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Longer Term Economic & Financial Outlook

Executive Summary

The world economy is in the early stages of recovering from the worst financial crisis since the 1930s. The recovery is occurring more rapidly in those countries that avoided major changes in government policies and less rapidly in those, such as the US, that have placed greater reliance on massive government programs. In the US, a host of major new policy changes threatens to produce an extended period of relatively high unemployment and subpar economic growth.

Even though the downturn in business activity has ended, there is still a good deal of confusion regarding the cause of current economic problems. As it did in the 1930s, monetary policy has played a key role in the economy's collapse. From 2005 until earlier this year the US (and much of the rest of the world) experienced the most restrictive monetary policy since the 1930s.

Earlier this year the Federal Reserve belatedly adopted an expansive monetary policy. Given the typical 6-9 month lag between a shift in monetary policy and a shift in spending, business activity began to recover this past summer right on schedule. While monetary policy has been expansive for most of the year, the Fed's monetary mechanizations have produced unprecedented volatility. This volatility creates serious concerns over both the stability of the economy's recovery path and the potential for future inflation.

The Fed's shift to an expansive monetary policy will boost spending. It did so during the Depression of the 1930s and will do so again. However, creating money does little to alter the economy's underlying growth potential. During the 1930s there were many ill-conceived policy initiatives that extended the economy's problems through the entire decade.

As during the 1930s, recent government policy changes have made economic conditions even worse. Moreover, the potential for more significant changes in the period ahead carries with it the threat of an extended period of economic malaise.

One relative bright spot is the potential for significant increases in both spending and stock prices in the coming year. The Fed has increased high-powered money by 10%-15%. As this money works its way into the economy spending the pace of spending will continue to improve. The collapse in economic activity has left a significant amount of unutilized labor and productive capacity idle. A faster pace of spending will help to redeploy idle resources. The immediate effect will be rapid growth with relatively little inflation.

In spite of some encouraging developments in the year ahead, massive new government initiatives have a consistent record of creating failure. The current policy mix of rapid increases in federal spending, higher taxes and greater regulation have never succeeded in creating economic prosperity. Unless these policies are reversed, unemployment will remain relatively high and both higher inflation and higher interest rates will return in 2011 and beyond.

Current policies represent the most significant threat to the nation's prosperity in at least three decades. The hope for a long-term sustained economic recovery rests with the ability of the public to sense that economic policies are creating more harm than good and impressing on policymakers the importance of reestablishing classical economic principles.

Monetary Policy & the Business Cycle

For real economic activity to occur, someone has to expend the effort to produce something. When we work, we produce goods or services for others. In return for those goods and services we receive income. The income we receive represents a claim to goods and services that others have produced.

In the US, all individuals produced almost \$15 trillion of goods and services this past year. In the process, these individuals earned almost \$15 trillion in income. The income represents the spending power over what was produced.

There are only two groups that have the power to spend money without having produced anything of real value. One of these is the Federal Reserve. The other is counterfeiters. Each produces money that can be exchanged for goods and services. But unlike those who earned their spendable earnings by creating goods or services, neither of these two has created anything of value to correspond to the money they spend. We put counterfeiters in jail. With Fed critic Ron Paul heading the House Monetary Policy Subcommittee, those at the Fed may also face some punishment.

Money Mechanics

Congress has given the Fed unlimited power to write checks without having any money in the bank. They use this power to buy securities. Traditionally they restricted their purchases to government bills and bonds, but they have recently expanded purchases to include a wide variety of assets. Although the Fed spends a great deal of time deciding what to buy, all of that is beside the point. With an unlimited power to create money, what you buy is not nearly as important as how much you buy.

When the Fed buys securities, it effectively writes a check. The securities become part of the Fed's portfolio of assets. The check represents a monetary asset of the one who sold the securities to the Fed. When the check is deposited in the bank, the bank presents it to the Fed for payment. The Fed credits the bank with a deposit at the Fed, deposits that are called bank reserves.

Recall that anyone other than the Fed (or a counterfeiter) has to create some goods or services in order to earn their spendable income. Those who sold the securities to the Fed earned the money to buy those securities by creating goods or services. They bought the securities with their hard-earned spendable earnings. In contrast, the Fed's purchase was not made with funds that represent the production of goods or services. Instead, its funds represent spending that was backed by nothing.

Bank reserves are the first step in the creation of money. In normal times the bank that receives the check will either loan or invest a portion of its newly acquired funds. These loans or investments are then re-deposited by those receiving the funds. The whole process leads to something often referred to as a multiple expansion of credit. This expansion of credit increases money or liquidity by some multiple of the original increase in bank reserves. As a general rule, a dollar of bank reserves can produce roughly \$10 or more of checking account deposits. When the process is finished, individuals end up holding a wide range of monetary assets including checking deposits, money market funds, savings deposits and currency.

In unusual circumstances, this multiple expansion of credit can be muted. When either banks or the public decide to hold their funds in cash instead of loaning, investing or depositing them in the banking system, it will limit, or even entirely offset, the monetary impact from a given increase in bank reserves.

While the behavior of banks and the public can influence the relationship between the creation of bank reserves and its monetary impact, the Fed ultimately controls the money process. With its unlimited power to buy anything, the Fed can offset any action taken by either banks or the public. The Fed is therefore totally responsible for the amount of money (liquidity) in the economy.

The Monetary Process: How Fed Policy Affects Money and Spending

The Fed's purchase of securities that starts the whole process is unique. Every other law-abiding individual purchases things with money that was earned either by their work effort or the work effort of others. The Fed alone is responsible for creating an asset (bank reserves) that was not associated with the creation of goods or services. Once the Fed has created bank reserves the public may want to hold some of the new money in the form of currency. The combination of bank reserves and currency represents monetary liabilities of the federal government. These liabilities are referred to as the monetary base or high-powered money, something that is totally controlled by the Federal Reserve.

Under current laws, the Federal Reserve is the only government entity that has the power to create an asset that does not correspond to the creation of goods and services. Neither Congress nor the Administration has the power to create money. When Congress and the Administration agree to spend money, they have to take the money from those who earned it by creating goods or services. In this sense the federal government is much like any state or local government. Each has the power to tax or borrow the hard earned earnings from its citizens.

This means that to spend money, government spending replaces individual spending. Since government spending replaces individual spending it doesn't add to total spending. This is why the term "fiscal stimulus" is so misleading. It's also why so many economists are puzzled as to why the massive increase in Federal spending has not produced a boom in total spending.

By creating assets that do not reflect the creation of goods and services, the Fed initiates a series of events. These events initially change the prices of various financial assets. They then change the amount of money spent on goods and services. The entire process, from the time the Fed increases the money supply to the time that there is an overall increase in spending normally takes six to nine months.

The transmission mechanism by which additional money affects spending begins in financial markets. When the Fed starts the process by buying securities, it must offer a higher price for those securities than the current market price. If the Fed didn't offer a higher price, the owners of the securities would have no incentive to sell them to the Fed.

This higher price for one type of securities sets off a chain reaction through financial markets. Those who sold securities to the Fed now hold cash in the form of a checking account deposit. They have no incentive to buy back the same securities they just sold to the Fed at the new, higher price. Instead, they normally would choose a close substitute to the securities they sold. With the additional money they will bid up the price of the close substitute. This process continues through financial markets where bonds are a substitute for shorter duration securities, and stocks are a substitute for bonds. Ultimately, real assets are a substitute for certain stocks. When this chain reaction reaches real assets, it takes the form of an increase in demand that boosts spending as well as interest rates.

