

Greg Valliere: The Economy will Grow in Second Half of 2009

Robert Huebscher
January 20, 2009

Greg Valliere, Chief Political Strategist at the Stanford Group and frequent contributor to CNBC, unabashedly admits he is an optimist. Speaking to a group of over 100 wealth managers at the Fortigent Winter Forum on January 16, Valliere said he expects the economy to recover by mid-2009, with positive GDP growth over the second half of the year.



Shrinking yield spreads, surges in mortgage refinance applications, and lower energy prices all bode well for a sooner-than-expected turnaround, Valliere said.

“This is a great time to be the incoming President,” he said. “The bar is set really low, and January 20 could be the bottom of the recession.”

Valliere was bearish throughout 2008, he said, adding that he has seen “nothing like this in the markets in my entire career.” But steps necessary for economic recovery have been taken. They fall into four broad categories.

First, Valliere is pleased with the Fed’s aggressive monetary policies, and he’s confident they will continue. “For Ben Bernanke and Larry Summers, money is no object,” he said. Valliere expects the Fed to broaden its mandate in terms of the securities it will purchase from the private sector, and he expects the Fed Funds Rate to remain at zero throughout 2009.

On the fiscal side, Valliere expects the Obama administration to push forward with its \$850 billion economic stimulus plan, and he predicted that the price tag would eventually approach \$1 trillion. The plan, he noted, includes tax cuts to “finesse” Republicans, money for states, expanded unemployment benefits, and the highly-trumpeted component – infrastructure spending – which will not be limited to highways and bridges, encompassing in addition funds for alternative energy, broadband capabilities, and school renovations.

Third, on the housing side, Valliere expects new action to stem foreclosures now that Citibank has opened the door to bankruptcy relief for homeowners. Valliere expects to see liberalized tax credits and congressional action to guarantee Freddie Mac and Fannie Mae loans.



Lastly, Valliere cited a number of “ephemeral” reasons for his optimism. Obama takes office with an 80% approval rating, coupled with “something that money cannot buy – an adoring press,” he said. Valliere didn’t forecast whether such confidence will persist, but believes it is necessary for the time being to overcome an “angry” retail investor sentiment.

Putting Bernie Madoff in jail might also ease investor discontent, he added.

Valliere also acknowledged the downside of the monetary and fiscal policies that are giving him hope. He expects deflation to be an issue for the rest of 2009, but “we have a long way to go before we have to worry about inflation,” he said. He expects inflation to become an issue in mid-2010, but he believes Bernanke can “slam on the brakes” to arrest runaway inflation.

Budget deficits are now projected to be 8% to 8.5% of GDP, topping the previous post-War high of 6% in 1982-1983. But Valliere says this will not drive up interest rates because they have shown “no correlation in the past” to the deficit. These deficits will, however, preclude the federal government from dealing with some of its big long term problems, like Social Security reform, he said.

A weaker dollar will be another consequence of these policies, Valliere said. But in previous periods of high deficits (like 1982-3), interest rates actually bottomed, he noted.

The final downside consequence to government policies over the last year has been “the total rewriting of the concept of moral hazard,” Valliere said. “We are now in a climate where no one can fail.” He expects another “chunk of money” to be handed out to GM, he added.

On the political side, Valliere noted Obama’s facility for moving to the center, but he also questioned the sincerity of such moves. “I am not naïve enough to think this will be a centrist government,” he said.

Valliere offered four predictions in the political arena. Really ambitious programs, like universal national health care, will be tabled, replaced instead by more modest initiatives similar to the existing s-chip program, the federal government’s health coverage program for low-income children. NAFTA will not be rewritten, and no significant steps will be taken to undo free trade. Secret ballots for labor unions, which have become a highly sensitive issue for some Democrats, will not be outlawed. Lastly, he said, “by far the biggest step” will be with taxes. Higher taxes for the “rich” will come “much later” in Obama’s presidency, probably at the end of 2010.



The weak economy has necessitated Obama's centrist moves. But, Valliere said, Obama is also keenly aware of cases where previous Democratic presidents overplayed their hand and suffered a loss of popularity. Clinton saw his ratings decline when he pushed for national healthcare, and Carter, who had 61 Democratic senators when he took office, "squandered his mandate" in a similar fashion.

The big wildcard in Valliere's analysis is on the geopolitical front, especially with regard to Iran. Valliere expects it will not agree to limit its nuclear arms programs, and Israel will not "wait forever," despite the recent report that the US had refused to sell Israel bunker-busting bombs and to grant fly-over privileges for its pilots to cross Iraqi air space in order to bomb Iranian nuclear sites.

"I worry that, longer term, the great threat is the Iranians," he said.

www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:
<http://www.advisorperspectives.com/subscribers/subscribe.php>