Financial Market Weekly

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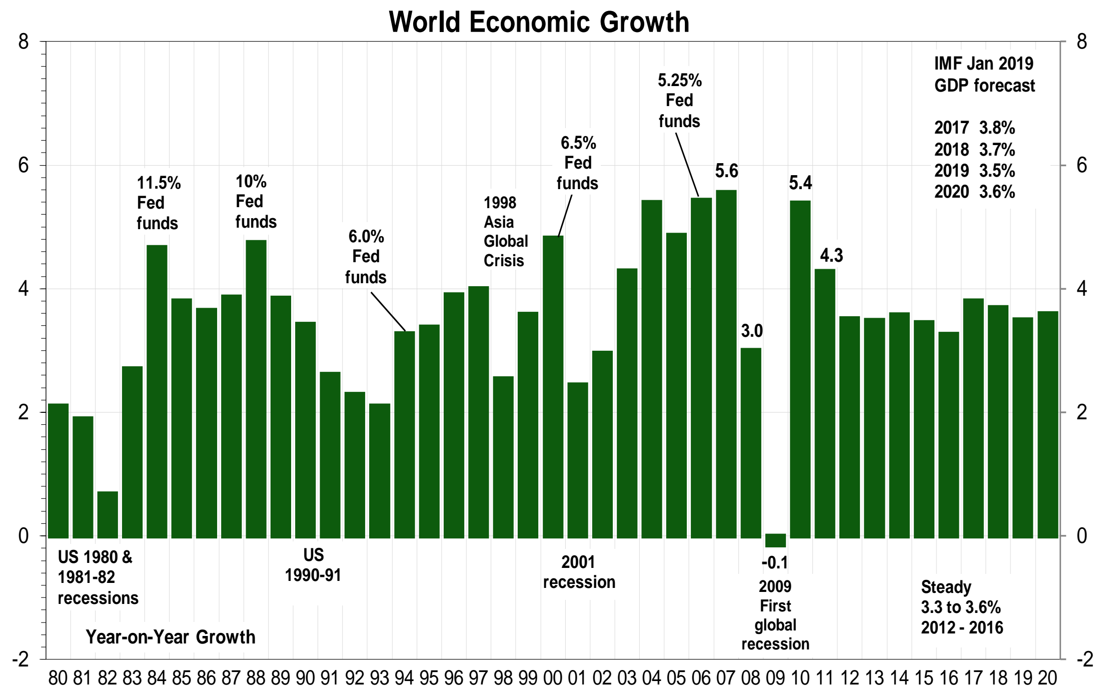
RETWEET: IMF SEES WEAKEST GROWTH IN THREE YEARS



Federal Reserve officials and markets alike are worried about the world economic outlook and China's slowing economy, so lucky for us we got fourth quarter China GDP on Sunday at the start of the week and then the IMF update on the world economic outlook at 8am New York time (is there any better time) on Monday morning. Markets were closed on Monday for the Martin Luther King Day holiday, but stocks fell Tuesday in part due to world growth concerns. So what did the IMF say? We are always getting burned by their characterizations of the world economic outlook in part because they are like risk management-always looking for what will go wrong next. Talk, Talk, Talk. Half the time the risks never materialize. "IMF Sees Weakest Growth In Three Years" sounds bad, but doesn't look all that bad. A picture is worth a thousand words (wish it were more like a thousand bucks). The IMF world growth forecast for 2019 in the chart above was cut from 3.7% in their forecast made last October to 3.5% in the January update released this week. Two-tenths off the top. It is the worst in three years but that seems beside the point. Despite all the dire news headlines and some event shocks over the last several years, world economic growth has actually been pretty steady: 3.3 to 3.6 percent. The chart above doesn't lie.