The US economy is dynamic. As individuals adopt more efficient ways of producing things and as more workers enter the workforce there has been a tendency for the US economy to produce roughly 3% more goods and services each year. Ideally, an economy that produces 3% more goods and services should have 3% more money each year. The additional money can help to accommodate the additional spending.

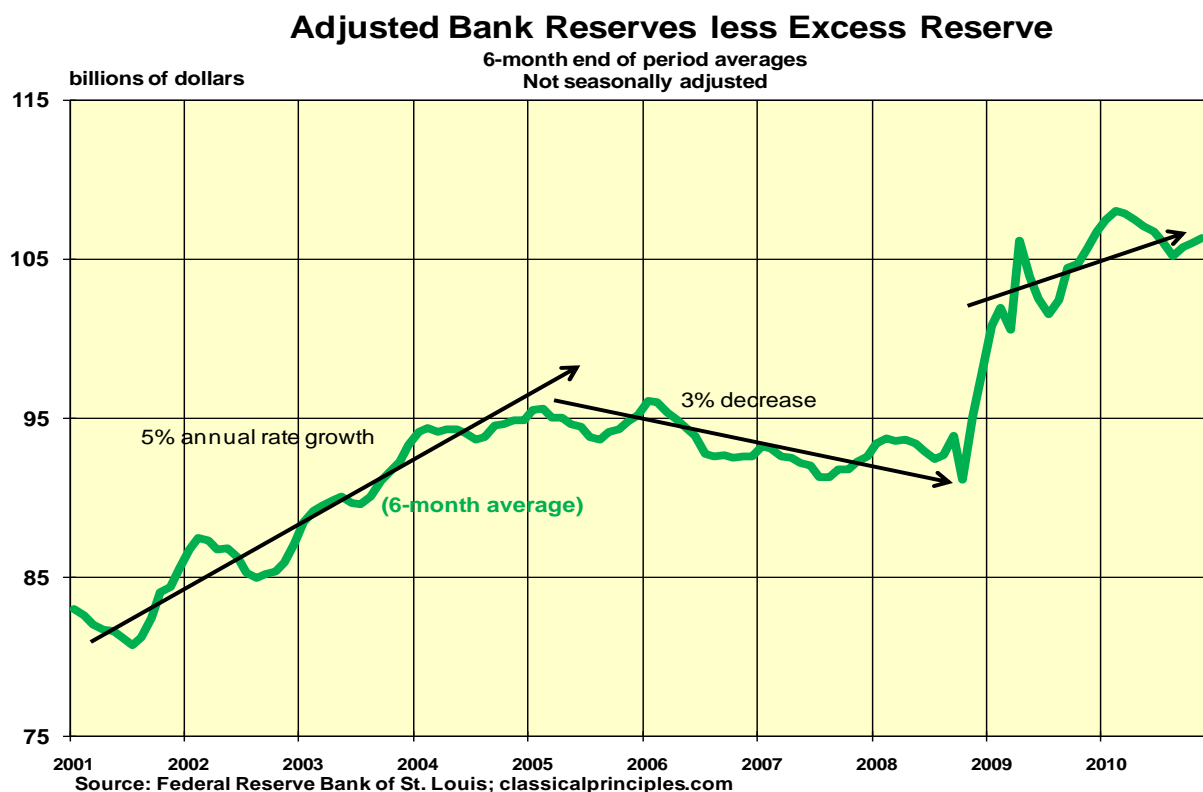
Before Congress created the Federal Reserve, the government often used gold to back the money supply. If gold became relatively scarce, the supply of money would grow less rapidly than the increase in goods and services. As a result, spending would increase by less than the increase in goods and services. When spending increases at a slower pace than the creation of goods and services it produces a decline in the overall level of prices. This occurred during the later part of the 19th century. The discovery of gold along with more efficient techniques for extracting it produced an increase in the supply of gold toward the turn of the century. More gold meant an increase in the supply of money, which caused spending to increase faster than the increase in goods and services. When this happens, it leads to inflation.

Money & Spending: The Evidence

Previous long-term reports showed the relationship between bank reserves and spending for almost a century of data on bank reserves. Other than at the end of WW II, every recession during this period had been preceded by either a slowdown or an outright decline in the amount of bank reserves placed into the economy. The greatest decline in bank reserves occurred in the early 1930s. At that time, the Fed reduced bank reserves by 15%. This was followed by a major collapse in spending.

The second greatest relative decline in bank reserves occurred prior to the recent economic collapse in 2008-09. After increasing bank reserves at a rate of 5% a year from 2001-2005, the Fed spent the next three year reducing reserves by 3%. The shift represented an eight percentage point reduction in liquidity. By 2009, year-over-year spending had collapsed. Instead of spending increases of roughly 6% a year following the Fed's increases in liquidity, the year-over-year spending pace went to -2%.

Was this trip necessary?



The major cause of the sharp reduction in spending the produced the financial crisis can be directly attributed to the Federal Reserve's monetary policy. The Fed produced too much liquidity during the early part of the decade. In the process, interest rates were artificially low. This created strong incentives for individuals to spend and speculate. When the Fed reversed its policy by withdrawing liquidity, it led to a collapse in spending and the ensuing financial crisis.

Since the latter part of 2008, the Fed has succeeded in increasing money and liquidity. However, many observers (including those at the Fed) are confused over the extent of the increase in liquidity. The confusion stems from the Fed's convoluted approach to conducting monetary policy. Instead of simply increasing the amount of bank reserves, the Fed expanded its portfolio by about \$2 trillion. Only about half of this produced an increase in bank reserves. And, most of the remaining \$1 trillion was offset by banks increasing excess reserves or deposits with the Fed in excess of what the Fed requires.

The bank reserves numbers are produced by the Federal Reserve Bank of St. Louis. They are appropriately adjusted for reserve requirements. When the Fed requires banks to leave a certain amount of reserves with the Fed, those reserves cannot be used to increase the money supply. The same is true if banks voluntarily decide to leave additional (excess) reserves with the Fed.

Beginning October, 2008, the Fed began paying banks to keep reserves on deposit at the Fed. Since the Fed pays a higher interest rate than banks are able to earn from equally secure liquid assets, banks have been holding close to a trillion dollars on deposit with the Fed. So long as banks keep these funds at the Fed, they cannot be used for loans and investments and for expanding the money supply. Hence, it is necessary to subtract these excess reserves from total reserves to determine how much liquidity is actually in the banking system.

Fed Statements indicate that its members believe that monetary policy over the past year has been "highly accommodative." Fed critics believe that policy has been wildly expansive. However, policy has only been moderately accommodative. Using a 6-month moving average to smooth erratic monthly moves shows that liquidity increased by roughly 8% late in 2008 and in early 2009. Since that time, there has been relatively little additional liquidity,

Fed Policy 2011 and Beyond

Anticipating future Fed policy presents a number of challenges. Instead of targeting bank reserves less excess reserves, the Fed prefers to focus on interest rate targets and, more recently, shifts in the components of its portfolio. The Fed ignores the amount of bank reserves in setting policy. This is why reserves increased so rapidly in the early part of the past decade. It is also why the Fed reduced reserves and brought about the financial crisis.

With the Fed members preoccupied with everything except bank reserves it is difficult, if not impossible, to determine where monetary policy is headed. It could easily expand very rapidly and justify the fears many have of a highly expansive policy. Alternatively, policy could also turn restrictive, as it did prior to the financial crisis.

