

The Light at the End of the Tunnel: A Forecast for 2009

By John Tuccillo, JTA LLC.

I suppose we could start out with the old Dickens line about “the best of times...worst of times” but, when it comes to the economy, that would only be half right. From housing downturn to financial meltdown to economic recession, the past three years have been disaster, and 2008 was the worst of them all for both the United States and the world. All the excesses, missteps and flat out fraud of the decade came to fruition in 2008, with the economy in recession and losing nearly three million jobs, the Dow down a third and major industries coming hat in hand to beg for handouts. No, I don't think we want to dwell on 2008 any more than we must.

This year does not, in the minds of the media and economic pundits, look any better. The consensus forecast among economists seems to be that the economy will be in recession the whole year, real estate values will fall another ten percent, another couple of million jobs will be lost and we will be in a free fall that will rival the Great Depression or worse.

I think we all need to step back and relax. This is not the second coming of the Great Flood, and there's no need on anyone's part to build an ark or start collecting pairs of living things. This is a normal recession, albeit more severe than any in the past three decades, and it will pass sooner or later. I think sooner. There are both good things and bad things happening in 2009 and our forecast (see the attached chart) suggests that this recession will end sometime in the third quarter of 2009, with significant growth returning in the fourth quarter and through 2010. Let's look at the positives and negatives driving the economy.

Negatives

1. Financial markets have ceased to function. This is the single major problem facing the economy. Without a freely and efficiently function financial market, the economy cannot grow. We have two tasks here. First, we need to get financial institutions back into the business of lending to households and businesses. The first bailout, as well as the efforts of the Federal Reserve to flood the system with liquidity have not yet done their job, although there is some reason to believe that this is changing. Second, the abuses that caused the financial sector debacle must be dealt with, and this includes closer regulation of both exotic securities like derivatives as well as mortgage lending
2. The housing market remains dead in the water. In some areas, inventories remain intolerably high from overbuilding and foreclosures, while in other areas inventories are fine but the slowing of the economy has reduced the ability of

buyers to enter the market. More bad news on this front will come as the financial meltdown works its way through the economy of New York City and environs. Moreover, financial problems have paralyzed lending institutions and hampered the use of short sales to clear out excess inventory.

3. Consumers lack the confidence to help the economy recover. There's no surprise here. There is real pain from job losses in many parts of the country. But we are also being taught to lose hope. Since consumption is two-thirds of all economic activity in the United States, we can't emerge from the recession without the lead of households spending on goods and services.

Positives

1. The Federal government is wading in full force. We will see fiscal stimulus of nearly a trillion dollars in the first half of 2009. But unlike the checks distributed by the previous administration and Congress or the confused and unfocused bailout of 2008, this one will target job creation spending by state and local governments and long term investment in modern industries. In short, it's being done right, and it should succeed. In effect, we are bombing a very sick patient with massive amounts of experimental drugs.
2. Interest rates are low, and will stay there through the year. Nothing works better to stimulate big ticket spending than interest rates verging on zero. This is where we are now. For example, the mortgage industry is being swamped by refinance requests and every one of those households now has more to spend out of their monthly income on things besides shelter. This is how lower interest rates can bring the economy back.
3. In most of the country, real estate is poised for a comeback. It's not just low mortgage rates. For most of the metropolitan areas in this country, housing inventory has been cleared out and lack of effective demand is now the only issue. As the recession moderates and interest rates stay low, we will see a sharp comeback of the real estate sector.

That's part of the scorecard and it represents the thinking behind the forecast attached to this commentary. We think that the first half of 2009 will be a continuation of 2008, but that by late summer, it will be clear that the economy is coming back. This in turn will trigger jobs growth, housing activity and a stronger flow of credit. After that, as we get into 2010, we'll need to start worrying about inflation, but that's a story for another day.