Financial Market Weekly

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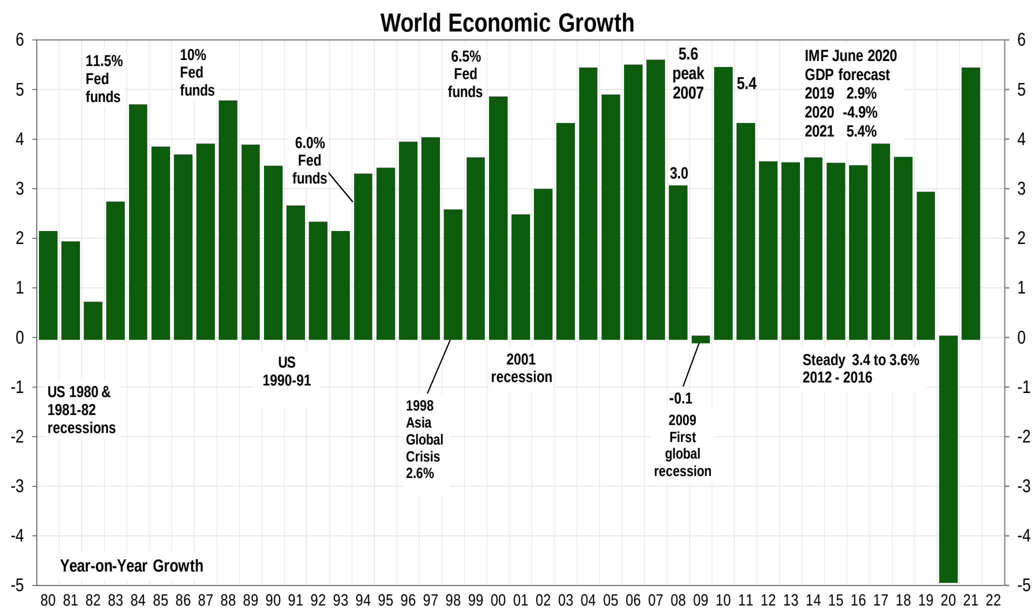
WORLD ECONOMIC OUTLOOK GROWS DARKER



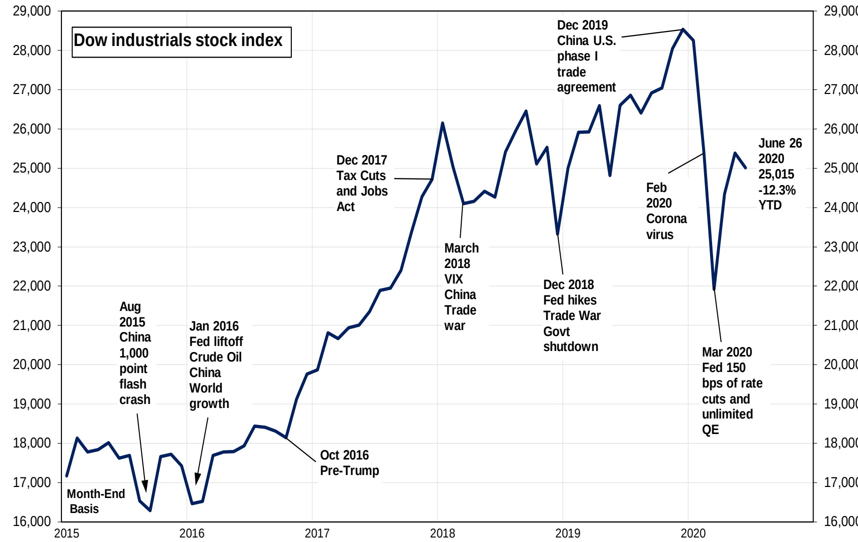
The headline from the IMF World Economic Outlook update at 9am ET Wednesday said they forecast the world economy would drop 4.9% in 2020 where their April forecast this year looked for a decline of just 3.0%. There is a deeper hole to climb out of. The IMF's call for growth in 2021 is a gain of 5.4% and it won't be enough to get back to normal. The global economy seems to lose either way when it comes to the coronavirus pandemic. If there's a second wave of the virus then the economic recovery is delayed or it slows. If there is no second wave, continued caution (Once bitten, twice shy) on the part of the public and social-distancing measures will lead to a more gradual recovery in economic activity. And on a separate track, trade frictions are also a negative for world growth.

When world growth falls 4.9% this year, and rises 5.4% in 2021, the level of GDP is back to where it was in 2019 , but we can't really call that V-shaped because the economy is missing out on two normal 3-1/2 percent growth years, so economic activity should have been roughly 7% higher and better at the end of 2021. The pandemic made the economy lose out on two years of growth.