Until those at the Fed recognize the importance of focusing policy decisions on the creation of reserves in the banking system, it is difficult to determine what havoc their flawed operating procedures will produce.

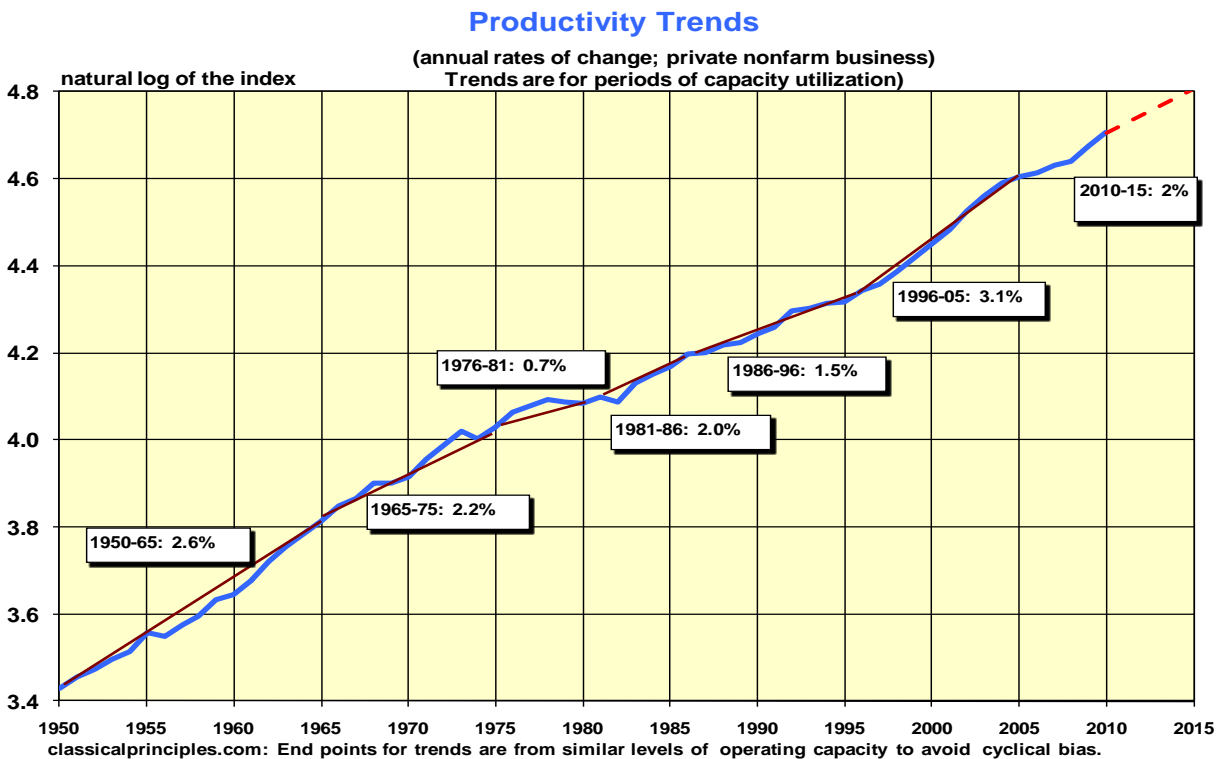
The forecast for the coming years continues to suggest that the Fed increases liquidity at a moderate pace. However, since the Fed is flying blind it is difficult to have a great deal of confidence in such an outcome.

Economic Policy & the Outlook for Real Growth

While sharp changes in monetary policy can produce dramatic changes in current dollar spending, they cannot create sustainable real growth. Sustainable growth depends on the incentives people have to create goods and services. With the proper incentives individuals become more productive and work more hours

Productivity refers to the efficiency with which the economy combines resources. It is the basis for any increase in living standards. During the post-World War II period the US economy has combined resources far more efficiently than any other major developed economy. Since 1950, productivity gains in the US economy have averaged just over 2% a year. This is consistent with the overall trend during the 20th century.

Productivity performance often exhibits a strong cyclical trend. Hence, to view the underlying trend, it's important to compare periods of similar capacity utilization. The chart below compares such performance. Although the long-term productivity trend has been stable, major policy changes have produced shifts in productivity trends.

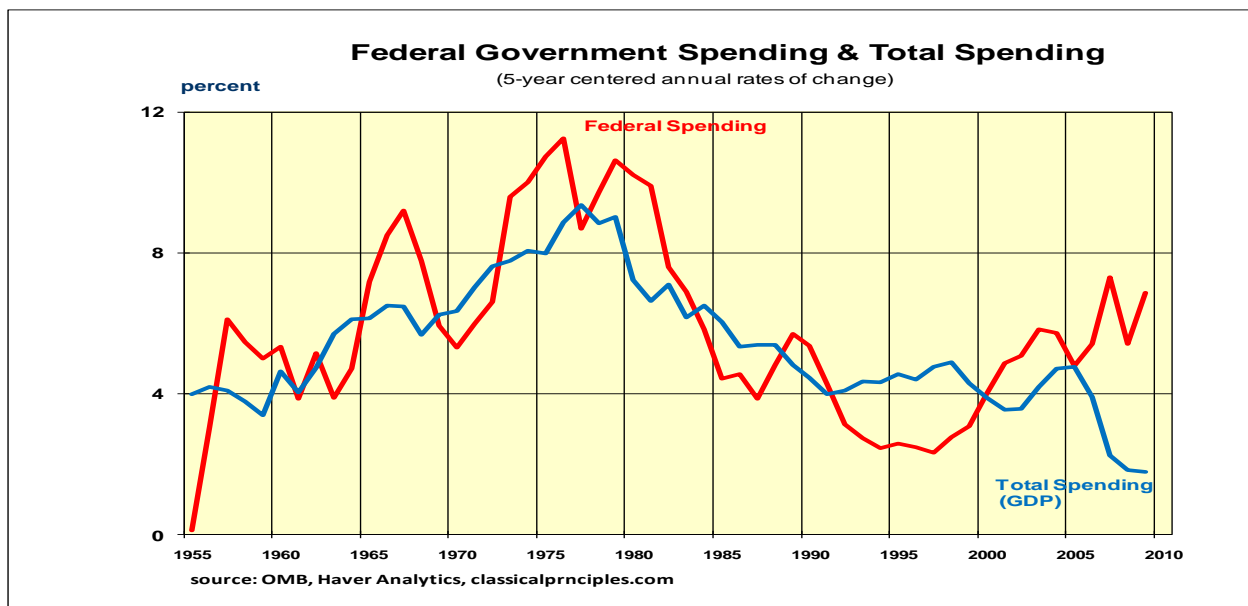


Relatively strong productivity growth occurred from 1950-65, from 81-86 and from 96-05. These are all periods when tax rates were low or falling and federal spending grew slower or no faster than private spending. The worst productivity performance occurred from 1976-1981, when tax rates and government spending soared. There was a more moderate slowdown from 1986-1996, when tax rates and federal spending moved moderately higher.

Government Spending, Taxes & Regulation: The Evidence

The idea that the government can increase spending in the economy by either spending more money or sending people checks represents a serious flaw in economic thinking. Apart from its ability to create money, government can only increase its spending by taking spendable earnings from someone that created those earnings. As a result, every dollar the government spends is a dollar that cannot be spent by the person that earned it. On balance, there is no increase in demand from government spending.

