Financial Market Weekly

CHRISTOPHER S. RUPKEY, CFA
MANAGING DIRECTOR
CHIEF FINANCIAL ECONOMIST
ECONOMIC RESEARCH OFFICE (NEW YORK)
(212) 782-5702
crupkey@us.mufg.jp

MUFG | 1251 Avenue of the Americas
New York, New York 10020
A member of MUFG, a global financial group

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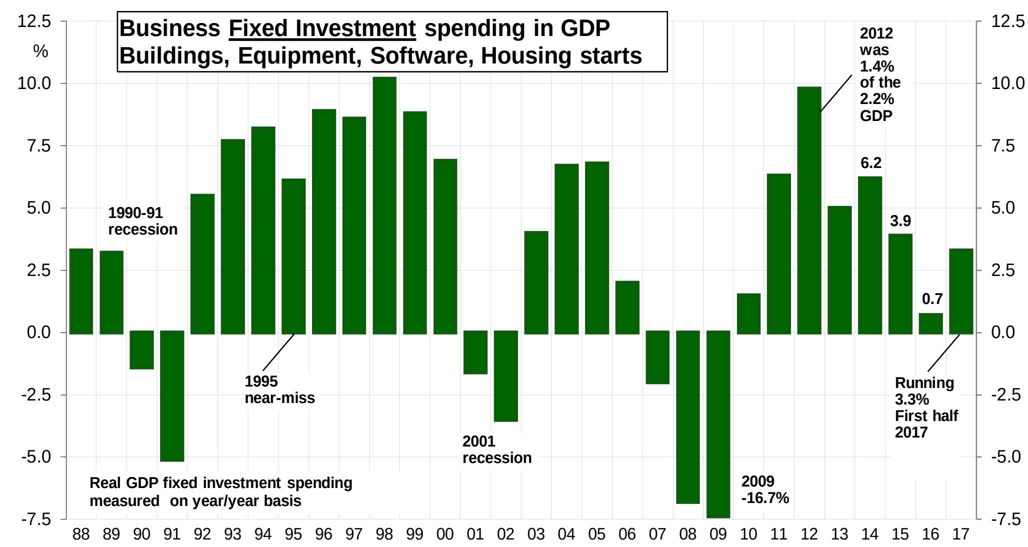
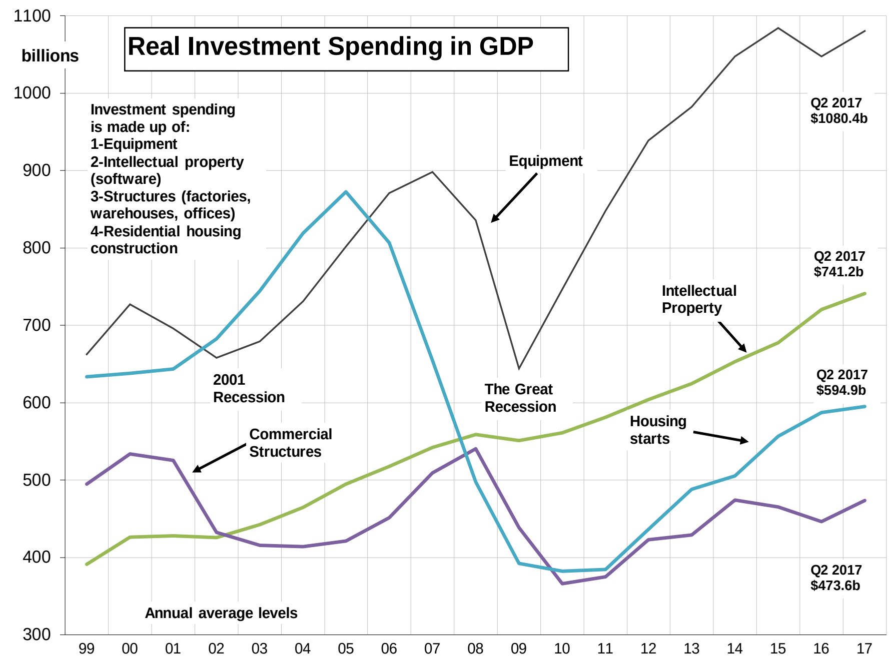
INVESTMENT: WAIT FOR IT, THE FED CERTAINLY IS

