Jim Smith's OUTLOOK
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THIS TOO SHALL PASS

It would appear to be impossible to attribute this well-known and very useful title phrase properly. Some sources link it to the fabled King Solomon, who lived about 3,000 years ago. Still others link the phrase to Abraham Lincoln. Both make good stories. In any case, the statement is totally relevant to today's global economic environment. The financial world seems to have gone totally bonkers.

On September 17, investors were so frantic for safety and preservation of capital over return that they bid the yield on one-month Treasury bills down to 0.03 percent and on three-month ones down to 0.04 percent, the lowest since February 1941. On September 18, the yield on these three-month Treasury bills rose to 0.07 percent and on six-month bills the yield was 0.61 percent, a huge drop from 0.98 percent the day before.

The government announced rescue plans on Friday, September 19 (details of which appear later in this newsletter), which caused yields on three-month Treasury bills to shoot up to 0.98 percent and to 1.46 percent on six-month bills. Clearly, investors are somewhat less fearful than they were two and three days earlier.

At the same time, the U.S. stock market has been giving a wonderful imitation of a yo-yo. The Dow Jones Industrial Average (DJIA) fell 504.48 points on Monday, September 15, rose 141.51 points on Tuesday, plunged 449.36 points on Wednesday and shot up 410.03 points on Thursday. Friday saw the DJIA add another 368.75 points to end the tumultuous week at 11,388.44, a drop of only 0.3 percent for the week. This is enough to give investors whiplash. They can all calculate that another 20 or 21 days like Monday or Wednesday would leave the index below its July 8, 1932 low of 41.22, which was the lowest since 1900. The index began on May 26, 1896 at 40.94 and hit its all-time low of 28.48 that summer.

The range over the year to September 19 is from September 17th's low of 10,521.81 to the October 11, 2007 record close of 14,164,53. That's a decline from peak to trough of 25.7 percent, a bear market for sure.

The broadest stock market index is the Dow Jones Wilshire 5000 Composite index, which covers all traded stocks and which is measured in dollars. Its peak and trough dates over the past year are the same as for the DJIA. Its high was 15,938,99 and its low was 11,815.71. That's a drop of $3.1 trillion in the value of all traded stocks.

That's only about half the losses on stocks from the "dot.com bomb." Investors lost over $6.0 trillion from the March 24, 2000 peak of 14,703.89. That peak was not surpassed until April 13, 2007, when it closed at 14,736.40.

The big difference in the current environment and the "dot.com bomb" is that this time bank capital is being eroded. About $470 billion of it has disappeared and only about $380 billion in new capital has replaced it so far. Since there is no instance in history of a capitalist free market economy being able to grow without increases in bank credit and since banks can't lend without adequate capital, the current situation feels much worse even though it is so far much milder.

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THE PANIC CONTINUES

It's a hard cruel world out there with much economic turmoil and concern. Since August 9, 2007, the day that the huge French bank BNP Paribas (one of the 10 largest in the world with assets in excess of $1.3 trillion) told owners of shares in three of its mutual funds they could not redeem them "because we own bonds based on U.S. subprime mortgages that we can't put a value on right now," financial panic has spread around the world.

Nothing makes an investor madder or more scared than being unable to cash out his or her investment from a fund. This problem has recurred many times throughout history. A comprehensive documentation that is also a most delightful and interesting book to read is *Manias, Panics, and Crashes: A History of Financial Crises (5th Edition)* by Charles P. Kindleberger and Robert Aliber (ISBN 978-0-471-46714-4). This wonderful book, which has always been a huge hit with my MBA students in the several second-year elective courses when I've used it, covers the history of financial panics around the world from *Kipper-und-Wipperzeit* of 1619-1622 and the Dutch tulip bulb episode in 1636-1637 through the Asian collapse in 1997 as well as the Russian default and the collapse of Long Term Capital Management in 1998 and the corporate scandals of 2001-2003 (Enron, Worldcom and so on).