IMF JUNE 2020 WORLD ECONOMIC GROWTH FORECASTS

	World GDP	U.S.	Euro Area	Germany	France	Italy	Spain	UK	Japan	Canada	China	Russia	India	Brazil	Mexico
2019	2.9	2.3	1.3	0.6	1.5	0.3	2.0	1.4	0.7	1.7	6.1	1.3	4.2	1.1	-0.3
2020	-4.9	-8.0	-10.2	-7.8	-12.5	-12.8	-12.8	-10.2	-5.8	-8.4	1.0	-6.6	-4.5	-9.1	-10.5
2021	5.4	4.5	6.0	5.4	7.3	6.3	6.3	6.3	2.4	4.9	8.2	4.1	6.0	3.6	3.3

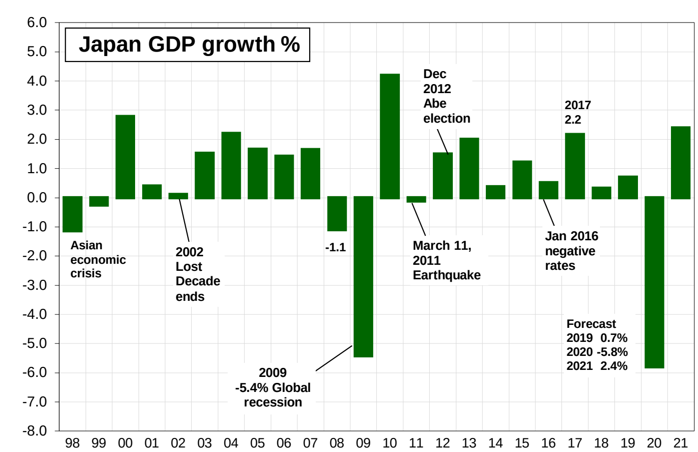
We always like to check where the IMF sees U.S. growth and it looks a little more bearish than we were thinking at -8.2% this year and +5.4% in 20201 on a Q4/Q4 basis. Heck, that's a deep hole: we are forecasting just -3.9% this year and bouncing 3.1% in 2021. The Fed median forecast from the June meeting is -6.5 this year and a gain of 5.0% next year. The IMF must be expecting investment spending to drop harder because consumer spending is already coming back at a faster rate.

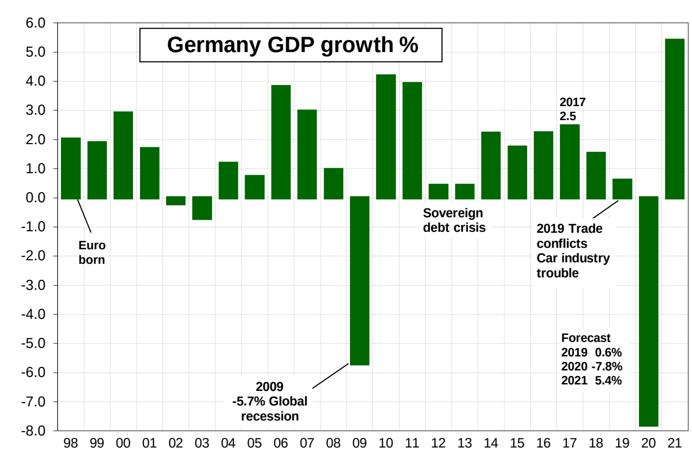


The IMF forecast seemed to affect the stock market as it often does over the years when the four world economic outlook reports each year are released. Dow industrials fell over 700 points on Wednesday, and stocks seemed to stop their intraday recovery from an overnight loss at 9am ET when the IMF headlines hit (growth -4.9% in 2020 down from a -3.0% forecast in April). Most of the stock market's loss Wednesday was second-wave coronavirus related, especially the headline at 1137am ET saying New York, New Jersey and Connecticut order out of state visitors to quarantine.

The stock market figures prominently in the IMF warning of the risks to world growth. The IMFBlog "Financial Conditions Have Eased, but Insolvencies Loom Large" talks about the disconnect beteen the financial markets and the real economy. They put up a graph showing the relationship between consumer confidence and the equity markets is no longer in sync. There could be a correction in the stock market if "investors' attitudes" change and that such a decline in stocks could threaten the economic recovery. The blog even went as far to say that there have been bear market rallies in recessions before only to "unwind swiftly." Not very opitimistic for the Americans who have their wealth tied up in the stock market.

The IMF doesn't stop there. It asks what the triggers of a stock market correction might be. (1) The recession is deeper and longer than expected. (2) Second wave of infections. (3) Geopolitical tensions or social unrest tied to rising global inequality. (4) The overly optimistic expectations about central bank "support" for markets could be reassessed by investors. (5) Nothing. Just kidding. These four reasons are worrying enough. After reading this blog we are tempted to sell out all our stock holdings.





