THE U.S. ECONOMY FOR 2006

The likelihood is that Detroit will never fully recover its former glory and, as many tens of thousands of US workers from General Motors Corporation and Ford Motor Company hit the streets of the United States and Canada, looking for alternative employment, it will start to weigh heavily on the US economy as a whole.

This is because, inter alia, if some of the largest corporations of the US are seen to be vulnerable to the vagaries of the US economy, which is the largest single economy of the world, the question must be raised as to the prospects for other US corporations to start to tighten spending belts even further.

This could result in further lay-offs at *'USA Incorporated.'*

Higher interest rates, during the 2006 Fiscal Year, are a given because the US Federal Reserve is duty bound to restrain inflationary tendencies as they appear on the economic horizon.

The US housing balloon is, already, known to have a slow leak. That small hole will expand, no doubt, as the 2006-Year wears on.

All of the above and much more suggest, strongly, that the year 2006 will not be a good year for investors, locked into US equity markets.

It stands to reason that, if it is not a good year for The Land of The Free and The Home of The Brave, it cannot be a good year for Europe and Asia, with, perhaps, the lone exception of the People's Republic of China (PRC).

Looking only at the US, during the 2005-Year, the economy of the largest economic power of the world shrank by nearly 17 percentile points, compared with the 2004-Year, down from the 2004-Year's growth rate of about 4.20 percent to the 2005-Year's growth rate of about 3.50 percent.

Actually, considering the devastation, wrought by a couple of massive hurricanes, one of which *'drowned'* New Orleans, Louisiana, the growth of the US economy was remarkable, if not commendable.

For the 2006-Year, most economists are suggesting that the growth of the US economy will continue to wane, probably by another 14-plus percentile points, Year-On-Year, to about 3 percent.

Consumer spending, which is the mainstay of the US economy, is almost guaranteed to dry up to a great extent as the 2006-Year progresses for a number of quite obvious reasons, the lack of full employment for many Americans, being but one of the reasons.

Cash From Bricks And Mortar

The US housing market, in the 2005-Year, provided a great deal of the source of disposable income to many lucky US families.

As the price of bricks and mortar rose across the nation, lending institutions loosened purse-strings, based on the then market value of property, used as collateral for further loans.

Much of that money was spent on one frivolous thing or another, with some of it, finding its way into equities.

Mortgage borrowing, which had been a source of household income in 2005, will definitely evaporate, during the first half of 2006.

In the middle of the 2005-Year, US home owners determined to borrow more money, based on the then market value of their homes.

Many financial institutions agreed to the demands and joined the *'party'*, and this type of borrowing came to be known as *'Mortgage Equity Withdrawals'*.

Such borrowings contributed about 5 percent to the disposable income of many an American household.

But higher interest rates in the US in 2006 will weaken the incentive for higher prices for new and second-hand homes, to be sure, and this will put paid to borrowing more money against the remaining equity of the family home.

Which, in turn, will mean that at least 5 percent of household disposable income will disappear.

For many US households, they have already gone overboard in their spending habits.

This is easily recognisable by the fact that, in the fourth quarter of 2005, US household savings were in negative territory.

So, by the middle of 2006, many US households will be burdened by (a) debt service and (b) finding the wherewithal to reduce the principal amount of loans, in part at least, afforded by lending institutions from which they borrowed money, during the years, 2003, 2004 and 2005.

Rolling over debt may be an option for some people, but many, if not most financial institutions in the US, will be loath to take any unnecessary risks, based on the falling market prices of homes.

This, alone, could well impact on consumer spending in the US.

Most likely, this situation will spill over into the 2007-Year, causing the growth of the US economy to fall again by about another 33 percentile points, compared with the expected growth rate of 2006 of about 3 percent.

Getting back to the Detroit situation, US manufacturers of motor vehicles have proved, over the past few years, that they have been unable to compete with their counterparts in Asia, specifically Japan and South Korea.

The PRC has yet to join this elite Asian *'club'*, but it will not be long before this emerging economic giant will challenge the might of its Asian competitors.

For the US consumer, buying Asian-manufactured, motor vehicles at cheaper prices than similar motor vehicles, produced in the US, will mean savings, which will be badly needed in many cases.

There appears to be no cure for that which ails Detroit, which has been dragging its feet for such a long period of time that, today, the Asian steam-roller has run over it, squashing a goodly part of it.

The petitioning of bankruptcy for either or both, General Motors and Ford, should not be ruled out.

In fact, this eventuality has, already, been suggested strongly in many quarters.

For *'Japan Incorporated'*, therefore, the problematic US economy could well be to that country's advantage as Japanese manufacturers will continue to take a larger and larger slice of the US motor-vehicle market.

Lower production costs, better quality control, a much-better work ethic, lower salaries/wages for workers, and cheaper funding will all conspire to continue to cut a swath through Detroit's once hallowed ground.

While the zero interest-rate policy of Japan is quite likely to end in 2006, it will make little difference to the growth of this economy, which appears to be on a roll.

However, for consumer electronics, electrical appliances, etc, Japan may well find itself in difficulty because, after all, the US is, still, that country's largest single market for its products and services.

In conclusion: The year 2006 will see the beginning of many changes as the US economy is forced to rethink the way that it does business, both domestically and internationally.

It will be an economy in transition.

One may be well advised not to consider speculating on US stocks and shares until the mist over the US economy clears.

For the PRC, its economy will continue to go from strength to strength in the lead up to the 2008 Olympics, with, of course, certain of its industries, seeing lower profits as the US economy cuts back on garment imports, household goods, etc.

What is very clear, as **TARGET** () has stated, many times in the past: When the US catches a cold, many other countries are infected by the same virus, but to a much greater extent.

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