The *Wall Street Journal* had a lead editorial on September 16 ("Surviving the Panic") referring to the usefulness of this book in understanding the current situation. You'll feel better if you get a copy of the book and peruse it carefully.

A primary lesson from the book is that the way to stop panics or reverse crashes is to have a lender of last resort supply whatever capital (liquidity) is needed to the financial markets to end fears of being unable to get your money out of the bank or investment fund. This is what the Federal Reserve System (the Fed) and central banks around the world failed to do in 1929, which was a major factor in turning what should have been the recession of 1929-1930 into the Great Depression of 1929-1933. They won't make that mistake again, although they were rather slow in getting started.

The other problem is that there is still no international lender of last resort. The Federal Reserve System can only supply liquidity to the U.S. and the European Central Bank (ECB) can only do the same in its 15 member countries (Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia and Spain). These countries are known collectively as the Euro Zone. The good news is that central bankers from all the major countries with convertible currencies meet regularly and know each other well so that coordinated action is easy to conduct.

This is exactly what happened in August, September and December 2007 and March 2008 to quell panic in European, British, Canadian, Japanese and U.S. financial markets. On September 18, the Fed announced it had doubled its currency swap line to the ECB to $110 billion and increased its currency swap line to $27 billion (a $15 billion increase) to the Swiss National Bank. It also announced new currency swap lines of up to $60 billion with the Bank of Japan, $40 billion with the Bank of England and $10 billion with the Bank of Canada. These swap lines allow those central banks to make loans to their member institutions in U.S. dollars. They have already begun doing this. All these were authorized through January 30, 2009.

Of course, the pioneering effort at this type of coordinated action was that taken after the global stock market crash of October 19, 1987. Prompt action by the Fed and others prevented that panic from continuing and leading to severe economic consequences.

To this day, banks in the Euro Zone refuse to make short-term loans to banks in other countries within the zone because they're worried about the soundness of those banks. The same phenomenon has caused huge problems in the United Kingdom, Canada, Japan and right here in the U.S. This is what caused the ridiculously low yields on Treasury bill discussed above.

The Board of Governors of the Federal Reserve System has taken many extraordinary steps to try to break up this logjam in financial markets, yet it persists. These steps include the Term Auction Facility (TAF), which allows banks to get loans

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they are unable to get from other banks or from the use of the discount window. There are now TAF auctions of $75 billion every two weeks for loans of 28 or 84 days.

The most dramatic new lending arrangement is the Primary Dealer Credit Facility (PDCF). This provides overnight loans to the sixteen nonbank entities (though several are subsidiaries of bank holding companies) that are qualified to buy and sell Treasury securities on a daily basis with the Federal Reserve Bank of New York. This type of lending by the Fed had not been offered to non-depository institutions since the Great Depression of August 1929 to March 1933 until it was announced on March 16, 2008. This is what was used to facilitate the purchase of Bear, Stearns by JPMorgan Chase. After several weeks in which there was no borrowing under the PDCF, the amount outstanding leapt to $59.8 billion on September 17.

Another innovation for the primary dealers is the Term Securities Lending Facility. This allows them to offer mortgage-backed securities as collateral to the New York Fed in exchange for Treasury securities. This innovation was expanded to $200 billion on September 14. On September 18, the Fed reported it had received bids of $49.6 billion and accepted $25.0 billion for 28 days. Also on September 18, the Fed reported that AIG had drawn down $28 billion of the $85 billion credit line extended to it. The interest rate is 11.3 percent and floats at 850 basis points above the three-month LIBOR rate. The government also took a 79.9 percent equity stake in AIG.

In addition to these actions, the Federal Open Market Committee (FOMC), the part of the Federal Reserve System that sets monetary policy, has been aggressive in lowering its short-term interest rate target. It first reduced its target for the Federal Funds rate, the interest rate that banks charge each other for overnight loans to meet their reserve requirements, from 5.25 percent to 4.75 percent on September 18, 2007.

Since then it has cut the target six more times. On April 30 it reduced it to 2.0 percent, the lowest since November 10, 2005. They may lower it again later this year if the unemployment rate keeps rising above the 6.1 percent of August, the highest since September 2003.