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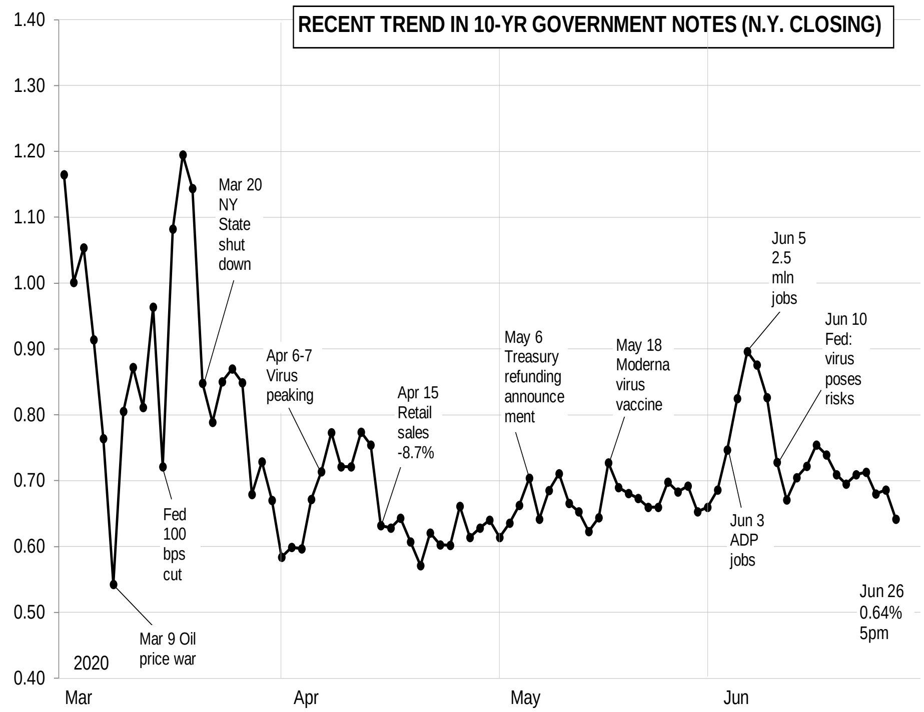
MARKETS OUTLOOK

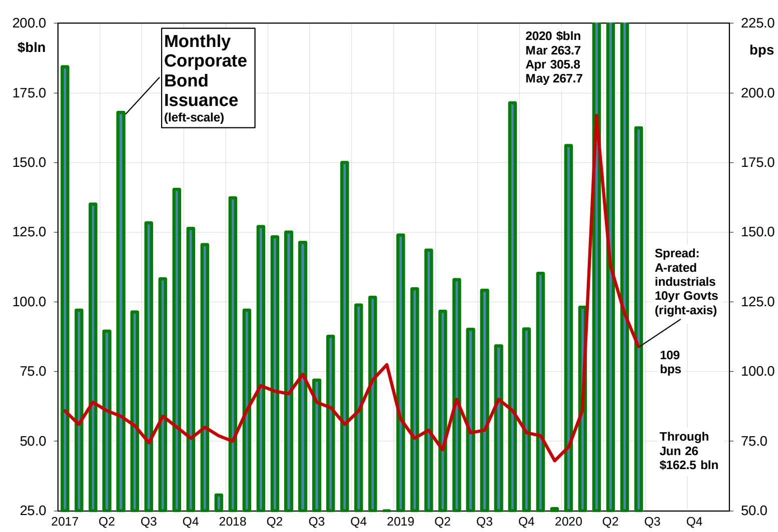
	29-Mar 2019	28-Jun 2019	30-Sep 2019	31-Dec 2019	31-Mar 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021
30-Yr Treasury	2.81	2.53	2.11	2.39	1.32	1.30	1.30	1.40	1.50	1.60
10-Yr Note	2.41	2.01	1.67	1.92	0.67	0.70	0.70	0.80	0.90	1.00
5-Yr Note	2.23	1.77	1.55	1.69	0.38	0.30	0.40	0.60	0.70	0.80
2-Yr Note	2.26	1.76	1.62	1.57	0.25	0.20	0.30	0.30	0.40	0.40
3-month Libor	2.60	2.32	2.09	1.90	1.45	0.40	0.30	0.20	0.20	0.20
Fed Funds Rate	2.50	2.50	2.00	1.75	0.25	0.25	0.25	0.25	0.25	0.25
2s/10s spread	15	25	5	35	42	50	40	50	50	60



10-yr year yields 0.64% this week after closing 0.69% last week. Coronavirus headlines, and how they move the stock market, dominate the news for bonds. Yields fell 3 bps to 0.68% on Wednesday when the Dow industrials fell 710 points. Yields fell 4 bps to 0.64% on Friday, when Dow stocks dropped 730 points. The stock market's Wednesday loss was helped along by the news the tri-state area would quarantine visitors from out of state. Stocks dropped on Friday in part due to the 959am ET headlines that Texas was closing the bars back down due to the virus. Not much to update on the interest rate forecast at the close of the second quarter. Just push the upward drift in yields out another quarter in the future.

