Insight

Top 5 Problems for 2011

JANUARY 3, 2011

1. GDP at 2.5%. This is Ben Bernanke's biggest fear for the economy. Growth at 2.5% (or lower) is too slow for companies to hire additional workers due to slack capacity and high productivity. In turn, this reduces future sales and a downward spiral begins by which employers fire workers due to lack of demand.

2. State finances. Individual states have major funding issues for 2011. The federal stimulus money ebbs early in the year and necessitates a reduction in spending and employment by state governments. Education is one of the largest state expenditures and is likely to be cut the most unless the unions are will to take cuts to keep their membership employed. The state fiscal issues are likely to generate higher sales and income taxes which will further pressure growth.

3. Residential real estate. Residential real estate continues to building amounts of foreclosures and shadow housing stock. The recent Case-Shiller home price index have fallen four months in a row and show downward price pressure remains in the housing market. The shadow inventory of homes with mortgage delinquency and creditor owned remains extremely high. The drop in mortgage applications along with the Conference Boards % planning to buy a home in the next 6mths show a dearth of demand.

4. US fiscal crisis. The 111th Congress left town without passing a 2011 budget that began October 1st 2010. This is the first time a budget has not been passed since 1974. During the lame duck session, Congress wisely passed a CR for the budget until March 4th and means that the entire government is operating on stopgap funding at fiscal 2010 levels. The deficit remains over $1 trillion a year and forces the US government to borrow massively from the markets. As the debt piles up, the US Treasury must ask Congress to increase the debt ceiling to allow them to borrow more. This is where the potential for a fiscal crisis develops as the Republican House leadership will have to decide if they want to keep extending the ceiling. The need for an extension should occur sometime in the second quarter.

5. Food Inflation. Is this really the most under-reported story of 2010? Since June, wheat is up 60% and corn is up 74%. Food accounts for up to half of all household spending in emerging countries compared to just 10-15% in Europe and the US according the FT. China has increased reserve requirements and raised interest rates because their CPI is running above 5.0% and food inflation is running above 10% and vegetables up 21%. Mexico bought call options on corn this week as Mexican tortilla makers threatened to raise prices by 50% to offset higher corn and natural gas costs. If the price of food continues to soar, social unrest is likely to occur in the EM countries and disrupt economic growth.

This originally appeared on AndrewBusch.com on December 29, 2010.