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WHAT THE WALL STREET GURUS MISSED

Wall Street gurus, as is their wont, smelt the flowers, listened to the songs of the thrushes, bathed in the warmth of the sun, and, then, remarked on how wonderful was the weather and the ambiance of the entire scene – while the first strong winds of a hurricane approached, threatening to destroy the entire garden.

This, in a nutshell, was akin to the reaction to the well-crafted speech of the most-celebrated economist of this period – Dr Ben S. Bernanke – who delivered his thoughts to the members and guests of the Economic Club of New York, last Monday.

The gurus of Wall Street, almost in unison, stentoriously advocated to anybody who would listen to them to buy stocks and shares on The New York Stock Exchange and The NASDAQ because, at the end of Dr Ben S. Bernanke's speech, he said:

> *'The Federal Open Market Committee continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.'*

Dr Ben S. Bernanke, who is the Chairman of the US Federal Reserve, said much, much more than the above one sentence.

The gurus, however, were not very interested in his acute observations or, it seemed, his prognosis and prognostications for the coming year or so – because the gurus were only interested in the here and the now.

It was as though the gurus of Wall Street were telling their existing clients and prospective ninnies: *'Don't look at the colour of the material, just feel its texture… and put your faith in us.'*

Inter alia, that which the Wall Street gurus missed was almost a caste-iron promise from The Fed that interest rates would stay at next to zero for the next year, at least, and, perhaps, for more than 2 years.

For Wall Street gurus to be able to extract that important piece of intelligence from the speech of Dr Ben S. Bernanke of last Monday, they would have had to have been imbued with a little more than the brain of pigeons.

For most of them, **TARGET** () has noted, over the past few years, there is a dire shortage of grey matter.

On scanning the speech of the head of The Fed, the following excerpts appear to be crucial in order to understand the nuances, delivered by this very learned economist:

Paragraph 2

> *'Today, financial conditions are considerably better than they were then* (about one year earlier), *but significant economic challenges remain. The flow of credit remains constrained, economic activity weak, and unemployment much too high. Future setbacks are possible ...*
>
> *'… I think it is fair to say that policymakers' forceful actions last fall, and others that*

followed, were instrumental in bringing our financial system and our economy back from the brink…'.

Paragraph 3

'How the economy will evolve in 2010 and beyond is less certain …'.

Paragraph 4

'My own view is that the recent pickup reflects more than purely temporary factors and that continued growth next year is likely. However, some important headwinds--in particular, constrained bank lending and a weak job market--likely will prevent the expansion from being as robust as we would hope…'.

Paragraph 8

'However, access to credit remains strained for borrowers who are particularly dependent on banks, such as households and small businesses. Bank lending has contracted sharply this year, and the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices shows that banks continue to tighten the terms on which they extend credit for most kinds of loans--although recently the pace of tightening has slowed somewhat. Partly as a result of these pressures, household debt has declined in recent quarters for the first time since 1951. For their part, many small businesses have seen their bank credit lines reduced or eliminated, or they have been able to obtain credit only on significantly more restrictive terms.[2] The fraction of small businesses reporting difficulty in obtaining credit is near a record high, and many of these businesses expect credit conditions to tighten further.'

Paragraph 9

'The demand for credit also has fallen significantly: For example, households are spending less than they did last year on big-ticket durable goods typically purchased with credit, and businesses are reducing investment outlays and thus have less need to borrow…'.

Paragraph 13

'While I am on the topic of bank lending, I would like to add a few words about commercial real estate (CRE). Demand for commercial property has dropped as the economy has weakened, leading to significant declines in property values, increased vacancy rates, and falling rents. These poor fundamentals have caused a sharp deterioration in the credit quality of CRE loans on banks' books and of the loans that back commercial mortgage-backed securities (CMBS)…

'With nearly $500 billion of CRE loans scheduled to mature annually over the next few years, the performance of this sector depends critically on the ability of borrowers to refinance many of those loans. Especially if CMBS financing remains unavailable, banks will face the tough decision of whether to roll over maturing debt or to foreclose.'

Paragraph 15

'In addition to constrained bank lending, a second area of great concern is the job market. Since December 2007, the U.S. economy has lost, on net, about 8 million private-sector jobs, and the unemployment rate has risen from less than 5 percent to more than 10 percent. Both the decline in jobs and the increase in the unemployment rate have been more severe than in any other recession since World War II ...'.

Paragraph 16

‘ Besides cutting jobs, many employers have reduced hours for the workers they have retained …’.

Paragraph 17

‘With the job market so weak, businesses have been able to find or retain all the workers they need with minimal wage increases, or even with wage cuts. Indeed, standard measures of wages show significant slowing in wage gains over the past year. Together with the reduction in hours worked, slower wage growth has led to stagnation in labor income. Weak income growth, should it persist, will restrain household spending …’.

Paragraph 18

‘The best thing we can say about the labor market right now is that it may be getting worse more slowly. Declines in payroll employment over the past four months have averaged about 220,000 per month, compared with 560,000 per month over the first half of this year. The number of initial claims for unemployment insurance is well off its high of last spring, but claims still have not fallen to ranges consistent with rising employment.’

Paragraph 25

‘I expect moderate economic growth to continue next year …’.

