

Economic Prediction for the Rest of 2006

By Gary D. Halbert

The US economy continues to surprise on the upside. Despite eight interest rate hikes last year and another one this year, despite oil prices as high as \$70 and despite three hurricanes and a national disaster on the Gulf Coast, the US economy has continued to surge, with GDP growth of 4.1% (annual rate) in the third quarter. Yet the media continue to downplay the robust economic growth. The Wall Street Journal called it the **“Rodney Dangerfield Economy”** because it gets no respect in the mainstream media.

Latest Wall Street Journal Survey of Leading Economists

On January 3, the WSJ published the results of its year-end survey of 56 leading economists. Overall, the results were very positive regarding the outlook for 2006, clearly suggesting a fifth consecutive year of economic expansion.

Perhaps the area with the most consensus was the housing market. Most of the economists surveyed agreed that the US housing market will cool off in 2006 (in fact, it has already), and on balance, the economists believe this will slow economic growth slightly in the New Year. However, there was a similar consensus that US businesses will increase capital spending and new investment in plants, equipment and technology, which they believe will offset much of the drag from the slowing housing market.

The consensus estimate of the 56 economists surveyed is that GDP will rise 3.5% in the first half of 2006 and 3.1% in the second half. While these estimates are more than respectable, they are below the average of 4.1% over the last 2½ years. Most importantly, few of the economists surveyed believe that a recession will unfold in late 2006.

On balance, the economists are also optimistic about inflation. The CPI rose 3.5% in the 12 months ended November. For 2006, however, the economist consensus estimate was for inflation to cool to a 3.1% rate in the first half of the year and then recede to 2.3% in the second half. If correct - both on the GDP front and the inflation front - this should assure that the Fed will cease hiking rates soon.

On balance, the economists believe that the current economic expansion can continue for several more years. Only 15% of those surveyed believed that a recession will occur in the next couple of years. This level of optimism assumes, of course, that there is not another huge spike in oil prices; the consensus was that oil prices would stay in a range of \$50-\$60 per barrel in 2006. It also assumes that the housing market contracts only modestly, and that there will be no implosion in home prices.

As for interest rates, the consensus was that the Fed will hike two times during 2006, thus putting the Fed Funds rate at 4.75% in March. The consensus was also that long-term rates would remain generally low. The consensus forecast suggests that 10-year Treasury Notes will remain below 5% for all of 2006. This suggests a continued trading range in bonds.

The consensus was that stocks will be higher in 2006. A plurality of the economists surveyed expects the Dow to end 2006 somewhere between 11,000 and 12,000. Very few expected the equity markets to be down for 2006.

BCA Remains Optimistic For 2006

In the mid-1990s, BCA predicted that the US economy had entered a multi-year, technology-driven economic “long-wave upturn” which would last for many years, perhaps a decade or longer. BCA defined their economic long-wave upturn as a period of relatively strong economic growth with only modest recessions along the way. In short, they predicted that the US economy would surprise on the upside, and it repeatedly has over the last decade.

In 1995, they also predicted that inflation would trend significantly lower over the next 5-10 years, which it certainly has. And they predicted that interest rates would decline substantially over the same period of time. Indeed, we saw interest rates fall to 40-year lows in the last couple of years. In their bold forecast in 1995, the editors also predicted a spectacular bull market in stocks and bonds at a time when most analysts were bearish. What followed were the greatest bull markets in stocks of all time, with a similar move up in bonds.

As long-time readers will remember, I questioned BCA's long-wave forecast at the time as a result of our bulging federal budget deficits, trade deficits and the falling personal savings rate. I even challenged Martin Barnes in 1995 in an interview that we reproduced and made available free to our clients. As Barnes pointed out in that interview, BCA was well aware of the many financial imbalances. He even admitted, readily, that a "*day of reckoning*" will come at some point in the future. Nevertheless, Barnes was convinced that the day of reckoning was somewhere well out on the horizon, and BCA has stuck to its optimistic long-term forecast. They have been correct as usual, and investors who doubted them, and invested for the worst as advised by the gloom-and-doom crowd, missed two of the greatest bull markets in history, and most probably lost a *LOT* of money over the years.