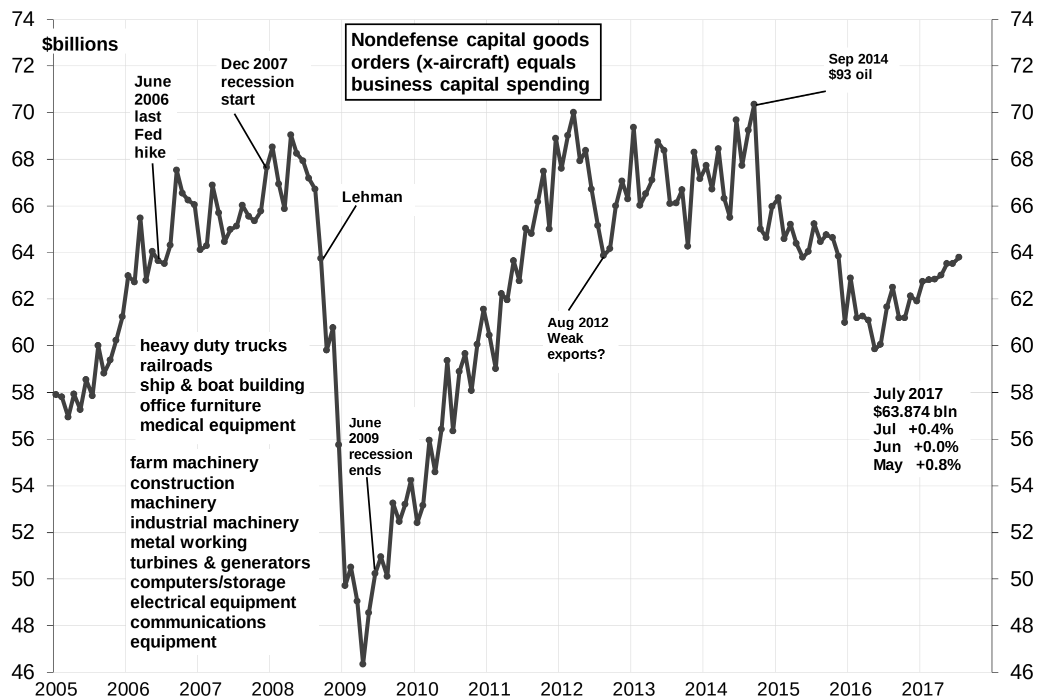
One of the reasons Fed officials give for low interest rates (besides their own darn policy we mean, what do you expect for bond yields with a 1.25% Fed funds rate?) has been not enough investment demand. They could have a long wait. Not enough investment, or a gradual pick up in investment demand the next few years, is certainly a major reason why they think they can only raise rates gradually up to 3%, like there is some headwind force preventing them from putting rates there. Wouldn't be prudent. The path forward at the moment, to be updated by the Committee on September 20, is 1.25% today, 1.5% December, 2.25% next December in 2018, and the 3% finish line (terminal rate indeed) in December 2019. It would be our guess that investment spending won't be any stronger when we get to the end of 2019. Hope this doesn't scuttle some of those rate hikes. Been long enough this wait for normal rates again after the recession.



While the Fed waits for more investment and ponders why less-than normal rates has not made companies borrow more for investment, we thought we would review again the current state of investment in the GDP accounts. We just got the second quarter GDP figures, along with benchmark revisions back to 2014, on July 28 where funnily enough 2015 real GDP growth under Obama was revised up from 2.6% before to now 2.9%, just short of the goal of Trump's economics team. None of the major investment categories were revised stronger in 2015: business spending on structures, equipment, software, or residential housing construction (realtor fees too). Of these four categories, it is really only home building that hasn't returned to housing bubble economy years highs. Although structures have been held down by the collapse in oil & gas drilling. We are skeptical whether companies are going to find reasons to make more investment in the next few years. They have most likely bought enough equipment and built enough factories for now. Keeping interest rates low, that is the decision to fix rates at 1.25% or 3.0% isn't going to make any difference in company decisions to borrow more and invest. More home building would count as economic demand we guess, but the housing market looks in no hurry to recover further at this time.

