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# Watching the Economy: The Incredible Shrinking Recovery

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How low? That is the question on everybody's minds. It doesn't matter if we're talking about the stock market or interest rates or consumer confidence or…you get the picture. Where once we were looking forward to an accelerating economic recovery—admittedly, slow at first—now we are looking for signs that the US economy will avoid a dreaded "double dip" recession.

## Signs

The tea leaves are still unread, and the signals are truly mixed. Signs of positive, albeit slow, expansion remain, but they are fitted in among signs that the economy is still in the woods and not yet in the clear. Factor in the volatile roller coaster ride of the stock market—and many Americans' retirement savings—and widespread, negative but well-deserved press reports about corporate America's "bad apples," and the only thing one can say with certainty (even though nothing is ever certain), is that interest rates are not going to rise any time in the near future—at least, not through the end of the year. Instead, the question has become one of a neutral, essentially static position for the remainder of the year versus continued falling interest rates. Grumble if you will, but another truth at this time, is that nobody—absolutely no one—knows for sure whether rates will continue to fall or by how much. Not even Alan—he is busy looking for signs.

The Fed wields considerably less immediate influence over the economy, having already used monetary policy to lower the Federal Funds rate to historic lows. Market rates, including



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mortgage rates and Treasuries have followed in lockstep fashion, also toying with record lows. In the present low inflation environment, with businesses adopting a "wait-and-see" attitude—waiting for signs—and consumers responding to the loss of wealth in the stock market and high levels of household debt, additional interest rate cuts by the Fed will not have an immediate nor a dramatic impact. There is no jumpstarting the recovery to avoid backsliding toward recession, again—if that is indeed where we are headed.

## More Signs

As we move into uncharted territory, the current interest rate forecast has been revised downward, calling for a 25 to 50 basis point *decrease* in short rates for the remainder of the year, with longer rates sliding less (15-35 bps). The outlook for 10-year Treasuries remains near the middle of the range. Residential mortgage rates will follow. Again, the decline will be less on the long end of the spectrum (12-35 bps, 30-year fixed). The downward drift will prove unsustainable, but not before the end of the year—*unless* there are signs of a strong and sustained rebound. Don't expect the bottom to go lower, however, if rates fall to the levels indicated before year's end.

## The End of "For Sale" Signs

Housing market activity will finally show enduring signs of a slowdown, despite downward pressure on mortgage rates, as a result of consumer retrenchment. By comparison, further declines in interest rates will accelerate refinance activity, as consumers struggle to lower expenses any way they can, to offset however slightly, equity market—read, "retirement savings"—losses.

Hold onto your hat. And wallet. And continue watching for signs…

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