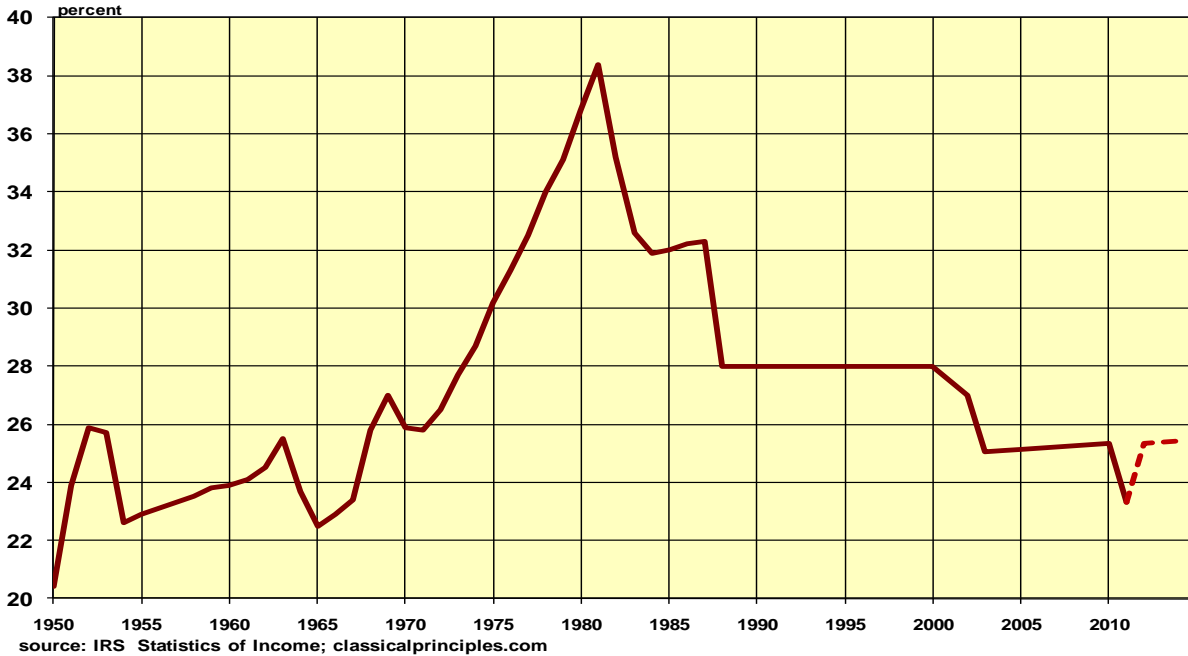
Even though an increase or decrease in government spending may not affect overall spending, that doesn't mean it does not affect the economy. An extensive amount of research indicates that government spending tends to be roughly half as efficient as spending in the private economy. This suggests that major increases in government spending should be associated with economic weakness, while decreases in government spending should be associated with a stronger economy. This is precisely what the evidence shows.



Tax rates have also been associated with periods of economic strength and weakness. The following charts show individual tax rates and capital gains tax rates. High and rising tax rates have been associated with periods of slower productivity growth. In contrast, productivity trends have been relatively strong when tax rates were low and stable or declining.

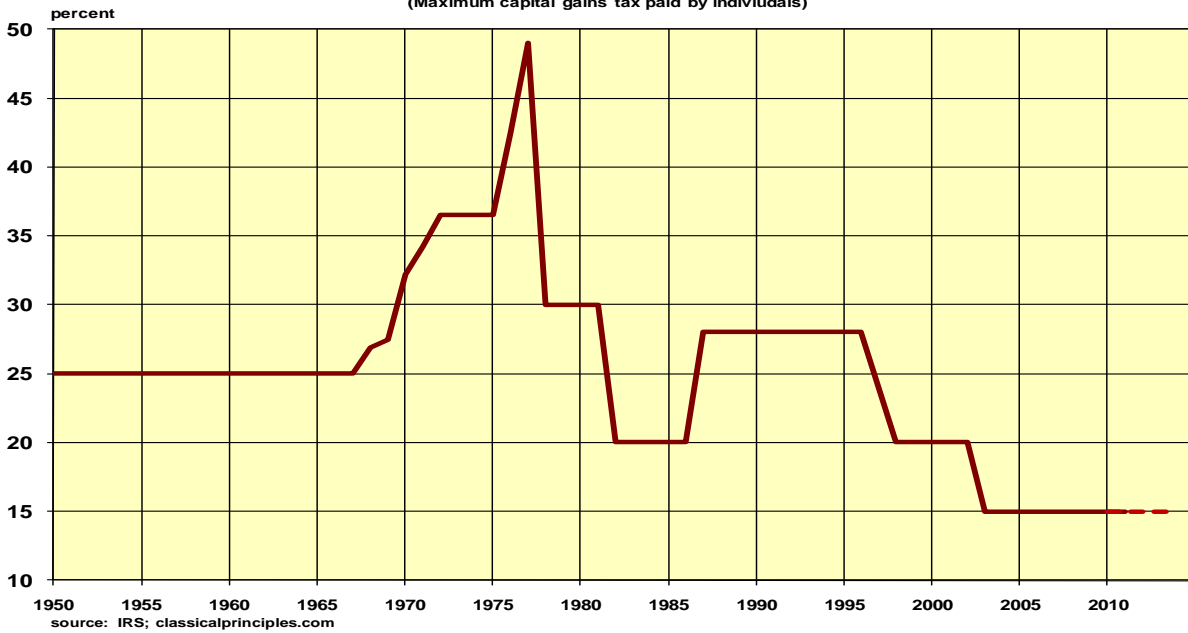
Effective Marginal Tax Rates: Individuals

(Data are based on estimates of MTR for indiv. in 70th-95th percentile)



Marginal Tax Rates: Capital Gains

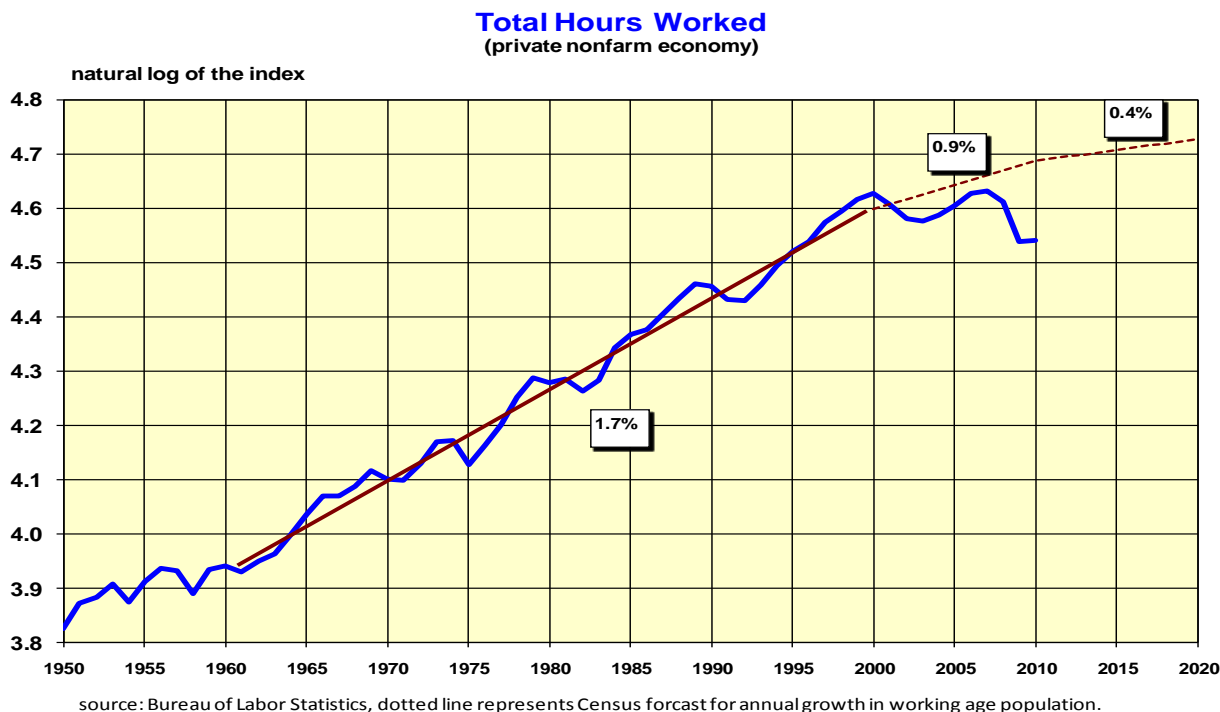
(Maximum capital gains tax paid by individuals)