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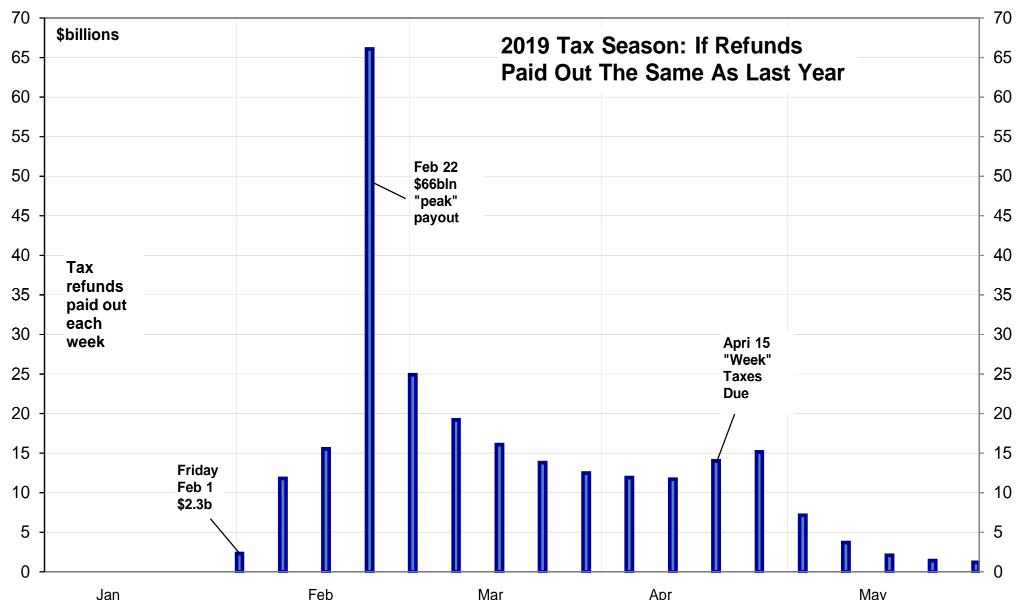
	World GDP	U.S.	Euro area	Germany	France	Italy	Spain	UK	Japan	Canada	China	Russia	India	Brazil	Mexico
				IMF JANUARY 2019 WORLD ECONOMIC GROWTH FORECASTS											
2017	3.8	2.2	2.4	2.5	2.3	1.6	3.0	1.8	1.9	3.0	6.9	1.5	6.7	1.1	2.1
2018	3.7	2.9	1.8	1.5	1.5	1.0	2.5	1.4	0.9	2.1	6.6	1.7	7.3	1.3	2.1
2019	3.5	2.5	1.6	1.3	1.5	0.6	2.2	1.5	1.1	1.9	6.2	1.6	7.5	2.5	2.1
2020	3.6	1.8	1.7	1.6	1.6	0.9	1.9	1.6	0.5	1.9	6.2	1.7	7.7	2.2	2.2

The IMF outlook update was released at 8am NY time Monday where markets were closed for the Martin Luther King Day holiday. We were at our desk, but not many other U.S. market participants were in work. IMF Managing Director Lagarde was asked about the possibility of a global recession in a Davos interview later in the week and she said, well no, 3.5% world growth this year, and 3.6% in 2020. She even mentioned the two countries whose growth outlooks were left unchanged from the October forecast and these were America and China interestingly enough. The two countries the market feels will soon be at death's door. Actually, the only year that global output actually turned negative, recession requires negative growth, was in 2009 after the Lehman bankruptcy broke the world. Emerging market countries run faster and keep the world economy from declining into a recession normally.

Europe is another worry for markets, Brexit, potential auto tariffs from the U.S. side. Euro area growth is slowing the IMF says from 2.4% in 2017 to 1.8% in 2018 and then 1.6% this year before rebounding slightly in 2020. Draghi gave an update on Euro area GDP on Thursday at the ECB meeting press conference where he talked about the downside risks for growth. They say they are still not looking for a rate hike at least through this summer, but markets don't believe one is coming in 2019 now. ECB members said in interviews later after the meeting they were taken by surprise how quickly conditions worsened.

