

<u>Date</u>	<u>Indicator</u>	<u>For</u>	<u>Estimate</u>	<u>Consensus*</u>	<u>Previous Period</u>
Dec. 15	Empire Manufacturing	December	-25.0	-25.0	-25.4
Dec. 15	Industrial Production	November	-0.5%	-0.5%	1.3%
Dec. 15	Capacity Utilization	November	75.9%	76.0%	76.4%
Dec. 15	NAHB/Wells Fargo Housing Index	December	10.0	NA	9.0
Dec. 16	CPI	November	-1.2%	-1.0%	-1.0%
Dec. 16	Housing Starts	November	730K	745K	791K
Dec. 16	Building Permits	November	700K	NA	730K
Dec. 16	FOMC Meeting		0.50%	0.50%	1.00%
Dec. 17	Current Account Deficit	Q3	-\$178.4B	-\$179.6B	-\$183.1B
Dec. 18	Initial Jobless Claims	Dec. 13	550K	NA	573K
Dec. 18	Philadelphia Fed Manufacturing Index	December	-39.0	-38.3	-39.3
Dec. 18	Leading Economic Indicators	November	UNCH	-0.5%	-0.8%

*Consensus from Action Economics

The U.S. Economy May Be in a “Liquidity Trap” but I Am Concerned with the “Machiavellian Trap”

Much has recently been said about the inability of monetary policy to produce a recovery in economic activity, a situation economists call a “liquidity trap,” i.e., very low interest rates (close to zero percent) but with no effect on any of the important economic variables, like consumption or investment, etc. This “liquidity trap” is one of central bankers’ biggest fears, and together with deflation, one of the most difficult situations to be in, because there is no easy way out from this trap.

However, while we are close to such a liquidity trap, monetary policy still has some more ammunition. And this ammunition has nothing to do with injecting more money into the U.S. economy. The Bernanke Federal Reserve has been extremely “innovative,” to say the least, in this regard.

What monetary policymakers need to be doing nowadays is preventing speculation on potential pseudo-proposals that are affecting the U.S. economy. Yes, I am talking about an active speaking-out policy that will end speculation on such ideas as the most recent one: “the Federal Reserve is planning to target mortgage interest rates at 4.5%,” an idea that has gained momentum during the last several weeks.

Why, you would ask, am I opposed to the Fed targeting mortgage interest rates at 4.5%? There are several very good reasons for my opposition to this idea, but the most important one is the following: if you are a potential home buyer interested in purchasing a home with a mortgage interest rate of 5.7% on a fixed 30-year mortgage, would you go ahead with the purchase of that home if you hear somebody saying that the government is planning to offer 30-year mortgages at an interest rate of 4.5%? Of course not! In fact, this speculation is plain and simply delaying a recovery in the U.S. housing market. This speculation has a similar effect to the speculation that the government is going to come to the rescue of all of those who made terrible investment decisions; it is just making things worse, not better.

Thus, what I am proposing is for the Federal Reserve governors and Chairman to go out to the media and, if needed, scream to all that would like to hear that this speculation is completely absurd and that the Federal Reserve will never target mortgage interest rates as a way to solve the U.S. housing crisis. Otherwise, the U.S. housing market is not going to recover any time soon! This is part of what is called “monetary policy.” Monetary policy is not only concerned with increasing or decreasing the amount of money in the economy. Monetary policy is also responsible for having a handle on all the regulation and all the oversight of what happens in the U.S. financial sector, because the stability of the financial sector is one of the most important roles and objectives of the Federal Reserve. And we all know how bad that institution failed in fulfilling this objective lately!

Thus, in order to fix the systemic risk we are facing today, the Federal Reserve has to enforce its role as the financial regulator. It has to come out forcefully to establish itself as an institution that is really concerned with the stability of the U.S. financial system. And stopping this speculation in its tracks is a first step to solving today's financial problems.

A second reason why I am opposed to the idea of targeting mortgage rates at 4.5% is because this is what we tried to do during the period heading into this collapse. The financial services industry came up with mortgage instruments that, with the tacit support of the Federal Reserve and of the federal government, pushed short-term mortgage interest rates so low that it allowed sectors of the population that were not capable of paying a higher interest rate to buy into the American homeownership dream. But those products were basically sold under the false pretense that either interest rates will always go lower and/or that home prices will always go higher, something that everybody knew was incorrect, especially those in charge of regulation, yet everyone was willing to look the other way. That is, once again in the history of human kind, the Machiavellian premise that the "ends justifies the means" trumped all other more common sense considerations.

Thus, while monetary policy may be suffering from a liquidity trap, my biggest concern is that today's monetary policymakers are actually facing what I call a "Machiavellian Trap," that is, the inability to regulate the financial system in order to prevent a repetition of what happened during the last several years, which translates to "the end justifies the means," that is, sell homes to everybody irrespective of their ability to pay.

Is the Failure of the Auto Bailout a Repeat of the Original TARP Project?

I remember the day when the U.S. Congress failed to pass the original TARP project as if it was yesterday. I was just getting on a plane when, using my mobile device, I got into the internet and watched, incredulously, the events unfold: The stock market was plunging by more than 600 points and politicians on both sides of the isle were blaming each other for it.

On Thursday night, December 11, I learned that the U.S. Senate failed to approve the U.S. House of Representatives' bailout of the "Detroit-3" to much of the dismay of many that had originally thought this outcome was almost impossible. Never underestimate a Lame-Duck Congress! Thus, immediately after the news came out, U.S. Treasuries started to rise and its yield dropped as investors across the world rushed to those instruments in another flight-to-quality stampede. Even though market participants may disagree on the benefits or costs of such a bailout, markets don't like surprises and definitely dislike the uncertainty that these surprises create. And the consequences of this failure are very difficult to measure.

