Financial Market Weekly

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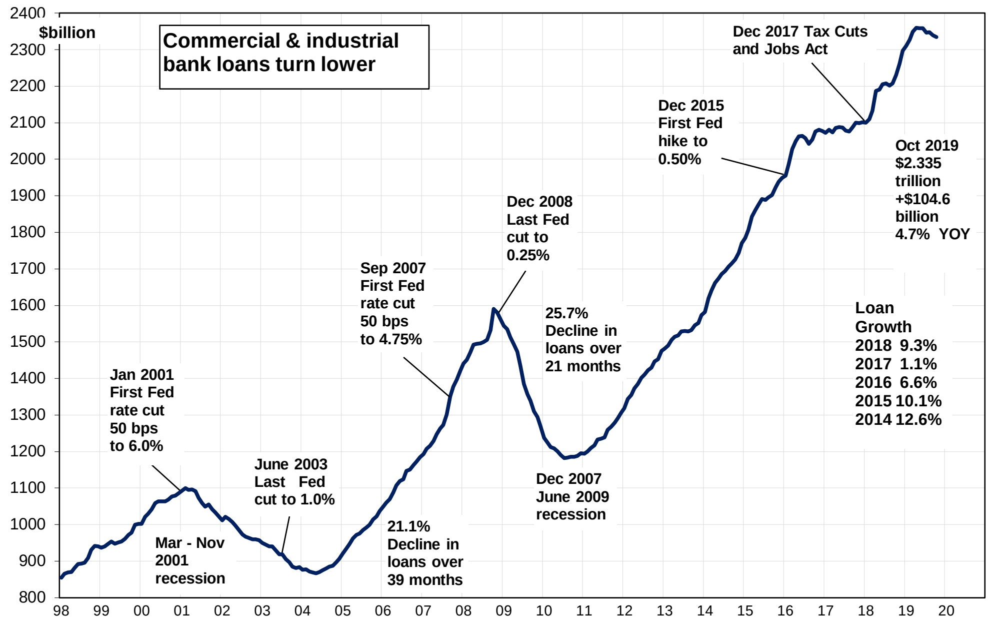
CREDIT IS THE LIFEBLOOD OF THE ECONOMY