The bad news is that monetary policy impacts the real economy (the actual production of goods and services) with "long and variable lags" as we all learned from the late Milton Friedman, who became the Nobel Laureate in Economic Science in 1976 for this and two other pioneering insights documented in his research. That means that the biggest boost to the economy from those actions to reduce short-term interest rates won't come until 2009 and 2010.

The Bush Administration and the Congress were sufficiently frightened early in 2008 to cobble together the Economic Stimulus Act of 2008 in what passes for warp speed in Washington, DC. President Bush signed it into law on February 13 and on April 28, the first people to receive money got their payments. The total sent out by the Treasury is $93.9 billion to 114,809,000 people as of August 31.

The good news is that the impact of this stimulus will show up much more quickly than that from lower interest rates. It is expected that the economic impact from the stimulus will be enough to keep the economy growing well into the fourth quarter.

By then, we optimists expect that we'll be past the bottom of the housing collapse in both housing starts and prices and oil prices will be much lower than $140 a barrel. While some forecasters are calling for oil to hit $170 or even $200 a barrel, most of us expect prices to fall back to at least $85 a barrel if not lower. The closing price was $97.88 on September 18.

None of these prices are even close to a record adjusted for inflation. You have to go back to the beginning of the industry for that. When "Colonel" Edwin L. Drake brought in the world's first successful oil well in Titusville, PA on August 27, 1859, he sold the oil for $20 a barrel. That would be $480 today. No one has forecast that we'll ever get close to that!

Another recent attempt to rein in the financial panic is what the Federal Housing Finance Agency and the U.S. Treasury have done to effectively take over Fannie Mae and Freddie Mac from September 7 to date. This has brought down 30-year fixed rate mortgages from 6.26 percent on September 5 to 5.79 percent, but only for top quality borrowers with 20.0 percent or higher down payments and conforming mortgages ($417,500 or less).

RECENT ECONOMIC NEWS IS MIXED

The industrial production data for August that the Fed released on September 15 were awful. The total index was 110.3 (2002=100), the lowest so far in 2008 and 1.5 percent below the level a year earlier.

The manufacturing index at 111.4 was also the lowest this year. It was 1.9 percent below August 2007.

There was some good news in the consumer price index (CPI) release from BLS on September 16. The total CPI for all urban consumers fell 0.1 percent in August from July on a seasonally adjusted basis. While it was up 5.4 percent from a year earlier, that was less than the 5.6 percent year-over-year increase in July.

The index excluding food and energy (the core CPI) was up 0.2 percent on a seasonally adjusted basis in August. It was 2.5 percent higher than a year earlier.

Much has been made of the fact that the number of nonfarm payroll jobs in August was 605,000 less than in December 2007. That represents a drop of only 0.44 percent. Furthermore, while the average loss of these jobs every month in 2008 is 76,000, there has not been a single month in which the number of jobs lost has been statistically significant. That requires a monthly change of 104,000 jobs or more.

