

ARE WE GOING TO HELL?

WEB BUZZ 2009.02.23

We have followed the economic working papers of the Levy Institute of Bard College for many years. Although they are basically Keynesian followers, their record emanates from a flow of funds model, which has been very accurate over the last ten years. Starting in about 1999, what they picked up was the acute acceleration of private debt, which was absolutely unsustainable. They and Stephen Roach of Morgan Stanley—along with our two favorite economists Gary Shilling and Kurt Richebacher (now deceased)—were also on it from the very beginning. While the talking heads of CNBC were promoting the Goldilocks scenario, the U.S. economy was moving ever so certainly to a plunge in economic activity of severe proportion.

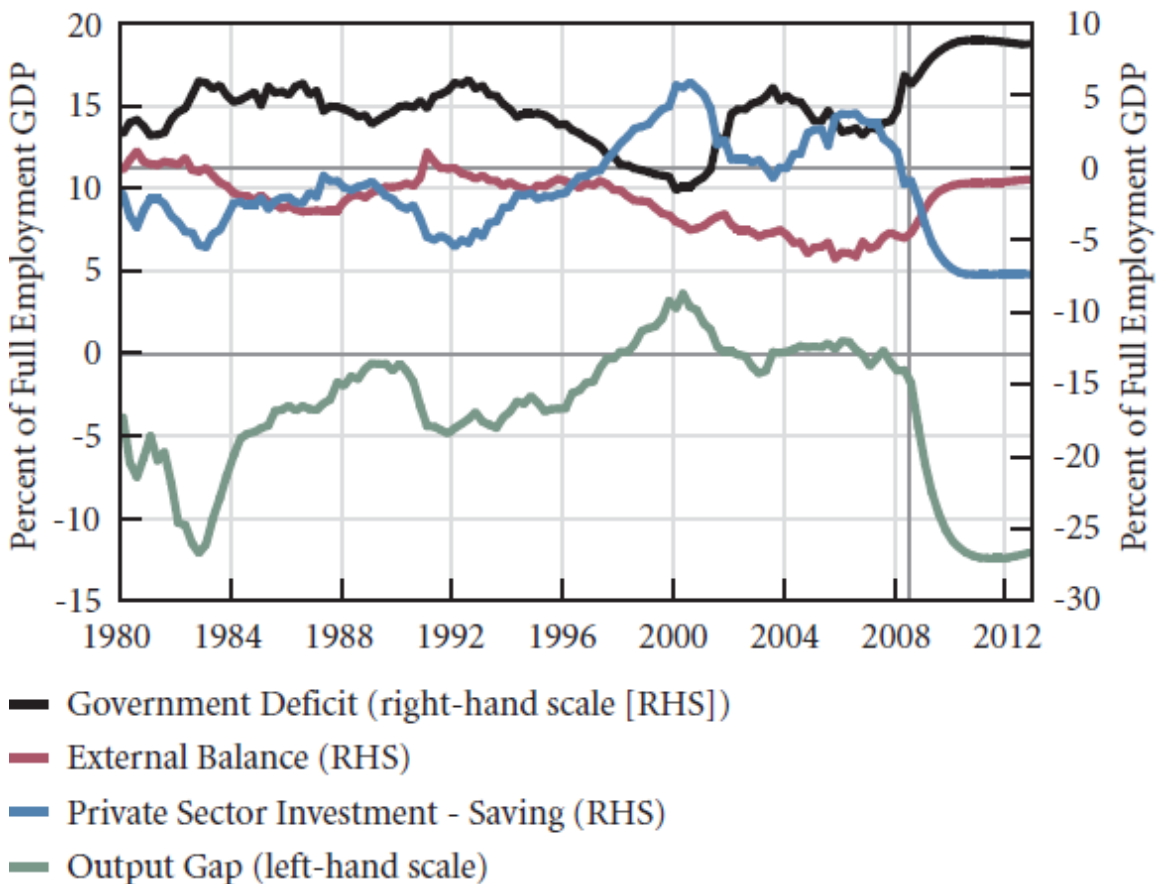
Interestingly enough, a chap by the name of Bob Parenteau, formerly from the Levy Institute, is now writing the *Richebacher Letter*. The Levy Institute's recent paper is titled *Prospects for the United States and the World: A Crisis that Conventional Remedies Cannot Resolve*. This, my friends, is a very scary scenario. The Levy Institute has this to say, "The prospects for the U.S. economy have become uniquely dreadful, if not frightening." This is the polite way of saying things are going to hell! We do not believe financial market participants have come anywhere close to understanding just what trouble we are in. The Levy Institute admits they have no way of suggesting how we can get out of this mess as things are presently constituted. They infer that only through superior cooperation among the world's nations can an answer be found. What do you think the chances are of that becoming a reality? Slim to none would seem to be the correct answer. Please note

the chart below, which displays their economic projection for the next four years. This is a flow of funds chart, whereby

$$\begin{aligned}
 &\text{domestic private financial balance} \\
 &+ \text{government financial balance} \\
 &+ \underline{\text{foreign financial balance}} \\
 &= 0
 \end{aligned}$$

The line at the bottom is the full employment GDP gap. Note the government balance is shown as a positive, when it is actually a negative.

U.S. Main Sector Balances and Output Gap



Sources: Federal Reserve and authors' calculations

Adapted from Strategic Analysis, December 2008

Please don't get lost in the verbiage and presentation. What is important is that economic conditions are destined to be very weak, and there is very little that can be done until debt is liquidated. Maybe government spending will soften the blow at first, but it will not solve the problem.