Financial Market Weekly

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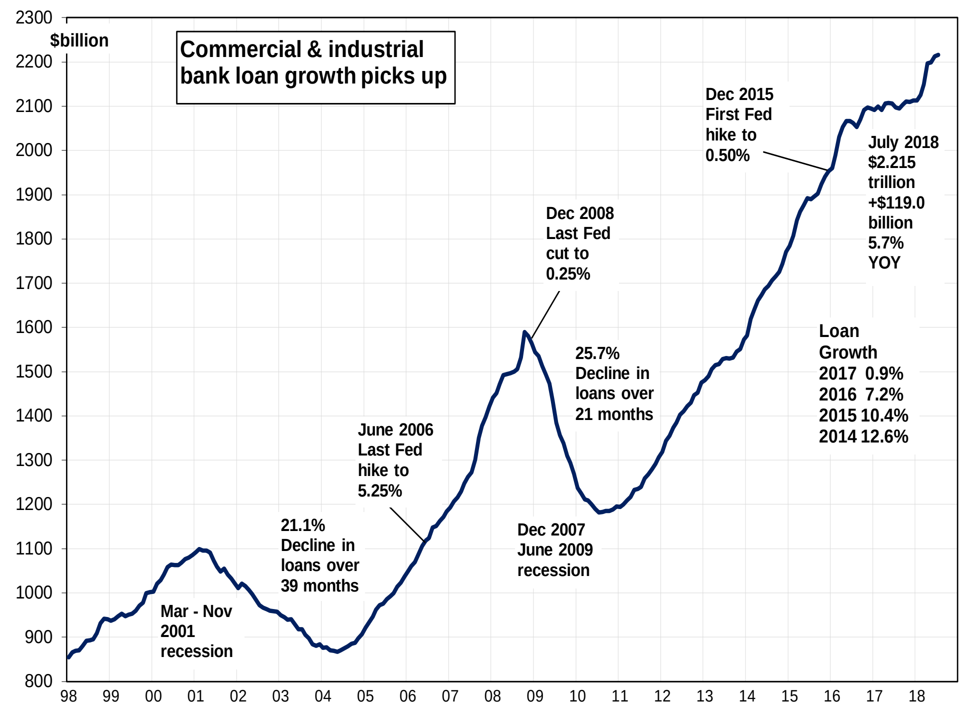
BANK LENDING TO COMPANIES HAS REBOUNDED, SEEMS SUFFICIENT TO MAKE THE ECONOMY RUN FASTER (3%) FOR NOW



