Labor Department announced last Friday that the US unemployment rate jumped to 9.7% in August, up from 9.4% in July, and above pre-report expectations. In August, the official number of unemployed persons increased by 216,000. The Labor Dept. also reported that there are now 14.9 million unemployed Americans, and this number is likely headed even higher in the months ahead.

Is the Recession & Credit Crisis Over?
In the 30 years that I have been writing about the markets and the economy, a "recession" has consistently been defined as two or more consecutive quarters of negative growth in GDP (or GNP back in the old days). Likewise, two consecutive positive quarters meant that the recession was over. Be that as it may, if the initial GDP report for the third quarter is even mildly positive (which we won't get until the end of October), you're going to hear virtually everyone declare that the recession is <u>over</u> – whether or not that proves to be the case.

While I remain a bit skeptical, most of my trusted sources believe at this point that third quarter GDP will be at least mildly positive, and that the fourth quarter will be as well, in large part due to inventory rebuilding. But most of these same sources are <u>not</u> predicting a strong recovery in the economy. Some believe that there is still a real chance that we will slip back into recession in late 2010 or 2011, especially if consumers continue to save rather than spend.

As for the credit crisis, I think it is fair to say that it is no longer a crisis. But as anyone who is trying to get credit for a business knows, the banks are still not lending remotely as they were before the subprime blowup occurred. New lines of credit are few and far between. Many banks still have too many bad loans on their books, so they're not looking for new ones.

According to the FDIC, 84 US banks have failed so far in 2009, a record pace. So while it may be safe to say that the credit "crisis" is over, we are still far from being out of the woods. There are now 416 banks on the FDIC's "problem list" (up from 305 in March), so there will continue to be multiple bank failures every month for some time to come.

Then there's the 800-pound gorilla in the room – **the Fed**. At some point, the Fed will have to unload the $2+ trillion in questionable securities and toxic assets on its balance sheet. The Fed can't continue to print money ("quantitative easing") indefinitely; likewise, it will have to shrink the money supply at some point; and finally, short and medium-term interest rates will have to be allowed to rise somewhere down the road, especially if the economy rebounds.

Obama Adds $2 Trillion to Debt Forecast
In an earlier article, I reprinted the non-partisan Congressional Budget Office's (CBO) projections of annual federal budget deficits over the period from fiscal 2009 to fiscal 2019, which showed the national debt more than <u>doubling</u> over that 11-year period.

2009	**$1.845**	**trillion**
2010	**$1.379**	**trillion**
2011	**$970**	**billion**
2012	**$658**	**billion**
2013	**$672**	**billion**
2014	**$749**	**billion**
2015	**$785**	**billion**
2016	**$895**	**billion**
2017	**$945**	**billion**
2018	**$1.023**	**trillion**
2019	**$1.189**	**trillion**

TOTAL: <u>$11.11 Trillion</u>

Both the CBO and the White House Office of Management & Budget (OMB) recently reduced the budget deficit forecast for fiscal 2009 from the $1.845 trillion noted in the table above to approximately $1.6 trillion. So, the $11.11 trillion shown above would now be reduced to approximately. **$10.87 trillion** (if the latest projections prove to be correct).

Note that this astronomical amount does not include over $1 trillion for nationalized health care (if it passes) and several trillion more that will be required to rescue Social Security, Medicare and Medicaid over next decade as the Baby Boomers retire. Nor does it include the existing national debt of $11.7 trillion. **The $10.87 trillion is merely the sum of annual budget deficits over the 11 years from 2009 to 2019.**

Given that September is the end of fiscal 2009, the talk is now focused on record budget deficits for the 10 years from 2010 to 2019. Never mind that the 2009 deficit will be approximately $1.6 trillion, **almost four times larger than our previous worst deficit in history**, which was $438 billion in fiscal 2008 under President Bush.

Economic Assumptions Still Too Optimistic

Warren Buffet is absolutely correct. Whether it's $7 trillion or $9 trillion, it's way **too much** and unsustainable. Over the next five years alone, 2010-2014, the debt swells by $4.5 trillion. In fact, these projections could actually be too low based on the economic forecasts used in the projections. I should point out that this is not just an Obama phenomenon. White House budgets, whoever was president, have been laced with optimism, and no president has forecast a recession in these 10-year projections.

(By the way, all presidential administrations produce these 10-year forecasts on spending, revenues and the budget deficits/surpluses, even though they won't be in office 10 years from now.)

Excessive Obama optimism is not limited to economic growth. Despite the enormous monetary stimulus pumped out by the Federal Reserve in 2008-2009, bank credit that is widely regarded as potentially inflationary, the Obama administration assumes that inflation will actually decline from 2.1% in 2008 to 1.5% in 2009 and then to 1.3% in 2010 and 2011, and not rise above 1.8% through 2019. While it is true that inflation is declining now, thanks largely to the big drop in energy prices over the last year, we are almost certain to see higher inflation down the road.

What in the World Are They Thinking?

Most Americans that keep up with the economy and rising government spending, even remotely, are very alarmed about the exploding debt that President Obama has proposed for the next decade. Many of us wonder, what in the world could they be thinking? Do they want to purposely wreck the US economy? Frankly, I'm beginning to think so, as I will discuss later on.

Do you honestly believe the US economy will grow by 2.5% annually for the next 10 years when consumer spending is stagnant and Americans are increasing savings at the highest rate in over a decade? We've just been through the worst financial crisis since the Great Depression, and we are very likely looking at several years of below-trend economic growth. On top of that, if we spend the $9 trillion, taxes will have to go up on almost all Americans at some point, which is also bad for the economy.

They make these assumptions and leave out certain facts to justify their belief that bigger government and higher taxes are the answer to all of our problems. Take a look at Social Security, Medicare and Medicaid – and more recently President Bush's prescription drug program. Give me one example of how these government-run programs have been anything but a fiscal disaster. You can't.

Do They Want Control Even If It Ruins The Economy?

As noted earlier, I have thought about this question for many years. Why do they want the government to control most everything in the economy and our lives? While members of Congress have the best healthcare in the world, they will have dozens of family members and friends and countless colleagues that will be subject to the House healthcare bill, if it is passed. So why are they so hell-bent on passing it?

The answer can only come down to two questions. Question #1: Do they really believe that their proposed national heath care program is the very best we can offer the American people? And if so, why doesn't Congress adopt it for themselves? Or Question #2: Is this really just a massive power grab that puts the government in control of our healthcare and our lives?

President Obama would like us to believe that nothing will change if healthcare reform is passed - that if you like your current insurance plan, you can keep it. **But that is patently false and abundantly clear** if you read the onerous House healthcare bill, or even just the highlights that are readily available on the Internet. If they ram this down our throats, I firmly believe that the quality of our healthcare will suffer and the costs will far exceed any estimates being put forth by President Obama and the Democrats.

At the end of the day, I have to conclude that nationalizing healthcare (one-sixth of the US economy) is nothing more than a giant power grab. In addition, if our government racks up $10+ trillion in cumulative deficits over the next 10 years, as Obama proposes, we are on our way to financial ruin.

Bill Clinton never scared me; he was too much of a political animal to swerve too far from the center. Unfortunately, the same could be said of George W. Bush, who routinely strayed from his supposedly conservative principles. Not so with President Obama. Sadly, many of those who voted for him did not do their homework or they would have known that he is a left-wing ideologue, as I warned in these pages last year.

Sorry to end on such a negative note, but it is what it is.

Gary D. Halbert is the president and chairman of Profutures, Inc. Subscription rates for Forecasts & Trends is $197 for 12 issues and may be obtained by visiting his website at www.profutures.com.