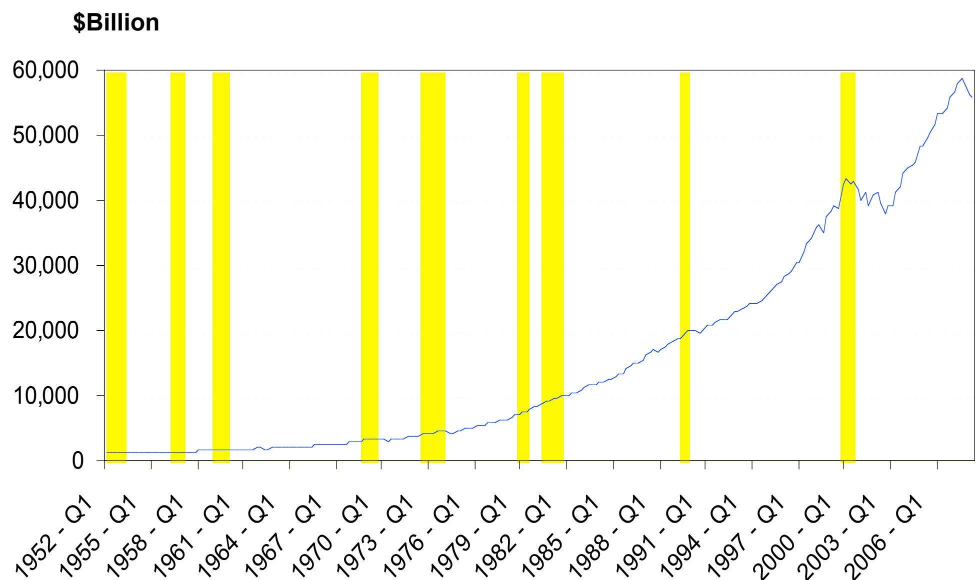
On September 17, the Census Bureau told us that housing starts were running at a seasonally adjusted annual rate of 895,000 units in August. That was the lowest since January 1991 and was 33.1 percent below a year earlier. For the first eight months of 2008, housing starts have been 681,200 units. That's down 30.5 percent from the comparable period in 2007.

Total housing starts have now plunged 60.5 percent from the peak rate of 2,265,000 units in January 2006. That would seem to suggest we are probably at the bottom or very close to it.

The homebuilder confidence index, as reported by the National Association of Home Builders on September 16, has risen slightly from 16 to 18. The inventory of new homes for sale has also fallen dramatically over the past year.

The Flow of Funds Z.1 release from the Fed on September 18 showed that consumers had total assets of $70.5 trillion as of June 30 with total liabilities of $14.5 trillion for a very sizable net worth of $56.0 trillion.
That's four times nominal GDP. It is $2.0 trillion below a year earlier and only very slightly above the level at the end of 2006.

Chart 1 shows the picture of net worth well. The vertical lines are recessions. Consumers' holdings of corporate equities were worth $4.9 trillion on June 30, a drop of $1.2 trillion from a year earlier. Mutual fund holdings of consumers were also worth $4.9 trillion, a decline of $159 billion from June 30, 2007. The chart clearly shows the long-lasting impact of the 2000 stock market crash.



Source: Federal Reserve Board

The value of our homes was $19.4 trillion on June 30. That was a decline of $730.5 billion from a year earlier.

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Consumers still had $8.8 trillion of unborrowed home equity on June 30. That was 45.2 percent of the value of our houses. Chart 2 shows this.

