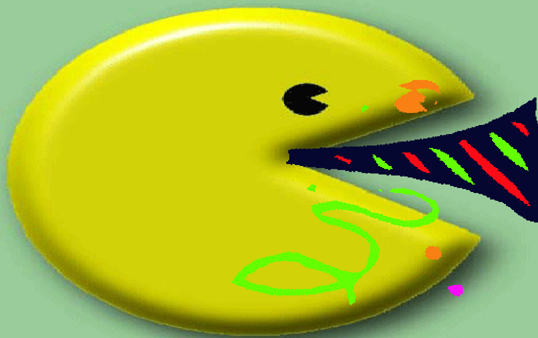

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THE MONTH IN REVIEW

12/1-12/3 The Dow soared 250 points Wednesday as investors reacted to a batch of economic reports, including a strong gain in private-sector payrolls and better-than-expected auto sales. **A 10.4% surge in pending home sales** in October and the European Central Bank's plan to extend liquidity measures **powered stocks another 106 points higher, Thursday. The unemployment rate rose to 9.8%** after holding at 9.6% for several months.

12/6-12/10 The **Federal Housing Administration said it would leave the ceiling unchanged at $729,750.** The limits apply to all mortgages originated between Jan. 1, 2011, and Sept. 30, 2011, or the fiscal year for the FHA. **Bonds fell sharply lower Tuesday on fears that the tax cut deal would add to the deficit. The yield on the benchmark 10-year note rose to 3.16%, up from its close of 2.92% on Monday. Mortgage-backed securities followed suit and mortgage rates jumped 65 basis points or 2/3rds of 1% in one day! Treasury prices continued to slide Wednesday, pushing the yield on the benchmark 10-year note from 3.13% Tuesday to 3.28%, its highest level in six months.**

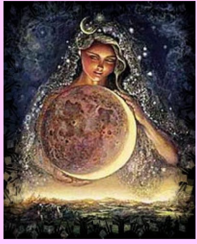
12/13-12/17 Upbeat economic data pushed stocks higher and sent Treasuries tumbling. **The yield on the 10-year benchmark note surged to 3.46%,** the highest level since early May, from 3.28% late Monday. The Senate approved an extension of the Bush-era tax cuts, Wednesday. **Investors see the bill as adding $858 billion to the national debt and have subsequently pushed the yield on the 10-yr. Treasury note up to 3.52%, a rise of 115 basis points in 1 month! New home starts rose in November 3.9%** above revised October figures but 5.8% lower than a year ago. **Due to robo-signings the number of fore-closure notices filed in November plunged 21%,** the biggest month-over-month drop ever recorded by RealtyTrac, the online foreclosure marketer. Filings fell 14% compared with November 2009.

12/20-12/24 The National Association of Realtors' monthly report said **sales of previously-owned homes jumped 5.6% in November.** Even so, it was down 27.9% from a year earlier. **Stocks hit fresh two-year highs as oil topped $90 a barrel,** Wednesday. **Unemployment claims fell for the third week in a row. The markets closed early Thursday and were closed Friday.**

12/27-12/31 China raised its interest rates by a quarter of a percentage point. It marked the second hike in just over two months.

The Consumer Confidence Index retreated from 54.3 the month before to 52.5 in December. The report issued Tuesday shows that Americans concerned about the overall economy and the jobs forecast has heightened. For the first time in more than two years, **the number of Americans filing for their first week of unemployment benefits fell below 400,000 last week.**

THIS ISSUE'S TOPIC:
THE ANNUAL FORECAST—2011 or We're Turning Japanese



The problem with most forecasts is that they're really not forecasts at all, but extrapolations of recent trends that the pundits "predict" will simply keep rolling along and not really based on complex economic assumptions. This year my forecast focuses on those issues that were of paramount interest to Americans. Before going further, however, I believe it is important to assess the current state of the economy and why.

WHERE WE ARE NOW AND WHY

President.Barack Obama was enthusiastically elected in a spirit of "Yes, we can". But, given that America had just suffered its worst financial crisis since the 1930s, the electorate's optimistic expectations and time frames regarding an economic recovery were unrealistic. The aftermath of any major financial crisis is typically followed by multiple years of very high unemployment. Given this grim scenario, what the nation needed, was a really ambitious recovery plan, something akin to the 3R's of FDR's New Deal (Relief, Recovery and Reform), the nation's plight being akin to what the country experienced during the 1930's. With consumers and businesses not spending, it was critical that government do so particularly since it was the only remaining entity that had both the means and the motive to jump start the economy.