One thing that becomes readily apparent is the anomaly of the past decade with respect to patterns in federal spending and tax rates. Although tax rates remain relatively low, there has been a significant increase in government spending. Politicians have voted to increase government spending dramatically. However, instead of raising taxes to take the money from others, they have decided to borrow the funds to increase federal spending.

When politicians decide to spend money without providing the taxes to pay for it, they have not discovered a new way to get something for nothing. The true burden of government is what it spends. Taxes are the upfront, visible cost associated with the spending. Deficits or borrowing represent the deferred cost of government spending. So long as people believe that the tax burden is relatively low, they may continue to save and invest in a way that continues to increase productivity and growth. This appears to be what has occurred in the past decade as productivity has continued to advance.

Borrowing can be useful if it is for a temporary emergency or if it supports spending that is more productive than private spending. It cannot be used over extended periods of time to support less productive spending without doing serious damage to the economy. Some of that damage may already be apparent in terms of hours worked. Government programs that make it more attractive for individuals not to work will tend to decrease the amount of work done.



The trend growth in hours worked is influenced by demographics. From the 1960-2000 the workforce grew rapidly along with hours worked. Annual increases in the working-age population slowed to 0.9% over the past decade and will slow to 0.4% yearly pace in the decade ahead. The two percentage point reduction in the payroll tax will increase the rewards for working. This should help to boost the number of hours worked in 2011 as well as reduce the unemployment rate.

Outlook for Government Spending & Regulation

Over the past decade federal spending has grown twice as fast as total spending. This has placed a major burden on individuals. It means that a portion of the gains that individuals would tend to have received from increases in productivity came in the form of increases in federal programs. Spending for defense, a major expansion of Medicare, growing demands for Social Security payments and new regulatory burdens have replaced the income that individuals would have experienced.

Government spending and regulatory burdens are scheduled to increase substantially in 2011 and beyond. The health care legislation enacted this past year is expected to cost \$2.7 trillion over the course of the next decade according to the Congressional Budget Office and calculations by Michael Tanner. In addition, based on detailed analysis of provisions by the law firm of Davis Polk, I estimate that the recently passed financial reform legislation will cost \$1.5 trillion over the course of the next five years.

Major new burdens such as these can seriously reduce the economy's productivity growth. Individuals who might normally engage in productive activity that would create wealth will be encouraged to earn income by engaging in activities that assist compliance with complex regulations. Hence, less true wealth is created.

With Republicans gaining a large majority in the House of Representatives, it is likely that some of the major costs associated with recent legislation will be postponed or even eliminated. While at this point the outcome is clearly speculative, my forecast assumes that the future costs associated with both health care and financial reform will be significantly reduced.

Outlook for the Economy

People want to produce, save, invest and create. It's human instinct. Classical economists noted that these activities will flourish when policies allow individuals to keep much of what they create, when free markets are allowed to operate, when property rights are protected and when the value of a nation's currency is stable.

Over the past few years, as policymakers place constraints on these conditions, individuals did their best to create wealth in spite of those constraints. Even so, the threat of higher taxes and increased burdens from health care and financial reform legislation created real barriers to increasing wealth.

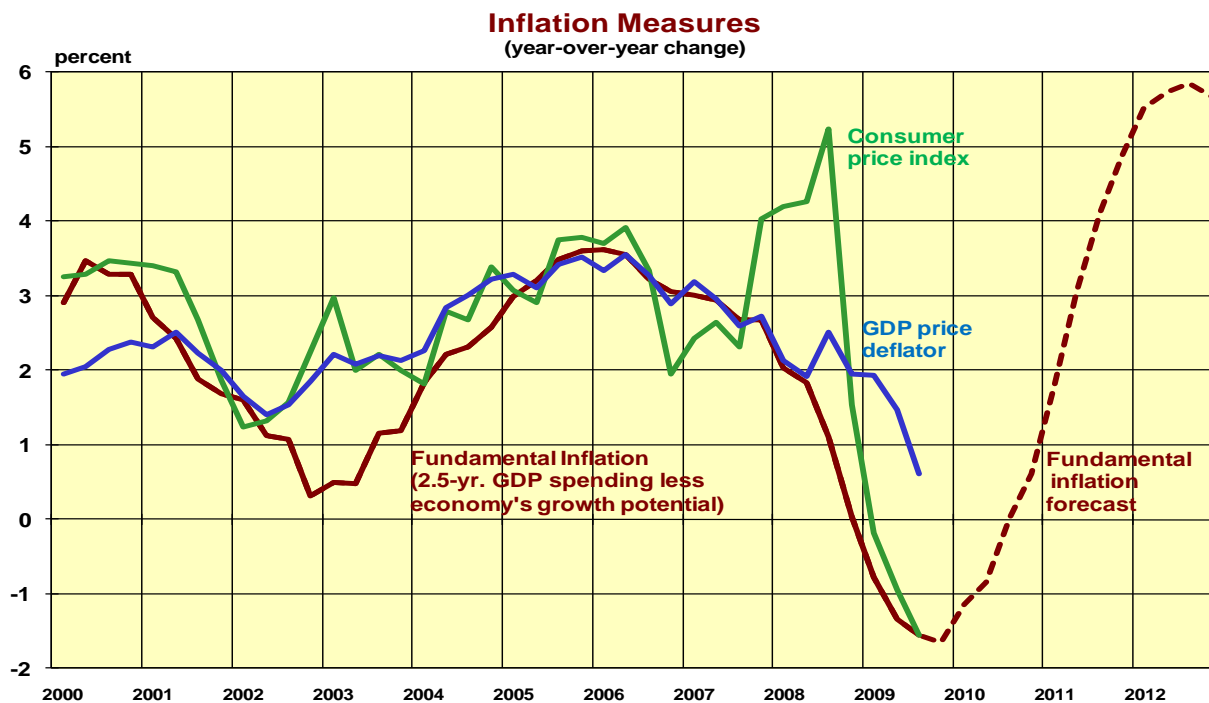
Some of those barriers have been removed as the President and the 111th Congress agreed to extend current tax rates for the next two years. This removes one barrier to improving creating wealth. In addition, the potential for a slower growth, or even decline, in federal spending and regulations would remove more such burdens.

