Economic outlook is sunny, with a chance of tar balls

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Gulf Coast vacationers' forecast: Sunny with a chance of tar balls. With a forecast like that, some Gulf Coast vacationers are changing their summer plans. Bravo to the tourism officials, business owners and residents who are taking matters in their own hands in dealing with economic, environmental, and "relief" disasters. And as we all work through the financial crisis, recession, and matters at hand, that forecast too is relevant. I'll briefly summarize some of the major challenges and implications.

Personal – I continue to hear concerns and fears of prolonged recession and/or the direction of this country. *"We're not sunk yet, are we?"* And paralleling the natural 'aversion to risk,' Americans want assurance they're making smart financial decisions.

Economy – Feds have 2 mandates – reduce unemployment (5% acceptable range) and keep inflation in check (2% target).

- **Debt** – Debt plagues many developed countries and hampers long-term economic security. *"You can't spend your way out of recession, or borrow your way out of debt,"* warned Britain's Daniel Hannan. US national debt ($13 trillion) is 62% of our economy and the highest level since WWII. Total US credit market debt (Fed, state & local, business, and individual) is about 360% of GDP.
- **Unemployment** – At 10% nationally (regionally, much higher), it is a huge financial and social drag. Job growth via stimulus has been benign. Assuming the US can achieve/maintain 350,000 in monthly hires, it'll take years to put some 15 million back to work.
- **Austerity** – As countries recognize their deficit spending is unsustainable, they generally look to cut spending and/or raise fees and taxes. EU's problem children (e.g. Greece, Italy and Spain) are a warning sign to us all. A <u>coordinated</u> global austerity plan is good medicine. However, countries differ, as reflected in the discord of Toronto's G-20 Summit. And like Saint Ebba and her nuns who traded disfigurement (and eventually death) for their virginity, austerity taken too the extreme, or too soon, is the recessionary equivalent to cutting off your nose to spite your face.
- **Regulation** – Granted, "putting the fix" to broke systems is needed. However, we risk "Devil's in the (2000 – 3000 page) Details" and the land of unintended consequences. "Reform" legislation almost always goes too far.
- **Interest Rates & Inflation** – The Fed's printing of money and borrowing raise inflationary fears. But, the gap between actual and potential output (i.e. excess capacity) dampens those fears, and potentially constrains core inflation for a couple of years.

The New Normal – Yes sir, we've got change… in the global economy, the use of debt, and the markets. Some economists describe the New Normal as a period of reduced economic output, and hence, single digit bond and equity returns, possibly for the remainder of the decade. This is largely attributed to a decline in global aggregate demand. Developed countries need to <u>produce</u>, and developing countries must <u>consume</u>. However, in a world of discord, the calls for effective leadership have yet to be answered.

So, do your best, better yet, do what's required. And enjoy the beach and dodge the tar balls.