CORPORATES: UNITED AIR, ABBOTT LABS, CANADIAN NATURAL RESOURCES

Corporate bond offerings were $25.0 billion in the June 26 week versus $50.4 billion in the June 19 week. On Thursday, Intuit Inc. sold $2.0 billion 3s/5s/7s/10s. It priced a $500 million 1.65% 10-yr (m-w +15bp) at 100 bps (A3/A-). The business and financial management software company (TurboTax) may use the proceeds to finance a portion of its potential acquisition of Credit Karma. Corporate bond yields (10-yr Industrials rated A2) were 109 bps above 10-yr Treasuries Friday versus 106 bps last Friday.



FEDERAL RESERVE POLICY

The Fed meets July 28-29, 2020 to consider its monetary policy. The meeting is a month away. There were some Fed officials speaking this week (what can they say?), but we never finished with day two of the semiannual monetary policy report with the testimony of Number One at the Fed and the buck stops there always. Powell gave his testimony and took a lot of questions Wednesday, June 17 before the House. Were there any interesting tidbits in his Q&A?

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	24-Jun	17-Jun	10-Jun	3-Jun	pre-LEH
Factors adding reserves					
U.S. Treasury securities	4197.404	4169.340	4150.409	4134.356	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1943.441	1918.741	1835.595	1835.594	0.000
Repurchase agreements	70.201	79.053	167.300	211.550	126.750
Primary credit (Discount Window)	6.237	7.479	8.427	11.011	23.455
MMLF	22.889	24.680	26.977	29.859	
PDCF	3.624	5.306	5.829	5.847	
Commerical Paper Funding Facility	12.798	12.797	12.796	12.795	
Paycheck Protection Facility	62.597	57.552	56.983	55.230	
Corporate Credit Facility (CCF)	40.617	38.916	37.374	36.154	
Municipal Liquidity Facility	16.080	16.079	16.077	16.075	
Main Street Lending Program	37.502	31.876	31.875	0.000	
Term Asset-Backed Facility (TALF II)	8.500				
Central bank liquidity swaps	274.963	352.470	444.520	466.945	62.000
Federal Reserve Assets	7131.0	7143.4	7217.6	7213.4	961.7
3-month Libor %	0.28	0.32	0.32	0.33	2.82
Factors draining reserves					
Currency in circulation	1963.978	1959.750	1955.861	1952.420	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Treasury credit facilities contribution	114.000	104.000	104.000	104.000	
Reverse repurchases w/others	0.001	0.001	0.012	0.013	0.000
Reserve Balances (Net Liquidity)	2937.657	3069.439	3190.654	3257.435	24.964
Treasuries within 15 days	64.328	70.365	42.873	49.583	14.955
Treasuries 16 to 90 days	274.008	276.151	292.827	283.619	31.549
Treasuries 91 days to 1 year	605.122	587.886	586.718	589.247	69.272
Treasuries over 1-yr to 5 years	1592.447	1581.775	1581.035	1575.173	170.807
Treasuries over 5-yrs to 10 years	735.883	729.159	725.316	719.393	91.863
Treasuries over 10-years	925.617	924.006	921.640	917.341	101.337

**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08
MMLF: Money Market Mutual Fund Liquidity Facility: loans secured by assets bought by banks from money market funds
PDCF: Primary Dealer Credit Facility: o/n and term funding with maturities to 90 days
CCF: Corporate credit facility: Primary market (PMCCF) and Secondary Market (SMCCF)

Powell did say there would be strong jobs creation through July, but here he was just agreeing to a question from Rep. Wexton (D-VA). It was about whether he was in favor of continuing with the additional $600 weekly unemployment claims benefits after they expire on July 31. This is when he said you probably wouldn't want that benefit to go immediately from $600 to zero dollars. While he did say there would be more jobs created he was less certain perhaps if the unemployment rate would come down. The BLS did say last month's 13.3% unemployment might have been 16.3% if the survey responses had been more accurate. The consensus on Thursday, July 2's monthly employment report covering June is for payroll jobs to increase 3.0 million and the unemployment rate goes to 12.4%. Given the uncertainty, the report shouldn't be the final verdict on the strength of the economic recovery. Payroll employment dropped 22 million in the first two months of the pandemic during the lockdown, and rose 2.5 million in May. It seems reasonable to think the job losses will be cut in half quickly even with perhaps 8.5 million jobs created all in June. The unemployment rate is trickier, not just due to the survey misclassification, but because 30 million people are receiving unemployment benefits which means the unemployment rate may be more than 20%.