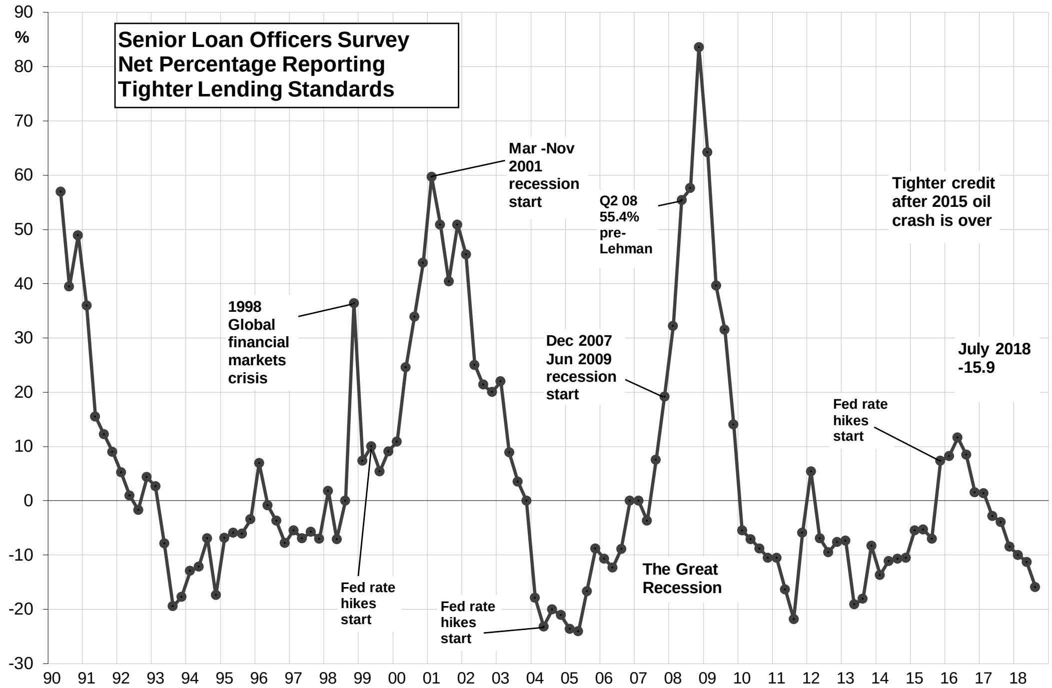
Commercial & industrial bank loans have rebounded. Bank loan trends are cyclical and run parallel to the economy's fortunes, although they tend to lag, rising into the recession and continue to fall for a time after the recession has ended. This runs counter to the theory that banks need to restart their lending, provide credit, so that economies can recover from downturns. Bank credit trends are different in other countries, where new lending in China is being encouraged to counter rising trade tensions and promote more economic growth. In the U.S., credit is a kind of chicken or egg thing when it comes to who is helping whom. Will bank lending boost the economy or is the stronger economy producing greater demand for credit? Bank lending will usually not materialize unless the economy is strengthening: profitable companies get more loans, and to be fair, corporations don't need credit during the dark times of falling sales, revenues and profits during a recession.

FDIC Banks and S&Ls

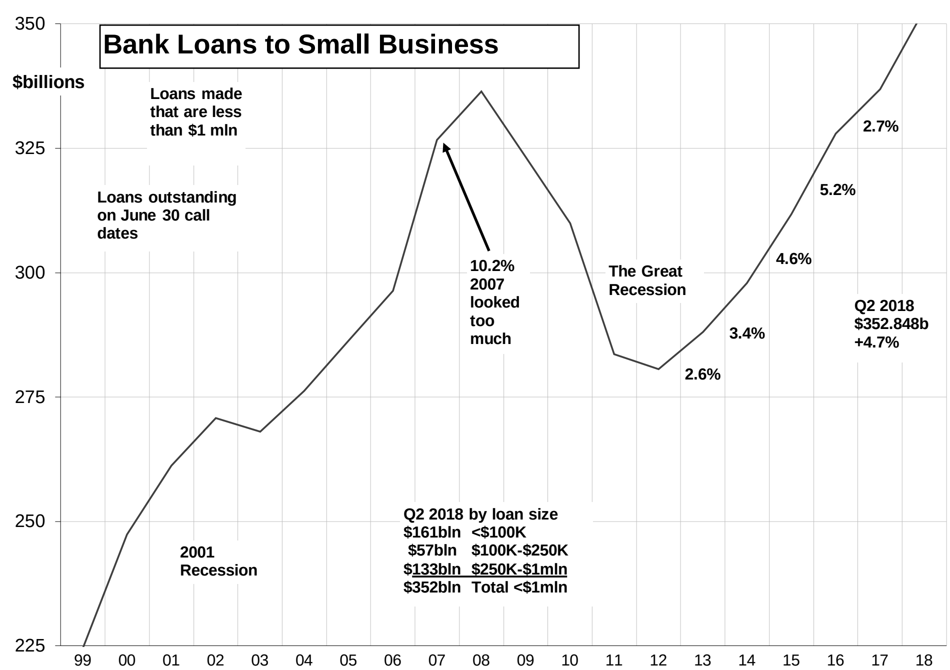
	2018	2008	1998
Number	5,542	8,451	10,713
Employees	2.077	2.203	1.842
Deposits	13.468	8.572	4.209