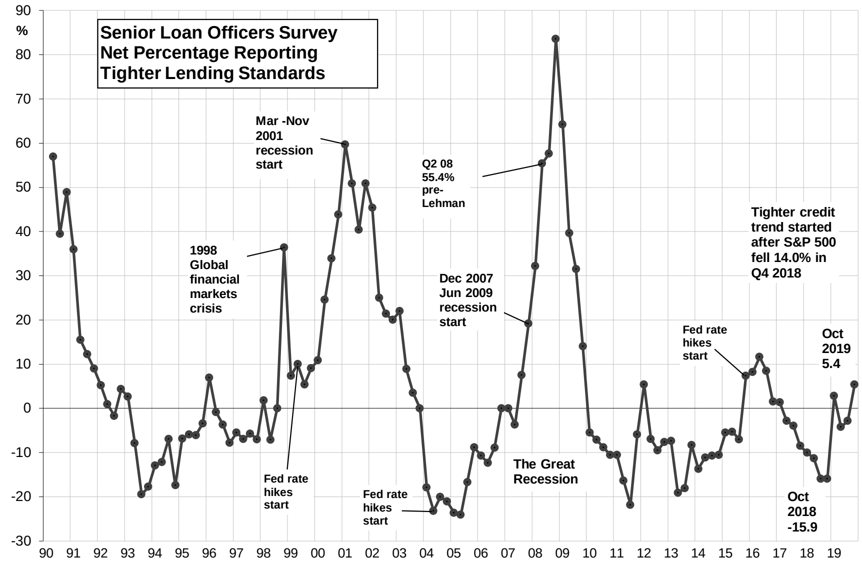


Credit is often thought to be the lifeblood of the economy. If that's the case, then the economy is in trouble as commercial & industrial (C&I) loans at banks have turned back down after peaking in April this year at a record $2.359 trillion. Theoretically, the Fed tunes its setting on interest rates to boost or slow borrowing for business investment by lowering or raising interest rates, respectively. The Federal Reserve's timing on interest rate changes looks to be a bit off however historically. They cut interest rates early before the last two recessions while business loans outstanding were still climbing. There are some reasons for that perhaps. Fed officials want to get out in front of mounting risks to the economic outlook, maybe they had some data showing companies were laying off workers. Sometimes bank loans are taken down as the economic skies start to darken as a precautionary move on the part of companies to secure liquidity ahead of the advancing storm. What can we say? The three rate cuts the Fed did this year in July, September and October don't look likely to stimulate business borrowing to make new investments. The economy is probably feeling exhausted with the

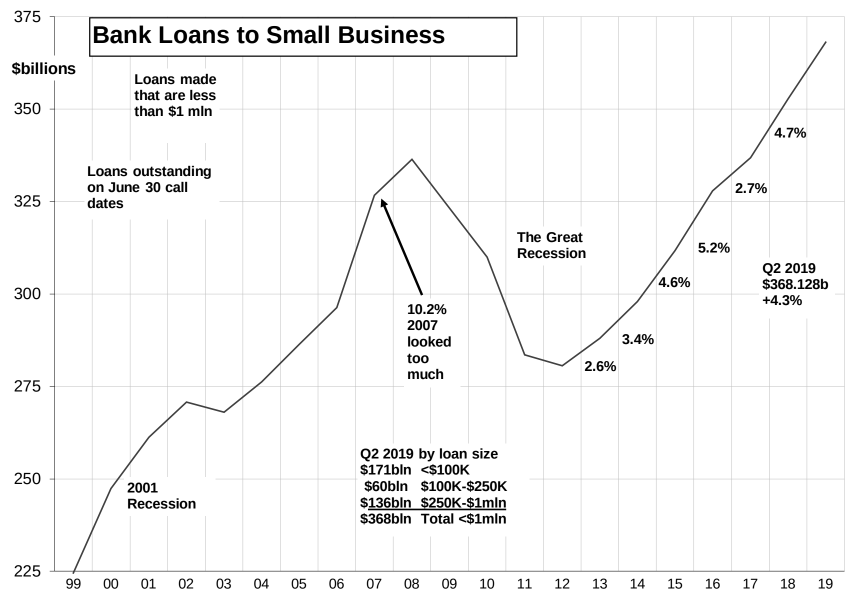
FDIC Banks and S&Ls	2019	2009	1999
Number	5,303	8,195	10,328
Employees	2.069	2.093	1.864
Deposits	14.039	9.021	4.379
C&I loans	2,214	1,364	959.6
Credit cards	881.1	398.2	205.8

5,303 banks in June 2019, 2.069 million employees, $14.039 trillion in deposits, $2.214 trillion C&I loans, $881 billion credit card loans to individuals

Fed's micromanagement of interest rates and companies are less sensitive to minor interest rate changes anyway ever since the Fed cut rates to zero (0.25%) in December 2008 and left them there for seven long years until "liftoff" in December 2015. The Fed's interest rate tool's effectiveness may have fallen prey to "use it or lose it."