President Obama's plan was not wrong, per se; his error lay in miscalculation. He has since admitted that he was unaware of the depth of the nation's financial debacle when he took office. As a result he settled for an economic stimulus plan that was inadequate, only to see the plan weakened further in the Senate as much of the increase in federal spending was effectively negated by cuts at the state and local level, thereby mitigating the net stimulus to the economy. At $787 billion, the funds for job creation and worthwhile correctives like investments in energy, technology, infrastructure, education (for students), retraining (for the unemployed) extending unemployment benefits and extending tax cuts for the middle class were simply insufficient for so many ambitious undertakings. Another notable shortcoming was Obama's failure to effectively communicate the gravity of the situation to the public and the necessity for bailing out the banks and the auto industry.

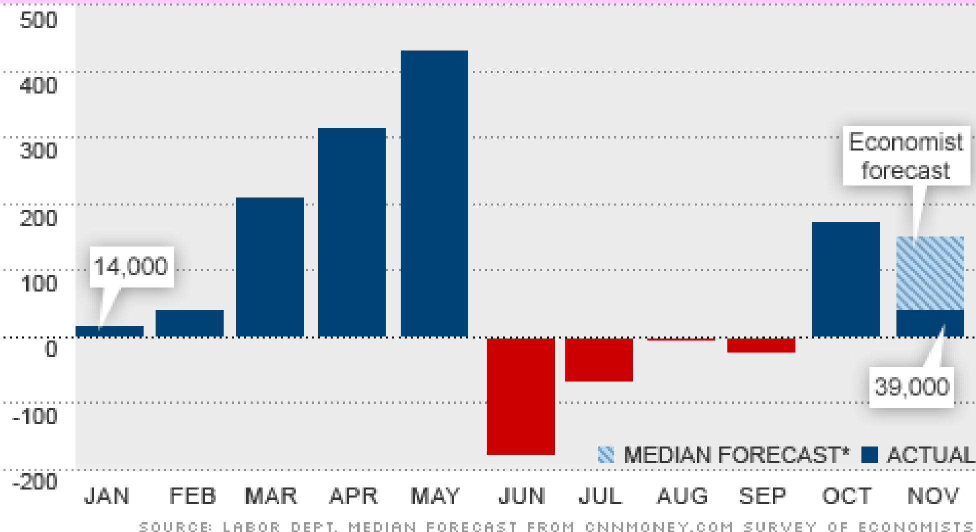
Miscalculating the intractability of his political opposition was one more misstep for the President. Obama defined America's problem as one of process, not substance—we were in trouble not because we had been governed by people with the wrong ideas, but because partisan divisions and politics as usual had prevented men and women of good will from coming to together to solve our problems. And, he promised to transcend those partisan divisions. But his conciliatory efforts to reach across the aisle in the spirit of bipartisanship and cooperation were spurned. The process that resulted was one of gridlock with the Republicans proud to be the "Bloc Party of NO". When he should have been more audacious, he remained "No drama, Obama" and these conciliatory gestures were viewed as weakness which the opposition sought to exploit to their advantage. Yet, insufficient as the stimulus was, and contrary to popular opinion, what there was of it—did work. Economists estimate that without it, our unemployment rate would now be about 12%, nationally, instead of the current 9.8%. Nevertheless, in September of this year, the National Bureau of Economic Research (NBER), the body officially charged with dating when economic downturns and upswings begin, declared that the Great Recession ended in June 2009.

JOBS: Just as there is an inescapable time lag between economic cause and effect, there is also one between implementation and resolution. Recoveries from financial crises tend to be weak because consumers and businesses are slow to resume spending. Research has revealed that over the last century, the typical crisis caused the jobless rate to rise for almost five years. During the Depression, unemployment peaked in 1933, four years after the Crash of '29. And, despite an unprecedented burst of government spending, it took until 1936, a full 7 years after the crash for unemployment to be reduced from 24.9% to even 20.1%. The NBER cited December 2007 as the onset of the Great Recession. It's been 13 months since unemployment peaked in November of 2009. By this timetable, the unemployment rate would rise for another two years. Even though this recession was not as severe as what FDR had to deal with, an economic recovery and a rebound in employment in so short a time was wholly unrealistic, particularly with a divided Congress.