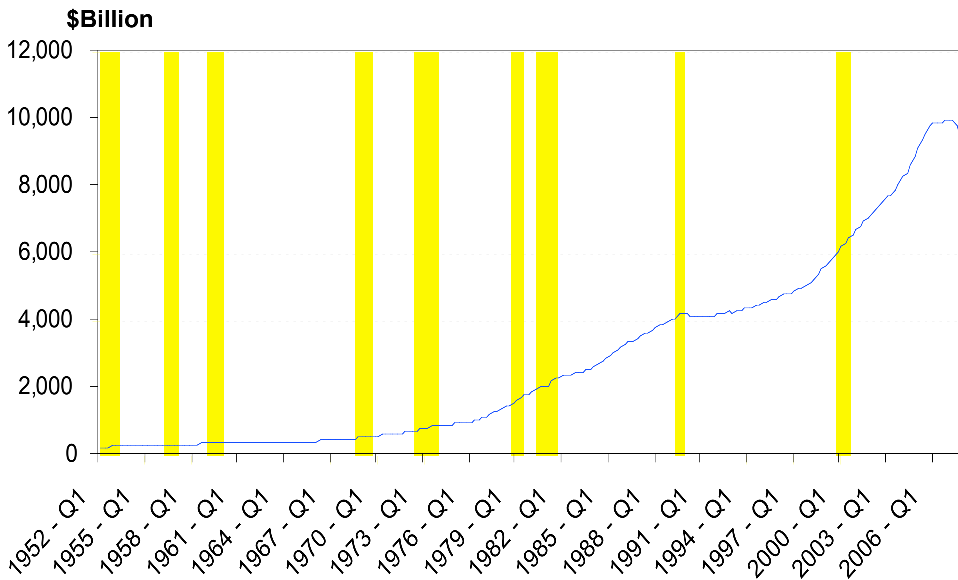
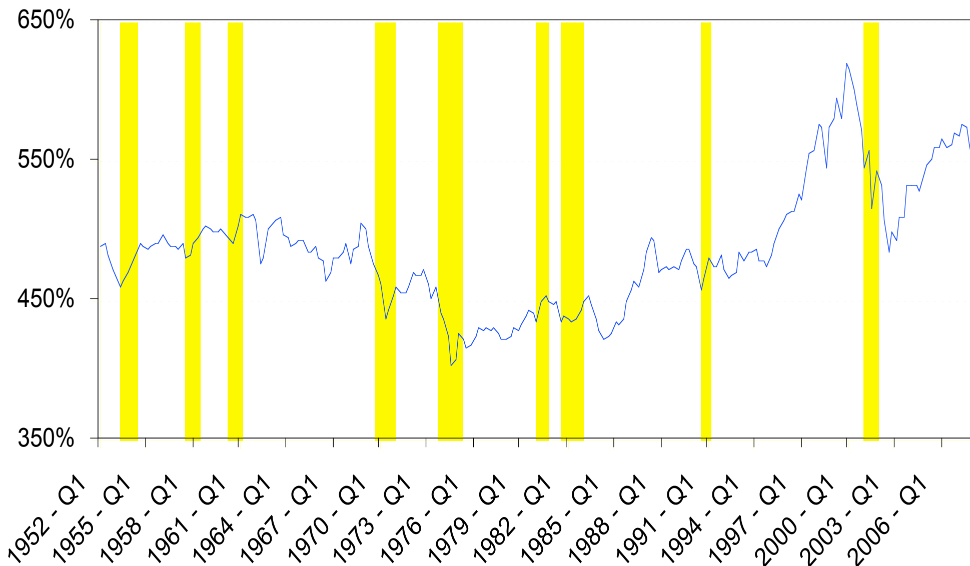


Chart 3 shows the relation of consumers' net worth to disposable personal income. That was 517.4 percent on June 30.



Source: The Federal Reserve Board

In the September 2 press release announcing that their August index was 49.9 percent, the Purchasing Managers Institute said that the January through August index results would be consistent with real GDP growth of 2.6 percent for the first half of 2008 on a year-over-year basis. The actual result was only 2.4 percent. They also said the August level, if continued, is consistent with 2.8 percent growth. We'll find out about that on October 30, when the first ("advance") estimate of third quarter GDP is released by BEA.

They pointed out that a value of their index above 50.0 percent is consistent with a growing manufacturing sector. They also said a value over 41.1 percent indicates real GDP is growing. The distance from 41.1 (8.8 percentage points in August) "is indicative of the strength of the expansion or decline" (if the index is below 41.1 percent).

Despite all this gloom and doom and the longest panic since the Great Depression, the U.S. economy keeps growing. In the second quarter, real GDP grew at a seasonally adjusted annual rate of 2.8 percent and the level was 2.1 percent above a year earlier.

This was by far the highest growth rate for the period of any of the G-7 countries. These are the seven largest economies in the world excluding China.

MANY OTHER MAJOR ECONOMIES ARE STRUGGLING

The world's second largest economy is Japan. It used to be about half the size of the U.S. economy, but is now only a little over one-third given its anemic economic performance since the bursting of its stock market bubble in 1990. The Nikkei average peaked at 38,915.87 on the last trading day of 1989. It closed at 11,489.30 on September 18, 2008. That's a plunge of 70.5 percent. Can you imagine how irate U.S. investors would be if anything remotely like that had happened here in recent years?

The Japanese economy fell at an annual rate of 3.0 percent in the second quarter after an increase at a 4.0 percent rate in the first quarter. The Japanese government has almost no room to maneuver to boost growth.