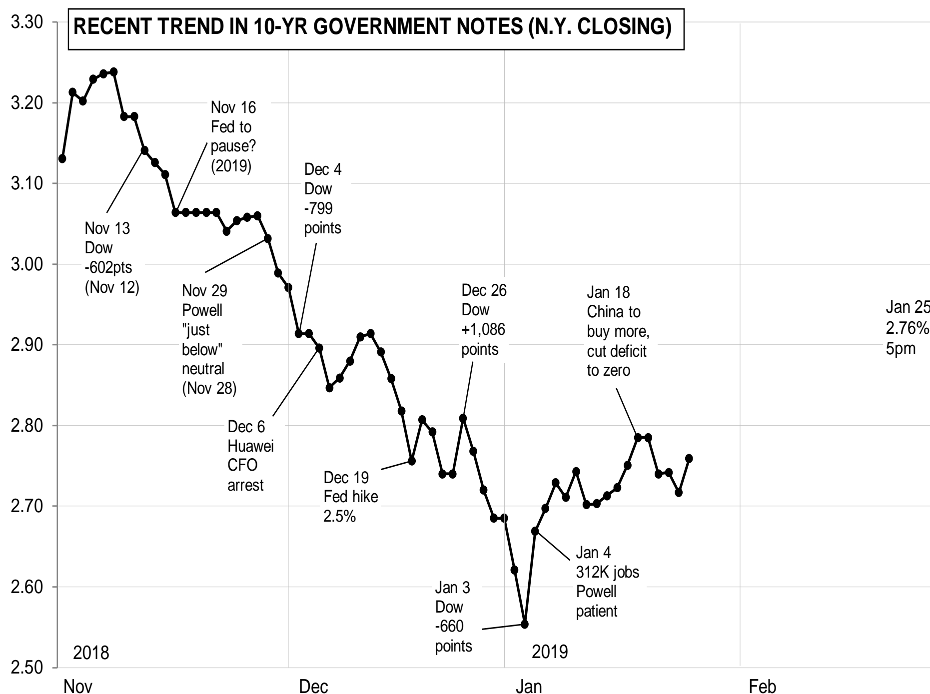


Meanwhile for USA, USA, USA. The check's in the mail. We never talk about politics. But the Federal government has shut down, does this mean we aren't getting our income tax refund any time soon? Refunds historically start right about now. They are probably built into the seasonals for consumer spending, so it's a good thing we won't know what spending is doing with the monthly retail sales report and personal spending in the monthly personal income report being postponed by the shutdown. Most taxpayers with refunds file their taxes early and you can see the peak $66 billion in refunds that will be paid out in the Friday, February 22 week, if refunds are paid out at the same pace as they were in 2018. The IRS has not had a lot of employees at work. We will see. *** Friday afternoon January 25 news. All is forgiven, the government is up and running again for three weeks. We're winning. Check's in the mail.

MARKETS OUTLOOK

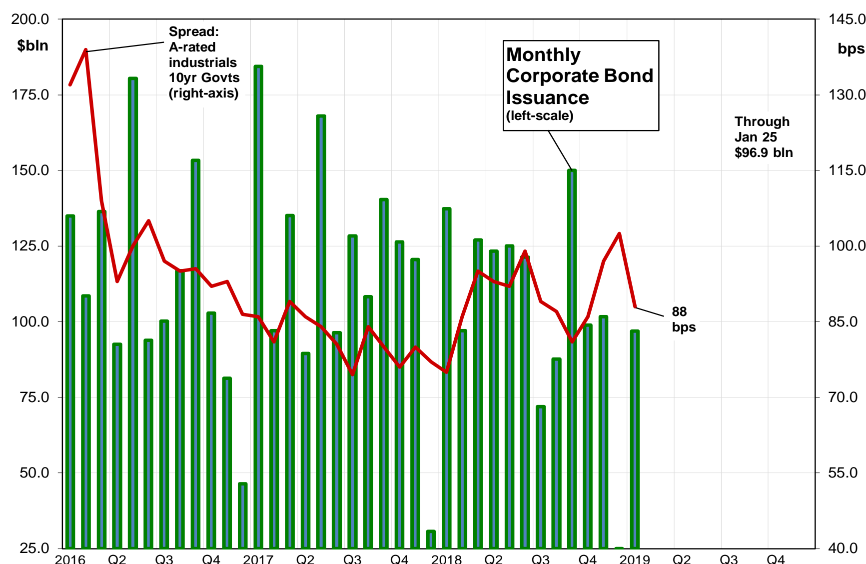
	31-Dec 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	3.02	3.20	3.30	3.35	3.45	3.45	3.50	3.60	3.70
10-Yr Note	2.68	3.00	3.10	3.20	3.30	3.30	3.40	3.50	3.60
5-Yr Note	2.51	2.85	3.00	3.10	3.20	3.25	3.35	3.45	3.60
2-Yr Note	2.49	2.80	3.00	3.10	3.20	3.20	3.35	3.45	3.60
3-month Libor	2.81	2.70	2.95	2.95	3.20	3.20	3.45	3.45	3.70
Fed Funds Rate	2.50	2.50	2.75	2.75	3.00	3.00	3.25	3.25	3.50
2s/10s spread	19	20	10	10	10	10	5	5	0

Bond yields closed the week little changed at 2.76%. Yields came down at the start of the trading week on Tuesday as the IMF downgraded its world growth forecast. Bonds may have followed Euro yields down on Thursday on weak PMI data and Draghi warned about downside risks. The low yield for the week was 2.70% Thursday. The Federal government shutdown is over (for three weeks anyway), but the market did virtually nothing when the rumors started flying around 1230pm EST that Trump would make a statement later Friday afternoon. In fact, it looked like stocks dived to the lows of the session. The government is back for now so economists can stop marking down Q1 2019 GDP forecasts. We have 2.0%, down from 3.0% expected for Q4 2018.