The jobless rate has remained above 9% for 19 straight months, the longest stretch on record since the Labor

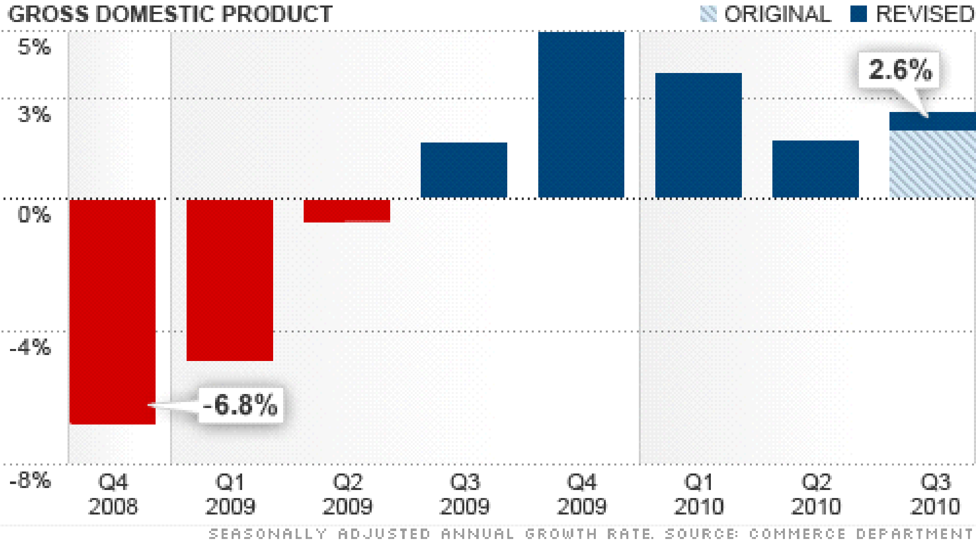
Department started tracking unemployment in 1949. This is further evidence that Americans are stuck in a jobless recovery, much like what Japan experienced during the 90's. As the graph depicts, employment began rebounding in January through May of 2010, but as the stimulus began to wane unemployment rose again as state and local governments pared 115,000 jobs and temporary federal hires were laid off as they completed the census and the nation experienced a net loss of jobs from June through September. The stimulus was poorly explained by the White House from the start because the 3.3 million jobs that it saved were dwarfed by an intractable unemployment rate. While private employers are hiring again, having added more than a million jobs over the past year, November's job growth came in far lower than expected and the unemployment rate hit 9.8%. At the current rate of recovery, it'll take years to fully regain the 8.3 million jobs lost over the past two years.

Businesses are not hiring simply because of excess capacity—the supply of goods and services exceeds the demand. What businesses need are customers. Since they have excess capacity, a tax incentive to invest is unlikely to have much impact. Even if the recession is technically over, for most people it is ongoing.



THE ECONOMY OR GROSS DOMESTIC PRODUCT (GDP):

As mentioned earlier, the economy got a kick start last year from the $787 billion stimulus package, which gave help to cash-strapped state and local governments, funded public work projects and cut taxes.

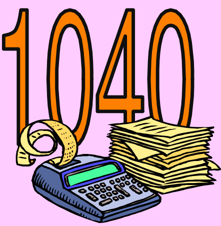


But that money has run out. As the stimulus monies dwindled, Gross Domestic Product, the broadest measure of the nation's economic activity, subsided from 3.7% in the first quarter, to 1.7% in Q2 and 2.6% in Q3. For sustained growth to continue, private spending in the private sector needs to pick up. Fortunately, this appears to be occurring with consumer expenditures. A forecasted growth in GDP of 3.1% for the fourth quarter of 2010 is expected.

THE ELECTION:

The real game-changer this past year was the election. Republican leaders, who will take over the House and have a bigger minority in the Senate, say that based on election results they have a mandate from the American people in the words of the incoming House speaker, John Boehner, to cut taxes, cut the deficit and to repeal the "monstrosity" of health care reform. In fact, the American people said no such thing. Even among the Republican-tilted electorate, election exit polls found that only 39 percent favored extending the Bush tax cuts to all Americans, including those making more than $250,000 while 60% objected to extending the tax cuts for

the richest 2% or lowering the estate tax. The “loud message” to cut spending cited by Mr. Boehner was actually far more muted. The polls showed that 39 percent of voters say cutting the deficit should be the highest priority of Congress, but a statistically equal 37 percent prefer spending money to create jobs. Fully a third of those who want to spend money to create jobs were Republicans. In exit polls of voters, only 18 percent said health care was the nation’s top issue. While 48 percent of voters said they wanted to repeal the health care law, 47 percent said they wanted to keep it the way it is or expand it—hardly a roaring consensus.

