

# The Kiplinger Letter

FORECASTS FOR MANAGEMENT DECISIONMAKING

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Dear Client:

Washington, Oct. 17, 2008

It's a good bet Uncle Sam's plan will work, thawing frozen credit markets and easing the crisis... though calming a chaotic Wall Street may take months.

THE  
ECONOMY

But recession will be with us well into 2009. Nothing like the Great Depression, it's true... no 25% unemployment and years of negative growth.

The economic pain will be spread unevenly, with some sectors reeling and others nearly unharmed. An especially tough slog is likely for industries that were struggling before the meltdown: Autos, housing, retail, financial services, just for starters.

Consumers' easy access to credit is over. With borrowing curbed, spending will be flat at best. First to go: Luxuries...travel, spas and pricier dining. Entertainment and leisure...golf, cable TV, movies. Shoppers will buy less of nearly everything: Clothing, automobiles, furniture and electronics. Also home services and fix-ups, and impulse purchases. And when it comes to holiday shopping this season... a dismal year for retailers. Plus the lousy Christmas will lead to even more-miserable sales in the new year.

Expect joblessness to hit 7.5% in '09, as demand shrinks and firms contract. Managers won't start hiring again until the end of next year, at the earliest. Only then will consumer spending rebound...restarting a "virtuous" cycle: Workers spend money, create demand for goods and services, and trigger more hiring. Still, there'll be pockets of strength. The economy won't be all doom & gloom. Watch for profits from health care businesses, exporters, sellers and producers of food. Ditto for data providers, accountants and lawyers hired for the federal rescue plan. Defense and aerospace companies should also weather the economic storm well.

No increase in business spending until 2010, when the credit crunch eases: Few equipment purchases and only essential repairs. Companies will stockpile cash for emergencies, since loans will be hard to get. That'll hinder the technology sector, as will fewer orders from Wall Street, which faces its biggest restructuring in 70 years.

And another year of suffering for housing: More builders and lenders going broke. Fewer sales of appliances, carpeting, aluminum siding, landscaping, etc. Home prices will continue to slip and foreclosures to rise, despite rescue efforts. The new president and Congress may take another run at stimulating the economy, but the rapidly soaring deficit will make finding the money very difficult indeed.

Blunting the recession's blow...lower oil, gas and other commodity prices. Oil's 50% drop since July is better than a tax rebate, and food prices are more stable. The dynamism and heft of the U.S. economy will be tested but not defeated.

## ECONOMIC FORECASTS

↔	<b>GDP growth</b> NEW A flat year in '09
↔	<b>Interest rates</b> NEW Prime rate at 4% in '09, 10-year T-notes yielding 4.25%
↓	<b>Inflation</b> Moderating in coming months
↑	<b>Job growth</b> NEW Monthly losses moderating in '09
↓	<b>Crude oil</b> NEW Averaging \$95/barrel in '09
↑	<b>Housing sales</b> A small pickup during '09
↓	<b>Retail sales growth</b> Around 1% next year
↓	<b>Trade deficit</b> NEW \$140 billion, 1% of GDP in '09
Complete economic outlook at <a href="http://kiplingerbiz.com/outlooks">kiplingerbiz.com/outlooks</a>	

**WORLD  
BUSINESS**

No need to worry that foreign investors will suddenly shun the U.S. Recession or not, this is still the most attractive place for capital.

The U.S. response to the financial crisis has been bigger and faster than most, and the U.S. has more resources to deal with it. Some nations...France, Switzerland and the Netherlands, for example...have banks that are bigger than their GDPs.

A good measure of foreign investors' trust is the dollar's sharp rise.

It's up against the euro, pound, Canadian dollar, Mexican peso and Brazilian real. That shows how many still view the greenback as a safe haven in times of turmoil.

China, the healthiest big economy, has too many capital controls.

As long as it limits the yuan's rise, there's only so much investment it can absorb.

Still, foreign direct investment in the U.S. will begin to slow somewhat.

Tight credit conditions will limit *all* cross-border mergers and acquisitions.

But with many U.S. companies starved for cash, the price they are willing to accept is much lower. The same holds for corporate assets, such as brands and patents.

