DOWNWARD DEATH SPIRAL IN BOND YIELDS SHOULD FRIGHTEN EVERYONE

A couple more weeks left before the start of the widely expected Fed rate cuts. The bond market, 10-yr Treasury yields, has been preparing for this day for some time. Yields fell decisively below the 2.5% Fed funds rate in early May waiting for the Fed to cut rates at least a couple of times. The original death plunge over the cliff was on the pair of Sunday afternoon tweets on May 5 from the president escalating the trade war by moving up tariffs on $200 billion of imported goods from China from 10 to 25 percent. That was an external shock to the economy, not too long ago, so it is not unreasonable to still be on a recession watch, and see if companies lay off workers and make the bond market’s recession hopes and fears a reality. [Nothing so far with jobless claims low at 216K in July 13 week.] In recent interest rate cycles, Treasury bond yields never went higher than the Fed funds rate, so if the Fed is cutting rates, that is going keep bond yields lower.

Ahead of the Fed’s July 30-31 meeting we are rereading the Fed’s mandate from congress, and having a Fed Chair who is a lawyer is a benefit. Who would have guessed? By our analysis, it looks

Federal Reserve’s Dual Mandate
Congress amended The Federal Reserve Act in 1977
"The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates."
like Fed rate cuts will not be in keeping with the Fed’s mandate. It’s not a dual mandate. There are three goals, and try to forget the Fed is supposed to achieve the goals by increasing the money supply. The third goal is moderate long-term interest rates; that won’t be achieved if the Fed cuts rates.

We want to go back to the time when Senator Corker and Bernanke had some words over low interest rates, why were they so low? Maybe it helps explain how we got here with interest rates well below normal levels ten years after the recession. Keep in mind this was 2013 when the unemployment rate was 7.9 percent. We can’t see any justification for monetary stimulus, interest rates below normal, at this point with the unemployment rate at 3.7%, despite the claims from some over “uncertainty” and inflation below the 2% target, and the “slowing world economy.” The recovery Bernanke hoped for by providing monetary stimulus with ultra-low interest rates was strong enough to put people back to work and push unemployment down. Mission accomplished.

Back to the present… Senator Tina Smith D-Minn. asked Powell on July 11— “What can we learn from the experience with Europe?” We would think the answer would be don’t do what the ECB did, and Japan did before them. Don’t push rates to zero because it will not achieve anything: the economy would have created as many jobs as it was ever going to with or without the central bank. Unfortunately it sounded like Powell said the lesson is indeed cut the central bank rate to zero: “-- you don’t want to get behind the curve and let inflation drop well below 2 percent, because what happens is you get in to this unhealthy dynamic potentially where lower expected inflation gets baked in to interest rates which means lower interest rates, which means less room for the central bank to react, and that becomes a self-reinforcing thing. We’ve seen it in Japan, we’re now seeing it in Europe, and that’s why we think it’s so important that we defend our 2% inflation goal here in the United States and we’re committed to doing that.” We’re committed alright. Get behind the curve sounds like Powell’s policy will drive down the meager real returns to bond holders ever further. Those early 2000s 4% bond yields with juicy 200 bps real yields look to be history.
MARKETS OUTLOOK

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<td>2.81</td>
<td>2.53</td>
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<td>2.40</td>
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<td>3-month Libor</td>
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<td>2.32</td>
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<td>Fed Funds Rate</td>
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<td>2.00</td>
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<td>2s/10s spread</td>
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<td>20</td>
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10-year Treasury yields rose to 2.14% on the stronger retail sales data Tuesday, getting close to the Sunday night high for the week in yields. Yields started falling with Dow stocks Wednesday afternoon on earnings and reports the China-US talks were not making progress. The 2.02% low for the week was Thursday afternoon after the market thought it heard NY Fed President Williams, saying a 50 bps rate cut was possible on July 31. His comment about the need to be aggressive when facing an adverse outlook for the economy was later clarified to be just a summary of two decades of academic research.

FEDERAL RESERVE POLICY

The Fed meets July 30-31 to consider its monetary policy. Rate cuts are coming. Here is our reasoned University level Fedwatcher 101 course analysis of the pros and cons. Mostly cons.

Friday, July 19, 2019 Donald J. Trump @realDonaldTrump

843am EDT tweet Because of the faulty thought process we have going for us at the Federal Reserve, we pay much higher interest rates than countries that are no match for us economically. In other words, our interest costs are much higher than other countries, when they should be lower. Correct!

