

Week of January 12, 2009

Market Comment

Any goodwill the economy might have banked during the holiday weeks of Christmas and New Year was certainly depleted last week. Most of the news was bad, and in some cases bad in ways unseen in years.

To wit, the Federal Reserve's minutes from its mid-December meeting of the Federal Open Market Committee (the committee that sets interest rates) revealed continued fears of a prolonged recession and a possibility of deflation. Some members indicated "the distinct possibility of a prolonged contraction." The minutes suggested that the Fed believes the economic outlook will remain weak "for a time" and hints that economic activity might be at substantial risk.

Consumers likely contributed to the Fed's rising anxiety. Con-

sumer spending accounts for two-thirds of total economic output, but the Fed reported on Thursday that borrowing through credit cards and other consumer loans dropped \$8 billion in November, the biggest decline in 65 years of record-keeping. Economists are now worried the economy's troubles could trigger a major retrenchment by consumers that will make the current year-long recession, already the longest in a quarter-century, even worse.

But the most disconcerting news for the Fed (and for all of us, for that matter) was saved for Friday, when the Labor Department reported the U.S. economy lost 524,000 jobs in December – a 12th straight decline that makes last year's collapse in employment the worst since the end of World War II. The latest reduction of jobs pushed the unemployment rate to 7.2% (the consensus was for 7.0%), a 15-year high. So much for the previous week's unemployment claims suggesting that job creation was on the rise.

Economic Indicator	Release Date and Time	Consensus Estimate	Analysis
Mortgage Applications	Wed, Jan 14, 7:00 am, et	None	Important. Lower rates continue to stimulate borrowing activity.
Retail Sales (December)	Wed, Jan 14, 8:30 am, et	1.2% (Decrease)	Important. Sales struggle on a pessimistic economic outlook.
Import Prices (December)	Wed, Jan 14, 8:30 am, et	0.5% (Decrease)	Moderately Important. Lower prices will keep any inflation pressure in check.
Producer Price Index (December)	Thurs, Jan 15, 8:30 am, et	Finished Goods: 1.8% (Decrease) Core: 0.1%(Increase)	Important. Falling producer prices gives the Fed more room to lower interest rates.
Consumer Price Index (December)	Fri., Jan. 16, 8:30 am, et	Finished Goods: 0.5% (Decrease) Core: 0.1% (Increase)	Very Important. Consumer prices that fall too much could be a sign of deflation.
Consumer Sentiment (January)	Fri., Jan. 16, 10:00 am, et	60 Index	Moderately Important. Consumers appear less worried than the pundits.

Be Skeptical of Forecasts

The recession will continue "well into 2009" before beginning a slow recovery in 2010, so says a budget and economic outlook published by the Congressional Budget Office. The CBO expects real gross domestic product to decline 2.2% before clawing its way back 1.5% in 2010. The CBO also said that "borrowers will continue to find the terms and availability of credit tight, which will increase the cost of capital and hold back the growth of investment and consumption, dampening economic activity for several years."

A dire prediction on the CBO's part, to be sure, but is it an accurate one? Probably not. In fact, most economic forecasts are inaccurate, and many grossly so. Indeed, the financial literature is loaded with studies demonstrating just how inaccurate the professionals are at predicting tomorrow. Consider oil prices: Last year, many of those quoted in the media were predicting

\$200-a-barrel oil by early 2009. Look where oil prices are now.

That's not to say that the CBO is wrong or that things can't get worse. But we have to question the CBO's call on the credit markets, given the current state of the mortgage market where the prime 30-year fixed-rate mortgage is available at 5% and the prime 15-year fixed-rate mortgage is available at 4.5%. Yes, you need a strong FICO score and income-to-debt ratio to get those rates, but money is also available at good rates for people of lesser credit standing. Indeed, most home buyers can qualify for a reasonable-rate FHA-insured loan, and with a down payment as low as 3.5% to boot.

We might be tempted to extrapolate last week's economic data through 2009, but before we do, let's not forget that yesterday's news has questionable predictive power for tomorrow's markets – a fact that has been proven many times in the past.

This newsletter brought to you compliments of:

usbancorp
Mortgage Advisors, LLC

Doug Ward
425-885-9544

Email to: doug.ward@usbank.com



Keeping up-to-date on market fluctuations allows you to bring greater value to your clients.