Is the Recession Going to Hit and When?!

by John V. Kamin

The boom in housing is slowing. The auto industry has slumped. But the oil industry is going strong. Health care, often chaotic, is taking a bigger share of the economy. Remodeling and commercial building are both strong.

What the evidence is showing is that different sectors of the mid-2006 economy are moving at different speeds.

When you lump all sectors together though, the government comes up with a general recession vs. expansion verdict. The "national arbiter" of when a recession begins and ends is the National Bureau of Economic Research in Cambridge, Massachusetts. As of June of this year, measurements indicated that you are still in a boom, though weakening slightly.

How Long Do Recessions Last?

At a recent seminar I was asked how long recessions last. Quick answer: each is different. But the average recession, (average bell-shaped curve) would likely last 18 to 37 months. Occasionally, you might get a downturn that lasts as little as 11 months or as long as 54 months. But more than 80% of the recessions would be inside the bell-shaped curve of 18 to 37 months.

When Is It Coming?

The business cycle has not been eliminated nor outlawed, even though politicians have been trying for centuries to get rid of it.

The four most expensive words on the planet are, "This time it's different". It's not. Personally, I'm expecting a downturn between 2007-2009. More data and more evidence is required. For example, the Federal Reserve Board is raising interest rates. One of their purposes for raising rates is to "slow down" the rate of price appreciation in homes. It's working. Slowly.

One thing about economic policies, they usually work slowly.

Kamin's 33rd Law: Timing: big tax hikes drag down economic activity almost immediately. Example: Oct. 1990 tax bill, 1968 10% income tax surcharge. Whereas, interest rate cuts take a long time (to stimulate economic activity)…years…like pushing on a string.

A lot depends upon who will be President in 2009. Will you get a big spender and a tax hiker? When Kerry was running against Bush, Kerry promised to "undo all the Bus tax cuts within the first 100 days of office".

Kamin's 20th Law: Raising taxes raises the inflation rate. Therefore, tax increases are not a cure for large government deficits. Spending cuts are.

Much depends upon how soon American troops can be recalled from Iraq. How soon can foreign spending in Iraq, Afghanistan, Israel, Egypt and other places can be reduced by the USA.

Kamin's 21st Law: As soon as taxes are raised to "cure deficits", bloated overspending will resume to create newer and greater deficits.

Harry Truman said he wanted to meet a one-armed economist. Truman was frustrated because his economic advisors kept saying, "On the other hand…". On the other hand, if

you get an aggressive tax cutter (so businesses can plan better) there will probably be job creation in 2009 and later. Clearly, tax cuts helped keep the current 2003-2006 boom going.

Kamin's 30th Law: When governments increase taxes and burdensome regulations, individuals will change their behavior, to reduce government's tax rate and reduce added regulatory burdens! Therefore, projections by tax hikers and regulators based on past behavior studies will always be wrong, due to changes in future behavior. Example: 10% "luxury" tax.

Regarding property prices, I suggest you think longer term. Personally, I like to buy property when everyone hates it, and sell it when everyone loves it. Usually, the public does it the other way around. But my personal opinion is that property prices will be higher a decade from now - two decades from now.

Forecast: Five decades from now the USA population will double by 2056 to 2061.

But you'll have to make your own plans and strategy along the way. Government is not going to alert you to hedge inflationary activity, steps that you should take. Inflation is longer term.

Kamin's 23rd Law: Most "experts" simply aren't.

Competition from Communist countries in Asia is heating up, China and Vietnam.

Kamin's 26th Law: Maintaining socialism in a socialist state, while seeking a free "market economy", are incompatible goals. Each system will work against the success of the other.

Forecast: I expect turmoil in Communist regions, especially in Asian nations.

Prediction: Japan and the Philippines will clash with China and Vietnam over valuable oil deposits in the South China Sea.

China's military build-up is hidden but its aggressive stance toward reclaiming Taiwan is no longer hidden. Would the USA defend Taiwan if China were to invade? Pentagon planners and politicians would have to determine USA reaction.

More Forecasts

Will interest rates rise toward double-digit levels, 10% or higher? They did and exceeded that in 1979-1980. The level of interest rates can have a great impact upon job creation, home prices and borrowing. Right now in 2006, the USA and the world are both awash in liquidity. Homeowners are using their homes as piggybanks or home equity loans to finance frequent overspending. Plastic money. Consider the average family has six to nine credit cards and is $9,000 or so in the hole on un-repaid plastic debts.

Gold Message to You?

Is the price of gold signaling a potential rise to four figures, $1,000 oz or more? Gold is surely telling you something, and Central Bankers worldwide are watching gold, I guarantee. OPEC and other oil producing nations clearly are shifting money around and may shift more of it into hard assets such as gold and silver, as their pile of paper assets grows!

The Feds' Dilemma: Inflation vs. Recession

Myth: That you can't have inflation during an economic slowdown. Nonsense! Truth: Many recessions have occurred amidst high inflation, during increasing inflation.

The Big Question: If faced with a choice between say, controlling inflation and averting a slowdown, which path would the Federal Open Market Committee (FOMC) and Dr. Ben Bernanke choose? Would FRB Head choose to keep raising interest rates, or keep rates high to short-circuit inflation? After all, higher interest rates are the Feds' main tool to "control" inflation and the economy.

Alternatively, at the first signs of an economic slowdown, would the FOMC choose to lower interest rates, ease money and pump money into a deteriorating economy?

Liberal economic policy dictates lowering interest rates and pumping money into the economy as the main tool that the Feds have for averting an economic slowdown.