CORPORATES: BANKS AND FINANCE WEEK, BROOKFIELD, EXPERIAN, PENSKE

Corporate offerings were $12.4 billion in the January 25 week versus $31.0 billion in the January 18 week. On Thursday, Experian Finance priced a $500 million 4.25% 10-yr (m-w +25bp) at 155 bps (Baa1/A-). The consumer credit reporting company will use the proceeds for general corporate purposes, including acquisitions and debt repayment. Corporate bond yields (10-yr Industrials rated A2) were 88 bps above 10-yr Treasuries this week versus 94 bps last Friday.



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FEDERAL RESERVE POLICY

The Fed meets January 29-30 to consider its monetary policy. Wow. That's next week already. Forget January though for any policy action as the odds of a rate hike at the March 2019 meeting are only 4 percent. At least Fed Chair Powell will hold a press conference after the meeting. We need something to do, and it will be interesting to see if he tells us how long the flexible, patient Fed will be on hold.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	23-Jan	16-Jan	9-Jan	2-Jan	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2220.115	2220.219	2222.412	2222.517	479.782
Federal agency debt securities	2.409	2.409	2.409	2.409	0.000
Mortgage-backed securities (MBS)	1628.895	1632.729	1637.123	1637.123	0.000
Primary credit (Discount Window)	0.013	0.012	0.007	0.005	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)	0.000	0.000	0.000	0.000	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	0.086	0.088	0.086	4.207	62.000
Federal Reserve Assets	4094.7	4097.9	4104.3	4106.2	961.7
3-month Libor %	2.77	2.78	2.80	2.79	2.82
Factors draining reserves					
Currency in circulation	1704.945	1705.632	1711.945	1720.052	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	11.415	1.316	2.537	19.481	0.000
Reserve Balances (Net Liquidity)	1611.716	1625.501	1664.186	1607.335	24.964
Treasuries within 15 days	14.191	14.191	2.090	2.091	14.955
Treasuries 16 to 90 days	78.611	78.611	92.622	92.622	31.549
Treasuries 91 days to 1 year	292.514	292.515	290.222	290.222	69.272
Treasuries over 1-yr to 5 years	955.541	955.556	958.045	958.061	170.807
Treasuries over 5-yrs to 10 years	261.168	260.811	260.849	260.887	91.863
Treasuries over 10-years	618.090	618.535	618.585	618.634	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

If there is nothing to do on rates and yet the sky is falling somewhere in the world economy, maybe Fed officials can talk about their great big balance sheet. Maybe they could stop unwinding the balance sheet and that would "restore needed liquidity" in the global markets. Trump thinks so. From the table above, the balance sheet was $4.094 trillion on January 23, 2019 and it was $961 billion before Lehman in September 2008. The Fed's five or six quantitative easing (QE) programs added securities to the balance sheet and pumped badly needed liquidity into the floundering economy. Actually, we call it liquidity, but it is really dead money sitting as excess reserves at banks (Reserve Balances in table here were $1.611 trillion on January 23, 2019).

Eurodollar futures say no more Fed rate hikes

Year-ends for Interest Rates				
Percent %	2018	2019	2020	2021
Eurodollar futures	2.803	2.76	2.610	2.58
Fed's Dec forecast	2.5	3.0	3.25	3.25