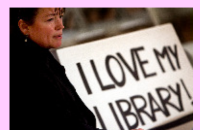


TAXES: The first big post-election fight in Washington came as Democrats and Republicans battled over extending Bush-era tax cuts. The chief difference between the combatants--about $139 billion—was whether to extend tax cuts for individuals making more than $200,000 and families making over $250,000. Tax cuts for this group, the top 2%, will generate relatively little new growth because the rich are less likely to spend their tax savings. Their impact on reducing unemployment is estimated to range between 0 and 0.1%. The most constant refrain heard was that with taxes increasing from 36% to 39%, small-business owners, the entities that are most responsible for new job creation, would then be so hard hit they could no longer afford to hire new employees. One economist calculated that the yearly tax increase at the lower end of the bracket, for those with earnings between $200,000 and $250,000 would amount to $700—which isn’t enough to hire anyone. It also begs the question: If those in the higher income group weren’t already investing in creating new jobs when the full Bush tax cuts remain in effect, why would extending them make them more likely to do so?

Conceivably, the bigger issue that was seldom raised—was whether the country could afford the systemic damage being done by the ever-growing income inequality between the wealthiest Americans and everyone else. The richest 1% of Americans now take home almost 24% of income, up from under 9% in 1976. C.E.O.’s of the largest American companies earned an average of 42 times as much as the average worker in 1980, but 531 times as much in 2001. Perhaps the most astounding statistic is this: from 1980 to 2005, more than four-fifths of the total increase in American incomes went to the richest 1%. The richest 1% of Americans now has tax rates a third lower than the same top percentile had in 1970.

Despite these staggering statistics, Republicans demanded that the Bush-era tax cuts be extended for everyone for another 2 years. In addition, the payroll tax was cut by 2%, unemployment benefits were extended for 13 months and the estate tax on assets over $5 million was reduced from 55% to 35%. The total cost of negotiating the recent tax cut package was $858 billion. Both sides agreed on extending the $330 billion for the other lower income groups.

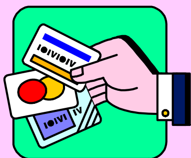
Most economists believe that the cuts will drag the country deeper into debt, while doing little to spur growth. There are efficient ways to stimulate the economy and there are inefficient ways. Generalized tax cuts are inefficient. Evidence from past tax breaks show that only about two-thirds of the money put into the average taxpayer's pocket will be spent. The rest will be saved or used to pay down debt, adding little to the economy. Meanwhile, the non-partisan Congressional Budget Office (CBO) ranked the extension of any Bush Tax Cuts, let alone those to the wealthiest Americans, as the least effective of 11 policy options for increasing employment. Congress’s decision to extend the Bush-era tax cuts and reduce the estate and payroll taxes was subsequently viewed by the Bond Market as inflationary and credit negative which pushed Treasury yields to their highest levels since May thereby hiking mortgage rates. Furthermore, because excessive tax cuts worsen the deficit, they actually threaten Americans by creating pressure to cut spending on other programs that actually are needed.



Areas that received scant media attention this year are the serious budget shortfalls for state and local municipalities. The sources of future economic distress are likely to originate here.

THE DEFICIT: Our national debate about fiscal policy has become skewed with far too much focus on the deficit and far too little on unemployment. As we have seen, despite the constant repetition by senators McConnell and Boehner, deficit eradication and tax cuts for all were not voters' No. 1 priority, nor does its constant reiteration make it true. Deficits are not as pressing a problem as economic recovery. A stronger recovery must not only come first, but it is the best way to begin to heal the budget. By focusing on the wrong things, we are in serious danger of failing to do the right things to help the economy recover from its worst labor market crisis since the Great Depression. Ironically, the federal budget deficits are sky high because of the earlier Bush-era tax cuts, the costs of the wars in Iraq and Afghanistan, and the spending that was needed to keep the Great Recession from spiraling into the another Great Depression. The deficit hawks want to radically cut budgets and shrink the government. But you can't have a coherent conversation about deficit reduction if tax increases are off the table and the country is still at war. It is an irresponsible fantasy that tax cuts do not deepen the deficit. Even if deficit reduction right now were a good idea—which it is not, given the sorry state of the economy and the vast legions of the unemployed—the deficit zealots have no viable plan for getting their misguided mission accomplished.

The CBO estimated the federal deficit for the just-finished 2010 budget year was a little under $1.3 trillion (October 7, 2010). Deficits of $1 trillion in a single year had never happened until two years ago. The 2009 deficit was more than three times the size of the previous record-holder, a $454.8 billion deficit recorded in 2008. The deficits are a serious, long-term problem and they will shrink in the near term as the economy recovers. But by the end of the decade, they will breach the $1 trillion mark again, even if the economy is performing well, mainly because of chronically low taxes and rapidly rising health care costs.