Financial institutions will remain major targets, as will the Detroit auto industry and other big manufacturers. As long as the U.S. doesn't succumb to protectionism, it will continue to lure capital from Europe, China, the Mideast and Latin America.

**BANK  
MERGERS**

Expect more U.S. bank mergers, now that the IRS is offering incentives... basically rewarding banks that take over failing financial institutions.

The temporary change, which lets acquiring firms write off a much greater share of the troubled firm's losses, allowed Wells Fargo to snatch Wachovia from the hands of Citigroup. In that case, the new IRS incentive cost taxpayers about \$14 billion.

Other likely bank targets: Fifth Third, National City, KeyBank and Regions.

The buyers: PNC, U.S. Bancorp, Morgan Stanley and Goldman Sachs.

**ROAD  
BUILDING**

Another side effect of the financial crisis: Delays in infrastructure projects.

There's little public or private cash. Though there's some talk of a stimulus from Congress that would include a temporary boost in aid to states and cities, the long-term outlook is for tight budgets and less federal funding for several years. Plus pension funds and other investors in public-private highway partnerships have taken a hit to their portfolios. They'll be both less willing and less able to commit cash to partnerships allowing private firms to build and operate toll roads.

That will mean a slowdown in construction of vital infrastructure projects... highways, bridges, tunnels and connectors to speed freight to railroads and ports... just when they are needed most, both for transportation and to create new jobs.

**BUSINESS  
TRAVEL**

The balance of power is shifting from hotels to business travelers.

The recession lets companies demand...and often get...a better deal, even reopening completed contracts under threat of going elsewhere next year.

Try asking for free parking, breakfasts, late checkouts or newspapers.

Companies planning big meetings may also be able to get conference rooms, setups and breakdowns and audio visual assistance for free or at a big discount.

On new contracts, smaller rate hikes are likely, even from five-star hotels.

Many companies are planning to ask for less than 3% in increases over 2008 rates.

The plan to auction landing rights at airports near New York City won't fly.

The airlines and airports are going to court to challenge the government, which had hoped an auction of slots would ease congestion and improve efficiency. If airlines have to pay a lot for slots, they will charge passengers up to 12% more.

The airlines figure they just need to run out the clock on Bush's term

but believe they'll win if the case gets to court. The Government Accountability Office has said the Federal Aviation Administration lacks authority for the auction.

Congress and business travelers oppose the idea, as do the N.J. and N.Y. governors.



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**JOBS &  
WORKERS**

The recession will push immigration reform to a back burner in 2009. As jobs dry up, fewer illegal immigrants are sneaking into the U.S., and more of those already here are packing up and going home to their families. Plus fewer employers find themselves in need of guest workers. They're much more likely to lay off help than to put more on their payrolls.

Illegal immigration from Mexico is down by about 50% so far this year. Tighter border controls and high-profile workplace raids at meatpacking plants and other businesses suspected of knowingly hiring illegal aliens are factors. But so is the job outlook. Most immigrants do some kind of cost-benefit analysis before deciding whether to come to the U.S. and how long to stay. Fewer people are deciding to risk the move as the economic and social climates turn hostile.

The slowdown hasn't hit legal immigrants, who now outnumber illegals. There's still plenty of demand for entry visas, which are limited by statute. Meanwhile, it's too soon to say how foreign graduate students will be affected. Whether they stay or go home will depend on where the job market is stronger.

This will provide breathing room for the next president and Congress. But when the economy improves, expect a new push for major legislation that combines tighter borders, a guest worker program and a path to citizenship for the millions of illegal immigrants who are already here and choose to stay.

Barack Obama and John McCain both favor a comprehensive approach. And with more Democrats in Congress, which is almost certain to be the case, it will be easier...though still not easy...to overcome conservative GOP opposition.

**EDUCATION**

Boeing is launching a program to help improve U.S. engineering schools. The aerospace manufacturer is going to evaluate the nation's colleges and universities on how well they prepare students for the real world's demands. The results will be shared privately with schools, along with the company's advice on how to improve, including which courses and skill sets may need special focus. It's part of a major push by businesses to be more involved in education.

**BUSINESS  
TECH**

Soon to catch on: Cell phones that scan bar codes on posters and ads to get more details. Point your cell at a movie poster and find reviews and local start times. Aim at an ad on TV and reach the Web site of the company. At bus stops, scan a sign to find out the likely arrival time, based on the bus's GPS. Point to a magazine article and view or hear other content, including interviews.