There was no clarity in Powell's Q&A before the House on why the Fed is still buying $80 billion of U.S. Treasuries per month. What is it doing. Why 80? The Bernanke Fed bought $45 billion per month as QE during 2013 before tapering it to zero in 2014. We thought it might be helping to finance the Federal government debt, but Powell gave no such indication and if he did it might create an uproar as some representatives believe the Fed's expanded $7 trillion balance sheet could lead to inflation pressures.

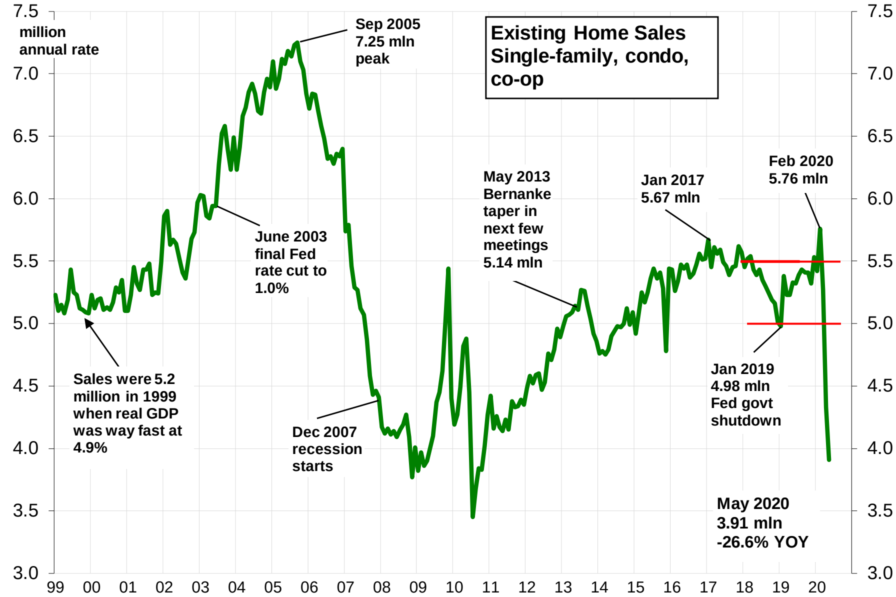
Meanwhile, what did the IMF say this week? What happens if equity markets question central bank support? We added a couple of credit provision lines to the Fed's QE purchases table here to monitor.

U.S. Treasury New Cash Needs and Fed Treasury Purchases (QE)
Monthly Changes ($ billions)
Fiscal Year (FY) Ending September 2020

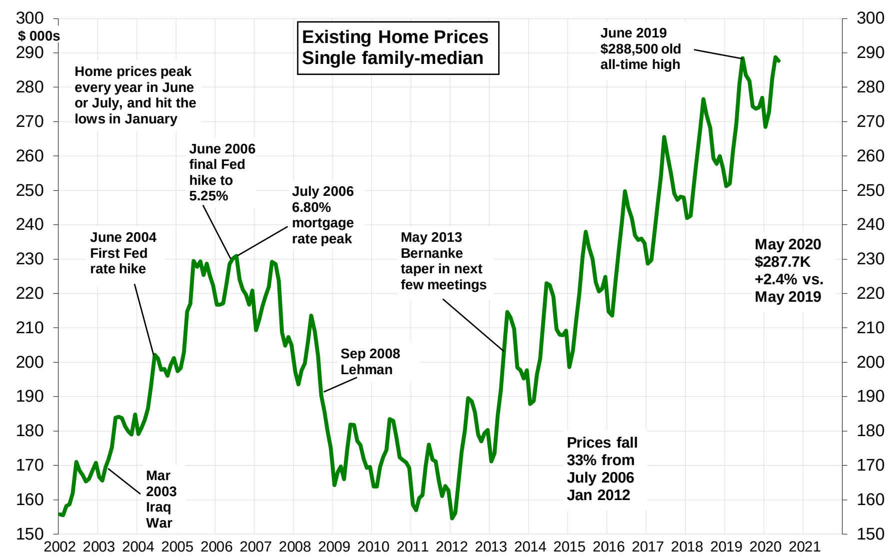
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total FY 2020
Fed QE	67.808	73.007	80.364	80.246	64.952	504.312	993.047	138.093	87.892	2,089.7
New Cash	166.8	112.5	50.9	38.5	199.8	238.7	1368.6	699.2	685.2	3,560.2
Bills	79.1	59.0	-98.2	-12.5	160.3	92.8	1344.3	628.2	449.7	2,702.6
Coupons	87.6	53.4	149.2	51.1	39.5	145.8	24.2	71.0	235.5	857.3
Federal Reserve's 11 Lending Facilities (month-end outstanding)					0	58.352	94.641	136.343	204.607	
Central bank liquidity swaps (month-end outstanding)					0.044	206.051	438.953	448.946	274.963	