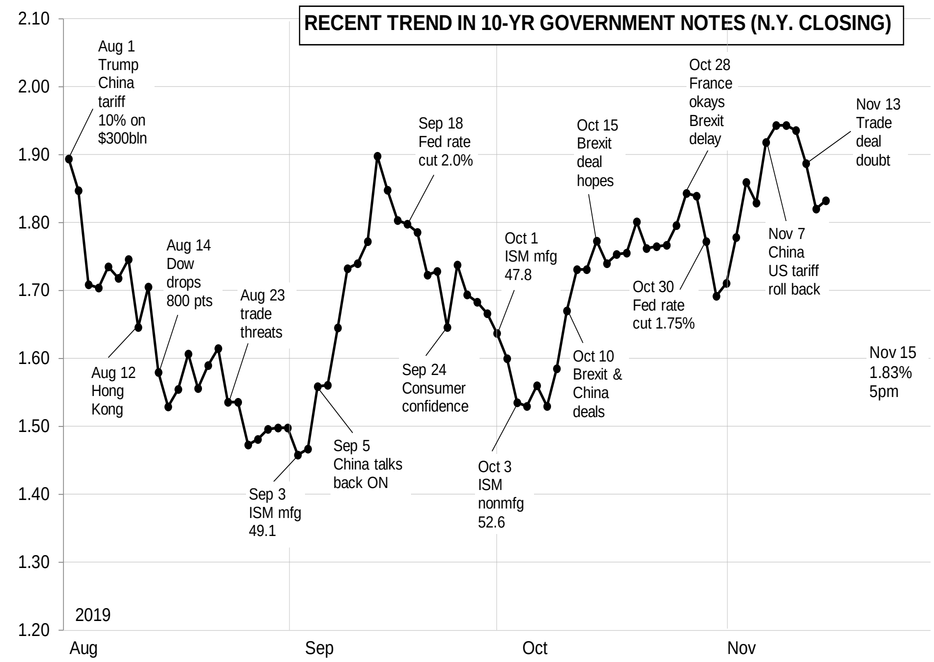
That's the macro picture of loans, what are bankers saying? The Federal Reserve does a quarterly survey of senior loan officers at banks every quarter. Lending conditions at large and medium financial institutions aren't as easy as they were a year ago in October 2018 with a survey reading of -15.9, but they aren't all the restrictive yet either with a reading of +5.4 in October 2019. The 5.4 figure is based on the net percentage of 74 responses where 7 said they had tightened lending standards somewhat and 3 had eased standards somewhat. The net percentage is 5.4 percent and keep in mind that 64 senior lending officers said credit standards remained basically unchanged. Credit standards for small firms with annual sales less than $50 million were also tighter, 6 said somewhat tighter, 63 unchanged, and 2 eased somewhat, but this has had no effect on bank loans to small business which are up 4.3% this year to $368.1 billion in the graph below. There was a special question on auto lending in the October survey. A number of banks said they were less likely to approve auto loans with FICO scores of 620 and 680 as they had increased concern about borrowers' ability to make payments on the loans given the worry about a more uncertain economic outlook.



In conclusion, we will see how grave it is for the economic outlook that bank loans to companies have stopped increasing in this business cycle. Business loans had flat-lined for a time during the oil price crash in 2014 that sent industrial production into a period of decline, but then lending picked up again after the passage of the Tax Cuts and Jobs Act in December 2017. Who knew? The biggest corporate tax cut in history and yet borrowing still went higher, which was M&A deal related possibly. Stay tuned. Story developing. Watch the nation's credit trends here.