As a result of these actions, the prospects for an increase in real growth have improved. So long as the Federal Reserve allows for a sufficient expansion of bank reserves to accommodate that growth, real growth for at least the next two years should advance at a faster pace than the 3¼% growth of the past year. Meanwhile, with substantial amounts of excess capacity and labor, inflation is likely to remain below 2%. Beyond the next year, both growth and inflation will depend on the uncertain prospects of the Fed's monetary policy.

Outlook for Financial Markets

The outlook for interest rates hinge on expectations regarding inflation. So far, concerns that Fed policy has been inflationary are overblown. Inflation depends on the extent to which spending exceeds the economy's ability to produce goods and services. The collapse in spending has left the economy with a lot of excess capacity. In 1933 the unemployment rate was 25% when the Fed reversed its tight money policies. Over the course of the next three years, spending increased at an average annual rate of roughly 11%. In spite of such rapid growth, the available idle capacity was able to generate annual growth of roughly 9%, leaving only 2% for inflation.

While conditions today are not nearly as extreme, the economy should be able to utilize the current excess capacity in such a way that most of the pick-up in spending will take the form of real growth. Eventually, as the excess capacity is used up and as bottlenecks appear in certain areas, prices will again move higher.



Interest Rates

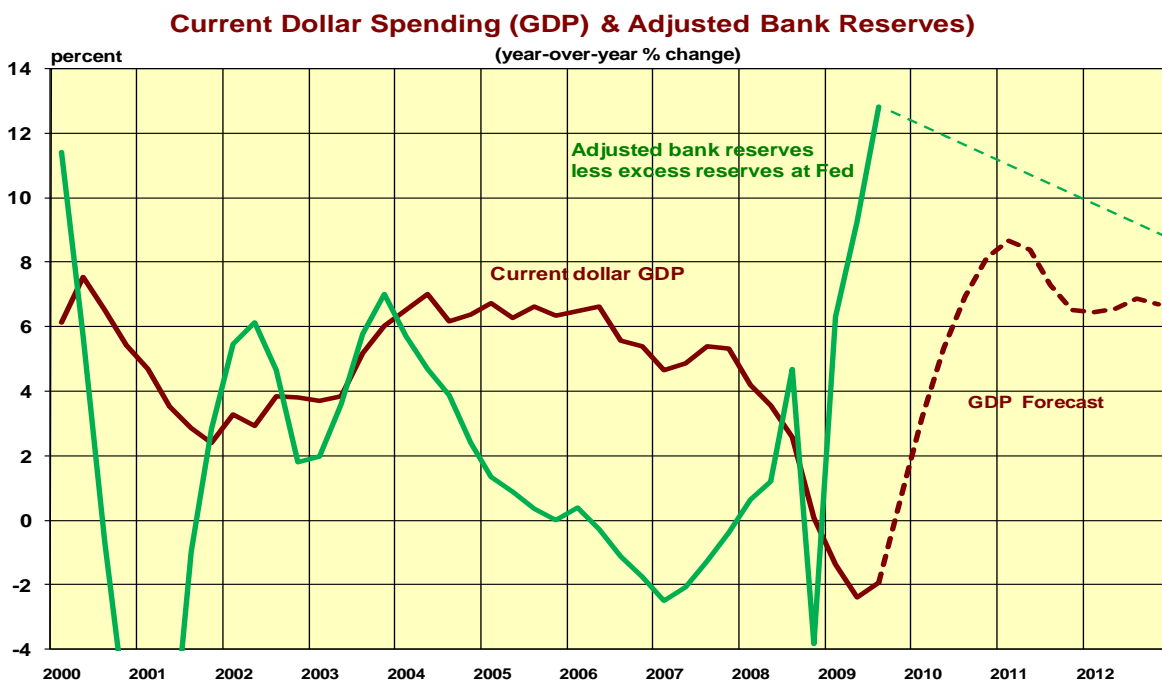
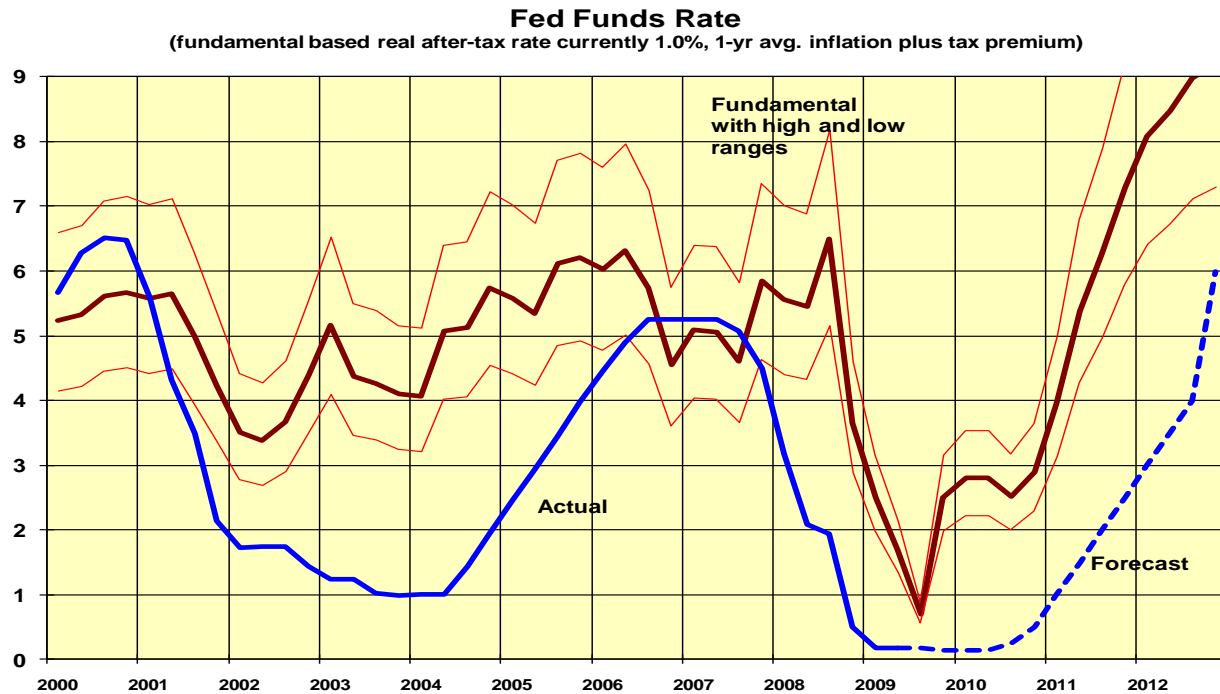
Inflation is a key element in dictating the future path of interest rates. So long as inflation remains subdued (the underlying rate for 2010 is forecast to be only 1%), interest rates are likely to remain low.

Short-term interest rates are set by the Fed, via its target for fed funds. The Fed can temporarily control the level of short-term rates by buying and selling securities to affect the amount of high-powered money in the economy. Over the past year, the Fed has increased the amount of high-powered money by 10%-15% to key short-term rates close to zero.

A key unknown is how the Fed will respond to a strong increase in spending. With a double digit unemployment rate in an election year, the political pressure on the Fed will be intense. As

a result, it is unlikely that the Fed will make any move to restrain liquidity until later in the year. Even then, the Fed is likely to move slowly and cautiously. If this assessment is correct, the rapid increase in spending will extend well into 2011.