Congress and the White House have other tools, such as cutting taxes, guaranteeing loans.

Kamin's 29th Law: Tax cuts in highly industrialized nations stimulate individual productivity, job creation, entrepreneurs, high standard of living and prosperity.

Witness the "easy money, easy borrowing" posture running from Oct. 2001 to 2003, after the 9/11 tragedy, when the Fed lowered the Federal Funds Rate to 1%. The weekly government auctions of 180-day T-bills fell to a low of 0.99% annualized discount (interest) as further evidence.

Given both strong inflation and a coming economic slowdown, which strategy would be chosen? Easier money? Or raising interest rates higher to avert inflation?

History suggests that given the unenviable choice, the path taken would be to create jobs, make borrowing easier, lower interest rates to low as possible, while "eating" price increases. That's usually the political choice. Is it the wisest economic choice?

Sometimes, permitting an economic correction is the wisest economic choice, particularly in an inflated, overheated economy subject to excess. Symptoms include excessive spending by consumers, excessive spending by government and ramped-up wage and price increases.

Controls and More Controls

August 15, 1971, President Nixon shouted, "I am a Keynesian" and "This is a new era" as he slammed the economy with wage/price/rent controls.

His successor, President Ford, had little buttons made up with the initials WIN for "Whip Inflation Now". Did it work?

Nope. Hindsight indicates that it didn't. Inflation, since 1973, has cost American consumers and owners and asset holders the major portion of their purchasing power over the last 1/3 century.

Kamin's 35th Law: Plans to increase consumer spending usually mean less consumer savings; plans to increase consumer savings usually mean less spending; therefore plans that promise to do both at the same time are usually unworkable, unsuccessful, unrealistic and doomed to fail

To prove inflation is at work, is check the gold price in 1973, car prices, silver prices or house prices and you'll see that, over the long term, inflation has not been whipped but instead has been rampant. Inflation can be defined as, "Loss of purchasing power of the currency unit (the dollar)".

Kamin's 34th Law: When legal currency performs its function as store-of-value poorly, the currency's function as medium-of-exchange will be hindered, distorted, performed poorly and later over-regulated.

Those who retired on small pensions or Social Security in 1973 would have been hard pressed throughout the following years to maintain their standard of living. They would have had to engage in multiple cutbacks every decade since. Is inflation actually caused by people expecting inflation? No, people don't invent inflation; they don't foster it. They do, however, react.

Kamin's 32nd Law: Inflation is not caused by inflationary expectations. Indeed, inflationary expectations are caused by inflation. Inflation comes from cheapening money, deficit spending and devalued purchasing power. Evidence increases awareness, prompting expectations.

Lesser Evils

The point is, politicians are not elected nor re-elected, when they fail to do something about mounting unemployment, mounting job losses. As far as incumbent politicians are concerned, who intend to run for re-election, they'll choose job growth and an expansionary (albeit inflationary) monetary policy every time. They'll encourage greatly increased government spending for jobs creation, as much as they can and as fast as they can.

But little thought is paid to the 300 million consumers who will see their budgets surreptitiously slashed by inflationary price increases over time, as from 1973 to 2006. Bluntly, hidden inflation takes its toll, whether slowed down, or not. I'd like to buy a new Cadillac at a 1973 Sedan de Ville cost - around $45,000 plus tax and license, according to recent leasing agents and dealer.

Therefore, the bottom line is, whether little inflation or a lot, it is ongoing daily, monthly, yearly. Whether inflation is held to a "target rate" of 2% to 3% or so, it's still damaging. Inflation is even more damaging when, as under President Jimmy Carter in 1979-1980, inflation reached 16% and the prime rate reached 16%.

Strategic Moves?

1. Get control of your assets. You cannot fall asleep on money management or it will cost you.

2. Own some hard assets. Homes in this area that cost $30,000 in 1973 are now selling for $650,000 in 2006, even though they're 33 years older. In 1973, two-bedroom apartments used to rent for $150 per month; the current 2006 comparable average Los Angeles rent is now $1,430 per month.

Retire Early But Work Longer?

A recent survey among people over age 60 showed that 71% of them intended to work after retirement, either part-time or full time; some for the money, others to keep their minds active. But working longer instead of less years is one way folks deal with ongoing inflation.

A home has been a valuable asset, as most homeowners verify, if they've owned it more than five years. Gold and silver coins are a traditional inflation hedge.

Resalable collectibles, whether known artworks (not prints, nor reproductions), antiques and rare coins, have escalated but more than held their own against inflation.

Fun items such as muscle car convertibles from the 1960s and 1970s, drivable and restored, can be auctioned for $10,000s while providing fun and transportation. Older collector convertibles appreciate instead of depreciating.

Duplexes, triplexes, fourplexes, multi-unit rental properties and small rentable commercial buildings all have more than held their own against inflation. Rentable asset class increased purchasing power while providing cash flow.

Sidestepping House Prices

My advice to first-time house buyers over the past couple of years has been, "Don't buy a house. Instead buy a duplex, triplex, or fourplex, then let your tenants pay off your 15-year fixed rate mortgage. Soon, you'll have big equity and eventually own the joint with steady cash flow. Then you can buy any house you want."

Can't Inflate Your Brain

My advice to college students and recent graduates has been that highly specialized technical education is an asset. Get all the specialized education you can and become a problem solver in a particular niche; you will be eventually well rewarded, it's inflation-proof.

Then, slowdown or boom, you'll be able to deal with the hidden and sometimes not-so-hidden inflation over time by using your inflation-proofing assets judiciously. More predictions and forecasts in future articles.

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