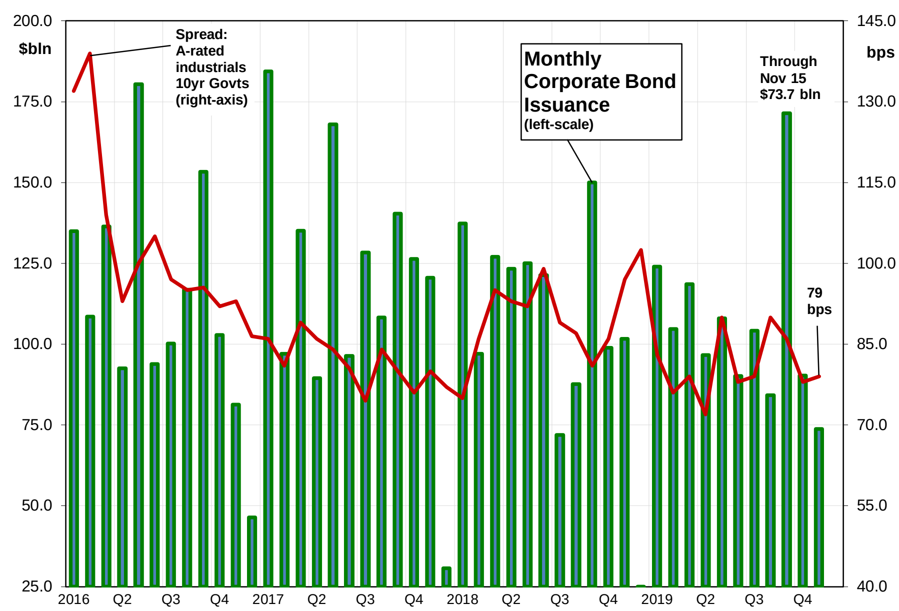
MARKETS OUTLOOK

	29-Mar 2019	28-Jun 2019	30-Sep 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
30-Yr Treasury	2.81	2.53	2.11	2.20	2.25	2.30	2.40	2.50	2.70
10-Yr Note	2.41	2.01	1.67	1.75	1.80	1.90	2.10	2.20	2.40
5-Yr Note	2.23	1.77	1.55	1.55	1.65	1.75	1.85	2.05	2.25
2-Yr Note	2.26	1.76	1.62	1.60	1.60	1.70	1.80	2.00	2.20
3-month Libor	2.60	2.32	2.09	1.90	1.90	1.90	1.90	1.90	1.90
Fed Funds Rate	2.50	2.50	2.00	1.75	1.75	1.75	1.75	1.75	1.75
2s/10s spread	15	25	5	15	20	20	30	20	20



Treasury yields came back down from last week's overshoot high perhaps of 1.97% last Thursday. The market is still driven by China-U.S. trade news, but while the stock market closed at record highs Friday on trade talk hopes, 10-yr yields didn't see much of a lift. That's ironic because yields dropped on Wednesday on trade deal doubts. Not a lot to go on for the bond yield forecast. If the Fed is done, yields can sit here a little above the 1.75% Fed funds rate, waiting for a new burst of recession news. Hope springs eternal for bond traders who make more money being long in a big rally. Atlanta Fed's GDPNow is just 0.3% in Q4. Keep hoping for doom y'all.

CORPORATE BONDS: $30 BILLION OF WEEK'S TOTAL WAS ABBVIE



Corporate offerings were $49.1 billion in the November 15 week versus $23.8 billion in the November 8 week. On Thursday, Kansas City Southern sold $850 million 10s/50s. It priced a $425 million 2.875% 10-yr (m-w +20bp) at 107 bps (Baa2/BBB). The railway transportation company will use the proceeds for debt repayment and share repurchases. Corporate bond yields (10-yr Industrials rated A2) were 79 bps above 10-yr Treasuries Friday versus 78 bps last Friday.

FEDERAL RESERVE POLICY

The Fed meets December 10-11 to consider its monetary policy. Not a lot to consider after Powell said monetary policy was in a good place at the press conference on October 30 after the FOMC cut rates a third time this year to 1.75%. He added later in the press conference in questioning that the "current stance is likely to remain appropriate" as long as the economy stays where it is with the Brexit and China trade war risks diminishing.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	13-Nov	6-Nov	30-Oct	23-Oct	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2201.529	2194.318	2175.491	2149.188	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1450.089	1445.776	1445.762	1457.914	0.000
Repurchase agreements	209.609	215.160	215.500	178.204	126.750
Primary credit (Discount Window)	0.016	0.002	0.028	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	0.041	0.046	0.041	0.043	62.000
Federal Reserve Assets	4096.1	4087.6	4067.1	4016.9	961.7
3-month Libor %	1.91	1.90	1.91	1.94	2.82
Factors draining reserves					
Currency in circulation	1787.932	1784.936	1781.082	1773.219	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	1.762	1.650	0.196	18.290	0.000
Reserve Balances (Net Liquidity)	1542.664	1528.757	1484.718	1451.555	24.964
Treasuries within 15 days	41.805	41.822	17.783	15.736	14.955
Treasuries 16 to 90 days	66.967	65.966	81.959	77.195	31.549
Treasuries 91 days to 1 year	287.950	285.932	292.006	276.315	69.272
Treasuries over 1-yr to 5 years	867.266	866.728	856.122	852.320	170.807
Treasuries over 5-yrs to 10 years	310.038	308.578	302.405	302.406	91.863
Treasuries over 10-years	627.503	625.292	625.215	625.216	101.337