Businesses will be able to gather data on customers who opt in. Many will if cell phone firms offer freebies...product trials, ring tones, etc. Even if customers don't, firms can find out which ads are hot and where users are.

This ad tool is already common in Japan and Europe. It's gaining steam in this country, and it will get a boost when phone carriers agree on standards.

Companies can integrate worker cell phones into their PBX phone networks with new software from Ascendant Systems. When their office phone rings, executives at home or employees on the road can hear it on their mobile phones, so calls don't go directly into voice mail. Office and cell phones can share voice mail, and conference calls are easy to set up. It's more flexible than forwarding calls.

Employees can toggle between personal and business phone calls, getting billed separately. If the worker quits, the phone number is dropped, too.

It's most useful for BlackBerrys, which are better able to transfer calls, take conference calls and dial extension numbers connected to the network. But other cell phones can use it, too. Price: \$39.99 for software. The server is extra.



ELECTION  
2008

Time is running out for John McCain. With two and a half weeks to go...  
Barack Obama leads in enough states to give him the White House.

McCain had his best performance to date in the final debate of the presidential race, but he didn't land the knockout punch he needed to reverse Obama's momentum.

The financial crisis and the recession continue to work in Obama's favor.

They are by far the biggest issues, with voters, rightly or wrongly, blaming the GOP for the current state of affairs and feeling Obama offers the best hope for change.

Bush's low ratings aren't helping McCain, despite the GOP nominee's efforts to distance himself from the president. Voter satisfaction with the way things are in the U.S. is at a post-World War II low...under 10% in several recent opinion polls. That's an enormous obstacle for McCain to overcome so close to Election Day.

McCain has hurt himself by going negative, according to all indications.

His attacks appeal to the GOP base, which was a McCain soft spot early in the race, but they don't work with independents, who want to hear more about policy plans. The same is true of Gov. Sarah Palin...loved by the party faithful but not by others.

None of this is to say the race is over. While Obama has an impressive lead in most polls...nationally and in battleground states...this is no typical election year.

Polling may prove even less accurate than usual, for several reasons:

The huge number of new registrants who may or may not actually show up to vote. The large number of cell-phone-only households most pollsters miss. And, of course, the race factor...sure to hurt Obama somewhat in the privacy of the voting booth.

Still, Obama's lead is widespread. Our analysis gives him 273 electoral votes, three more than needed, with 102 in toss-up states.

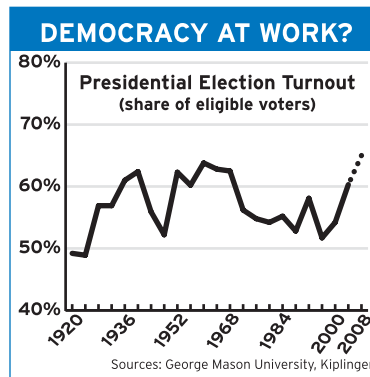
Obama has an edge in every state that John Kerry won in 2004 plus three that Bush won: Iowa, N.M. and Colo.

Obama is also close to snatching Fla. and Va., while McCain and Palin have had to spend valuable time and money in usually safe places like W.Va. and N.C.

Expect a modern-day record in voter turnout.

There are indications of that already in the 31 states that have early voting. As many as one-third of voters will take advantage. Big participation is being reported in Ga., Va., Ohio, Fla. and several other states...

a sure precursor of what's to come on Election Day.



SPACE

NASA is likely to extend the life of the space shuttles beyond 2010, when they are scheduled to be mothballed. That will mean costly retrofits and repairs just to buy a few more missions before safety experts pull the plug.

Blame frostier U.S.-Russian relations since Moscow's invasion of Georgia.

Officials are unwilling to rely on Russia to service the International Space Station until a shuttle replacement is built. But there will still be a gap of at least two years.

The shuttle's successor...Orion...won't be ready until 2015 or later.

It's being developed by Lockheed Martin Corp. and Teledyne Technologies Inc.

Yours very truly,

*Knight/Kiplinger*  
THE KIPLINGER WASHINGTON EDITORS

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