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Too Soon to Think About The Next Recession?

One short week after witnessing a return of interest rate volatility, it disappeared again this week. Mortgage rates saw **some** small-scale ups and downs, but generally held very close to last Friday's levels. All this despite the presence of important economic data and a policy announcement from the Fed.

Investors are **wrestling with bigger decisions** about where the economy goes from here. This might seem a bit silly considering economic data has been stable and strong for so long, but financial markets are always doing their best to price-in the future.

When the tax bill was just coming to fruition in early 2018, the future seemed much clearer. Treasury yields would still have to rise because they hadn't yet priced-in the excess government debt supply associated with the tax bill (more supply = higher rates).

On the other side of the market, equities traders were **just beginning** to price-in the tax bill's anticipated effect on corporate earnings. And of course, the Fed would have to hike rates a bit more quickly if the tax bill ended up having a stimulative effect.

As of mid-February, markets were telling us this "pricing-in" process was potentially winding down. Bonds had reached a bit of a plateau and were **finally** moving sideways. Stocks had recovered from the early February flash crash and began to consolidate without making new highs. We even saw a plateau in the markets that bet on the Fed's rate hike pace.

Then the **trade war headlines** began to circulate. This was to be the theme that would underpin a growing level of indecision in the marketplace. It was the manifestation of the question: have investors priced-in enough of the future's positive economic potential?

While it **may** well be **far** too early for the debate, the question of the timing of the next recession (or simply the next economic deceleration) is already being asked. One of the most common arguments in favor of asking the question is the falling (or flattening) "yield curve"--the spread between 2yr and 10yr Treasury yields.

Although many pundits and even several Fed members have opined that **history will not repeat itself** in the same way this time around, in the past, an

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.07%	+0.02	0.00
15 Yr. Fixed	6.45%	0.00	0.00
30 Yr. FHA	6.51%	+0.02	0.00
30 Yr. Jumbo	7.26%	0.00	0.00
5/1 ARM	7.02%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.86%	-0.01	0.00
15 Yr. Fixed	6.16%	+0.03	0.00

Rates as of: 6/28

Market Data

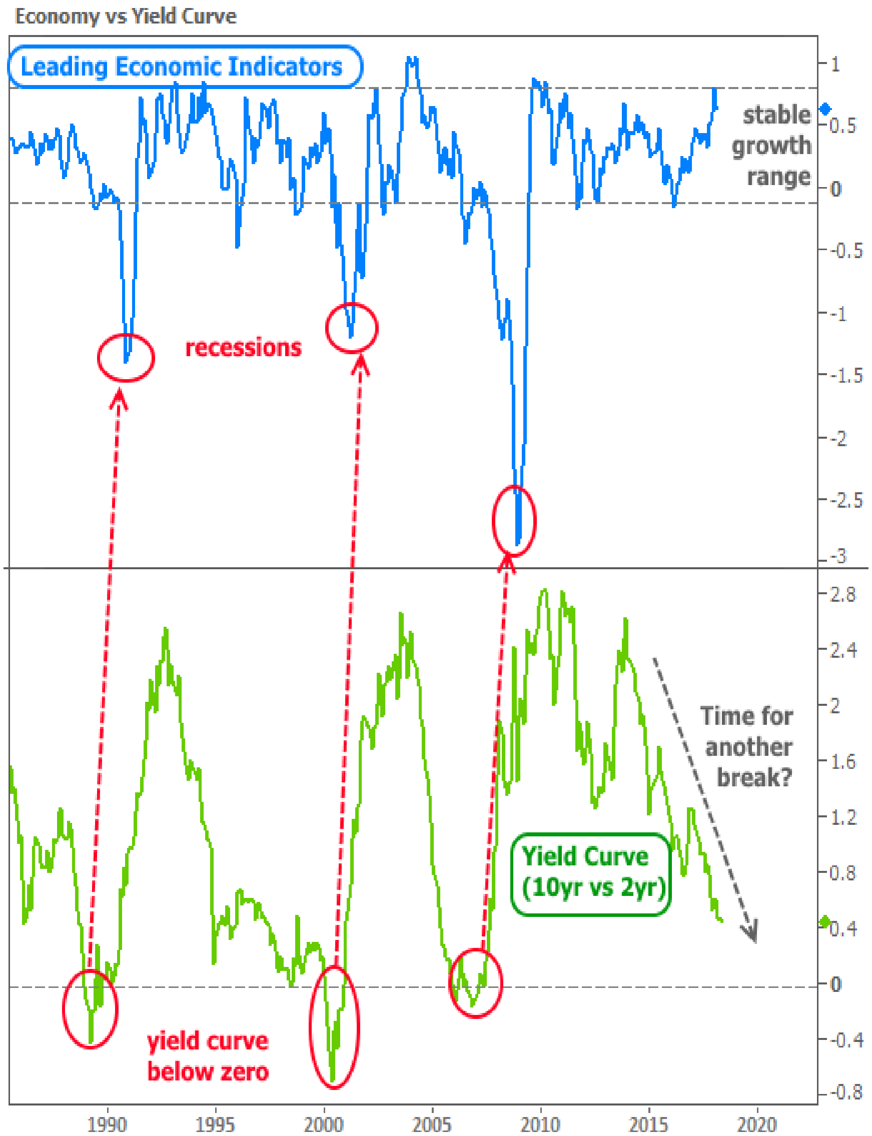
	Price / Yield	Change
MBS UMBS 5.5	98.49	-0.45
MBS GNMA 5.5	99.10	-0.44
10 YR Treasury	4.4069	+0.0089
30 YR Treasury	4.5678	+0.0038