5,542 banks in June 2018, 2.077 million employees, $13.468 trillion in deposits

Anyway, bank loans to commercial & industrial concerns are back. Certainly, a coincident indicator of business/economic conditions, if not exactly a leading indicator of a weakening economy; markets are wondering about the risks there, given the rise in trade tensions. Monthly commercial & industrial bank loans peaked in February 2001 and the recession started in March 2001 (okay, okay… leading.) Then again, monthly commercial & industrial bank loans peaked in October 2008, ten months after the recession began in December 2007 (full disclosure: the 18 months long December 2007 to June 2009 recession means the final month of growth before the downturn was December 2007). Recessions aside, more recently, bank loan growth to companies slowed during what now looks to be a recession in manufacturing when oil prices crashed in late 2014. Industrial production fell almost 5% from late 2014 to early 2016. Things have picked back up: no recession in the broader economy even as manufacturing was on the ropes for a time.



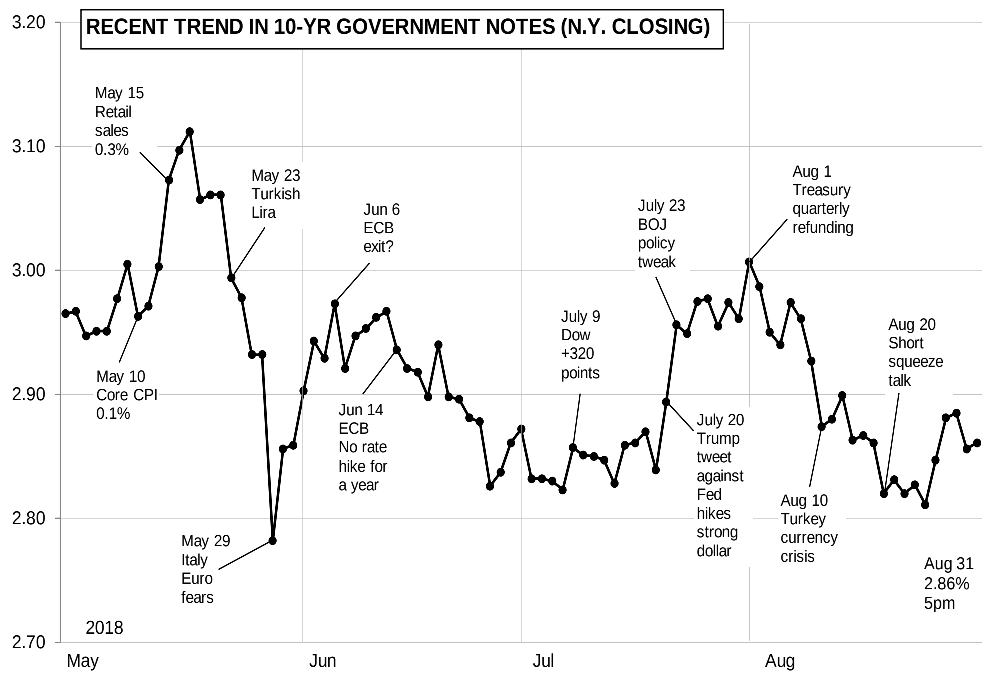
Banks are certainly open for business on new loans. Just ring up your friendly relationship manager. M&A activity seems to be the driver with large bridge loans being made in March and April.



What about the little guy? Can they get credit? Is there a level playing field if you are a small business? Well, the trend is rising, looks okay here certainly. Bank loans rose 4.7% to $352.8 billion in the June 2018 year, faster than 2017's 2.7% rise. Small business loans of less than $100,000 were $161 billion of the total. There were 23.6 million loans of less than $100,000 made by banks to small firms and individuals. Sounds like plenty.

