



# HOW LONG DOES THE RECESSION LAST

## And How Will You Know The Economy is Getting Better?

by Harold Montgomery

The recession we're currently in the middle of will last for a while – in my view, at least through the rest of this year. On December 8th, 2008, yields on 3 Month U.S. Treasury Bonds hit 0%. That means bond buyers were willing to lock up their money for 90 days with no yield. That tells me those buyers are pretty pessimistic about the near term economic outlook. They think that for the next 90 days there's no private investment they would make at any stated rate of return – no matter how large, and they for sure are not going into the stock market that has seen 3 to 5% swings in a day become routine.

In short, there's nowhere for money to go that looks safe, and so it's retreating to the refuge of last resort – 0% yields on government bonds. Buyers would rather have no return and guarantee the return of their capital than they would risk that capital to get a return on capital. That's a bad sign – a really bad sign.

It's safe to say at this point that the smart money thinks the recession is real and that it will last a while. A survey of 1,275 Chief Financial Officers conducted by Duke University's Fuqua School of Business revealed that 60% think the recession in the U.S. will last until the end of 2009. In Europe, the number was 71% who think the recession there will last through 2009.

How bad will it get? No one knows. That's not a dodge of the question, it's the reality of the situation. And that uncertainty is exactly why investors are hesitating to make new deals and are instead running for the protection of government bonds instead. That hesitation is what will make this recession the worst in living memory and could drive it deeper,

possibly even resembling the Depression of the 1930's when unemployment peaked at 25%. I don't think we'll see those kinds of numbers this time, but unemployment over 8.5% seems highly likely and it could crest at 10% in mid to late 2009.

There's so much over-leverage (excess borrowing) in the economy that it will take years to work itself out. Companies and consumers both gorged on debt for a long time without regard to the risky nature of debt finance in a changing environment. And the environment didn't change for a long time – the last ten years, the economy has been great, which encouraged more borrowing. Companies were able to borrow 6, 8 even 10 times cash flow. Today, debt at 2 times cash flow looks excessive. But how do you pay off banks who need the cash? It's tough, and sometimes impossible. There's going to be lots of restructuring in the coming years.

I am writing this article in mid December 2008, and right now, things have stopped in the credit markets. It's not about what price credit costs – there's none there. No money is moving. Until things unfreeze, we're going to be in a worsening situation in all sectors of the economy.

How will you know when the recession is ending? Watching financial indicators is probably the best early sign that things are turning. For the economy to get going again, credit will have to loosen, and when it does, you will see Treasury yields return to a more normal level – say 3% or so. Look for prices on high quality corporate debt to firm up a bit. Same with AAA rated mortgage paper. Also, I like to look

at some basic factors. Steel prices and aluminum prices are good ones. In the fourth quarter of 2008, steel mills stopped buying scrap steel for recycling because no one was buying cars. When mills start buying again, that will be an indicator that things are at least starting to function. But when prices start going up a bit, that's sign the recession may be ending.

Unemployment is a lagging indicator of the recession and therefore not a good predictor of future economic activity. The stock market is also not necessarily a good indicator of reviving economic activity, and this time, may be too optimistic. The Bond market is a better judge of the future usually.

The bottom line is that we're in a severe recession now and it could get worse. In any case, it's going to last the rest of this year at least, and truly no one can see what 2010 holds right now. It's a good time to slim your operations, cut costs and increase the productivity of each employee. Prepare for retail sales to be weak and merchants to struggle. ■

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