As for 2006, BCA continues to believe that the US economy is still in the midst of a technology-driven long-wave upturn which could continue for several more years.

BCA's outlook for 2006 is somewhat the reverse of that offered by the 56 economists surveyed recently by the Wall Street Journal. I stated that the WSJ economists expect GDP growth to be 3.5% in the first half of 2006, and then slow to 3.1% in the second half of the year. BCA's view is different in that they expect growth to be slower in the first half of the year, and then accelerate in the second half. Either way, both groups expect a very respectable year in terms of economic growth.

BCA on the Markets - Good News and Bad

Up to this point, this summary of BCA's latest forecasts has been quite encouraging - continued economic growth, low inflation and low interest rates. But that's where most of the good news ends. Let's start with stocks and bonds.

As they have for the last year or so, BCA suggests that US equities are likely to remain in a broad trading range with a mild upward bias in 2006. BCA's most encouraging advice is that because the US equity markets lagged many of the international markets in 2005, they are likely to "see some catch-up in the coming year."

Let's hope so! The Dow Jones Industrial Index was actually fractionally lower in 2005; the S&P 500 Index gained only 3% for the year; and the Nasdaq Index was up only 1.4%. While BCA is slightly more optimistic on equities in 2006, it looks to be another difficult and potentially frustrating year for most equity investors.

Next, we move on to the real estate market, which has been a bonanza for many investors in recent years. As noted earlier, the signs continue to mount that we have seen a peak in real estate prices. My advice late last year was to take some profits and lighten-up on any speculative real estate you owned, including real estate mutual funds. I stand by that advice, and it's not too late to do so.

The big question now is whether real estate prices, including home prices, are in for a steep decline or rather just a modest correction. BCA suggests the latter. The editors believe that home prices will fall in the hottest markets, especially the coasts, but they do *not* see a major plunge in home prices on the national level. They point to the pattern of home prices in Great Britain, which saw a similar boom but no major implosion in prices. "*House prices in the U.S. are likely to stagnate rather than collapse.*" Let's hope they are right on this one!

As noted above, all of these forecasts are based on the assumption that no major negative surprises occur in 2006. Obviously, the threat of terrorism remains a wild card. Another huge spike in oil prices is also a wild card. While the editors at BCA remain long-term bullish on oil and energy prices, and recommend buying on dips, they do not expect that energy prices will rise to the point of snuffing out the strong economy in 2006.

BCA's Most Surprising New Forecast

BCA has not been a big fan of gold since the mid-1970s when inflation was soaring. In fact, BCA has mostly been bearish on gold since they recommended selling it in late 1979 before gold hit its record high of \$850 and then crashed. However, in December, the BCA editors published a Special Report on gold in which they predicted that gold will rise to near \$1,000 per ounce over the next several years. WOW!

Conclusions

There is indeed some very encouraging news on the US economy as we have discussed, news that you are not likely to hear in the mainstream media. While BCA predicts that the economy will slow marginally in 2006, to a 3-3½% rate in GDP growth, they see no recession in sight for at least the next year and probably longer. And they see inflation remaining low for the next several years, which is the centerpiece of their optimistic outlook.

The yield curve is likely to invert slightly over the next 3-6 months, especially if the Fed raises short-term rates. However, if inflation remains low as BCA expects, they do not believe that a mildly inverted yield curve will lead to a recession as has been the case in the past. Keep this in mind as you hear much more about the yield curves in the weeks and months ahead.

BCA predicts that equities and bonds will remain in a broad trading range again this year and suggests buying the dips and other active management strategies. BCA believes that home prices on the national level are likely to slip modestly but not collapse. The editors continue to believe that energy prices will rise over the next several years, but not by enough to send us into a recession. Finally, the editors have become long-term bulls on gold.

Lastly, I must remind you that while BCA has been my single best source for economic and financial advice for almost 30 years, they are not perfect. No one is. With that said, I recommend BCA very highly. I encourage you to visit their website at: www.bcaresearch.com.

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.