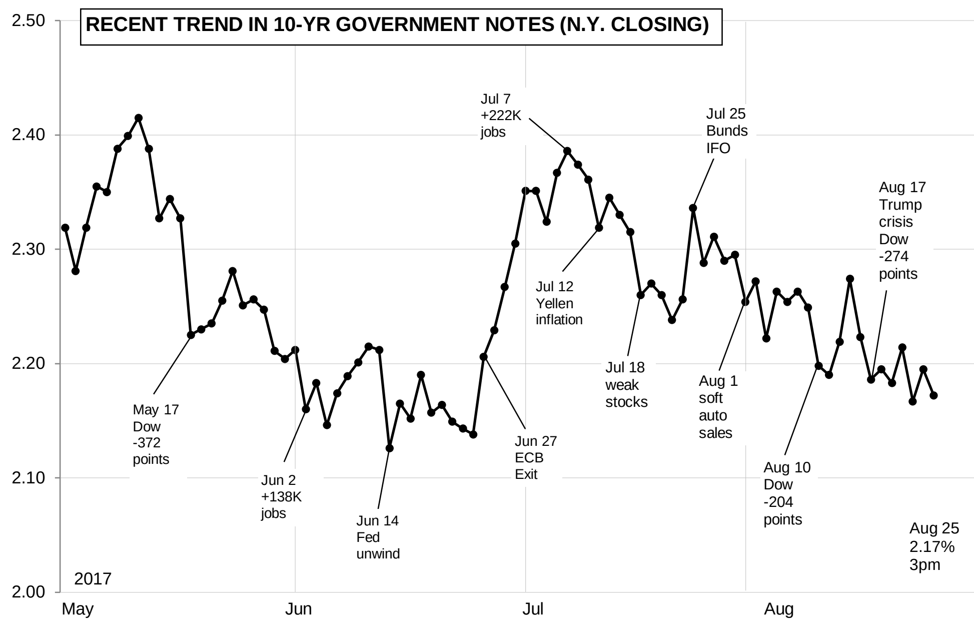


On Friday we got our monthly read on business capex in the durable goods orders report for July. Durable goods orders totaled $229.2 billion, but it is the $63.8 billion subset called nondefense capital goods orders ex-aircraft that we are interested in. A 0.4% increase in July is better than a poke in the eye with a sharp stick, but business equipment purchases had already regained the pre-recession highs before the latest downdraft, partly on crude oil's collapse, and massive additional investment spending on this equipment seems rather unlikely if that is what the Fed is waiting for to normalize rates.



MARKETS OUTLOOK

	30-Jun 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
30-Yr Treasury	2.83	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10
10-Yr Note	2.30	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90
5-Yr Note	1.89	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70
2-Yr Note	1.38	1.60	1.85	2.10	2.40	2.60	2.85	3.10	3.35	3.35	3.60
3-month Libor	1.30	1.65	1.90	2.20	2.45	2.70	2.95	3.20	3.45	3.35	3.70
Fed Funds Rate	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50
2s/10s spread	92	90	85	90	80	80	65	60	45	55	30
Libor/funds spd	5	15	15	20	20	20	20	20	20	10	20



We think the market was awake this week. 10-yr yields never strayed more than a basis point or two each day this week from 2.19% on a closing basis. Yellen did not say anything on policy on Friday and although many Fed officials said they could be patient on rates because inflation was low, it is unclear whether their forecasts on September 20 will take the last of the three expected rate hikes off the board for this year. Fed funds futures odds of a December hike are just 34% and many members take their cue from “what the market is saying.” The market’s not moving. The Fed’s not moving. It’s a standoff.

FEDERAL RESERVE POLICY

The Fed meets September 19-20 to consider its monetary policy. A rate hike doesn’t seem very likely, but we won’t stop forecasting one. The Fed inflation mongers are talking like they won’t even vote to hike rates in December if inflation does not pick up. Let’s see core PCE inflation is 1.5% and core CPI inflation is 1.7%, and the Fed is somehow trying to convey to the public that this “low inflation” is unacceptable and that business and economic conditions are not fully healed or something worse: stagnation and weak demand are causing the drop in inflation. Another reason not to return rates to normal pre-recession levels. Been so long we forgot when the recession ended.

Selected Fed assets and liabilities

Fed H.4.1 statistical release billions, Wednesday data	23-Aug	16-Aug	9-Aug	2-Aug	Sep 10 2008** pre-LEH
Factors adding reserves					
U.S. Treasury securities	2465.273	2465.247	2465.221	2465.195	479.782
Federal agency debt securities	6.757	8.097	8.097	8.097	0.000
Mortgage-backed securities	1778.699	1777.975	1769.029	1769.026	0.000
Primary credit (Discount Window)	0.005	0.002	0.001	0.003	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.708	1.708	1.710	1.710	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	0.000
Central bank liquidity swaps	0.036	0.036	0.036	0.035	62.000
Federal Reserve Assets	4510.5	4509.8	4515.8	4513.4	961.7
3-month Libor %	1.32	1.32	1.31	1.31	2.82
Factors draining reserves					
Currency in circulation	1566.641	1566.526	1567.095	1565.431	834.477
Term Deposit Facility	0.000	14.733	0.000	0.000	0.000
Reverse repurchases w/others	169.793	92.840	103.950	119.334	0.000
Reserve Balances (Net Liquidity)	2338.169	2364.971	2336.315	2291.576	24.964
Treasuries within 15 days	3.197	3.197	18.655	18.655	14.955
Treasuries 16 to 90 days	30.691	19.648	22.845	22.845	31.549
Treasuries 91 days to 1 year	310.315	321.357	298.287	298.286	69.272
Treasuries over 1-yr to 5 years	1163.479	1163.475	1129.964	1129.960	170.807
Treasuries over 5-yrs to 10 years	324.394	312.184	361.534	361.528	91.863
Treasuries over 10-years	633.197	645.386	633.937	633.921	101.337