CREDIT: The latest Fed figures show that credit to consumers has been falling for the last eight quarters. At this time last year, the total stock of commercial and industrial bank credit was $1.32 trillion; it was contracting a blistering pace—about $7 billion a week. Between the peak of such lending in October 2008 and the trough in June of this year, total commercial and industrial bank credit fell by one-quarter! This accounts for why the Fed continued to fret over price stabilization.

THE FED: It was in response to this on-going trend that caused the Fed to announce its intention to buy $600 billion worth of Treasury bonds the day after Election Day. It is standard operating procedure for the Fed to try to reduce interest rates when unemployment is high and inflation is low and especially so when worries that further delay could trigger price de-stabilization. Fed Chairman Bernanke thought he could stimulate the economy via a process he termed "credit easing" (that others characterized as "quantitative easing") via purchasing longer term securities which would bid up the price of the bonds and lower the interest rates. But, because of weak demand the Fed's efforts to provide more credit to small businesses to spur hiring has been like pushing on a rope—not terribly effective.

RETAIL SALES: Consumers appear to have been more optimistic this holiday season than in recent ones. The National Retail Federation is projecting 2010 holiday sales to post gains 5% above 2009's figures. Excluding auto sales, retail sales rose more-than-expected in November to 1.2%, and October sales figures were also revised higher from 1.2% to 1.7%. Total retail sales rose 0.8% in November, beating the 0.5% increase economists had forecast.

OIL: Oil was at $80/bbl in October. This past month it topped $90. The global market for oil is diverging as never before. In emerging markets, it has generally been full speed ahead. Auto sales statistics illustrate this well: The Chinese are expected to buy 18 million cars in 2010—a 32% jump from 2009, according to the China Association of Automobile Manufacturers. In the U.S., about 11.5 million cars are expected to be sold—a 10% increase for the country after a dismal 2009. Many experts believe that $100/bbl oil is likely in 2011. Should prices rise above the century mark it will likely dampen America's already slow economic recovery.

HOME SALES & MORTGAGE RATES: The expiration of the homebuyer tax credit in the second quarter created a substantial dip in overall buyer demand in the third

quarter. The National Association of Realtors reported that the number of **existing homes sales** fell 2.2% in October. **New home sales** dropped 8.1% during the same month while **new home construction** similarly declined to an 18-month low, according to the Commerce Dept. As heartening as the jump in the **sales of previously-owned homes** of 5.6% for November was, this number was still down 27.9% from a year earlier.

At present, a record 23.2% of mortgages are now underwater. The latest figures from the Mortgage Bankers Association show the foreclosure crisis has not abated. Households that are behind in their mortgage payments fell during the third quarter to 13.52 percent, from 14.42 percent in the second quarter.

Many banks have been slowing the foreclosure process because they already own a glut of homes. The banks are "staggering" their inventory so that they don't depress prices by throwing more inventory on the market than it can clear. Also, it's better for the banks to allow borrowers to stay in these homes, doing the maintenance and protecting them from vandalism, than leaving them vacant for months in moribund markets. Distressed homes sell, on average at a 32 percent discount from the sales price of homes not involved in foreclosure. Foreclosures accounted for 25% of all U.S. residential sales in the third quarter of 2010, which is up 1% from the previous quarter.

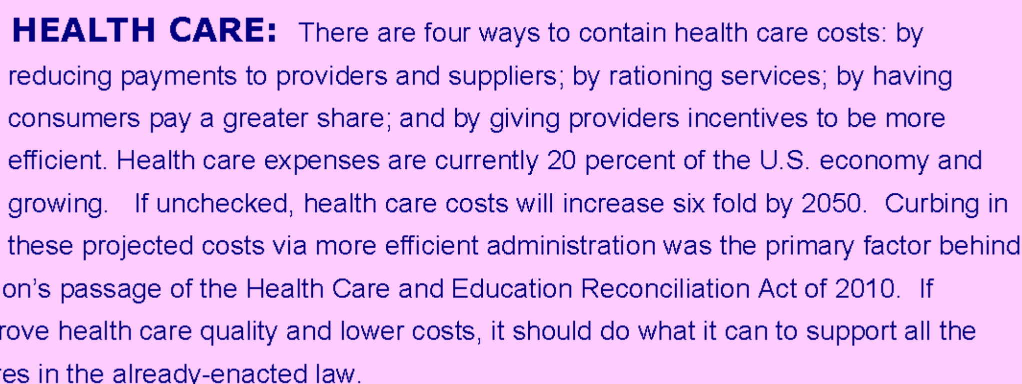
The sales volume of non-distressed properties also fell, decreasing 29% from the previous quarter, according to RealtyTrac data. Recent sales have only reduced 2% of the 4.2 million units of the visible supply of existing homes listed for sale, and these numbers don't include the so-called "shadow inventory" of foreclosed homes, or homes that owners would like to sell but haven't considered listing. This "shadow inventory" jumped 10% during the past year. CoreLogic, a financial information provider, reported that there were 2.1 million homes in this uncounted inventory. Adding the shadow inventory to the visible supply of homes on the market boosts the total housing-market supply to 6.3 million units. Although it can vary and it depends on the market and real estate cycle, typically a reading of six to seven months is considered normal so the current total months supply is roughly three times the normal rate. This is being exacerbated further due to the highly extended time-to-liquidation that servicers are currently experiencing.