MARKETS OUTLOOK

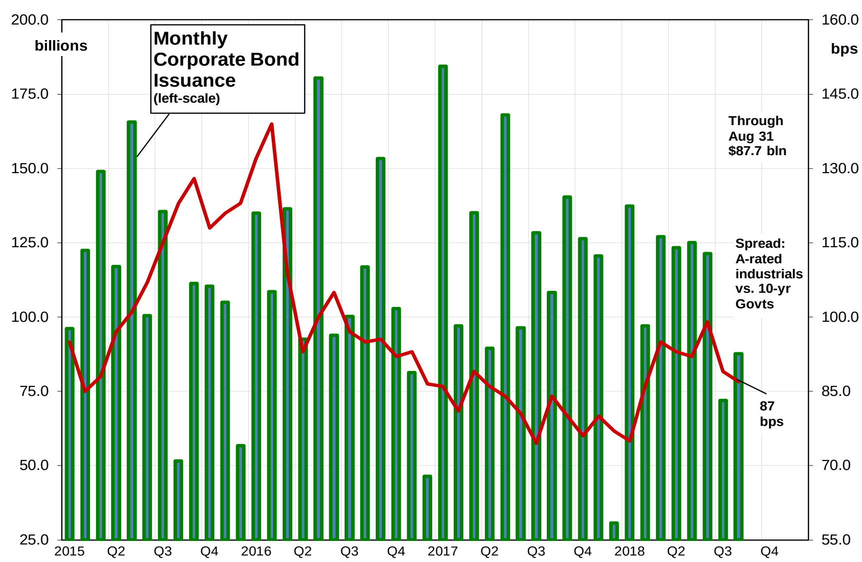
	29-Jun 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.99	3.10	3.20	3.35	3.45	3.60	3.60	3.75	3.85	3.80	3.95
10-Yr Note	2.86	2.90	3.00	3.20	3.30	3.50	3.50	3.70	3.80	3.80	3.95
5-Yr Note	2.74	2.70	2.90	3.10	3.20	3.45	3.45	3.65	3.75	3.80	3.95
2-Yr Note	2.53	2.55	2.80	3.00	3.15	3.40	3.40	3.60	3.75	3.80	4.00
3-month Libor	2.34	2.55	2.80	2.95	3.20	3.45	3.45	3.70	3.95	3.95	4.20
Fed Funds Rate	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00
2s/10s spread	33	35	20	20	15	10	10	10	5	0	(5)



Ten-year Treasury yields were 2.86% on Friday versus 2.81% the week before. Yields jumped on Monday with the U.S. Nafta trade agreement with Mexico. Dow industrials rallied 259 points and the S&P 500 hit record highs. Yields came back down Thursday afternoon on a Bloomberg news story saying the proposed $200 billion of additional tariffs on China imports would indeed take place after the comment period ends on Thursday, September 6. Trading conditions were thin this week before the Labor Day holiday weekend. The downtrend in yields from August 1 looks almost dead, as in should not continue.

CORPORATES: METLIFE AND CATERPILLAR, BOTH FRNS

Corporate offerings were $2.9 billion in the August 31 week versus $6.5 billion in the August 24 week. The week before the September Labor Day holiday weekend usually sees little if any new issuance. Corporate bond yields (10-yr Industrials rated A2) were 87 bps above 10-yr Treasuries this week versus 88 bps last Friday.