938am tweet .... but it is no thanks to the Federal Reserve. Had they not acted so fast and “so much,” we would be doing even better than we are doing right now. This is our chance to build unparalleled wealth and success for the U.S., GROWTH, which would greatly reduce % debt. Don’t blow it!

938am EDT tweet I like New York Fed President John Williams first statement much better than his second. His first statement is 100% correct in that the Fed “raised” far too fast & too early. Also must stop with the crazy quantitative tightening. We are in a World competition, & winning big....

942am EDT tweet …Fed: There is almost no inflation!

Growth? Fed policy is supposed to sustain the economic expansion. Real GDP in the second quarter is due Friday, July 26 at 830am EDT Consensus is 1.8% which is a slowdown from 3.1% in the first quarter. For the Fed, the heat is on. Wait till the White House sees a 1.8% growth print.
Ahoy Fed. Consumers have weathered the storm (Tuesday)

Breaking economy news. Consumer spending is very strong at the moment rising 0.4% in June and 0.4% in May. The consumer was frightened to death at the turn of the year with retail sales dropping in December during the stock market's plunge and in February after the Federal government shutdown. But now spending is running flat out at 7.5% in the second quarter which makes one wonder how the Federal Reserve can make the case for interest rate cuts. The consumer can't possibly buy any more goods and services than they are right now. Retail spending is so strong in recent months that the third quarter is running 1.7% even before we get the data for July, August, September.

Net, net, the economy looks solid from where the consumer is standing and they continue to take shopping trips to the mall despite the worrying headlines about trade wars and slowing world growth. China and Europe are a long way away from American shores and the growth slowdown there does not appear to be hurting consumer confidence and spending here. The stronger retail sales figures effectively shut the door on a Fed rate cut for traditional weak economy reasons after weathering the storm at the turn of the year. The Fed can talk about the need for risk management rate cuts all they want, but the risk is their interest rate cuts will fall on deaf ears. We have never seen a time where the Fed had such limited ammo to try to steer the course of the economy, and by cutting rates now, they risk having no firepower if the economy actually turns down and goes into recession. Save the rate cuts for a rainy day is what consumers are telling the Fed. We don't need them. The Fed says they listen, let's see if that's the case.
America has a homeless problem (Wednesday)

Housing: no recovery in sight

Residential housing construction is one of the leading indicators of a recession and while construction activity isn't dropping precipitously, housing is stuck in a rut and is so far unable to recover fully from the housing bubble crash over a decade ago. If the Fed thinks rate cuts are going to send housing construction up like a rocket, they better think again. Mortgage money is already cheap with the cost of borrowing to buy a new home falling from 4.9 percent last November to 3.75 percent today.

Net, net, don't tell homebuilders there is a critical shortage of housing in the country because they aren't listening. Homebuilders can't get permits, can't get financing, can't get skilled labor, and the cost of building materials is going through the roof. The critical housing shortage is a supply side problem not a demand side. Cutting interest rates to stimulate demand won't do a darn thing, and Fed officials will be wasting precious ammunition if they do. Save the rate cuts for a recession. Rate cuts to help make America great again won't help anybody. Bet on it.

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<th>Housing Starts Total, Single-Family, Multi-Family</th>
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<td><img src="chart.png" alt="Housing Starts Chart" /></td>
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- **United States**
  - Total: 1253, 1265, 1180
  - Single-Family: 847, 818, 854
  - Multi-Family: 396, 437, 316

- **Northeast**
  - Total: 109, 83, 104
  - Single-Family: 46, 49, 70
  - Multi-Family: 197, 155, 164

- **Midwest**
  - Total: 122, 113, 113
  - Single-Family: 635, 699, 567
  - Multi-Family: 478, 473, 449

- **South**
  - Total: 312, 328, 345
  - Single-Family: 201, 183, 222

- **West**
  - Total: 113
  - Single-Family: 113
  - Multi-Family: 113

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<th>Month</th>
<th>Total</th>
<th>Single-Family</th>
<th>Multi-Family</th>
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<tr>
<td>Jun 19</td>
<td>1253</td>
<td>847</td>
<td>396</td>
</tr>
<tr>
<td>May 19</td>
<td>1265</td>
<td>818</td>
<td>437</td>
</tr>
<tr>
<td>Jun 18</td>
<td>1180</td>
<td>854</td>
<td>316</td>
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<td>% Chgs</td>
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<tr>
<td>Jun/May</td>
<td>-0.9</td>
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<tr>
<td>Jun/Jun</td>
<td>6.2</td>
<td>-0.8</td>
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