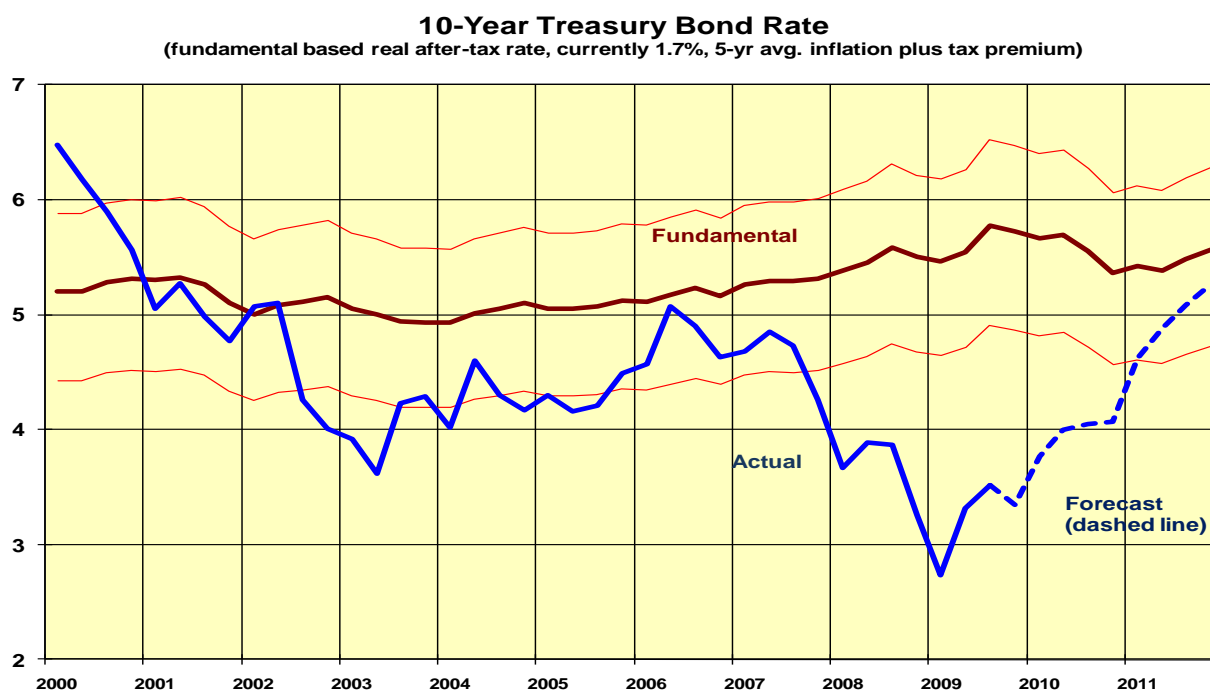
By 2011 there is likely to be growing concern that the strong pace of spending will lead to inflation. As inflationary expectations increase, investors will grow increasingly leery of bonds. Long-term interest rates will increase in anticipation of higher rates. Once the election is over, the Fed should be ready to raise the fed funds rate in an effort to dampen spending.



The ideal fed funds rate is the one that produces a moderately stable increase in bank reserves

while taking into account the demand for currency by the public and banks. This ideal rate will change with economic conditions. The Fed creates either too much liquidity or too little whenever it fails to change its target to match the changes in this ideal rate.

Just as the Fed failed to drop its target interest rate fast enough from 2005-08, it is likely to underestimate the need to increase its target as the spending pace increases. Based on its past performance, the most likely moves by the Fed will be to underestimate the ideal fed funds rate in the early stages of the recovery and then overestimate it once the recovery is in full force. If so, the Fed may well find itself raising the funds rate rapidly in 2011, just as the economy is hit with sharply higher tax rates. Even before the Fed decides to raise the fed funds rate, investors will sense the potential for higher inflation. Rising inflationary expectations will send long-term interest rates higher.



Stock Prices

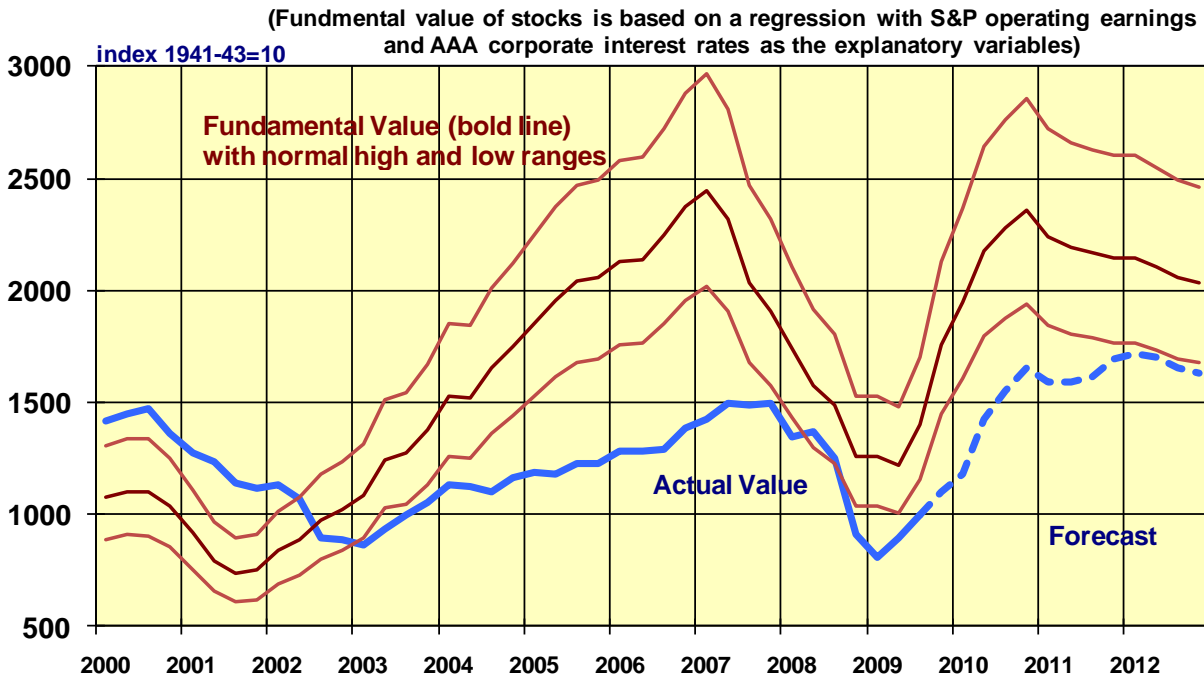
Stocks currently sell for prices that are well below fundamental values. The fundamental value of stocks depends on profits and interest rates. Actual stock prices will differ from the fundamental values because of the risk premium that investors place on holding stocks.

With the S&P 500 close to 1100 toward the end of 2009, stocks appear to be undervalued by roughly 35%. This means that investors continue to view stocks as an extremely risky asset. Although higher long-term interest rates in the year ahead will reduce the fundamental value of stocks, sharply rising profits will more than offset the negative impact.