FEDERAL RESERVE POLICY

The Fed meets September 25-26 to consider its monetary policy. Fed funds futures say the odds are still high for a rate hike to 2.25% on September 26 -- 96% at Friday's close. Odds for a fourth hike this year (less reliable) to 2.5% at the December 18-19 meeting are 64%. Eight of fifteen Fed officials (53%) see four rate hikes this year.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	29-Aug	22-Aug	15-Aug	8-Aug	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2324.589	2324.540	2324.391	2336.925	479.782
Federal agency debt securities	2.409	2.409	2.409	2.409	0.000
Mortgage-backed securities	1679.006	1706.731	1708.187	1709.545	0.000
Primary credit (Discount Window)	0.039	0.010	0.007	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)	1.718	1.720	1.719	1.719	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	
Central bank liquidity swaps	0.092	0.068	0.106	0.100	62.000
Federal Reserve Assets	4266.3	4276.5	4276.5	4305.6	961.7
3-month Libor %	2.31	2.31	2.31	2.34	2.82
Factors draining reserves					
Currency in circulation	1681.023	1675.101	1673.616	1671.632	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	0.840	1.126	0.315	1.659	0.000
Reserve Balances (Net Liquidity)	1880.507	1902.785	1918.744	1966.103	24.964
Treasuries within 15 days	20.932	20.932	0.000	23.069	14.955
Treasuries 16 to 90 days	77.244	77.244	63.772	63.772	31.549
Treasuries 91 days to 1 year	326.061	326.060	360.363	305.548	69.272
Treasuries over 1-yr to 5 years	1016.040	1016.033	1016.026	1028.055	170.807
Treasuries over 5-yrs to 10 years	267.189	267.171	258.449	296.639	91.863
Treasuries over 10-years	617.123	617.099	625.780	619.841	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

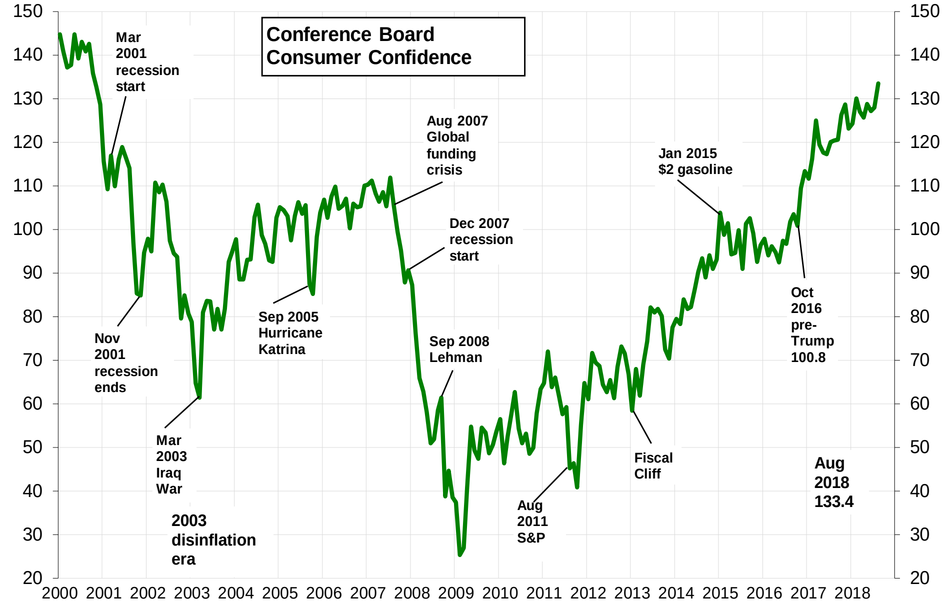
We still wonder what it means for the Fed forecasts that Eurodollar futures (assuming they will exist in the future seeing as the contracts expire and settle at where 3-month Libor is) are not backing up their 3 percent plus rate forecasts at the end of 2019 and 2020. What do they think that they are leading and the market isn't following? Sometimes Fed officials look to the market in setting their own forecasts, and we are worried about what their forecasts published at 2pm on Wednesday, September 26 might mean for policy. Will they back down that 3.5% forecast in 2020 and who knows what they are thinking about the (December) 2021 forecast for rates. The original reason for the forecasts as they first started under Bernanke in January 2012 was to telegraph to the world that the Fed would keep interest rates low and stimulative for a long, long time (count on it), and this view from the Fed would help the economy and encourage investment. It is unclear today, if we need Fed officials to tell us where they think interest rates will be in December 2021. On the other hand, maybe we do need them, given that market function is impaired and traders may not know how to discount the future without the Fed's helpful guidance.