Its national debt is 182 percent of GDP. Just servicing that debt, even at low Japanese interest rates that have averaged 1.44 percent for ten-year securities over the last decade, costs 2.8 percent of nominal GDP. However, nominal GDP in the second quarter was 0.6 percent below a year earlier. Japan only has two years to start reducing its national debt significantly or it will be facing economic oblivion as its debt increases exponentially and investors will refuse to buy it except at exorbitant interest rates.

At the same time, the Bank of Japan has a target for short-term interest rates of 0.25 percent. There's no room to reduce those.

The 15 countries in the Euro Zone saw their economies shrink by 0.2 percent (not annualized) in the second quarter of 2008 after growing 0.7 percent in the first quarter. The real GDP of the 27-country European Union fell by 0.1 percent in the second quarter after also growing 0.7 percent in the first.

Germany is the world's third largest economy, although China will soon pass it, and the biggest in Europe. Its real GDP shrank 0.5 percent in the second quarter after rising 1.3 percent in the first.

China[1] continues to grow at its sizzling pace of around 10.0 percent that it's maintained since 1980. However, it's still not big enough to raise global growth by much.

The United Kingdom (the world's fourth largest economy) was absolutely flat in the second quarter at 0.0 percent. It had experienced real GDP growth of 0.3 percent in the first quarter. I'm sure this stunned the Brits since they have experienced 16 years of positive growth every quarter until now.

France, the world's fifth largest economy, saw its real GDP decline by 0.3 percent. Its real GDP had risen 0.4 percent in the first quarter.

Italy is the sixth largest economy in the world. Its real GDP fell 0.3 percent in the second quarter after rising 0.5 percent in the first quarter. Italian real GDP also fell 0.4 percent in the fourth quarter of 2007. The Italian economy was exactly where it was a year earlier in the second quarter of 2008.

Canada is the smallest economy in the G-7. It saw a decline of 0.2 percent in real GDP in the first quarter of 2008 or 0.8 percent annualized and an increase of 0.1 percent (0.3 percent annualized) in the second quarter. The recent strength of the Canadian dollar has really been hurting their exports. They have a national election on October 14. The results of that vote could change their outlook.

[1] No one is sure of China's GDP though most people think it will soon pass Germany. Therefore, the rankings used here reflect the G-7 and exclude China from the ranking.

THINGS TO WORRY ABOUT

Unfortunately, you should worry about fiscal policy. The Japanese mess has already been discussed. Many European countries have huge problems with the aging of the baby boomers.

This probably will turn out to be a "watershed" election in the U.S., but not for the reason we usually hear discussed. This election will mark an important, historic change in course because the U.S. is clearly on an unsustainable fiscal path and things are going to have to change. It should be obvious that the changes will be painful. You can find an excellent summary of the problem in an article by Robert J. Samuelson in the September 1 issue of *Newsweek*.

The latest official forecast from the Office of Management and Budget (OMB) is for a budget deficit of $482 billion for Fiscal Year 2009, which begins on October 1, 2008. This would be the largest deficit ever for the U.S., although it would only be about 3.3 percent of GDP—the largest deficit as a percent of GDP was in 1942 at over 40.0 percent.

David Walker, president of the Peter G. Peterson Foundation and until earlier this year head of the Government Accountability Office (GAO), will tell any candidate who wants to talk with him that the net present value (NPV) of the obligations of the federal government is $52.7 trillion. Your individual share of this is $175,000.

Professor Laurence J. Kotlikoff of Boston University has been trying to alert economists and others to this danger for years. He puts the NPV of the future obligations at $70 trillion.

The Congressional Budget Office (CBO) places most of the blame on health care costs. They say and demonstrate with charts and graphs that this is a far more important factor than the aging of the baby boomers (the 77 million people born from 1946 through 1964). Sadly, you probably won't hear much about this huge problem during the election campaign. The main reason is that it's a very unpleasant topic that has no easy set of solutions.

