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A TARGET SURVEY

THE PROSPECTS FOR THE U.S. ECONOMY FOR THE REST OF THE YEAR

Make no mistake: The largest economy of the world could well be in for a difficult time before the year is out.

Not everybody may agree with this prognostication of **TARGET**, but that is this medium's conclusion in respect of the present situation.

'Statistics prove' is an old and well-worn logical fallacy, and **TARGET** does subscribe to it, but, at the same time, one can hardly ignore the obvious signs with regard to the US economy and make reasonable deductions as to what the near-term and intermediate-term future is likely to bring.

Disregarding the prospects of another natural storm of the strength and direction of Hurricane Katrina of last year at about this time of the year, there would appear to be much worse and much-more powerful *'storms'*, germinating worldwide.

These *'storms'* have the potential of being much worse than the devastation, wrought by Hurricane Katrina to The Gulf States.

High on **TARGET**'s list of *'storms'* are those, known to be intensifying in both Iran and North Korea, with North Korea, being, by far, one *'storm'* which has the potential of developing into another limited world war, similar to the Korean conflict, which lasted from June 1950 to July 1953.

In the Korean War, as it is, now, called, more than 19 nations were involved in the conflict and the tally of casualties and deaths is, conservatively, put at about 5.30 million soldiers and civilians, with the People's Liberation Army of the People's Republic of China (PRC), which supported North Korea with money, men and arms, losing about 900,000 of its soldiers in fire-fights with the forces of the United Nations.

Recent intelligence reports suggest, strongly, that North Korea has, indeed, weapons of mass destruction, including the ability to launch long-range missiles, equipped with nuclear warheads which can easily reach as far as Alaska.

These armaments are, of course, worrying, but more worrying, perhaps, is the man in charge of North Korea, today: Kim Jong Il.

This leader is either very clever or, alternatively, he is mentally deranged ... or a mixture of both.

Whatever may be the case, he must be watched carefully because his utterances, of late, are the ravings of a person, suffering from a form of acute paranoia, in **TARGET**'s opinion.

<u>And, Then, There Is Iran</u>

Iran is another *'storm'*, waiting to develop into a major hurricane.

This fundamentalist Muslim country is a theocracy, where the ruling Ayatollah is the last word when it comes to international relations and matters of decorum, internally and externally.

The Western World is concerned that this country is determined to become an international military power, complete with nuclear weaponry, and, to this end, it is building the infrastructure to be able to produce weapons-grade, nuclear fuel.

Iran's Government claims that it only wants nuclear power for the creation of energy for peaceful purposes.

The United Nations has given Iran until tomorrow to cease and desist in its enrichment of uranium.

Failing this undertaking, the question of sanctions against the country will be discussed at The Security Council.

Iran has thumbed its nose at the United Nations.

However, at the same time, Iran has stated that it is quite willing to talk to the West about compromise solutions to the current explosive state of affairs.

It seems likely that Iran will sit down at the negotiating table to break bread with the West because it is in the country's interest so to do.

The alternative is unthinkable, of course.

The US Economic Conundrum

Aside from the 2 major political *'storms'*, mentioned above, there is the growing problem of the seemingly ever-weakening US economy.

According to **TARGET**'s reading of the latest statistics, pouring out of organs of the largest single economy of the world, things are quite likely to get much worse before they have the ability to improve, materially.

One thing that is assisting the US, however, is the success that has been proven by US industry's massive amount of outsourcing to low-cost countries, such as the PRC, many other countries of Asia, and India.

This outsourcing has held inflation in check, so far, and, contrary to popular belief by those who do not understand economics or finance (popular television presenters, especially), outsourcing has, in fact, created more jobs in the US than have been lost by industry's determination to outsource.

Home Sales

Last week, The National Association of Realtors (of the US) brought out its findings for July with regard to home sales in the country.

The statistics should have frightened a great deal more people than the movements of key indices of Wall Street appeared to indicate, following this important release.

In a nutshell, about 6.30 million *'existing homes'* – previously owned homes – were sold, during the month of July, that figure, being a 4.10-percent fall, Month-On-Month, and a drop of about one percent, Year-On-Year.

The 3-month average stood at the negative figure of about 2.10 percent, according to the databank of **TOLFIN ()**(The Computerised Online Financial Intelligence Service and Web-Based, Credit-Checking Provider).

Just as important as the fall in the sales of homes was the fact that inventory levels are building: About 7.50 months, compared with about 4.50 months, as at July 2005.

Even sales of flats, known as condominiums in the US, are falling, with inventory levels at about 8.20 months in July 2006, versus about 7.20 months for the like month of 2005.

It is apparent that many people are finding the price of homes to be unaffordable in the present economic climate of the US.

It is highly probable that the July trend will continue for the next few years – at least.

If **TARGET**'s prediction is anywhere near the mark, the knock-on effects could be devastating for the largest single economy of the world.

Home furnishing companies in the US will be hit, very hard, as will sales of home appliances, just to mention 2 areas of the economy which will feel the brunt of declining homes sales.

Consumer spending throughout the economy will wane, rapidly, with households, tightening purse strings.

There is the fear, also, that many existing families will try to hold onto their homes as long as possible in the hope that there will be a turnaround in the housing market.

There is unlikely to be a turnaround, however, and the stubbornness of these families could well be their financial undoing.

The situation will continue, with families, strapped for cash, borrowing from Peter in order to pay Paul, until the day will come when the financial burden will become too onerous to bear.

And, then, banks and finance companies will step in to repossess homes, causing a further escalation of the falls in the price of homes.