Year-ends for Interest Rates				
Percent %	2018	2019	2020	2021
Eurodollar futures	2.615	2.955	2.935	2.915
Fed's June forecast	2.5	3.25	3.5	
Eurodollar futures price where 3-month Libor will be in the future.				
Friday, August 31, 2018 3-month Libor 2.32 %				

Fed Meeting	2017	2018	2019	2020	Longer run
Jun 18		2.4	3.1	3.4	2.9
Mar 18		2.1	2.9	3.4	2.9
Dec 17	1.4	2.1	2.7	3.1	2.8
Sep 17	1.4	2.1	2.7	2.9	2.8
Jun 17	1.4	2.1	2.9		3.0
Mar 17	1.4	2.1	3.0		3.0
Dec 16	1.4	2.1	2.9		3.0
Sep 16	1.1	1.9	2.6		2.9
Jun 16	1.6	2.4			3.0
Mar 16	1.9	3.0			3.3
Tax cuts and fiscal spending stimulus moved 2020 forecast to 3.4% in March. Now what for 2021?					

OTHER ECONOMIC NEWS THIS WEEK

Wow! Consumer confidence soaring to new heights (Tuesday)



Breaking economy news. Consumer confidence is soaring to the heavens this August, having left the atmosphere and is reaching dizzying new heights. The confidence index is 133.4 in August up 5.5 points from 127.9 in July. What trade war, what temperamental tweets from the White House, what emerging markets crisis, where are these so-called emerging markets anyway? This is America, and it is great again. The stock market is at all-time highs and so is consumer confidence. Well, not quite. Confidence is at a new high for this upswing in the business cycle that extends from the recession, and the prior record peak from the Clinton years of 144.7 is still out there, although it is in sight.

Is it that easy to buy off consumers, cheer them up with a massive tax cut that stuffs their pockets with spending cash? What about the growing financial time bomb caused by the soaring National Debt? What happened to those stagnant wages weighing down the consumer and those newspaper stories that many people still don't have enough money to feed their families or make their cell phone monthly bill payments even if they have jobs? It looks like the consumer confidence index surveys only those Americans that have money in the stock market because confidence is literally bursting at the seams and is likely to keep the economic outlook on track for further prosperity in the second half of the year.

In some states consumers are unable to write off their heavy load of state & local taxes making it likely they will have to fork more over to Uncle Sam? Don't worry about it. California confidence jumped from 119.7 in July to 130.0 in August. Guess that housing bubble out West can continue to inflate. New York state the same with confidence jumping from 93.5 in July to 103.2 in August. (Yes, it's true New Yorkers you'd be happier out West 130.0 to 103.2... 130/103.2 equals 26 percent happier.) And what about the generations? You old people, well, you feeling your age? Not so. Confidence soaring from 123.7 in July to 131.9 in August for those older than 55 years. Golden years indeed.

Net, net, economics isn't a science, and if people grow gloomy and sad, then they aren't going to spend their working wages and help the economy grow. Cash needs to circulate in society. At the moment, nothing but nothing thrown the consumer's way is getting any of them down. Confidence is soaring to new heights which makes us bullish on growth and forecasts that this expansion may indeed shatter records for longevity next summer. Stay tuned. Story developing. The consumer says the economic times we live in is better than you think. Buy a new house, a boat, a new car. Bet on it. This economy is going straight up.

GDP growth is strong and supports Fed case for more rate hikes this year (Wednesday)

GDP growth is strong at 4.2% in the second quarter supporting the case for one or two more rate hikes from the Federal Reserve this year. Rate hikes are dependent on the economy and right now the economy's good fortune is giving Fed officials the green light to take away the emergency stimulus left over from the recession and financial crisis a decade ago. There is no need for monetary policy to remain stimulative with interest rates below normal levels this long into an economic expansion.