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

That's what we wrote last week and it remains the same even with Powell testifying to congress twice this week on the economic outlook at the JEC at 11am EST Wednesday (headlines from statement at 930am) and at 10am EST Thursday before the House Budget Committee. Powell was on a tight schedule both days (not sure what he needed to be doing that is more important than talking to congress especially as monetary policy is in a good place leaving policymakers less to do for some time). On Day 1, we included his response in the box here which says again that interest rates will never go up again as long as he is in office. We are glad to hear that baby boomer savings rates are keeping interest rates down because (1) baby boomers we know don't have a lot of savings and (2) baby boomer savings rates are responsible for driving interest rates lower, so baby boomers have no one to fault for low interest rates but themselves.

Powell 11-13-19 Joint Economic Committee (JEC) Q&A

Well, if you look at postwar -- typical postwar recessions, what the Fed has done is, it's cut interest rates and on average, those -- those -- the amount of those cuts has been 5 percent or so. So with the federal funds rate having peaked at about 2.4 percent and now being at about -- a little above 1.5 percent, we don't have that kind of room. And there are a couple of reasons for that.

Just if you look at the longer-term interest rates, which are not directly affected much by our policy, they've just been declining for 40 years now. And that is because of inflation being lower and under control and less volatile, and also just the aging demographics means higher saving, means more savings relative to investment and that puts downward pressure on interest rates.

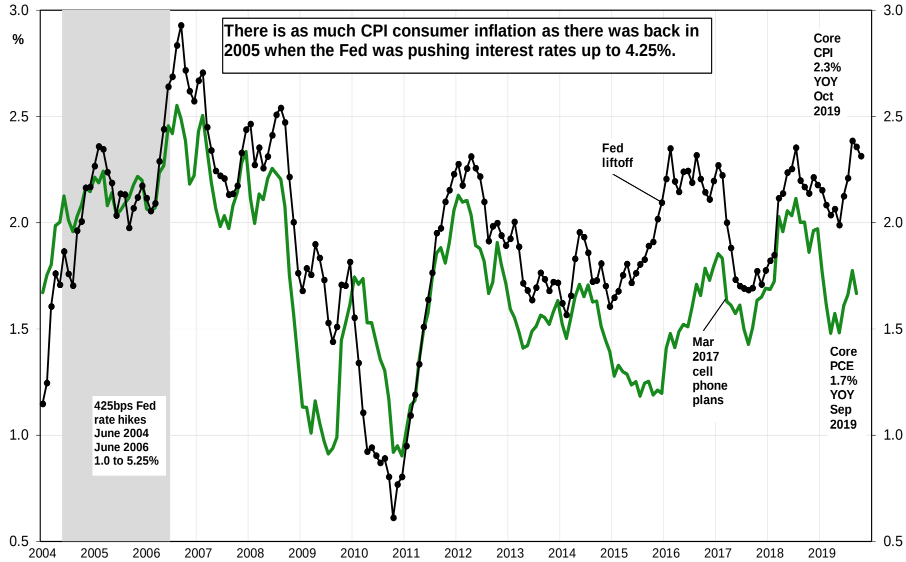
So I think the new normal, now, is lower interest rates, lower inflation, probably lower growth. And you're seeing that all over the world, not just in the United States.
(Pretty dismal assessment for a noneconomist.)