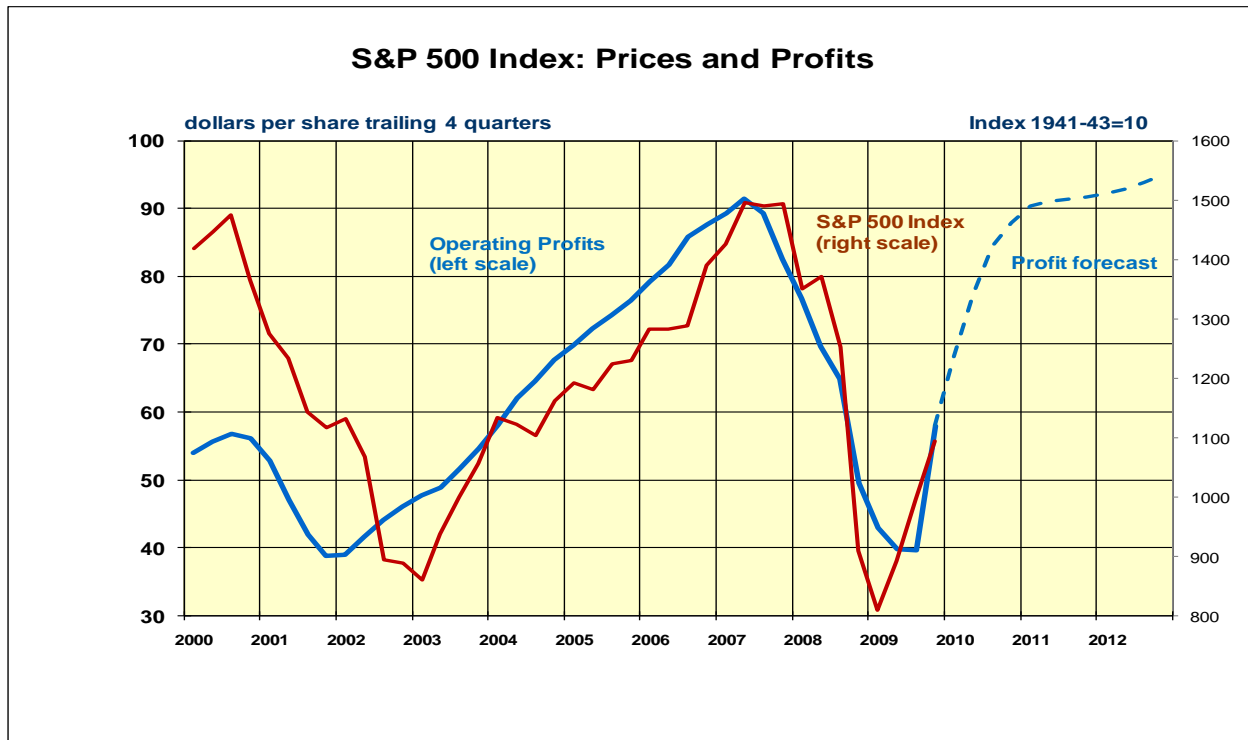
In addition to an increase in fundamental values, the Fed is expected to continue to increase liquidity. The combination of these factors should produce a sharp increase in stock prices in the year ahead. Even so, with two major declines in stock prices during the past decade, investors are likely to continue to view stocks as a risky investment. Above-average risk

premiums on stocks mean that prices are likely to remain well below historical fundamental values.

Stock Prices: S&P 500



As the following chart shows, changes in operating profits are a key driver of stock prices. So long as profits continue to rebound with the rebound in business activity, it will provide a key force driving stocks prices higher.



Conclusion

The past two years marks a monumental turning point for US economic policies. Under the guise of saving the economy, policymakers have extended government control over the banking sector and over two key auto companies. As the year ends there are growing indications that government control will be extended to the entire health care industry. If so, it means that the inefficiencies that accompany other government functions will now spread to a large portion of the economy. Initial calculations indicate that the cost of all aspects of health care will increase dramatically creating the equivalent of a major tax on economic activity.

Socialism is defined as government ownership *or control* over key sectors of the economy. While the word has a bad connotation, it is an accurate description of what is occurring. Policy changes such as these have occurred before when the public allowed politicians to dramatically increase the role of government. Except during wartime, when the nation's survival was at stake, each of the past such experiences has produced economic failure.

Although these changes will create a significant drag on the economy, a cyclical recovery in 2010 is likely to mask much of the negative impact. Instead, the first signs of significant damage will be delayed until 2011 and beyond. By that time, higher tax rates, rising inflation and interest rates and a relatively high unemployment rate will provide greater evidence that the economic climate has turned. Until that occurs, the economy will appear to have a reprieve from the impact of the shift away from classical principles.

The main hope for the future is in the hands of the electorate. Politicians often seek to place more power in the hands of government. When they do, the public loses some of its liberty and freedom. Each generation faces these challenges. The sooner the public realizes what is happening and the sooner it acts to reserve policies, the sooner there will be the type of

sustained increase in growth and prosperity that has been so much a part of our country's history.

12/23/2009	<u>Actual</u>		<u>Forecast</u>					Annual average 209-2014
	2008	2009	2010	2011	2012	2013	2014	
GROSS DOMESTIC PRODUCT	14441	14247	15081	16319	17494	18351	18775	
%ch	2.6	-1.3	5.9	8.2	7.2	4.9	2.3	5.7
REAL GDP	13312	12970	13557	14093	14234	14122	14027	
%ch	0.4	-2.6	4.5	4.0	1.0	-0.8	-0.7	1.6
CHAIN PRICE INDEX	1.085	1.098	1.113	1.160	1.232	1.302	1.341	
%ch	2.1	1.2	1.3	4.2	6.2	5.7	3.0	4.1
CPI- ALL URBAN	2.152	2.143	2.170	2.246	2.387	2.533	2.618	
%ch	3.8	-0.5	1.3	3.5	6.3	6.1	3.4	4.1
PRETAX PROFITS ADJ (1)	1360	1280	1454	1510	1607	1710	1798	
%ch	-11.8	-5.9	13.6	3.8	6.4	6.4	5.1	7.0
AFTER-TAX PROFITS ADJ(1)	1068	979	1112	1155	1229	1308	1375	
%ch	-2.0	-8.4	13.6	3.9	6.4	6.4	5.1	7.0
PRODUCTIVITY	1.43	1.47	1.52	1.55	1.56	1.58	1.60	
%ch	1.8	2.9	3.6	1.8	1.0	0.8	1.4	1.7
UNEMPLOYMENT RATE	5.8	9.4	10.2	9.4	9.8	9.9	9.9	9.8
Potential Real GDP		14006	14326	14537	14697	14868	15152	1.6
Actual as a percent of Potential	97.6%	92.6%	94.6%	96.9%	96.9%	95.0%	92.6%	95.2%
M2 %ch at annual rates	6.9	7.5	4.9	6.4	6.9	4.0	2.2	4.9
Mg %ch at annual rates	5.9	6.8	4.0	6.0	7.2	4.4	2.2	4.4
MORTGAGE RATES	6.0	5.2	6.0	7.2	8.4	9.7	10.1	8.3
10-YR GOVT SECURITIES	3.7	3.2	4.0	5.2	6.4	7.7	8.1	6.3
2-YR GOVT SECURITIES	2.0	0.9	2.0	1.9	4.2	6.6	6.0	4.1
PRIME RATE	4.9	3.2	3.3	4.8	7.1	9.5	8.9	6.7
FEDERAL FUNDS RATE	1.9	0.2	0.3	1.8	4.1	6.5	5.9	3.7
STOCKS:								
S&P 500	1221	947	1424	1573	1611	1537	1579	10.8
S&P 500 operating earnings/share	49.5	58.0	87.9	92.3	96.2	100.4	106.1	12.8
S&P 500 p/e	17.7	18.7	18.1	19.3	18.5	16.6	16.2	18.2

(1) Profits adjusted to exclude inventory profits and to allow for depreciation at replacement cost