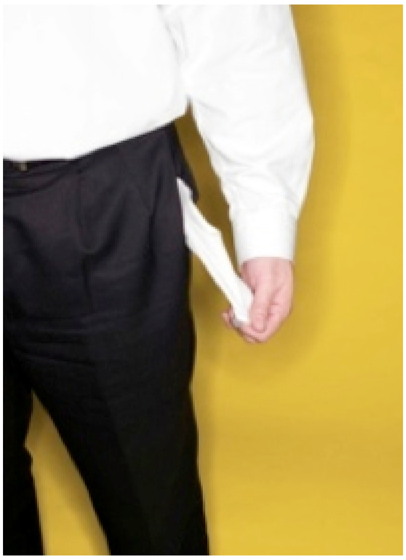
Recession "Double-Dip" Coming?



In spite of forecasts by some commentators of an improving economy, several factors point to a coming, even worse, "double-dip" recession: false government statistics that hide the real unemployment rate of 22 percent; the coming defaults of ARM loans; plummeting commercial real estate values; and, the ripple effect the declining real estate market will have on all other areas of the economy.

If Will Rogers didn't say "Those who don't read the papers are uninformed; those who do are misinformed," he probably should have.

Witness this headline from The *Wall Street Journal*: "Jobs, Spending Bode Well for Growth."

Compare that headline to this one from Bloomberg: "Orders for Durable Goods in U. S. Unexpectedly Fall".

Or to this from APNews: "Jobless claims off, spending up in sign of rebound."

Finally, to confound the confusion, see this from the *Denver Post*: "Good news raises hopes that recovery won't fizzle."

How does one make any sense of it all? Dr. Kenneth McFarland (named America's Number One Public Speaker by the U.S. Chamber of Commerce in 1965) once quipped that he had read so much about the harmful effects of tobacco and alcohol that he just decided to give up reading!

There is another option: dig deeper.

Since the foundation of any sound economy is real people producing real things, let's look first at the "real people producing" part of the equation.

According to the Associated Press, the economy has lost nearly 7 ½ million jobs since the recession started (officially) in December of 2007. This puts the unemployment rate at a little over 10 percent, or one in 10 workers without work.

Oscar Gonzalez, an economist at John Hancock, says: "The labor market remains quite weak. That, to me, is what will really affect how consumers behave in the coming months and how the recovery fares" Granting the point that one must first produce in order to be able to consume, how "real" is that 10 percent number?

Not very, as it turns out.

According to CNBC.com, 17.5 percent are actually unemployed.

Why the difference? It depends on who is doing the counting, and how they count. CNBC.com explains: "The difference [between 10 percent and 17 percent] is that what is traditionally referred to as the 'unemployment rate" only measures those out of work who are still looking for jobs.... [The higher rate includes] discouraged workers who have quit trying to find a job, as well as those working part-time but looking for full-time work or who are otherwise underemployed."

However, another group of "discouraged workers" (defined away during the Clinton administration) isn't included in that 17 percent number. According to Shadow Government Statistics, the most accurate unemployment number is over 22 percent, or more than one in five.

Now for the "producing real things" part of the equation.

The National Association for Business Economists (NABE) projects economic growth of 3.2 percent (annualized) in the fourth quarter of 2009.

But this was just recently revised downward to 2.8 percent (annualized).

And expressions of pessimism are rampant:

Rupert Murdoch, News Corp CEO (and Council on Foreign Relations member), says this about any economic revival: "I think it's an L-shaped revival. You've got a huge number of unemployed here in the U.S. today, and we won't get that cured or those people re-employed until we get the formation of small business on a big scale."

He goes on to say that he has a "real suspicion that we have a president who doesn't believe in the market system." And that will continue to dampen any enthusiasm about starting a new business: "They will sit on their hands and wait".

San Francisco Federal Reserve President Janet Yellen confirms Murdoch's expectations: "The durability of the expansion is in question. Some of the rebound is due to temporary government programs … that will not provide an ongoing source of growth."