OTHER ECONOMIC NEWS THIS WEEK

Home sales plummet to housing bust lows a decade ago. Prices fall too. (Monday)



Breaking economy news. Existing home sales fell 9.7% in May to 3.91 million at an annual rate meaning sales are back to the rock-bottom lows recorded after the housing bubble burst over a decade ago in the Great Recession. It's a good thing that existing home sales are based on closings and that the actual sales contracts were signed 30 to 45 days ago because today's data stink with not a hint that the housing market is in recovery. Single-family home prices fell in May as well which almost never happens during the spring selling season where the public pays up for a new home when the sun is out and shining and the birds are out singing. Maybe that was true for the sun and birds, but home buyers pulled back in May and this helped bring about a rare drop in home prices this spring. Existing single-family home prices fell 0.3% in May to $287.7 thousand. In May 2019 prices jumped 4.4%, rose 3.1% in May 2018 and increased 3.2% in May 2017.



Net, net, existing home sales in May collapsed back to the housing bust lows over a decade ago in the last recession which should come as no surprise given that realtors were unable to show properties and potential home buyers were stuck at home during the pandemic lockdown of the economy. We are hopeful that the worst is over in the housing market as the sales reflect closings where the actual sales contracts were signed a month earlier.

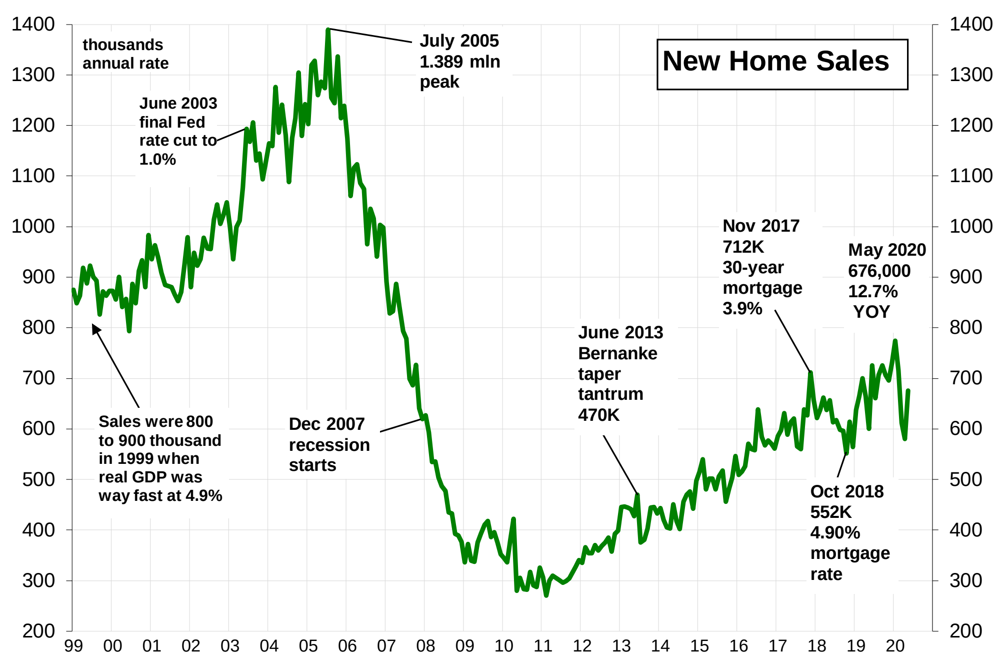
The only worrying sign is that home prices fell in May which is almost unheard of unless the economy is in retreat and the unemployment rate is soaring. Stay tuned. There is still a long road to recovery for the broader economy. Home sales may bounce with pent-up demand following the shutdown of the economy starting in March, but the massive scale of job losses and cautious consumers rebuilding their savings may limit the sales turnover of the housing stock later this year and into 2021. You have to be pretty confident to buy the biggest big-ticket item of your life and right now consumers are not as confident as they were earlier this year. This is no longer the best economy in 50 years. Bet on it.