Pricing as of: 7/1 4:52AM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Jun 12	208.5	+15.58%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

inverted yield curve (2yr > 10yr) has preceded 3 out of the last 3 recessions.

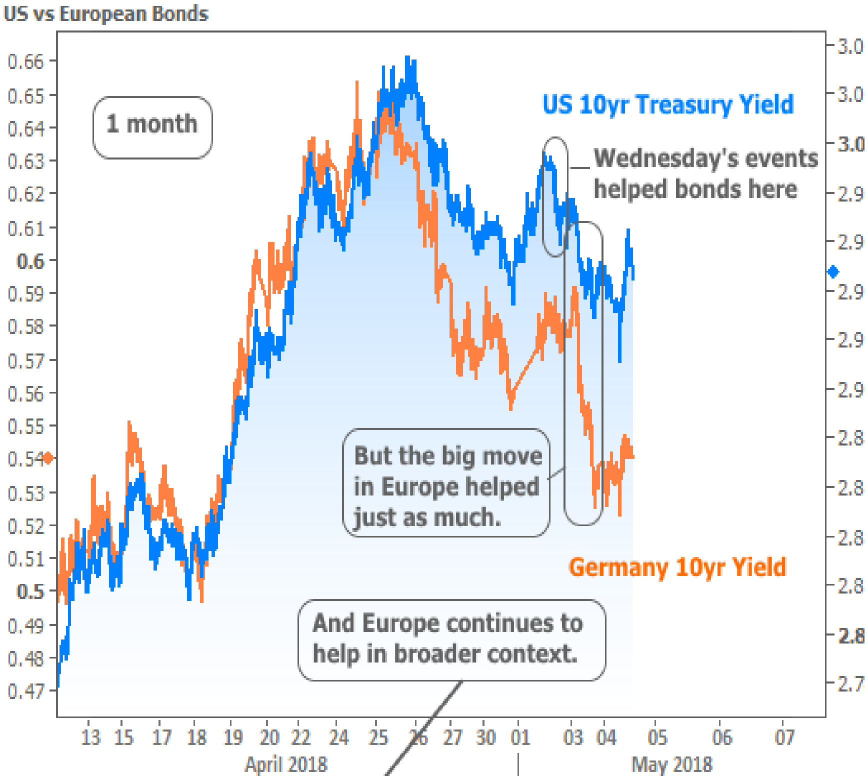


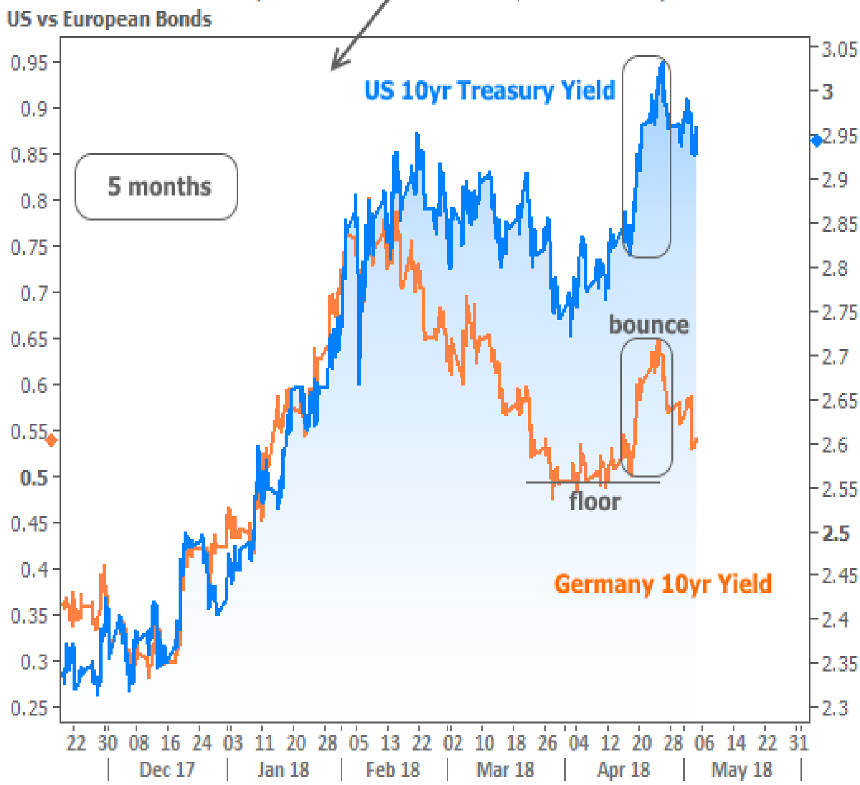
As you might guess, a recession has negative implications for stocks, but it typically coincides with lower interest rates. The timing **isn't coincidental**. Stocks have been consolidating in a an ever-narrower range. This means they MUST break out soon.

Bonds are also at a crossroads, having just lived through their **2nd** encounter with the **most important rate ceiling** in more than 10 years. We've already discussed reasons that 3% shouldn't be as firm of a ceiling when comparing the present situation to that seen in 2013/2014, but some investors are still holding out hope. Granted, it COULD happen if the bigger picture gets cloudy enough, quickly enough, but the 2 pessimistic scenarios in the following chart of 10yr yields are also on the table.

As for nearer-term, smaller scale considerations, the **unsung hero** of the past few weeks (and potentially even the past few months) has been a downturn in European economic data and European bond yields. The German 10yr yield is the representative benchmark rate for Europe, and it's arguably been leading the way for US 10yr yields at times.

This week, a **sharp** drop in European rates helped US rates just as much as the important domestic data that came out on Wednesday (a Treasury auction announcement that allayed concerns about how new bond supply could hit the market, and the Fed's relatively tame policy announcement). Things will get more interesting if German yields manage to break the floor seen in the lower pane of the chart (and interesting in a bad way if they break the highs seen during the last "bounce"):





The modest volatility at the end of the week came courtesy of the **big jobs report**. The job tally missed the mark, but was essentially 'as-expected' after we count last month's revisions. Wage growth slowed, but not in a terrifying way. At first glance, the slightly weaker data was good for bonds, but because last month's data was so rotten, **this month's** only had to come close in order to keep bonds from getting too excited. With that, rates finished out the week roughly unchanged.

In **housing-related news**, Pending Home Sales improved, but by slightly less than forecast. The series continues grinding sideways near its post-crisis plateau--something that's unlikely to change without a big shift in the inventory situation.