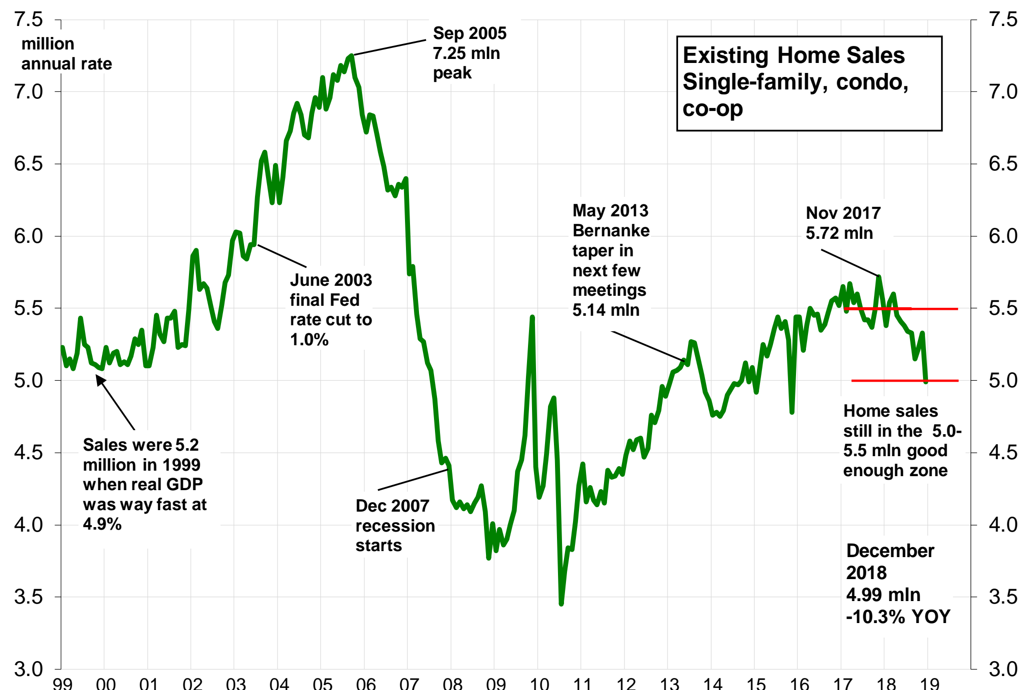
Eurodollar futures price where 3-month Libor will be in the future.
Friday, January 25, 2019 3-month Libor 2.75%

QE works in one way by its announcement effect, markets think the Fed is "doing something" and riding to the economy's rescue. That won't work again. People can't agree if it works and that it is a good thing. The other way that QE does good things for the economy is the Fed buys Treasury and MBS securities so the public does not need to. All things being equal, this means long-term yields should be lower than they would have been. Our back of the envelope calculation, using the annual Federal budget deficit that must be financed by selling Treasury securities to the market, the budget deficits from fiscal year 2009, after QE started, to fiscal year 2018 ending September 2018 add up to $8.7 trillion and the Fed bought $1.7 trillion (20%) of that from the table above: $2.220 trillion Treasuries held this week minus $479 billion Treasuries on the balance sheet before Lehman in September 2008. Was this enough QE to keep Treasury bond yields lower and help the economy? Stay tuned. We will see as the balance sheet unwind continues whether bond yields go higher. The unwind effect on yields may be hard to measure or see. The unwind is only $360 billion Treasuries and $240 billion MBS annually. Not sure halting this unwind will add up to a hill of beans for the public and the economy.

OTHER ECONOMIC NEWS THIS WEEK

Home sales fall sharply during December's market turbulence and Washington shutdown (Tuesday)

Existing home sales fell 6.4% to a 4.99 million annual rate in December, but that doesn't tell the half of it because the recent trend this year is straight down for home purchases. Federal Reserve officials were already on the lookout for signs that interest-rate sensitive sectors of the economy were coming under stress, and right now home sales are the smoking gun that the Fed's rate hikes are starting to bite and slow the broader economy down. There could be some winter-weather effect here with weaker home sales in the Midwest and South behind most of the decline this December. But the overall trend the last several months tells a different story where the homebuyer has lost confidence and simply doesn't have the means to keep chasing the home sales market where prices have continued to move higher than worker wages the last several years. It looks like home buyers have been priced out of the market.