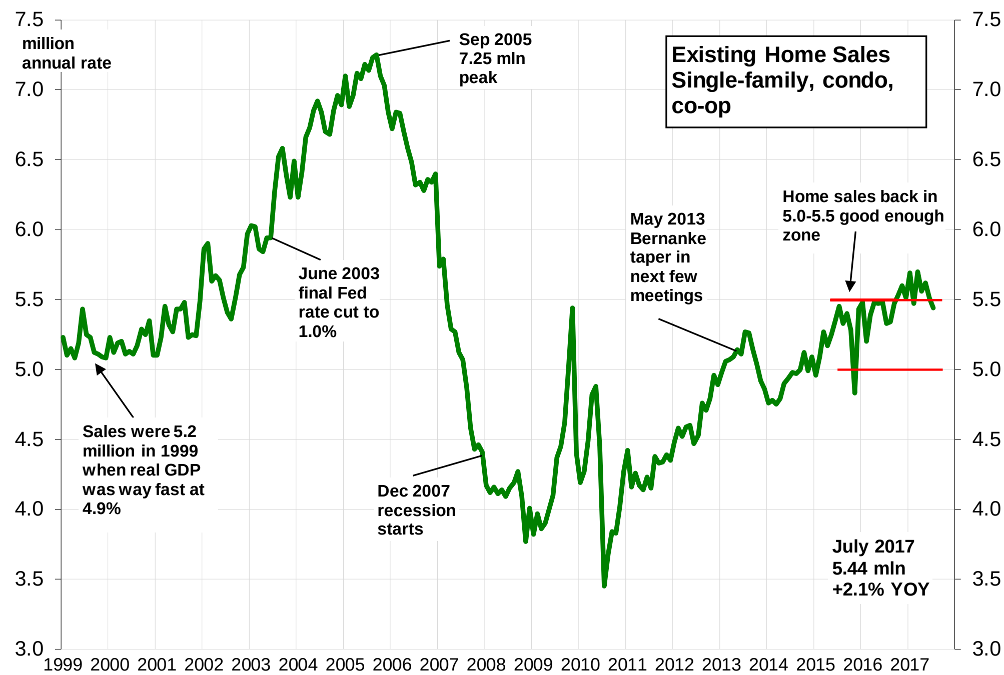
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08

Fed Chair Yellen spoke in Jackson Hole at 10am New York time on Friday, August 25 on the topic of "Financial Stability a Decade after the Onset of the Crisis." She gave a broad defense of post-crisis financial rules as they say. The 2017 Economic Policy Symposium is on "Fostering a Dynamic Global Economy." We want to give the Fed Chair our own note of special thanks for not getting into the nitty gritty of balance sheet wind downs or whether inflation is on its way back up. Nothing policy related. Thank you. It's a summer Friday in late August. See you all in September.

OTHER ECONOMIC NEWS THIS WEEK

Now it's Existing Home Sales sputtering in the month of July

Breaking economy news. Existing home sales are down at the lowest rate of turnover since the summer of 2016. Yesterday, New Home Sales and now today it is the Existing Home stock. Sputtering is probably not the right word unless you are writing for a fake news outfit, you know who you are, as existing home turnover fell just 1.3% from June to 5.44 million at an annual rate. Not a huge deal, and 5.44 million is a relatively fast rate of turnover historically. But existing home sales were higher when Trump was inaugurated in January at 5.69 million and while he is still here, existing home sales are not there.



If you are trying to sell your current house, forget it, you missed it, no matter how spectacular your property. Even real estate impresario Donald Trump couldn't get you a better price. Existing home sales are seasonal and the best price is in June each year. In today's report, single-family existing home properties fell back to $260,600 in July from the all-time record highs of $265,500 in June. You left a cool 5 grand on the table. Sad. The trend of home prices is still marching upward on a year-on-year basis with home prices in July up 6.3% from last summer, far outstripping the 2.5% rise in workers' average hourly earnings.

Net, net, existing home sales continue their slide since March which may signal home buyers are not as optimistic as they were earlier this year when President Trump was elected and hopes were high for health care reform, infrastructure spending and tax cuts and tax reform for companies and consumers alike. Despite some regional differences with sales gains in the West and in the South, the data today will feed the concern of some Fed officials who think the current soft patch for inflation may signal some weakening of economic demand in the economy. People certainly are not snapping up homes at the same pace they did earlier in the year and this certainly will not make the market pencil in a third Fed forecasted rate hike for December this year. The Fed funds futures odds of a December hike are no-go, too-low for a rate hike at just 32%. Stay tuned. Story developing.

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