Okay, too much on Day 1, on Day 2 one questioner said the last two economic expansions (that ended in recession) "were fueled by rapid growth" in tech and real estate, do you agree and Powell said yes, this expansion doesn't seem to have any excesses. Good to know. Not good to know is Powell's response about what they might do in a downturn. "We can use our unconventional tools and we'll do so aggressively as appropriate, if appropriate." Not looking forward to that day. Powell thinks they can do QE to flatten long term yields down to zero. It didn't work for Japan or Europe and we hope the Fed will decide later on that these "unconventional tools" are not appropriate."

OTHER ECONOMIC NEWS THIS WEEK

Inflation is back if you eat and put gas in your car (Wednesday)

Breaking economy news. CPI inflation for October which although it is consumer inflation, it is not the consumer inflation embraced by the Federal Open Market Committee. PCE inflation for October won't be released until Wednesday, November 27. Wait for that. Fed officials certainly will as PCE inflation is their preference.



CPI headline inflation bounced back by 0.4% this month after being unchanged in September and on a year-to-year basis it is 1.8% this October. We have been waiting for the decline in gasoline prices to wash out of the year-on-year data, and it is about to happen with gas prices and crude oil tumbling last year in November, December and January. As the gas price effect fades, headline CPI of 1.8% year-to-year will move up to the 2.3% core CPI inflation rate year-on-year. Food prices also kicked up with a 0.2% rise, the biggest jump if you will since 0.3% in May. Food away from home is always expensive rising 3.3% year-to-year, but this month food at home rose 0.3% and is up 1.0% the last year.

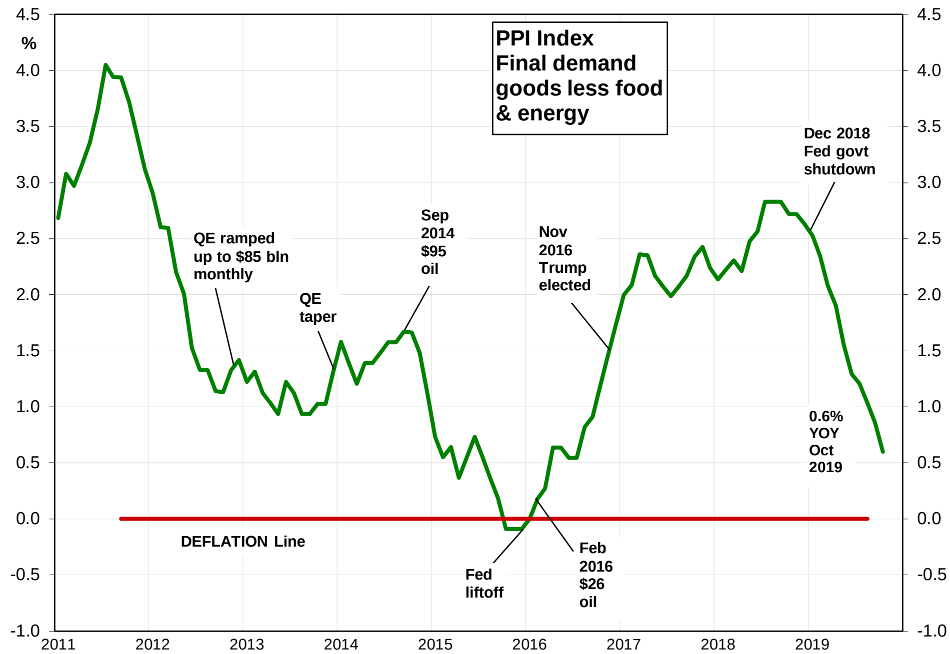
Are core consumer inflation pressures building? Mixed picture so far as we had a string of 0.1% monthly changes from February to May. We had 0.3% monthly core CPI increases in June, July, and August before getting that 0.1% print last month in September, and now today it is middle of the road at 0.2%. 0.2% is not nothing as 12 times 0.2 equals 2.4% core consumer inflation. Core inflation was held back this month by the small 0.1% rise in shelter prices which is rare. Shelter or housing costs are running 3.3% the last year so the 0.1% number is odd. Don't take this as a sign the new housing price bubble has stopped expanding.