Weak demand for housing is significantly increasing the risk of further price declines in the housing market and the most recent numbers are not encouraging as far as showing signs of improvement. The S&P/Case-Shiller Home Price Index declined 2.0% in the third quarter of 2010. It declined another 1.3% in October from a month earlier, an annualized decline of 15%. Mortgage rates followed Treasury yields and spiked a full percent between November and December, another troubling turn affecting the housing market's recovery.

THE STOCK MARKET: The stock market is often said to be a 6-9 month leading indicator of the economy, meaning that stocks move higher ahead of any upturn in the economy as investors bet on better times ahead. Markets have had a strong showing in December.

The blue-chip Dow is up 11%, the S&P has risen 12.7% and the Nasdaq has climbed 17.5%. All three major indexes are up more than 10% for the year. Gradually improving economic data,

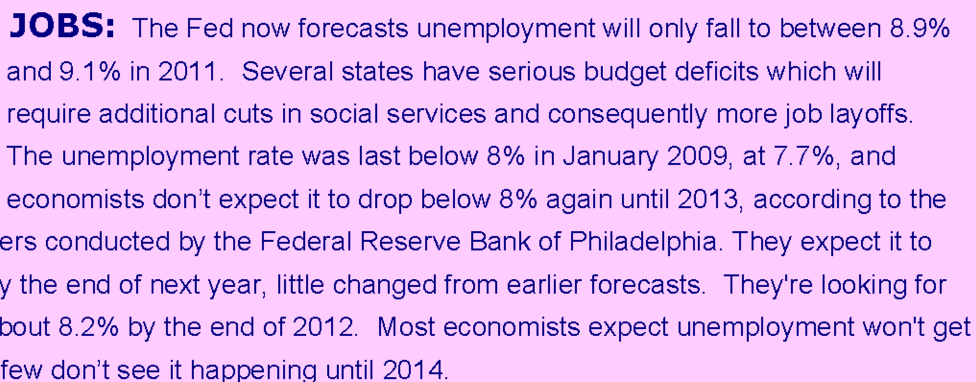
combined with the Federal Reserve's efforts to stimulate the economy, have given stocks a lift in recent months. Stocks are likely to continue their upward trend as investors purchase equities in lieu of bonds for their higher rates of return associated with them.



HEALTH CARE: There are four ways to contain health care costs: by reducing payments to providers and suppliers; by rationing services; by having consumers pay a greater share; and by giving providers incentives to be more efficient. Health care expenses are currently 20 percent of the U.S. economy and growing. If unchecked, health care costs will increase six fold by 2050. Curbing in these projected costs via more efficient administration was the primary factor behind the Obama administration's passage of the Health Care and Education Reconciliation Act of 2010. If Congress wants to improve health care quality and lower costs, it should do what it can to support all the cost-containing measures in the already-enacted law.

EUROPE: The European Union was the biggest market for U.S. goods last year, buying $221 billion of U.S. goods, more than triple what was purchased by the Chinese. A stronger dollar makes those exports more expensive and cuts into American companies' sales and profits. It also lowers the price of European exports, giving them a leg-up in competition with U.S. goods elsewhere.

WHERE THINGS ARE HEADED



JOBS: The Fed now forecasts unemployment will only fall to between 8.9% and 9.1% in 2011. Several states have serious budget deficits which will require additional cuts in social services and consequently more job layoffs. The unemployment rate was last below 8% in January 2009, at 7.7%, and economists don't expect it to drop below 8% again until 2013, according to the latest survey of 43 forecasters conducted by the Federal Reserve Bank of Philadelphia. They expect it to improve to just below 9% by the end of next year, little changed from earlier forecasts. They're looking for unemployment to drop to about 8.2% by the end of 2012. Most economists expect unemployment won't get below 8% until 2013 and a few don't see it happening until 2014.