New home sales bounce as stay-at-home orders are lifted (Tuesday)

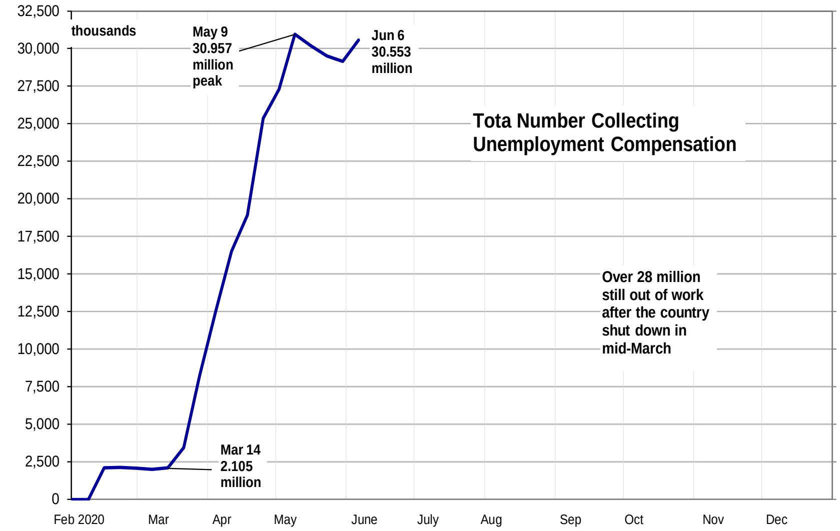
Breaking economy news. New home sales jump 16.6 percent in May to 676 thousand and are now above the coronavirus lockdown drop in sales of just 612 thousand in March and 580 thousand in April. Three out of four geographical regions were up sharply with just a moderate decline in the Midwest. Median new home prices increased to $317,900 in May and are 1.7 percent above last year's level.

Net, net, the economy looks a little more normal in May as Americans jump back into the market for a new home. Most of the monthly economic data are exhibiting strength in May based on pent-up demand as the country was under lockdown orders in March and April due to the spread of the coronavirus pandemic which had pushed home buyer traffic to bare minimum levels. The million-dollar question is what happens to demand for new homes after those postponed purchases get made and the extraordinary fiscal stimulus measures are pulled back later this summer. If the overall economy seems to be slowing, the public may not be quite as confident about putting a down payment on an expensive new home.

New home sales are bouncing back today as the stay-at-home orders are lifted, but a second wave of the pandemic virus later this fall could put the kibosh on the public's desire for a new home in a hurry. Many businesses are insolvent and there will be less spending from unemployed Americans as well that could keep this economic recovery in the slow lane for some time. If consumer confidence is dampened on disappointment in the recovery, then new home sales activity could slow later on this year.

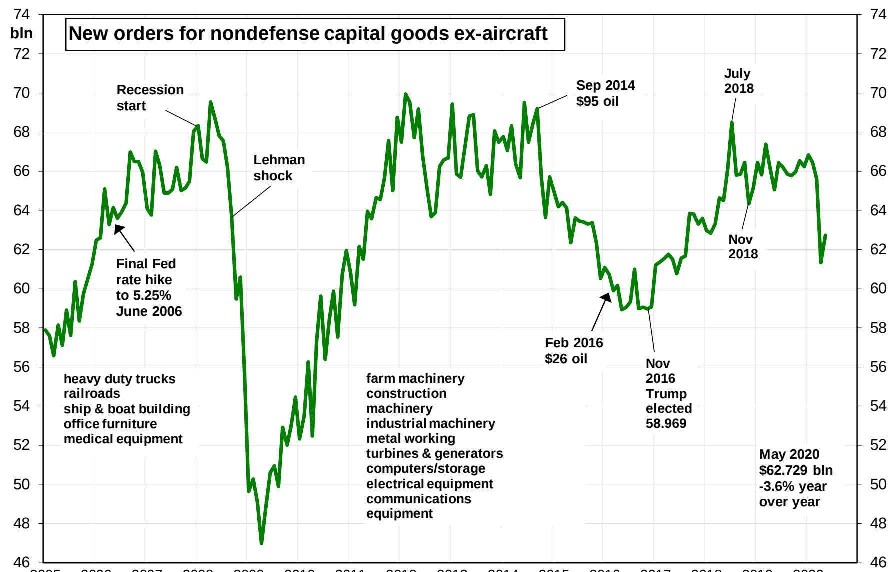


All is not well if 1.5 million apply for jobless benefits; business orders bounce (Thursday)



Breaking economy news. Too many economic reports to comment on today with the third look at first quarter GDP and the advance trade report for May and the weekly filings for unemployment benefits and the durable goods reports all out this morning. The recession isn't over if you are jobless and in the June 20 week 1.48 million more were fired and applied for unemployment benefits. Better file for the $600 a week jobless benefits sweetener this recession while you can before it expires at the end of July. The layoffs this recession are massive with 30.553 million receiving benefits in all the programs in the latest June 6 week where at the start of the pandemic virus outbreak in mid-March only 2.105 million were on the nation's unemployment rolls.

