

Where Is the Economy Going in the Next Six Months?

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As investors, the question we have to focus most of our attention on just now is what impact the credit crisis, the bursting housing bubble and the actions of the U.S. government will have on the economy and investment markets in the next six months.

We have seen the Fed and the federal government move to panic mode as they try to keep the system afloat. As expected, they have cut rates, as well as having given away checks and rearranged the Federal Reserve's entire balance sheet.

The underlying problems have not been fixed with this massive bailout. There are still many credit pot holes out there and new lending remains highly constrained. Even the government tax rebate checks, rather than boosting the domestic economy, were largely absorbed by higher oil prices. The resulting cut-back in consumer spending, coupled with ongoing constrictions in lending, will cause a severe slowing of the economy.

But the much bigger implication is that the Fed is busy pouring more gasoline on the fire by fighting the collapsing housing bubble, a housing bubble created by excess liquidity, with yet more liquidity. That is the key point that should be taken from this mess. The dollar is now firmly on an even steeper slope to its ultimate demise. Other currencies will be sliding down the same slope, so another paper currency is not the answer.

This, then, is a high-level context for many of our investment recommendations in the months ahead.

Short Term Projections

1. The housing decline is not yet done, because we will need another year to unwind foreclosures in the pipeline. In addition, the exuberance shown by appraisers at the height of the housing bubble still has a long ways to go to fully deflate. What is that house on the market down the road really worth? At this point, no one knows... and no one will know until it and many others are bought by willing buyers (as opposed to unwilling lenders taking them onto their books in a foreclosure).
2. Consumers in the U.S. are not able to expand credit and are increasingly concerned about the outlook for the economy, so they will slow spending both at home and on imports.
3. The financial/banking system is weaker than understood. The complexity of the global system and the ubiquitous presence of interlocking financial and credit instruments and literally trillions of dollars in derivatives has left the world's banks teetering on the edge.

Adding a push from behind, we have broadly rising inflation and soon the persistently higher interest rates that are the bane of fixed-income investors and financial institutions in general. As

the dollar continues its fall, and the banks continue to come under pressure, the lack of confidence in these keystones of the modern financial system will deepen. Already, the Sovereign Wealth Funds that rushed in early in the credit crisis to prop up the big investment houses are now signaling that, at least for the time being, they are going to step back and watch how things shake out.

4. A slowing economy – recession – coupled with inflation, creates a condition often referred to as stagflation, presenting much bigger policy challenges for the government than one or the other alone.

5. The food crisis. Shortages of food production come from rising energy and fertilizer costs. Rising demand comes from a shift in diet, especially in emerging markets, where increasing prosperity leads the citizenry to add more protein to their diets. Important shortages in grains have arisen that don't allow for a bad crop year. Most concerning is that these shortages are occurring despite good crop production last year, an occurrence that can be blamed, in part, on the diversion of some agriculture production for ethanol and bio-diesel.

These food shortages have already contributed to a doubling and tripling in the price of grains over the last two years. But even these elevated prices have not been sufficient to offset the higher costs of the energy required to produce the crops. And, despite today's higher prices, agriculture still lags the price increases seen in many other commodities.

[For more information on the subject of food, watch my recent appearance on FOX Business News [here](#).]

<http://www.foxbusiness.com/video/index.html?playerId=videolandingpage&streamingFormat=FLASH&referralObject=2518923&referralPlaylistId=5f186d43d92f1ce>

The result of this is that the inflation rate, interest rate, food, energy and precious metals are heading higher as the dollar is debased.

Higher rates are not good for housing and stocks. In the long term, they will recover in nominal terms, though not in actual terms. That's because, while their nominal prices may return to current or near current levels, the dollars used to express their value will have much reduced purchasing power... making those assets a mediocre investment for the foreseeable future.

Finally, it is important to recognize that the world remains in the throes of a deep and serious crisis. While many analysts will express the view that the worst is over or that, after a modest downturn, things will bounce back just like they always have, our view is that what we will actually witness going forward is a fairly steady occurrence of crisis and panic. The crisis will accelerate, moving faster, even, than in previous major shifts such as that witnessed in the 1970s.

While history may find we are too pessimistic at this point in time, in our view it is far better to prepare for a worsening crisis and hope that it does not materialize, than to expect business as usual.

Bud Conrad is the Chief Economist of Casey Research, LLC., publishers of Doug Casey's *International Speculator* which provides unbiased research and recommendations on the highest quality junior exploration companies.

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