Today's report supports our forecast of 3.0% growth in the third quarter. If nothing else, inventory levels will be rebuilt, after being a 1.0 percentage point drag in the second quarter that will disappear in the third quarter thus "adding" to real GDP.

	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18p	Q2 18r
REAL GDP	1.8	3.0	2.8	2.3	2.2	4.1	4.2
REAL CONSUMPTION	1.8	2.9	2.2	3.9	0.5	4.0	3.8
CONSUMPTION	1.2	2.0	1.5	2.6	0.4	2.7	2.6
Durables	0.1	0.6	0.5	0.9	-0.2	0.6	0.6
Nondurables	0.3	0.6	0.3	0.6	0.0	0.6	0.5
Services	0.8	0.8	0.7	1.2	0.5	1.5	1.4
INVESTMENT	0.8	1.0	1.5	0.1	1.6	-0.1	0.1
Business Plant	0.4	0.1	-0.2	0.0	0.4	0.4	0.4
& Equipment and	0.5	0.6	0.6	0.6	0.5	0.2	0.3
Intellectual Property	0.3	0.3	0.1	0.0	0.6	0.4	0.5
Homes	0.4	-0.2	0.0	0.4	-0.1	0.0	-0.1
Inventories	-0.8	0.2	1.0	-0.9	0.3	-1.0	-1.0
EXPORTS	0.6	0.4	0.4	0.8	0.4	1.1	1.1
IMPORTS	-0.7	-0.4	-0.4	-1.7	-0.5	-0.1	0.1
GOVERNMENT	-0.1	0.0	-0.2	0.4	0.3	0.4	0.4
Federal defense	0.0	0.2	-0.1	0.1	0.1	0.2	0.2
Fed nondefense	0.0	-0.1	0.0	0.2	0.1	0.0	0.0
State and local	-0.1	-0.2	-1.0	0.2	0.1	0.2	0.2
Below line: Percentage point contributions to Q2 18 4.2% real GDP							
Third estimate for Q2 is Thursday, September 27							

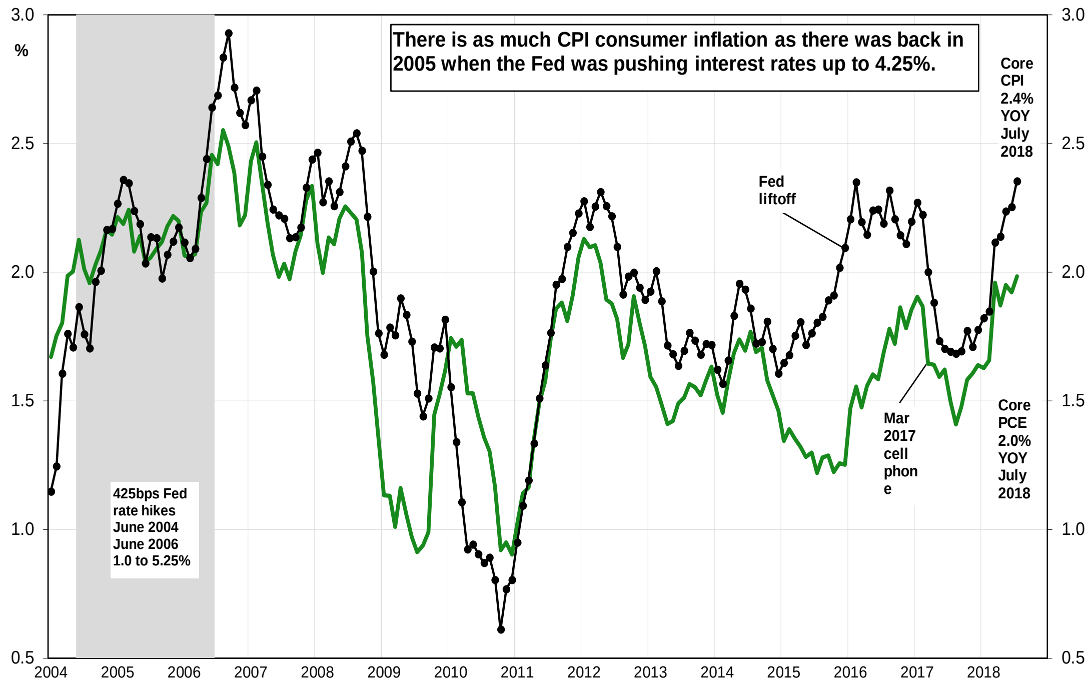
It's fashionable to say that mainstream economic indicators don't tell the whole story, but this morning's 4.2% GDP growth for the second quarter tells the true story that the economy is roaring with strength which is quite unusual this late in an economic expansion. The million-dollar question is for how long can the economy continue to hit it out of the park. If it's too good to be true, it usually is. We just had one of the biggest giveaways in corporate and individual tax cuts in modern economic history, and it would be foolish to ignore these as the primary driver of economic growth this year. 2019 is a different story, will the economy continue to put big numbers like this up on the board if the well runs dry and all the tax cuts monies have been spent on business equipment and consumer goods.