Net, net, inflation this month will not move the needle on the Fed's worry gauge of inflation pressures and Fed Chair Powell, who vows not to raise interest rates without more inflation, will not be swayed by today's report. "What inflation?" is what the Fed will continue to say. Core CPI inflation has been above the 2% Fed target for some time, but the Fed is turning a blind eye to it. The biggest discrepancy remains the measurement of medical care services where CPI says these are up 5.1% in October from year ago levels versus PCE inflation medical services that are up just 2.1% in September from year earlier levels. Stay tuned. Story developing. Fed officials should go to the doctor if they think there is no inflation in the economy.

We can't find any effect from the tariffs on imported goods that consumers buy from China, but it is early yet as roughly $112 billion of China goods were taxed at 15% on September 1 and the holiday season ho-ho-ho tariffs on another $160 billion of consumer goods from China don't take effect until December 15. The inflation threat for the consumer isn't over yet, and it depends on the trade negotiations between China and the U.S. and which way those talks go is still anyone's guess.

Producer goods prices still soft despite the tariffs on China imports (Thursday)

Breaking economy news. Producer prices and jobless claims. Jobless claims jumped 14K to 225K in the November 9 week which is the highest layoff rate since June. It's just one week and too early to say the manufacturing recession is spreading to the rest of the economy and forcing demand-hobbled companies to cut back not just on investment but on their compensation costs meaning headcounts. Unemployment claims were higher in California, but these were estimated due to the November 11 Veterans' Day holiday. Pay no attention to that man behind the curtain, the rise in job layoffs may be nothing.



Producer prices remain stuck in a rut which is understandable given manufacturing is in recession according to some of the economic data like the surveys of purchasing managers. We will see what industrial production does in Friday's report for the month of October.

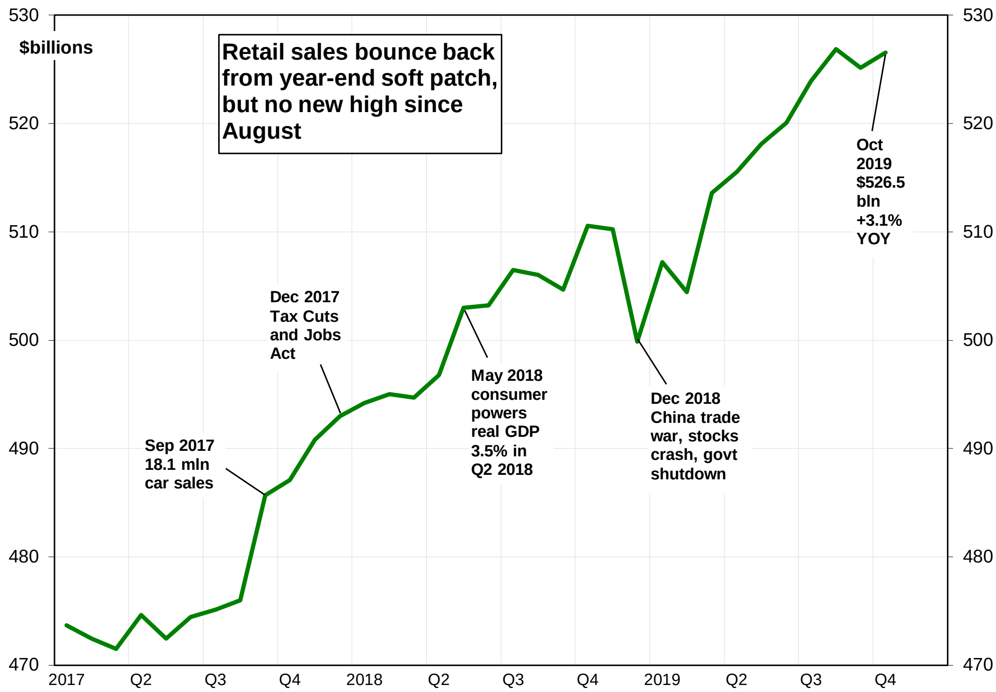
Final demand producer prices rebounded 0.4% in October from September's 0.3% decline. Much of the increase came from the rise in food and energy prices. The price index for trade that accounts for changes in margins received by wholesalers and retailers also moved the headline inflation number higher. Looking just at final demand goods prices, most of the strength was simply from a 7.3% rise in gasoline prices, while iron and steel scrap prices tumbled 15.7%.

