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THE U.S. ECONOMY: STAND BY FOR THE CRUNCH !

As the structure and/or environment of any territory's economy changes, or is modified, appreciably, so it impacts, directly or indirectly, on the entire spectrum of economic activity of that territory.

Economic activity, as **TARGET** has stated many times in the past, is akin to a chameleon, crawling over a tartan rug, changing colours as it moves from red through yellow, green, and blue, as determined by the dominant wavelength of the light.

The broad spectrum of structural changes in a society requires one to keep in touch with political, business and technological changes if one is to succeed in investment endeavours.

But events that shape the world do not happen in isolation, for the most part.

More often than not, one event impacts, positively or negatively, on another event, exacerbating a difficult situation or ameliorating it.

One event may well reinforce another or, conversely, it may inhibit the structure or continuance of another.

In integrating trends, which may be difficult to quantify at any particular period in time, but may, nevertheless, impact on a territory's economy, one may obtain a window to the direction of a territory's economy, or at least a segment of it if not in whole.

Take, for instance, the death of Palestinian President Yasser Arafat, who died last week at a French military hospital.

As far as the Israelis are concerned, his death was welcomed since President Yasser Arafat has, always, been seen as an impediment to the peace initiative between Israel and the Palestinians of The West Bank.

Clearly, the Israeli Government would, dearly, love to be at peace with its neighbours because the cost of maintaining the Israeli Defense Force in order to defend itself from the Palestinian freedom fighters – the Israelis refer to them as terrorists – and/or other Muslim extremists from further afield, has been crippling the country's economy since the country's founding in 1948.

According to official Israeli Government statistics, sent exclusively to **TARGET**, last Monday, the cost of maintaining the Israeli Defense Force, today, is 11.10 percent of the **G**ross **D**omestic **P**roduct (GDP), but between 1970 and 1980, it was closer to 25 percent of GDP.

Whether or not one can believe the statistics, presented by the Israeli Government, is questionable because the Israeli Government is not known to be overly cooperative with the international Press, which it cannot control, but whatever the true figure may be, it is a large chunk of cash.

Investment in Israel, other than those investments in bonds, for the most part, made by Jewish loyalists, who are not Israeli residents or even citizens of the country, has been inhibited for years by the constant killing of Israeli civilians and tourists to the country by Muslim suicide bombers, who infiltrate Israel on a regular basis.

The official Israeli Government website remarked, today:

> '*Deteriorating security circumstances have until 2003 been the chief cause of a distinct slow-down in almost all branches of economic activity. For the first time in close to five decades, the GDP actually decreased (-0.9 in 2001 and -0.8 in 2002) returning to a positive growth of 1.3% in 2003 - and 5.5% (on an annual basis) in the first quarter of 2004. This, after being listed as enjoying the fastest GDP-growth-rate among world economies.'*

It was only about 3 years ago that Mr Li Ka Shing, one of the richest men in the world, was asked at his offices in the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC) by official representatives of the Israeli Government to consider taking a 25-percent slice of the Israeli telephone company, Bezeq.

Bezeq (sometimes spelt, Bezek) is the State-controlled telephone company of Israel and, at the time to Mr Li Ka Shing, a 25-percents stake was up for grabs, but the Israeli Ministry of Communications wanted Mr Li Ka Shing's money because of the knock-on effect it would have, down the investment road.

Mr Li Ka Shing turned down the offer, **TARGET** has confirmed, even though the amount of money, needed to acquire this minority stake, would have been little more than petty cash to The Great Man of the HKSAR.

The reason: More political than financial because Bezeq is a monopoly situation in the telecommunications industry of Israel.

Getting back to the death of President Yasser Arafat, he has, always, been considered by the Israeli Government to be the fan, constantly keeping the embers of hatred against the Jewish State and the Jews, themselves, smoldering.

But, today, President Yasser Arafat is dead.

Who will replace him will, without question, determine the politics of The West Bank, the creation of a Palestinian State, and how these events will impact on the economy of Israel.

And so the politics of one territory is seen to shape the direction of the economy of another.

And, today, the **U**nited **S**tates of America (US) has a newly elected President, who has come out, openly, to state that he sees the death of President Yasser Arafat as an opportunity to restart the peace process between the Government of Israel and the Palestinians.

President George W. Bush, also, has stated that he would expect to see the establishment of a Palestinian state before 2008.