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Monday, Apr 30				
8:30AM	Mar Personal Income (%)	0.3	0.4	0.4
8:30AM	Mar Consumer Spending (Consumption) (%)	0.400	0.400	0.200
8:30AM	Mar Core PCE (y/y) (%)	1.900	1.900	1.600
9:45AM	Apr Chicago PMI	57.6	58.0	57.4
10:00AM	Mar Pending Sales Index	107.6		107.5
Tuesday, May 01				
10:00AM	Apr ISM Manufacturing PMI	57.3	58.3	59.3
10:00AM	Mar Construction spending (%)	-1.7	0.5	0.1
Wednesday, May 02				
8:15AM	Apr ADP National Employment (k)	204	200	241
9:45AM	Apr ISM-New York index	779.3		772.1
2:00PM	N/A FOMC rate decision (%)	1.500 - 1.750	1.625	1.625
Thursday, May 03				

Event Importance:

No Stars = Insignificant
☆ Low
★ Moderate
★★ Important
★★ Very Important

Date	Event	Actual	Forecast	Prior
8:30AM	Q1 Labor Costs Preliminary (%)	2.7	2.9	2.5
8:30AM	Q1 Productivity Preliminary (%)	0.7	0.9	0.0
8:30AM	Mar International trade mm $ (bl)	-49.0	-50.0	-57.6
8:30AM	w/e Jobless Claims (k)	211	220	209
10:00AM	Apr ISM N-Mfg PMI	56.8	58.1	58.8
10:00AM	Mar Factory orders mm (%)	1.6	1.4	1.2
Friday, May 04				
8:30AM	Apr Non-farm payrolls (k)	+164	192	103
8:30AM	Apr Unemployment rate mm (%)	3.9	4.0	4.1
8:30AM	Apr Average earnings mm (%)	+0.1	0.2	0.3
Monday, May 07				
3:00PM	Mar Consumer credit (bl)	11.62	15.00	10.60
Tuesday, May 08				
1:00PM	3-Yr Note Auction (bl)	31		
Wednesday, May 09				
7:00AM	w/e MBA Purchase Index	257.7		258.1
7:00AM	w/e Mortgage Refinance Index	1098.4		1104.9
8:30AM	Apr Core Producer Prices YY (%)	2.3	2.4	2.7
8:30AM	Apr Producer Prices (%)	0.1	0.2	0.3
10:00AM	Mar Wholesale inventories mm (%)	0.3	0.5	0.5
Thursday, May 10				
8:30AM	Apr Core CPI Year/Year (%)	2.1	2.2	2.1
8:30AM	Apr CPI mm, sa (%)	0.2	0.3	-0.1
8:30AM	w/e Jobless Claims (k)	211	220	211
Friday, May 11				
8:30AM	Apr Import prices mm (%)	0.3	0.5	0.0
8:30AM	Apr Export prices mm (%)	0.6	0.3	0.3
10:00AM	May 1yr Inflation Outlook (%)	2.8		2.7
10:00AM	May 5yr Inflation Outlook (%)	2.5		2.5
10:00AM	May Consumer Sentiment	98.8	98.5	98.8
Wednesday, Jul 11				
1:00PM	10-yr Note Auction (bl)	22		
Thursday, Jul 12				
1:00PM	30-Yr Bond Auction (bl)	14		

Real Talk

At The Rate Shop, we're not your average mortgage banker. We specialize in bringing you ridiculously low interest rates that will make you wonder what the other guys are doing. In fact the ONLY objection we ever hear is “your rates sound too good to be true”. Well they’re not, and here is why…

After 15 years in the retail banking world I was frustrated with the high interest rates that came from that business model. As I looked around at all the bloated layers of management and their expensive salaries and the overhead of running a larger company (think rent costs, employee health and benefit costs, payroll taxes, and on and on) it dawned on me that I was a part of the problem, and the solution, for me at least, was so easy to see.

Start my own mortgage brokerage shop. No expensive executive salaries, no expensive building to pay rent at, no unnecessary employees and all the costs that are associated with that. What happens when you cut out all the fat? You can provide lower rates and lower closing costs. It’s simple. Now here is the best part, you still get great service from a local Kansas City Lender. My mission is to let everyone know that low rates and great customer service are NOT mutually exclusive.

Thanks for coming along on this journey where Low Rates meet Great Service. The two do NOT have to be mutually exclusive. It’s just a lie that the big box mortgage companies have been telling you for years. Don’t believe me? Give me a call or shoot me a text on my personal cell phone today and compare my rates and costs up against any other lender in the country, and be prepared to be blown away.

Mike Baker