The new Republican elects have yet to explain how tax cuts and deficit reductions will promote job creation. I believe the freshmen congressmen are no more astute than the incumbents in this regard. More and more voters, both here and in Europe, are convinced that what we need is not more stimulus, but more spending cuts: Governments must tighten their belts; debtors must pay what they owe. The irony is that in their determination to punish the undeserving, voters are punishing themselves: by advocating economic contraction, rejecting fiscal stimulus and debt relief, they're perpetuating high unemployment. They are forgetting the First Rule of Holes: When you're in one, stop digging and ignoring the Second Rule of Holes: You can only grow your way out. You can't borrow your way out. Thus, they are, in effect, cutting off their own jobs to spite their neighbors. But they don't grasp that. Therefore, I believe at least for the next few years what lies ahead is faltering growth and debilitating unemployment.

A better solution would have been to allow the tax cuts to expire and use the money they would have cost over the next two years for more targeted and effective

stimulus measures such as investing in education, infrastructure, innovation and aid to state and local governments with more help for the weakest sectors like housing—all of which would have done more for job creation.

THE ECONOMY OR GROSS DOMESTIC PRODUCT (GDP): The economy is still only growing at a mediocre pace, especially if you consider the depth of the recession that we're emerging from. Growth in GDP of 4-5% for a couple of years is needed to really impact the unemployment rate. Even though the economy has grown for five consecutive quarters, consumers are still understandably cautious when faced with high unemployment, tight credit and a slumping housing market. Last month the Fed revised its forecast for 2011 and projected that it could take several years for the economy to return to health. The Fed projects growth of between 3% and 3.6% in 2011. Like Japan in the '90s we are doing relatively little to promote job creation, passing up fiscal stimulus for tax cuts and quantitative easing. I anticipate that growth will be more in the range of 2.8% -3.1% for the coming year.

THE DEFICIT: Reducing the deficit and preserving the Bush-era tax cuts are mutually exclusive. The last Republican to say this was Ronald Reagan who told us he could cut taxes, increase defense spending and balance the budget—all at the same time. In actuality, he nearly tripled the deficit in his eight years and never made a realistic proposal for cutting it. The Center on Budget and Policy Priorities calculates that the extended Bush-era tax cuts will contribute by far the largest share to the next decade's deficits—ahead of the recession's drain on tax revenues, Iraq, and Afghanistan war spending, Tarp and Obama's stimulus package.

Moody's, the rating agency, is the latest to warn that the tax cut deal could imperil the United States' fiscal position. It warned that unless Congress gets its act together, it could see a once unthinkable downgrade of the U.S. credit rating on its watch, which could balloon U.S. borrowing costs and make our financing position much more costly.

This observation appears to mirror the conclusion of the bond market: Rates have been rising since November as investors shift money out of Treasuries and into stocks. The yield on the 10-year Treasury has soared to 3.34% (12/29/2010) from around 2.4% two months ago, as investors bet on a stronger recovery and rising inflation. The risk Moody's is warning of is of a loss of confidence in the U.S. policymaking apparatus—a fear that appears legitimately justified at the moment.

RETAIL SALES: Prices for consumer goods are expected to rise between 1.1-1.7% for 2011, still well less than 2% through at least 2012. But some policymakers at the Fed have expressed concern that the steps the central bank is taking to stimulate growth could lead to higher inflation down the road.

OIL: With high unemployment, some analysts predict that the commoditywill hit $100 a barrel sometime this year as demand rises from China and other emerging economies. But various factors might send prices down as well, as the spread of Europe's debt crisis could strengthen the U.S. dollar and send prices for the dollar-denominated commodity downward. Oil demand in much of the developed world has been flat or declining in the last couple of years, partially due to the recession and partly due to conservation measures put in place over the last several years. Many analysts expect that trend to continue.

HOME SALES: The subsequent slump in mortgage backed securities further threatens a recovery in the U.S. housing market, which had been bolstered by record-low borrowing costs. About three-quarters of economists project home prices to be essentially flat in 2011, but roughly a quarter expect them to drop by 10%. I would estimate home prices to slide another 7% in the near term. A rise in prices of only 2.2% is forecast for 2012. We won't see a true rebound in prices until we have job growth.

CREDIT & MORTGAGE RATES: Economists are evenly split on whether the Federal Reserve's current policies are helping the economy. But they're in agreement on one point—the- Fed won't be raising interest rates anytime soon. Persistently high unemployment is one reason the economists think rates will remain low. A CNNMoney.com survey showed that economists expect the Fed funds rate -- the central bank's key overnight interest rate used as a benchmark for a wide range of loans—to remain near 0% for at least another year. With the Fed Funds rate at essentially zero the central bank has been forced to resort to credit easing

via the purchase of longer term Treasury bonds to encourage growth. Low inflation pressures should also allow the Fed to keep the low rates in place.