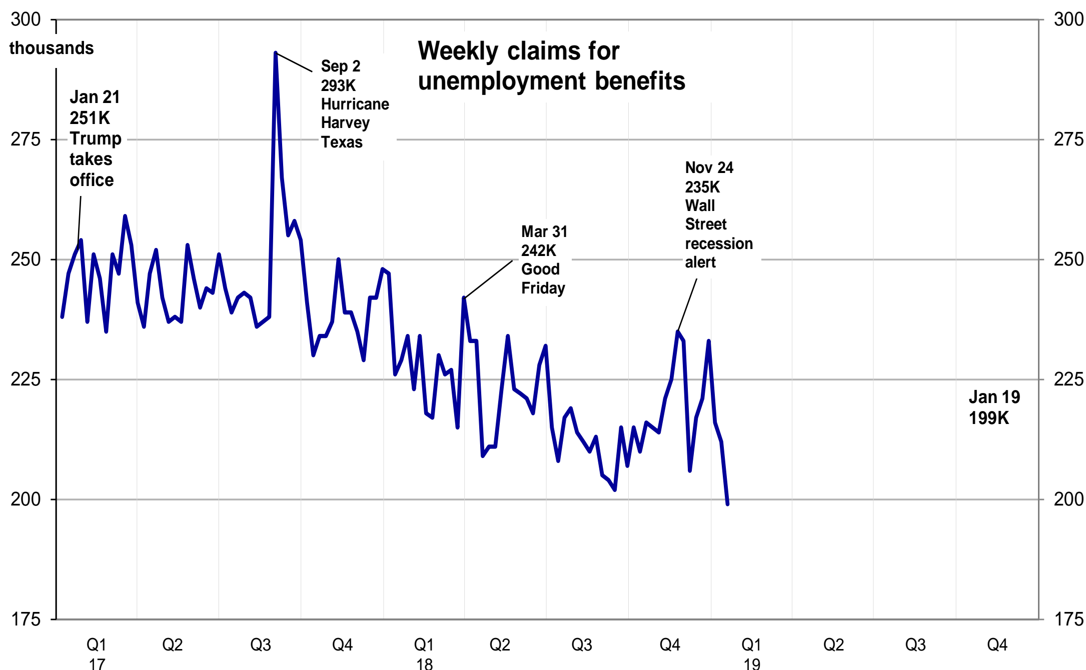


Net, net, you don't buy the biggest big-ticket purchase of your life when the markets are plummeting and scaring the daylights out of consumers. Existing home sales fell sharply in December, the start of winter when there is normally fewer home listings, but we believe the economic outlook also took a toll on consumers and caused them to pull back from putting down payments on the most expensive purchase they will ever make in their lives. The stock market fell over 20% in December from the highs of the year made just two months earlier, and this along with the Federal government shutdown, injected an air of caution into home buying plans.

Existing home sales are now the weakest since Trump was elected in November 2016, signaling the initial confidence boost from the new ideas and new legislation is falling flat. America isn't great again if you are in real estate. Rising mortgage costs and higher home prices took the oomph out of the housing market and even the Tax Cuts and Jobs Act giving more money back to the American people couldn't offset the increasingly expensive and perhaps risky proposition of buying a home. Stay tuned for our next update.

Consumers less confident, govt shutdown, but job layoffs fall to 1960s lows Thursday)

Breaking economy news. Jobless claims fell not rose in the January 19 week to 199K. Home resales are down, consumer confidence is down, the government shutdown is in its 34th day, yet companies continue to move ahead with confidence. Business sales and revenues start to slow and companies make adjustments by trimming production and finally laying off workers. That is the downside of the business cycle, but caution is nowhere to be seen. The market is way too far out in front of its skis in thinking recession is right around the corner. No one but no one is losing their job. You can't have a recession without job losses and right now the exact opposite is taking place.



Sure, sure, this is a difficult time of year to seasonally adjust the jobless claims statistics as the huge winter-related, cold weather layoffs are behind us. Not seasonally adjusted jobless claims fell more than expected perhaps, down 76 thousand to 267 thousand this week, and may not fall as hard next week, boosting seasonally adjusted claims from these 199K rock-bottom lows not seen in half a century. But still, the fact remains, despite the uncertainty from the news headlines, companies' operations remain steady and workers are staying out on the factory floor to finish the job.

Even Washington government workers are not applying for jobless benefits in the numbers we had thought. New filings for Federal employees were 25.419 thousand in the January 12 week up from 10.454 thousand in the January 5 week. A year earlier just 1.658 thousand applied for unemployment benefits. It's bad, but nowhere near the one million number commonly cited as the number of Federal government workers who are affected by the shutdown.

Net, net, Washington has put almost one million employees on temporary layoff, some working without pay, but the spillover effects to the broader economy cannot be seen as companies refuse to let workers go in this tightest labor market in a generation. There is the biggest labor shortage in modern economic history because the economy has run steady and strong for almost ten years now and everyone who was on the sidelines and could lend businesses and companies a hand has already been hired a long time ago. The state of the union could not be any better according to this latest reading on the labor markets. Times are good.

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