Paragraph 27

‘Jobs are likely to remain scarce for some time, keeping households cautious about spending …’.

Putting It All Together

In **TARGET**’s view, that which appears to be implicit in the speech of Dr Ben S. Bernanke is that there is a strong probability that, in addition to low interest rates – probably at zero percent or a few basis points higher –there will be another stimulus package, forthcoming.

In fact, it would not surprise this medium to learn that one has, already, been drafted and that the Administration of President Barack Hussein Obama is prepared to push the green button for *‘Go!’*

Also, it is very clear that consumer spending in the US will not increase in a hurry due to the fact that there is so much uncertainty with regard to the here and the now, the near-term future, going into 2010, and right up to 2011.

Unemployment in the US is a matter that must be tackled as a matter of urgency because, in the words of Isaac Watts (1674 – 1748):

‘In works of labour or of skill,
I would be busy too:
For Satan finds some mischief still
For idle hands to do.’

In addition, if willing workers are not gainfully employed, as Dr Ben S. Bernanke has intimated, household spending will be restrained until people are able to find employment.

The longer that this situation persists, the weaker grows the economy.

Consumer spending accounts for about 66 percent of the **G**ross **D**omestic **P**roduct (**GDP**) of the US so that continued weak growth in consumer spending must, inevitably, lead to an economy in stagnation.

GDP =
The total value of all goods and services produced within a country in a year, minus net income from investments in other countries.

The matter of bank lending in the US is another thorny issue for The Fed because banks are loathly to loosen their purse strings at this time, especially when there are important questions as to the creditworthiness of applicants, seeking loans.

Property prices in the US, both in the residential and commercial sectors, are low, relative to the period, prior to December of 2007 and, in most cases, the current prices are below cost.

Further, prices of property, generally, are tending to sink to even lower levels.

With consumer spending, far from being robust, investors, locked into commercial properties, are having difficulty in meeting debt service.

This situation is unlikely, in the next year or so, to be ameliorated, very much.

With the expiry of agreements in respect of some $US500-billion worth of commercial, real-estate loans in 2010, many of which will have to be refinanced in that year, and with the expiry of agreements of another $US500-billion worth of commercial real-estate loans, many of which will have to be refinanced in 2011, without a change in the economic fundamentals in the US, it could be disastrous for the largest single economy of the world.

It is a fiasco, waiting to happen.

The Fed knows this.

Thus far, little has been said or written about the commercial sector of the economy.

Well, now it has been said.

Banks do not want to repossess part or all of distressed shopping malls or large-scale commercial properties in the country, but, at the current rate, that is, exactly, what is likely to transpire.

The Fed is well aware of this situation and is working to find a solution to the problem.

If that were not the case, then Dr Ben S. Bernanke would not have made mention of this matter in his speech to the Economic Club of New York, last Monday.

Only last Wednesday, The US Department of Commerce announced, inter alia:

> ***'BUILDING PERMITS***
>
> *'Privately-owned housing units authorized by building permits in October were at a seasonally adjusted annual rate of 552,000. This is 4.0 percent (±1.9%) below the revised September rate of 575,000 and is 24.3 percent (±1.9%) below the October 2008 estimate of 729,000.*
>
> *'Single-family authorizations in October were at a rate of 451,000; this is 0.2 percent (±1.0%) below the revised September figure of 452,000. Authorizations of units in buildings with five units or more were at a rate of 85,000 in October.*

'HOUSING STARTS

'Privately-owned housing starts in October were at a seasonally adjusted annual rate of 529,000. This is 10.6 percent (±8.7%) below the revised September estimate of 592,000 and is 30.7 percent (±8.3%) below the October 2008 rate of 763,000.

'Single-family housing starts in October were at a rate of 476,000; this is 6.8 percent (±7.5%) below the revised September figure of 511,000. The October rate for units in buildings with five units or more was 48,000.

'HOUSING COMPLETIONS

'Privately-owned housing completions in October were at a seasonally adjusted annual rate of 740,000. This is 1.9 percent (±12.4%) above the revised September estimate of 726,000, but is 29.9 percent (±9.7%) below the October 2008 rate of 1,055,000.

'Single-family housing completions in October were at a rate of 528,000; this is 10.7 percent (±14.5%) above the revised September figure of 477,000. The October rate for units in buildings with five units or more was 200,000.'

It would have been unthinkable to this medium that Dr Ben S. Bernanke did not know and appreciate the importance of the above intelligence, long before the release of the above-mentioned.

The short answer to the many problems, facing the US, is, of course, to seduce consumers to return to High Street shops.

In order to accomplish this, jobs must be created and wages, paid to workers, must be sufficiently high to allow consumer spending to rise, materially.

Ergo: Interest rates will remain at their present, historically low levels, and, if push comes to shove, The Fed will, with the approval of the Obama Administration, push that green button to unleash another stimulus package in order to resuscitate the economy once again.

All of the above and more was clearly spelled out, implicitly and explicitly, in the speech by the Chairman of The Fed of last Monday, but insightfulness is necessary on the part of Wall Street gurus in order for them to understand the implications, to the man in the street, of that which Dr Ben S. Bernanke was stating to the members and guests of that prestigious New York club.

The problem for many Wall Street gurus is that they do not even know the meaning of insightfulness, let alone spell the word.

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