The simple fact is that Congress from 1933 to date has made a large series of promises to the public that we now know are unaffordable. The most recent example of this was their decision to override a veto by President Bush that would have allowed a provision of existing law to reduce Medicare payments to doctors on July 1 as a cost-saving measure.
The House of Representatives voted to override by 383-41. On July 15 the Senate concurred by a 72-26 margin following an emotional speech by Senator Ted Kennedy (D-MA) on his first floor appearance since having surgery for a brain tumor in June. He could not stay to vote, but his vote was clearly not needed.

The reason for this behavior is obvious. Members of Congress want to say "yes" to constituents. They don't want to tell you that you can't have what you want. It's also possible that a single change in the Medicare program that only directly affects doctors is not the place to start. But extreme changes must be made to Medicare, and indeed the entire health care system, if the U.S. intends to avoid a fiscal Armageddon.

The new crowd that takes office in January 2009 will have many tough choices to make. The fiscal nightmare that has been constantly pushed into the future is now looming. CBO has a number of charts that show interest on the national debt rising exponentially before very long. That simply can't be allowed to happen.

Meanwhile, we'll all be treated to many debates about the state of the economy. Mark Vitner, a senior economist at Wachovia, recently was quoted as saying, "The economy is stuck somewhere between sluggish growth and recession. We're in economic purgatory."

That's the consensus view and could turn out to be accurate. A large number of forecasters hold an extreme version of that view, which sees real GDP growth of 1.0-1.5 percent for the next four or five years. We have had only three consecutive years like that since World War II (1956-1958 with real GDP growth rates of 1.9, 2.0 and -1.0 percent). Otherwise you have to go back to the Great Depression of August 1929 to March 1933, which saw real GDP declines in each of the four years 1930-1933. The level of real GDP in 1933 was 45.6 percent below that of 1929.

If that extreme view turns out to be even close to correct, then all those people who win on November 4 will be very sorry for the next four years. The budget situation will get worse and worse as the economy stumbles along with rising unemployment and stagnant incomes. Then, when Election Day rolls around in 2012, the results are likely to be about as dramatic as in 1932.

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That year the Republicans lost a net 12 Senate seats and their majority. They had already lost a net of 57 House seats in the 1930 elections and enough of the subsequent special elections between November and March (as a nearly unbelievable 19 of the 435 people elected in November died) to give the Democrats a majority of four seats. In 1932 the Republicans lost another 101 net House seats.

Of course, they also lost the White House as Governor Franklin D. Roosevelt racked up victories in 42 states with 472 electoral votes and 57.4 percent of the popular vote. President Hoover won six states with 59 electoral votes. He received only 39.7 percent of the votes of over 38 million people who went to the polls.

It's highly unlikely that the U.S. is in a recession now. In the short run, what needs to happen is for consumers and small business people to become less gloomy and spend a little more.

There was some good news on the small business front on September 9. The National Federation of Independent Business reported that its Small Business Optimism Index rose to 91.1 (1986=100) in August, an increase of 2.9 points from July. Most of the change (66.0 percent) came from a large improvement in the percentage of small business owners expecting the economy to improve over the next six months. The index is still at recession levels, but any improvement is good. The small business sector accounts for over half of GDP and more than 60 percent of job creation in the U.S.

There is still no sign of unusual difficulties for small business owners in getting all the credit they want on what they regard as reasonable terms. This is certainly a good sign given all the media attention to various forms of credit distress.

There is certainly no evidence whatsoever of a "credit crunch." That's a situation in which qualified applicants can't get the credit they want and need at any price. We haven't seen conditions like that in the U.S. since 1980.

One very productive approach for the next administration and Congress would be to get serious about reducing the regulatory burden in the U.S. This was the only one of President Reagan's four basic economic goals (cut taxes, stop inflation, and raise defense spending while controlling other government spending were the other three) that he failed to achieve. The Clinton administration also took a shot at this in 1995.

A July 10 report from the Competitive Enterprise Institute estimated the deadweight loss (the costs that exceeded the benefits) of regulations at $1.16 trillion in 2007. That was nearly half of government spending of $2.7 trillion and nearly equal to the $1.17 trillion of personal income taxes.