THE STOCK MARKET:
The shifting balance of power on Capitol Hill is largely seen as a positive for Wall Street, since Republican lawmakers are viewed as more business friendly and fiscally conservative than their Democratic rivals, though stock market returns have not borne this out. Ironically, this tight-fisted attitude about the bottom line has produced comparatively meager results.

HEALTH CARE: The incoming Republican leadership in Congress has voiced its commitment to doing whatever it takes to stop the health care reform act from taking effect. Yet the bill and many of the provisions that politicians have been attacking were the essentially the same ones that Mitt Romney enacted in Massachusetts and other Republicans stumped for prior to Mr. Obama taking office. And, the provisions are the same ones that save money—like those that reduce excessive provider payments and create new institutions to curb cost growth. If the newly elected representatives and senators are truly concerned about rising health care costs, they should work to deploy the law's cost-containment measures fully rather than try to repeal them. While the health care law is not perfect, it would cut the nation's long-term fiscal imbalance by a quarter and reduce the projected deficit within Medicare by three-quarters. The health care law starts the arduous process of shifting the medical payment system away from an emphasis on quantity of care and toward an emphasis on quality. Upholding health care reform is crucial, because, in the long run, it is vital to taming the deficit.

FED POLICY: The case for a second stimulus is obvious, overwhelming—and unlikely. Unemployment is uncomfortably high while U.S. inflation data over the past few years almost perfectly track the early stages of Japan's relentless slide into corrosive deflation.

EUROPE: Finally, there are the problems in Europe. Given how fragile the recovery in the U.S. is, economists are worried about the euro crisis further denting investor and consumer confidence. The continued decline of the euro versus the dollar could cause other problems for the U.S., including putting a crimp in U.S. exports. Bailouts of the over-indebted countries cannot continue without impacting the less-indebted. Europe is the bigger risk to global economic stability in 2011. With another financial crisis, the dissolution of the European Union is a very high probability event. China, however, also poses a risk to the global recovery, due to the Chinese government's efforts to slow growth in order to combat inflation.

CONCLUSION

The jobs picture is unlikely to ameliorate below 9% in the coming year. The economy has grown for five straight quarters, but now the effects of the earlier stimulus spending are exhausted. The Fed is purchasing $600 billion in longer term securities to spur economic growth and jobs, although a second stimulus package via fiscal policy would have been more effective. Consumer spending is picking up as evidenced by the recent spurt in retail sales. The recovery's bright spots are the growth in GDP and the stock market. The weaknesses are in unemployment and income. Energy prices remain a wild card for 2011. Among the big questions for 2011 are: How severe will state and local budget crises turn out to be? Will Europe's debt troubles spread to Spain, Portugal, or elsewhere? The incoming Congress believes it has a mandate to cut the deficit, but demonizing spending and sanctifying tax cuts will only further retard job growth and the recovery. Once again, lawmakers have shied from dealing with the hard realities like raising taxes and have "kicked the can down the road" for some future day of reckoning. Thus I believe we are poised for a fate similar to Japan's in the 90's, a lingering, jobless recovery.

RATE SUMMARY:

Rates WORSENED, this past month.

Conventional conformings HIGHER by 1/4 to 3/8th of a percent

Jumbos—WORSE in the range of 0.35% - 0.50%

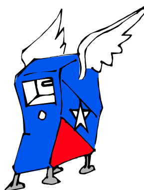
Governments (FHA/VA)—MORE EXPENSIVE by ¼ to ½ percent

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO:
www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

SPECIAL(S) OF THE MONTH:

The Conforming 5/1 ARM @ 3.125%
The Home Ownership Accelerator @ 3.357%
The VA High Balance 30-yr. fixed @ 4.625%
The CalHFA 30-yr. fixed @ 4.125%
The OA/DU Refi 30-yr. fixed @ 4.625%

MORTY'S MAILBAG



There were no letters in the mailbag this month.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to be identified as "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is….**morty@mortgagestraightTalk.com**

MORTGAGE MIRTH

Going to church doesn't make you a Christian any more than standing in a garage makes you a car.

If you'd care to share one that you've heard, please email it to me at….**rod@mortgagestraightTalk.com**

NEXT ISSUE'S TOPIC: FSBOs— A THEORETICAL APPROACH

Happy New Year!