Meanwhile, business orders for long-lived capital goods orders rebounded which is good news even if orders are well off the highs for this cycle. Nondefense capital goods orders ex-aircraft are a reasonable proxy for business investment and these rose 2.3% in May to $62.7 billion after declining 6.5% in April and falling 1.3% in March. Today's new orders may signal that America's industrial heartland has turned the corner and is starting to pick back up after the coronavirus lockdown that started in March.



Net, net, all is not well in this economy if 1.5 million applied for jobless benefits last week because they had been sacked. These layoffs are still over double those in the worst week of the Great Recession over a decade ago. While it counts as good news that businesses are ordering more equipment in May as the states reopened, the second wave of the pandemic may keep companies cautious in the months ahead when it comes to making new investments in the country's future.

The coronavirus pandemic is still spreading like wildfire across much of the nation so it can't be any surprise that millions of lost jobs are following in its wake. The recession may have ended for economic growth, but the recession in the labor markets still rages on. Consumers and businesses are still cautious where spending at the shops and malls and new orders for long-lived capital equipment remain well off the best economy in 50 years levels at the start of the year.

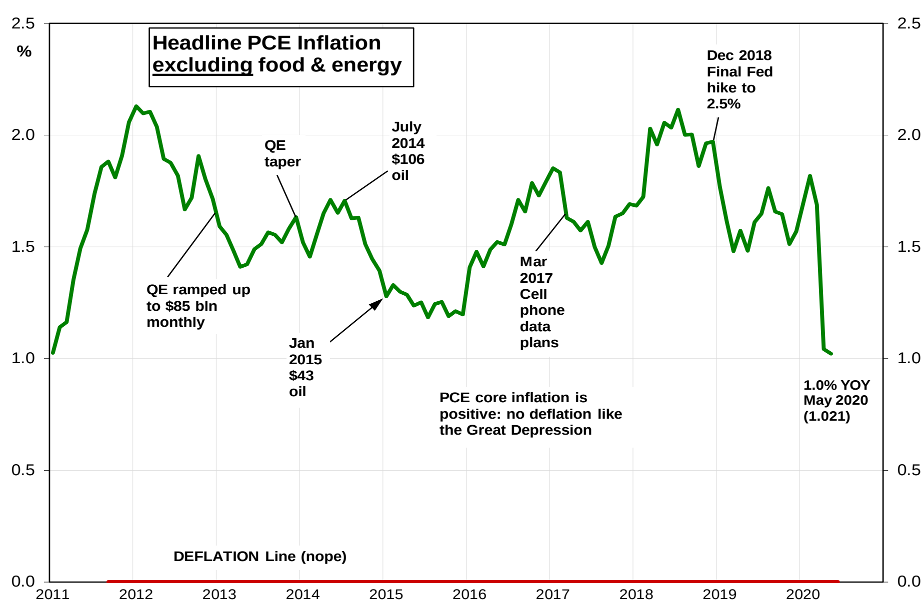
Income plunges endangering the recovery (Friday)

Breaking economy news. It is a good thing real consumer spending jumped back 8.1% in May after the record 12.2% collapse in April because the future spending plans of Americans are very much in doubt after personal income fell 4.2% in May. You can't spend it, if you haven't got it, and right now the economy's recovery is being dragged down by the millions and millions of Americans without jobs and simply haven't got it. The massive job losses mean the economy isn't out of the woods yet.

If the stock market hoped the report today was going to show the consumer was bringing America back, investors are sadly mistaken. The economy is not out of the woods yet despite the big 8.1% jump in real consumer spending in May. The only good news in the report perhaps is that there is no deflation. PCE headline inflation rose 0.1% in May, after falling 0.2% in March and 0.5% in April, and for the moment still has its head above water with a gain of 0.5% year-to-year.

Net, net, consumer expenditures are soaring as the states opened back up in May, but for how long is the question as the unstoppable coronavirus wave rolls on into new states and the positive boost from the Federal government's stimulus checks starts to fade. The consumer is still spending 11.3% less in May than it did in January before the coronavirus shut down the nation. The nation is not back to the best economy in 50 years yet.

Today's personal income report is a cautionary tale for Washington on the danger of letting the fiscal stimulus measures slide. The Federal government's $1,200 checks to the public are long gone, and the extra $600 a week in jobless benefits soon will be, pulling the rug out from under this fragile economic recovery as there won't be any money left to support unemployed workers and growth will downshift to a slower speed. The government's stimulus checks were one of the measures that kept this economic downturn from becoming a second Great Depression. No more. Massive job losses with no paychecks will hit consumer spending hard in the months to come, and once the public's pent-up demand purchases following the lockdown are made, economic growth could simply peter out. Stay tuned. Story developing.



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