A national commission of cost/benefit experts that would tackle this burden would be an excellent idea. Any reduction in the regutory burden would directly increase GDP.

THE FED AND TREASURY COME UP WITH MORE NEW MEASURES

On September 19, both these organizations came out with new announcements of unprecedented actions that really stretch the envelope of their respective existing statutory authority. We'll need action from Congress, which we'll probably get soon, to allow either of them to go further to stop the panic.

The first step taken by the Fed was to make loans at the discount rate (currently 2.25 percent) to U.S. depository institutions and bank holding companies to finance their purchases of "high quality asset-backed commercial paper" (ABCP) from money market mutual funds. This action will prevent other funds from "breaking the buck," meaning that their price per share falls below $1.00. That means investors lose money, which is not supposed to happen with these funds and only rarely has (twice since they were invented in 1970).

The second new Fed effort is to purchase agency securities (those issued by Fannie Mae, Freddie Mac and the Federal Home Loan Banks). This will be conducted with primary dealers as current open-market transactions in Treasury securities are done every business day.

The Fed has spent so much money, which it gets by selling some of its $800 billion of Treasury securities, that it needs more of these to keep its balance sheet in good order. Obligingly, the

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Treasury on September 17 announced it would be selling $100 billion or so of "cash management" bills on behalf of the Fed. As the Treasury deposits proceeds from its auction with the Fed, these special auctions should do the trick for the Fed.

The Treasury also announced a plan to have Fannie Mae and Freddie Mac, which have effectively been nationalized, increase their purchases of mortgage-backed securities (MBS). This will increase capital available to mortgage markets as will a separate program to buy MBS paper guaranteed by Fannie Mae or Freddie Mac announced on September 7 in conjunction with the takeover of these two companies by the Federal Housing Finance Agency.

The Treasury also announced on September 19 a special insurance program for money market mutual funds. Any publicly offered fund can buy the insurance and Treasury will guarantee the value of each share won't fall below $1.00.

This action was thought necessary to prevent a run on the $3.3 trillion money market industry. A real irony was that the fund (Reserve Primary Fund) that fell to $0.97 was the first fund offered by the industry.

The Treasury is using the $50 billion of assets in its Exchange Stabilization Fund (ESF) to back this insurance. The ESF was set up in 1934 to stabilize the U.S. dollar in foreign exchange markets after we severed its ties to gold. The ESF was also used to help Mexico in 1995 and to support the Plaza and Louvre Accords on the dollar in 1985 and 1987, respectively.

Finally, Treasury Secretary Henry (Hank) Paulson called on Congress to enact new legislation "to remove these illiquid assets that are clogging up our financial system." Keep watching to see how that all turns out after Congress finishes with the new legislation.

For now, my GDP forecast for the U.S. for 2008 is still for 2.2 percent growth on a year-over-year basis. For 2009 it's 3.4 percent. These are both on the optimistic side of the range of forecasters, but are certainly achievable. The uncertainty range is enormous, however.

THE OUTLOOK IS EXTREMELY UNCLEAR

Any forecaster who tries to tell you that he or she has a high degree of confidence in the outlook for the next five years should be looked at with a great deal of suspicion. Some prognosticators are certain that the U.S. will pull the world down into at best a time of slow growth (1.0 to 1.5 percent a year for real GDP in the U.S. for 2008 through 2011 and less than 3.0 percent for the world) while others assure you that all will be well if you just vote for them or their candidate.

One thing you shouldn't worry about is inflation. The bad old days of the 1970s when we lived through high and rising rates of inflation while enduring high and rising unemployment rates are not returning. Central banks around the world (except in Zimbabwe with its several million percent annual inflation rate) learned and have absorbed another lesson from the late Milton Friedman. That is, "inflation is always and everywhere a monetary phenomenon." If central banks don't allow the money supply to grow too rapidly there is no chance for inflation to become a problem.

If you would like to book me for a speech, please visit my website or contact
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Jim