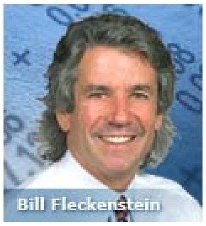

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The next crisis: The economy

The banking system's meltdown will run its course soon enough. Then we'll have to face the reality of the coming severe recession.

By Bill Fleckenstein

It was just a year ago, in my Oct. 1, 2007, column, that I wrote, "We are headed to recession, though it's not possible to pinpoint the 'when.'" To me, it was plain to see that a long-lasting credit spree could end only in pain and tears.

It should be obvious to everyone that the "when" is now.

My expectation has been that with passage of the financial-rescue legislation, a relief rally will be followed by the market's heading lower once again, and potentially violently.

Why? Because the intensity of the credit crisis has distracted folks from the economic crisis, the brutal recession we are destined to experience. The legislation is not going to change that fact. And when folks realize that, it could easily create a good deal of angst.

We don't need a grandiose plan

I continue to be against the bailout. As I noted in a column on my Web site (subscription required) last week, I thought portfolio manager John Paulson's plan (outlined in a Wall Street Journal article, "The public deserves a better deal") was better than Treasury Secretary Hank Paulson's plan.

But I'm not wild about any plan. I would prefer to see the problems handled ad hoc, as they have been. I think that for the long-term good of the country, no grand bailout would serve us better than individual plans, although I do think a broad plan would create opportunities for short sellers.

I especially haven't liked the tactics of the bailout proponents. They said that if this bill didn't pass, we would experience turmoil and chaos, the implication being that if the bill *did* pass, we wouldn't have much trouble.

That is an absurdity, brought to you by the folks who maintained that the problem was just subprime, contained, etc., and who still do not understand the environment. Turmoil and chaos were preordained once the credit and real-estate bubble was allowed to go on for so long.

Of course, a lot of the nouveau "economic patriots" in Congress see this plan as a chance to do what they do best, which is to throw some pork around. The bill has dozens of tax breaks for such important things as wooden arrows, owners of stock-car racetracks, Virgin Islands rum makers and so forth. These perks are not widespread, but I suspect there is more posturing and greasing of palms in Washington than there is genuine concern and understanding about what lies ahead.

Now comes the economic crunch

The current phase of the financial crisis is getting later in the day. Maybe we're two-thirds or more of the way through it. The next crisis will be in the economy.

During the expansion, as I explained in my book "Greenspan's Bubbles," the economy wasn't that strong, if you excluded the impact of the real-estate bubble.

Now, given the contraction in credit, it will weaken dramatically, with the Institute for Supply Management's data of Oct. 1 being a vivid example.

Many large European financial institutions are also in trouble, with new casualties popping up regularly, and they are seeking varying degrees of bailouts. Several -- **Fortis** (FTZBF, news, msgs), **Dexia** (DXBGF, news, msgs) and **Hypo Real Estate** (HREHF, news, msgs) -- have fessed up in the past week.

So this financial crisis is a global one, and the recession will be as well -- because the notion of U.S. problems being decoupled from everything else is fallacious. Nothing can easily be decoupled from the financial system.

Jubak says. In both Shanghai and New York, the rule is 'Privatize the profits and socialize the losses.'

Also in the misconception department, folks have heralded Warren Buffett's investment in **General Electric** (GE, news, msgs), similar to the one he made in **Goldman Sachs** (GS, news, msgs), as something akin to a vote of confidence. It's actually quite the opposite.

What he's doing is making the most senior equity investment that he can via preferred stock, and getting paid quite a large coupon to do so, with call options thrown in. Buying the common stock would be a vote of confidence. This is an investment you make when you're still worried about lots of damage yet to play out.

At the time of publication, Bill Fleckenstein did not own or control shares of any company mentioned in this column.