Initial conclusions:

More people are out of work than is reported.

Government stimuli, if they work at all, work only feebly, and temporarily.

The real engine of economic growth, small business, is stalled and not likely to pick up in the near future.

Actual production of real goods isn't increasing.

But wait! There's more!

There are three "headwinds" in front of the recovery that have received scant attention in the kept press:

1) Alt-A and Option ARM loan defaults;

2) Commercial real estate declines and the impact on tax revenuess; and

3) The ripple effect of the decline in real estate activity.

Alt-A and Option ARM Loan Defaults

In the October 26th issue of Agora Financial's 5 Minute Forecast, the Second Wave of "adjustable rate mortgage resets is just around the corner".

Alt-A and Option ARM loans are an especially interesting and seductive way of providing financing to people to buy a home who can't afford it. Mortgage payments are selected at a "convenient" level for the mortgage holder, usually “interest only” with a “reset” some time in the future. The reset begins the process of amortization of the mortgage itself. However, in many cases, payments were made at less than interest only levels, with the difference added back to the principal.

Here’s an (admittedly simple) example. A buyer purchases a home for $200,000. The mortgage (for simplicity’s sake) is also $200,000. At 6 percent interest, the minimum, interest-only monthly mortgage payment would be $1,000. Plus taxes and insurance. At reset, the mortgage moves to, say, a 30-year amortization schedule, with payments of perhaps $1,650 a month. Plus taxes and insurance.

So far, so good. By itself this can cause substantial problems for the homeowner, especially one who has just recently been laid off, and is now looking for work and just scraping by on unemployment.

But let’s assume that the buyer “opted” to pay only $200 a month. That means that $800 a month is being added to his $200,000 principal. If the mortgage “resets” in three years, that additional negative amortization has added almost $30,000 to his mortgage balance. At reset, his mortgage payment is over $2,000 a month.

And his house is worth $150,000 (or less).

What would you do?

Right: front door keys in envelopes stuffed into the mail slot at the bank, “midnight movers” pack up the furniture and “Ciao, baby!”

Back to Agora, if you haven’t already clicked on the URL above: This new wave of “resets” will equal, if not exceed, the resets that crushed the housing market in 2007 and 2008.

Commercial Real Estate Declines and the Impact on Tax Revenues

In San Francisco, commercial property values have declined by at least 50 percent in the last two years.

“Commercial values are just plummeting; this real estate market is a disaster,” says Oz Erickson, chairman of the Emerald Fund, a San Francisco real estate developer.

Bob Gilly, executive VP at CB Richard Ellis, put it this way: “To paint it with a broad brush, properties today are down 50% from the peak (in late 2007)”.

What’s the impact on tax revenues? With over 1,000 commercial properties appealing their assessed values, the city could suffer a potential tax hit of more than $100 million. Add in residential property tax appeals, and the number jumps to $130 million. And this at a time when the state of California’s deficit is expected to reach $500 million.

As Gary North so eloquently put it: “Commercial real estate is the next shoe to drop.”

The ripple effect of the decline in real estate activity

Michael Pento is the chief economist at Delta Global Advisors. He says, “There is no easy solution here. Unless you create [another] bubble in which the economy can create [more false] jobs, then you’re not going to have growth. That’s the sad truth. In the earlier part of this decade, 40 percent of all new jobs created were in real estate: attorneys, mortgage brokers, agents, construction — they were all circled around housing.”

No longer.

George Soros (billionaire investor and Council on Foreign Relations member) believes: “In commercial real estate and leveraged buyouts, the bloodletting is yet to come.” He adds [that the global economic recovery is] liable to run out of steam." He further reckons that a "double dip" recession may emerge in 2011.

The Solution

Free market economist Henry Hazlitt, in his book *Man vs. the Welfare State*, states the solution to these challenges with these words:

> The solution to our problems is not more paternalism, laws, decrees, and controls, but the restoration of liberty and free enterprise, the restoration of incentives, to let loose the tremendous constructive energies of 200 million Americans.

In other words, he says, stop the remedies!