Even the volumes of activity on US equity markets will drop – because there will be little money left for investment or speculation in stocks and shares.

The Negative Wealth Effect will eventually come to the fore in the fullness of time.

The Federal Reserve Bank of New York, some time ago, released a report which indicated that, by and large, Americans considered their homes to be, in fact, their castles: It is the very last thing from which they wanted to be separated.

For the middle classes of the US, the home accounted for 70 percent (or more) of total assets.

Holdings of stocks and shares accounted for less than 10 percent of household assets, the bank discovered.

It was only in the wealthiest 5 percent of households that holdings of stocks and shares exceeded the values of their homes.

Whether or not US President George W. Bush will order another financial finger to be put into the leaking, real-estate dyke, **TARGET** () cannot know or even speculate, but it would appear, even for the President, that the writing is on the proverbial wall and that if nothing is done, one may expect the worst.

<u>Chain Store Sales</u>

Since February, this year, sales at furniture stores across the US have slumped, with the lone exception of the month of May.

According to statistics, compiled by the International Customer Service Association (of the US), during the month of July, sales at furniture stores declined by about 7.10 percent, compared with June, which, itself, suffered a fall, Month-On-Month, of about 11 percent.

Overall, however, sales at US chain stores rose in July by about 3.50 percent, compared with June's sales.

It appears quite likely that sales for the month of August will be considerably lower than those of July's.

With the approach of cooler weather, the high cost of energy will, without question, become a drag on sales at chain stores and one may expect to see lower-end chain stores, such as wholesale clubs and discount stores, suffer the least as consumers look to be more careful where they shop.

But even these *'cheaper'* stores will experience declining sales, no doubt.

Also, record-high prices at the petrol pump will take its toll of household budgets.

Consumer spending in the months ahead will be determined, to a great extent, by the fall in the price of homes across the US, reduced mortgage equity withdrawals, and the ever-increasing burden of the requirement for consumers to service existing debt.

In **TARGET**'s opinion, based on current research (with the assistance of **TOLFIN**'s intelligence-gathering division), consumer spending will weaken, materially, leading up to the Christmas holidays.

Business Inventory Levels

The Bureau of the US Census Department reported, Month-On-Month, that business inventory levels rose, during the month of June, by about:

1. Manufacturers Plus 0.80 percent
2. Retailers Plus 0.90 percent
3. Wholesalers Plus 0.80 percent

The Bureau only releases such tidbits of information every 2 months so that it is fair to state that the above statistics are unlikely to be the situation as it exists today.

TARGET suspects that the levels of business inventories in the above categories will turn out to be much higher for the month of August.

And they are likely to continue to rise as the economic situation in the US continues to cool and consumers continue to keep purse strings, tied ever tightly.

One does not have to be the world's most perspicacious economist to be able to deduce how the US housing market *'freeze'* is going to affect every corner of the world's largest economy.

The build-up of inventory levels, especially in the month of June, suggests, strongly, that the demand for goods is on the wane.

The August statistics will give a much clearer picture, of course, but one should not be surprised to note substantial increases of inventory levels.

Durable Goods

The Bureau of the US Census Department, also, released its findings, last week, with regard to new orders for manufactured durable goods (goods with an estimated life of one year or more).

The Bottom Line was that, during the month of July, new orders were off by about 2.40 percent, Month-On-Month.

The larger-than-expected drop was due in large part to the component of motor vehicles, which accounts for about 33 percent or more of new orders.

The US motor-vehicle industry is on its proverbial knees – as everybody and his cat are well aware – with Ford Motor Company, in spite of selling off its family jewels, from time to time, appears to be unable to find the solution to its problems.

Motor vehicle sales, during the month of July, were down, Month-On-Month, by about 7 percent – which represented the largest, single-month's decline since July of 2004.

Inventory levels of motor vehicles grew by about one percent in July, compared with June – which was the largest single month's increase since October 2005.

In addition, shipments of durable goods, during the month of July, fell by about 1.30 percent, compared with a 0.30-percent increase in the month of June.

Conclusion: There are so many dark clouds on the economic horizon of the US that one may expect Wall Street to react violently to the slightest hint, one way or another, to both material international and domestic events.

The situation in respect of the US real-estate industry bears very close attention because a persistent and/or sudden fall in home sales will, definitely, affect the entire economy, from purchases of the kiddies' clothes, to rapid falls in indices on equity markets, to supermarket sales, to vacation spending.

The current hysteria with regard to air travel is frightening and must be very worrying for every senior executive of every airline in the world, today.

This situation could well lead to many people, determining not to travel overseas, at all: It, just, is not worth the hassle.

The US economy is entering a new phase, one which will see dramatic changes in its internal infrastructure and the methods by which it does business, internationally, no doubt.

TARGET cannot see the US motor-vehicle industry ever recovering.

Its failures to meet the challenges of today's changing world, successfully, is going to put a great number of US workers on the breadline, putting a strain on the country's finances as more and more of the unemployed line up for Government benefits.

But the US is, still, the most-important economy of the world and so that which affects the US, affects the world … in spades.

As for any sudden political developments, leading to more suggestions of increased jingoism by either Iran and North Korea, then, all bets are off – because anything could happen.

One thing appears very apparent and is, almost, indisputable: This is hardly the time to be making new investments in stocks and shares because there are far too many imponderables.

Equity markets do not appreciate uncertainties.

Further, it seems quite likely that the US dollar will come under further pressure in the months ahead and this could well be devastating for countries, such as Japan, whose industries rely heavily on sales to The Land of The Free and The Home of The Brave.

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