

Inside NAFCU Services



2010 economic trends and outlook

With 2009 almost behind us, TFCU turned to Hillary Elder, vice president and portfolio manager of the National Investment Fund for Credit Unions, for her outlook on several key indicators as we head into 2010. Here she walks us through her predictions for the year and her summation of 2009 data.

Pundits are now saying the current U.S. recession is likely in its final days and a synchronized global upturn is unfolding. Indications point to stronger second half domestic growth of between 3 and 4 percent. However we believe the broader recovery will be an anemic one, as much of this improvement can be attributed to the impact of a variety of stimulus and support programs implemented since September 2008. The most recent example is the 2.7 percent increase in August 2009 retail sales, driven partly by the Cash for Clunkers program.

Stronger housing data emerging in the second half of 2009 must be viewed in tandem with the still-rising volume of foreclosures and price declines. Many homeowners in Western states owe more than their homes are worth. Those with interest-only mortgages are at greater risk as their payments will soon recast and rise substantially. Absent another housing boom, this remains a looming negative for this segment. On the positive side, mortgage rates close to 5 percent are historically low, and price declines, combined with a first-time homebuyers' tax credit possibly expiring late this year, make the purchase of a home quite affordable. Commercial real estate, however, will continue to be a drag on the recovery, as business closings and bankruptcy filings are up in 2009.

While inflation is expected to tick higher, the core rate (excluding food and energy) should remain below 2 percent, so within the Federal Reserve's range of comfort.

Oil prices, after hitting a high of \$146 per barrel in early July 2008, are now half that price. Oil and other industrial commodity prices are being held in check by modest demand and worldwide excess capacity in manufacturing.

Generally market liquidity and access to credit have improved. But, for consumers, balance sheet de-leveraging and financial hardships continue. Although the pace of job losses is slowing, we are a long way from an uptrend. The unemployment rate stood at 9.7 percent through August 2009 and is expected to surpass 10 percent by year-end. Jobs, getting them and keeping them, will remain the key driver of a sustainable recovery. With credit approval standards continuing to tighten, revolving credit (primarily credit cards) has declined

dramatically year to date. Whenever the job market does recover, many consumers will likely want or need to place greater emphasis on rebuilding savings, especially for individuals nearing retirement.

Declining sales, income tax and property tax revenue are negatively impacting state and local budgets. Benefits of the 2009 stimulus bill have been slow to materialize, and municipalities are struggling to deliver services while cutting costs. Budget gaps are expected to continue to rise, as are borrowings in the bond market.

Concerns are mounting regarding the overall cost of the stimulus, the attendant growth in the federal budget deficit and the massive amount of new U.S. Treasury debt that must be issued to finance international commitments. Additionally there is an ambitious domestic agenda being advanced by the White House, including regulation affecting the banking and securities industries.

Our outlook for interest rates has the Federal Reserve beginning to hike rates in the first quarter of 2010, moving the federal funds target incrementally toward 2 percent by year-end 2010. We expect the two-year Treasury note to be above 1 percent at year-end 2009 and at 2.5 percent by the end of next year. We would be wary of purchasing callable Agency paper outside of the one-year area, as the likelihood of those calls being exercised is remote, thus leaving investors to hold these low interest rate securities to maturity. We recommend short-term investors allow portfolio maturities to roll off in early 2010, marshalling liquidity to redeploy at higher yields. ☘

Hillary Elder is the VP/portfolio manager of the National Investment Fund for Credit Unions (NIFCU\$), a NAFCU Services Preferred Partner. NIFCU\$ offers a short-term liquidity option for credit unions seeking competitive returns and a diversification option.

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