Already we are seeing a slowdown in after tax corporate profits to 2.4% in Q2 2018 from 8.2% in the first quarter and 4.7% in Q4 2017 showing the tax cuts effect on boosting profits has already hit the corporate bottom line. Pre-tax profits are 3.3% in the second quarter which will not be enough to support the 8.4% advance in the S&P 500 we have seen so far this year, won't support higher stock prices in 2019. Stay tuned. Story developing.

Consumer spending tax cuts cash, core inflation on target (Thursday)

Consumer spending in real terms is running 2.1% in the third quarter after rising 3.8% in the second quarter, and it is early yet with August and September data left to go. The results look pretty good given that car sales dropped from view in July, down 4% to a 16.7 million annual rate. We are watching consumer spending like a hawk because the economy won't repeat the second quarter's 4.2% fast pace without the consumer spending more of their tax cuts money. Just hope there is tax cuts money, as the country awaits the IRS tax forms for next year's filing season in April 2019. Not sure the tax cuts were massive for everyone, and won't believe it till my tax preparation software says it is there.

Core PCE inflation is back a tenth higher to 2.0%, the Fed's target. They won't be able to look the other way and pretend the economy doesn't have inflation pressures: today's report cements the case for another rate hike to 2.25% on September 26. If you are a diehard natural rate of interest nut, like the new New York Fed President Williams, maybe incoming Fed Vice Chairman Clarida, headline PCE inflation, including stuff like food and energy goods and services we purchase, is 2.3% in July, and add the estimate of real neutral rates from the Laubach-Williams economic model, currently 0.1%, and you get neutral rates of 2.4%. Fed officials think neutral is 2.75 to 3.0%, 9 out of 14 do anyway, but Laubach-Williams model says no, unless the estimate of real neutral rates or inflation move higher.



Unemployment claims remain low at 213K in the August 25 week. Everyone plays, everyone is a winner in this labor market. Jobless claims, what jobless claims? No one is getting sacked because workers haven't truly been this irreplaceable for two decades. The trade war thunder on the horizon hasn't moved closer to shore and we know this because companies would be letting some of their workers go if their business operations were seeing a loss of sales and revenues. Not happening. The economy, at least the labor market, is as strong now as it was during the roaring 90s under Clinton.

Net, net the consumer is doing their part to keep the economy's engines running strong in the second half of the year. With the inflation fires burning a little brighter the Fed will be able to proceed with a third rate hike this year when they meet in Washington next month. They won't have the blessing of the White House, but savers around the country, those in their golden years, will likely give a big round of applause. Interest rates below normal in a booming economy that is nine years long are not warranted.

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