**THIS IS JUST THE BEGINNING, FOLKS:**
**THE U.S. GOVERNMENT KNOWS**
**THAT THE WRITING IS ON THE WALL**

As **TARGET** () correctly forecast as far back as August 11, 2006 (Please refer to **TARGET** Intelligence Report, Volume VIII, Number 151, **'*THE U.S. ECONOMY: THE DOOMSDAY SCENARIO*'**), and, then, again reiterated with further elaborations on a number of occasions, culminating in this medium's prognostications of August 1, 2007 [Please refer to **TARGET** Intelligence Report, Volume IX, Number 143 – **'*THE MAKINGS OF A PERFECT (FINANCIAL) STORM*'**], the very difficult situation, internationally, with regard to the potential for a catastrophic financial disaster on the order of the 1929 - 1939 Great Depression in the US, still looms, very large.

And the situation is not going to right itself, overnight.

There should be no doubt in anybody's mind: The current international situation is almost bound to become a great deal worse long before the US financial ship can sail safely through the choppy US seas, the waves of which, today, threaten to swamp the world's largest and most-important, single economy.

What affects the US economy, adversely, must cascade down to the other economies of the world because of the importance of the financial health of The Land of The Free and The Home of The Brave.

On August 1, 2007, this medium outlined 4 nagging problems.

Those nagging problems were (and still remain) with the US economy:

1. The continuing, deteriorating US housing situation as prices continue to fall;

2. The subprime, mortgage-lending industry's spillover from the deteriorating, US housing situation into other areas of the US economy as defaults mount;

3. The guarantee that quite a number of international financial houses would have to bite the proverbial bullet in respect of provisions for underwriting risky situations, associated with cash-raising exercises, some of which these international financial houses had been forced to swallow, as well as mortgage lending; and,

4. The ever-escalating price of crude oil on the commodity exchanges of the world.

As at August 1, 2007, the price of a barrel of light sweet crude oil was about $US69.09.

Since that time, the price of crude oil has topped $US100 per barrel and continues to threaten to rise, once again, over that level.

That price increase of nearly $US31 per barrel represented a 45-percent increase in the price of crude oil over a period of just 5 months.

Such a rapid increase had to be inflationary – and it was, without question.

And inflation will continue to be a factor, high on the agenda of the Governors of the US Federal Reserve, the power-that-be at the **E**uropean **C**entral **B**ank (ECB), and the Governors of The Bank of England.

As for the US housing situation, it has deteriorated much further than most people expected; there is no need to harp on that subject because it has been relegated to history.

Turning to Point Number 3, above, only last Tuesday, Bank of America Corporation and Wachovia Corporation, the second-largest and fourth-largest banks in the US, respectively, announced falls in their Bottom Lines in their respective final quarters of 2007, ended December 31, of 95 percent and 98 percent, Year-On-Year.

The number of other banks and financial institutions that have had to bite their proverbial bullets, as **TARGET** put it on August 1, 2007, are too numerous to publish in this report.

Turning to the events of the first 2 days of this week, all of the international equity markets of the world suffered huge losses in their key indices, with estimates of more than $US5 trillion, having been wiped off the market capitalisations of companies, from Wellington, New Zealand, to New York, to London, England, to Tokyo, Japan, to all points east and west.

Last Tuesday, the US Federal Reserve, in what were, clearly, panic stations for most of the Governors, announced a 0.75-percent cut in interest rates, the largest single, interest-rate reduction of the past 25 years.

The previous Friday (January 18, 2008), US President George W. Bush announced to Congress that he was proposing an emergency programme of tax incentives, tax rebates and what-have-you, all of which would pump about $US150 billion into the US economy.

The idea of this cash injection was to try to stem the tide which could lead to a recession and which, in turn, could lead to another depression, similar to the situation that existed in 1929 and lasted until 1939.

**The Near Future**

As **TARGET** sees the situation, today, the near future is not very pretty.

To be trite and to misquote the little, well-known, nursery rhyme: All of the US President's horses and all of the US President's men are unlikely to be able to put the US economy back on the road to prosperity in a hurry, again.

To begin with, the growth of the US economy is slowing, grinding down, appreciably, and, as things stand, today, it will continue to grind down.

Unemployment is, already, standing at about 5 percent.

It will, most likely, rise again as companies cut back Establishment Levels in order to try to improve profit margins and, in some cases, just to allow ends to meet.

In the final quarter of 2007, ended December 31, the rate of growth in the US slowed to such an extent that it sent shock waves through the US economy.

This resulted in the key indices of US equity markets to fall, quickly.

But few people seemed to take the economic slowdown very seriously, thinking, most likely, that the situation would reverse itself without any required financial stimulus from the powers-that-be at The Fed or in Government.

The case for easing monetary constraints has been greatly strengthened of late by the disruption in global credit markets – last Tuesday's interest-rate cut in the US, as a classic example – and, as such, this foreshadows as an omen for the largest, single-economy of the world.

What touched off the current situation was, inter alia, the violent disruption in the US credit and money markets, which had been brought about by the rapid deterioration in the US, subprime housing market.