Immediately after the Senate failed to pass the bailout, speculation began that the Bush administration will move to Plan B, which seems to be the original plan put forward by the Democrats, which was to use the TARP funds to bail out the automakers instead of using the monies that had originally been allocated for investments in "green" technologies within the U.S. auto sector. Thus, we may have a bailout of the U.S. auto manufacturers. However, what markets will lack will be the confidence in the U.S. political system, which adds to the already thin trust in the U.S. financial system and its regulatory environment.

Major Economic Indicators

December 12, 2008

Economic Data	History								Forecast				Q4 to Q4 % Chg or Annual Average			
	2007.1	2007.2	2007.3	2007.4	2008.1	2008.2	2008.3	2008.4	2009.1	2009.2	2009.3	2009.4	2006	2007	2008	2009
Real GDP*	0.1	4.8	4.8	-0.2	0.9	2.8	-0.5	-6.3	-4.2	-0.9	1.2	1.6	2.4	2.3	-0.8	-0.6
Personal Consumption Expenditures*	3.9	2.0	2.0	1.0	0.9	1.2	-3.7	-4.3	-3.0	-1.5	1.4	1.4	3.2	2.2	-1.5	-0.4
Private Housing Starts (000s units)	1,453	1,460	1,298	1,151	1,053	1,025	879	807	752	834	929	962	2,073	1,341	941	869
Vehicle Sales (mill. Units, annualized)	16.4	16.0	15.9	16.1	15.2	14.1	12.9	10.3	10.7	10.9	11.2	11.6	16.5	16.1	13.1	11.1
Nonfarm Payroll Employment (mil.)	137.2	137.5	137.8	138.0	137.9	137.7	137.4	136.2	134.9	133.8	133.0	132.5	136.1	137.6	137.3	133.6
Unemployment rate	4.5	4.5	4.6	4.7	4.9	5.3	6.0	6.8	7.5	8.0	8.5	8.8	4.6	4.6	5.8	8.2
CPI* (percent)	3.7	4.6	2.8	5.0	4.3	5.0	6.7	-7.2	-1.7	0.6	1.1	0.9	1.9	4.0	2.2	0.2
PPI* (percent)	7.6	8.8	1.6	9.1	9.2	10.6	8.6	-18.8	-6.3	-1.0	1.0	0.2	0.3	6.7	2.2	-1.5
Compensation Per Hour*	6.4	1.3	3.3	4.6	3.8	0.9	4.1	5.4	3.6	2.4	1.9	1.8	5.0	3.6	3.6	2.4
Productivity*	1.3	2.7	6.0	1.8	2.6	3.6	1.3	-0.5	-0.2	3.0	3.7	2.8	0.8	2.7	1.8	2.3

*Quarterly Data Percent Change At Annual rate; Annual Data Q4 to Q4 % Chg.

Financial Data	History								Month-to-Date	Current	Forecast (monthly)							
	2008.06	2008.07	2008.08	2008.09	2008.10	2008.11	2008.12	12/12/2008	2009.01	2009.02	2009.03	2009.04	2009.05	2009.06	2009.07	2009.08		
S & P 500	1,341	1,258	1,281	1,220	969	883	869	862										
Dow Jones Industrial Average	12,057	11,321	11,531	11,134	9,177	8,620	8,558	8,453										
NASDAQ	2,427	2,277	2,389	2,213	1,730	1,542	1,499	1,506										
Federal Funds Rate	1.82	1.87	1.76	1.26	0.63	0.42	0.16	0.13	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50		
Treasury-3 Month Bills (yield)	1.89	1.66	1.75	1.17	0.67	0.19	0.03	0.01	0.05	0.15	0.20	0.25	0.25	0.30	0.35	0.35		
Treasury-10 Year Notes (yield)	4.10	4.01	3.89	3.69	3.82	3.51	2.67	2.64	2.70	2.80	2.90	2.90	2.90	2.90	2.93	2.93		
Prime Rate	5.00	5.00	5.00	5.00	4.54	4.00	4.00	4.00	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50		
Libor 3-Mo. U.S. Dollar	2.77	2.79	2.81	3.12	4.06	2.28	2.22	1.92	1.90	1.85	1.85	1.85	1.70	1.70	1.70	1.70		
Mortgage-15 Year (yield)	5.86	5.96	6.05	5.67	5.85	5.86	5.43	5.20	5.05	5.15	5.25	5.25	5.25	5.25	5.28	5.28		
Mortgage-Adjustable (yield)	5.15	5.24	5.25	5.16	5.18	5.29	5.08	5.09	4.90	5.00	5.10	5.10	5.10	5.10	5.13	5.13		
Mortgage-30 Year (yield)	6.27	6.41	6.50	6.08	6.16	6.16	5.65	5.47	5.30	5.40	5.50	5.50	5.50	5.50	5.53	5.53		
GNMA (yield)	4.96	4.94	4.93	4.84	5.35	5.91	5.89	5.87	5.15	5.25	5.35	5.35	5.35	5.35	5.38	5.38		
BAA Corporate (yield)	7.07	7.15	7.15	7.30	8.87	9.20	8.75	8.70	8.40	8.50	8.60	8.60	8.60	8.60	8.63	8.63		

Source: Wells Fargo Economics, Macroeconomic Advisers, Bloomberg, Federal Reserve