What the Shrinking GDP Means

The immediate impact of the news is that stocks tumbled to new 12-year lows, with the Dow Jones Industrial Average threatening to go under 7,000 for the first time since early 1997 and less than half the October 2007 high of 14,164.53.

The decline of the stock market since 2007 is proof that the business world has already recognized the damage done to the economy by the federal government's financial policies, where the Federal Reserve Bank suppressed the interest rates, the federally chartered Fannie Mae/Freddie Mac lowered housing loan standards and the Bush administration spiked federal deficit spending.

Even the *New York Times* — hardly a harsh Obama critic — is sensing that the record spending programs are not helping the economic situation. The *Times* noted on February 28 that during the last quarter of 2008 "every major component of the economy shrank, except government spending." A day earlier, the same newspaper reported that "the economy is spiraling down at an accelerating pace, threatening to undermine the Obama administration's spending plans, which anticipate vigorous rates of growth in years to come." The *Times* conceded there was a "sense of disconnect between the projections by the White House and the grim realities" of the economy.

That's an understatement. Obama's budget pledge to cut the annual deficit to the still-astronomical figure of $533 billion by 2013 assumes unrealistically rosy economic conditions, including a booming annual growth rate of four percent or more for 2011-2103.

But the disconnect goes even further. Despite repeated protestations not to follow "the same failed ideas that got us into this mess in the first place," the Obama administration wants to plunge ahead by further accelerating the Bush spending policies. "I think it underscores the urgency with which the president feels we have to move to improve our economy," White House spokesman Robert Gibbs told Reuters wire service February 27.

The downward spiral of the GDP means that tax revenue to the federal government will decline more sharply than in Obama's forecasts, increasing the deficit. The crashing economy will also increase unemployment more sharply, which in turn will increase demand for unemployment benefits, food stamps, and other welfare programs. That will spike government spending beyond Obama's projections, increasing the deficit further.

The irony is that the crashing economy has worked well with the federal government's deficit spending policies thus far. Investors have retreated from the stock market to buy municipal bonds and federal government debt. "It's the only borrower that people feel comfortable lending to at the moment," Nigel Gault, chief U.S. economist for IHS Global Insight, told the *Los Angeles Times*. But that won't last forever.

The question is, with the U.S. government continuing to pile up record deficits and issuing record debt, how long will investors channel their money into Treasury bills and facilitate the federal government's spending spree? The answer is not much longer than after the stock market hits bottom. The federal government will have to issue $2.5 trillion in debt this year, between recirculation of existing debt and the nearly $2 trillion in new debt. If Obama's plan to issue trillions in new debt every year succeeds in winning investors on Wall Street, those investors will impoverish the private investment needed from Wall Street to generate an economic recovery. When the bear market eventually ends, investors will dump federal debt for stocks again — even as the Obama administration tries to issue record new debt.

That means President Obama's spending spree will be stressed: he will face the choice of either paying astronomical rates of interest for federal debt (which have already spiked) or inflating the currency in order to continue the current spending bender.

Of course, wild inflation or exorbitant interest rates for federal debt could spook stock market investors again, creating another bear market and another economic downward spiral.

What the falling GDP means, in conjunction with Obama's more militant commitment to increase deficit spending, is that the American economy is spiraling down toward a severe depression. The only hope of not repeating a 1930s-style depression is for the federal government to cut spending and balance the budget. And with the rhetoric coming out of Washington right now, that doesn't seem a likely event any time soon.