But this was well known more than 17 months ago, as **TARGET** published – but the US Government and The Fed sat on their hands.

As far back as the middle of 2006, **TARGET** noted the increasing requirements for the inclusion of greater and greater provisions in the accounts of banks and finance houses in the US.

In acts of obvious desperation, many US banks and finance houses bundled potential bad debts into the acronym, called *'structured credit products'*, later to be termed, popularly, as **C**ollateralised **D**ebt **O**bligations (CDO's).

These CDO's introduced opacity and uncertainty into both the distribution and the scale of the losses that confronted the issuers of those products.

When the penny dropped, so to speak, it was a little too late – as The Fed has, recently, realised.

The turmoil, which is the result of a complete lack of nous and perspicaciousness on the part of those who could have ameliorated the current situation, prior to it reaching the crisis proportions of today, underlined the importance of liquidity and managing and regulating banks and finance houses.

Also, there is the question of valuations and ratings of structured credit products as well as the excessive weight that has been given to them, not by just the ignorant and innocent, the naive and unwary, but by some of the most sophisticated people of the financial markets of the world.

Then, there is the fact that, over the past few years, one has seen the originators of structured credit products – CDOs and the like – concentrating on quantity rather than quality, and the adverse effects that followed in the wake of these products, hitting the marketplaces of the world.

As a direct result of that, and other situations of the past 17 months or so, many banks are, today, illiquid.

Look at Northern Rock plc of Great Britain and the fact The Bank of England had to bail it out.

The problems of the subprime, mortgage-lending industry, internationally, will not go away in a hurry: Their effects are quite likely to be felt for at least another year.

And the fallout from this situation is unlikely to be very pretty.

Further, there is a probability that there is a high risk of reignition of the difficult situation on the money markets that was seen in December 2007 when many of the world's central banks had to stand up to promise to assist banks and finance houses with buckets of cash.

The problems with many banks of the Western World were that they lent too much money at interest rates that, in retrospect, were, clearly, too cheap.

As a result, these same banks are, today, suffering from increasingly high levels of defaults and/or late payments, stretching the banks' liquidity to breaking point in many cases.

Adding to the problems of banks is the fact that, as the US economy grinds down, it comes to mean a marked diminution of exports from trading partners to the largest and most-important economy of the world, thus exacerbating the situation, worldwide.

What has to be determined, at this point, is the effect of credit constraints and the impact it will have on the current situation -- and on expectations of confidence.

Confidence in the US has been badly bruised of late, as statistics have proved.

In respect of US consumer confidence, it is noted that many consumers are engaged in financial self-regulation, cutting back on spending, quite dramatically.

These consumers, obviously, are very concerned; and rightly, too.

The availability of extended credit is likely to be reduced, further, over the coming months, as more and more banks and finance houses become suspicious of prospective borrowers who come knocking at their doors.

Banks are being especially picky about to whom they want to lend money, the interest rate that they will charge; and, more often than not, these bank are turning away anybody who remotely is suggestive of a risk, regardless of the extent of that risk.

Credit-impaired borrowers, it seems, need not apply for loans.

This will have a knock-on effect on the property markets of the US and Europe, no doubt, although in many parts of Asia, there will be little impact because of the investing philosophy of Asian investors.

Having said that, there must be a fallout in respect of investors of Asia, who have been in the habit of overtrading, during the past few years.

One thing appears to be very clear: A tightening of credit conditions in the West will be exacerbated by a further weakening in the financial position of banks which are beset by a slowdown in the economy of the US.

Hence, the US President's suggestion of pumping $US150 billion into the economy, as well as The Fed's 0.75-percent, interest-rate reduction of last Tuesday.

It will take the US Government the best part of a month before Congress will endorse the President's plan (assuming that it passes) and, then, it will take another month or so before any part of that $US150 billion will enter the economy.

Then, of course, the question is whether or not US consumers will spend the money that they receive, directly or indirectly, or will the money be used to pay the milkman, the butcher, the baker, and down the line to other creditors?

Due to the widespread uncertainty in respect of the US economy, it is likely that households will become increasingly cautious with any money that they will receive from whatever source, leading to corporate America, postponing investments for fear of making wrong decisions and suffering the financial consequences.

A marked reduction in consumer confidence, brought about by questions of future growth in the US economy, will, eventually, lead to lower consumption, leading to industry, cutting back on investments.

As commercial property prices decline, it will impact on balance sheets and this, again, will affect determinations of corporations to spend, especially in a climate of higher interest rates – assuming that money is made available to these corporations, of course.

**Conclusion:**

Every economy of the world, today, has experienced very major financial shocks, of late.

These shocks have hit banks, especially.

Discomfort will be felt by these banks for some time to come, no doubt.

Tighter credit constraints will weaken consumer confidence in the West, regardless of the actions of the US Government.

The risk of continued downside risk to economic growth is high.

Cash will be king in these troubled times.

As **TARGET** has said, repeatedly in the past: Keep your knees, tightly together; and, keep your powder dry!

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