If this should transpire and Jew and Palestinian could live in peace, side by side, investment in Israel and the newly founded State of Palestine could well explode because a major political risk would have been eliminated, at least, to a certain extent.

Oil

While economists, employed by internationally acclaimed banks, maintain to the banks' investors and clients that the high price of crude oil, that is $US50 per barrel and higher, will not lead the US into a recession or stagflagation (weak economic growth, accompanying inflation), the **E**uropean **U**nion (EU) holds a diametrically opposite view.

And the EU can point to its statistics to support its assertions.

The French Government's Statistical Office, just last Friday, released the figures for the country's GDP for the quarter, ended September 30, 2004.

In that release, it was stated, very plainly, that the high cost of imported fossil fuels and a pullback in consumer spending were major contributory factors to the rapid slowdown in economic activity, which dropped to a gain of about 0.10 percent in that quarter.

It was the weakest quarterly performance in more than a year.

It coincided with the run-up in the price of crude oil to the $US50 per barrel level.

In the same quarter, the Japanese Government announced that about 0.20 percent had been chopped off the growth rate of the country's GDP due to higher oil prices, plus a weakening of the US dollar against the yen.

The price of light sweet crude oil on The New York Mercantile Exchange has fallen off the high spot of late, but whether or not it will stay below the $US50 per-barrel mark remains to be seen.

Certainly, it would be fair to state that the US Federal Reserve Board, in making its determination to raise the Federal Funds Rate by 25 basis points, last Wednesday, was predicated, in part at least, by the fear of future inflationary trends.

And the high price of imported oil must have been a factor in The Fed's decision-making process.

Corporate earnings will, inevitably, be hit by the higher cost of energy, of course, but depending on the industry, it will impact to a greater or lesser extent.

For the transportation industry, for instance, the price of fuel to keep the lorries/aeroplanes/buses/taxis, etc, operational is a large cost in the determination of profits.

Fuel surcharges have, already, been imposed on passengers of all international airlines, with the Japanese commuter, being penalised on domestic air routes by another surcharge, in addition to the cost of a ticket, in order, indirectly, to subsidise operational costs of Japanese international airlines.

The point will be reached, of course, when additional costs, brought about by higher energy prices, will impact, dramatically, in the High Street: Consumers will tighten belts more than just another notch.

While it is true that, over the past year or so, corporate earnings have been seen to have risen, in some cases, quite smartly, it is, also, true to state that the base from which one measures the growth of earnings of many companies was from a former very depressed level.

Which makes for good reading, of course, but says little about exponential growth.

In the US, the weaker US dollar vis-à-vis the Japanese yen, the euro, etc, has come to mean that US exports are cheaper, of course, but, on the other side of the coin, the cost of imports – and crude oil, especially – is more expensive to consumers in The Land of The Free and The Home of The Brave.

Since January, the US dollar's translation value to many *'hard'* currencies has fallen by about 27 percent.

It would appear that the potential for growth for *'USA Incorporated'* is, today, limited, due to a number of factors, internal and external.

The war in Iraq and the continued fighting in Afghanistan is costing billions of US dollars, weekly, and the increased cost of home security is in the neighbourhood of $US13 billion per month.

The US taxpayer will have to carry this heavy cross, either today or tomorrow.

There is no way for the US Administration to cut down on these recurrent costs because the Bush Administration is fully committed to maintaining the pressure on those factions, which would do harm to the US, given the opportunity.

These factions, mainly of Arab descent, have a number of soft targets, internationally, which, when attacked, successfully, or even superficially, tends to drive up the price of crude oil because, aside from production of crude oil and distillates, there is, also, the matter of logistics.

The relatively weaker US dollar, vis-à-vis other *'hard'* currencies, tends to reduce the trade deficit, automatically, on translation.

The trade deficit for Fiscal 2004 is forecast to be a record $US600 billion-plus.

Most economists appear to be more concerned about the US trade deficit, more so that is than consumers, perhaps suggesting that the consumer has better sense than the economist?

But when one spends more than one earns, it is called inflation.

The US Federal Reserve will attempt to contain inflation by the implementation of its weapon of choice: Mini interest-rate increases.

To this end, a doubling of the Fed Funds Rate in 2005, to about 4 percent, is more than likely.

It will impact on industrial growth in the largest economy of the world.

So, stand by for the crunch!

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