Net, net, Fed officials would be wise not to move too far off the sidelines after cutting rates three times this year because the geopolitical risks and trade tariffs are still weighing on producers who are unable to move their prices up in the current state of weakened demand seen in many industries. It remains a remarkable fact that producer price inflation remains subdued this far along into an economic expansion which broke the records for longevity this summer. Economics textbooks say that inflation pressures should be building right now this far along in the business cycle, but producer prices remain tame. The Fed may have hit the pause button on rate cuts for now, but there is sure no need to raise interest rates higher if inflation pressures remain quiet and subdued. Monetary policy is in a good place with little reason to tinker with the setting on interest rates for now.

Consumers bought more things on the internet and filled their gas tanks in Oct (Friday)

Breaking economy news. Retail sales rebounded in October by 0.3% which offsets the 0.3% decline in September, but the fourth quarter still is starting out on a weak note. The number looks a little fishy when it comes to auto sales unless you think car dealers marked up the price of a new car astronomically in October. Auto sales in the retail sales report increased 0.5% in October while the unit car sales data tumbled 3.5% to 16.5 million in October from 17.1 million in September, both at annual rates.

There were so many spending categories down in October, it is difficult to see how overall spending rose 0.3%. It looks like consumers shopped on the Internet or filled their cars with gasoline all month long and did nothing else. Spending on furniture, electronics, building materials, clothing, sporting goods, restaurants and bars, all fell... Ouch.



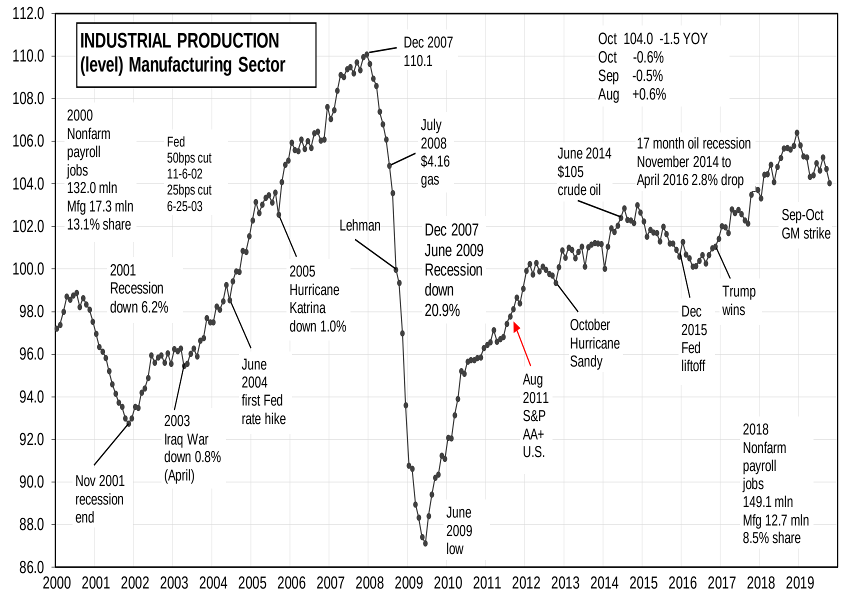
Net, net, American shoppers returned to the stores and malls in October, but the coast isn't clear yet for consumer spending in the fourth quarter of the year. It's looking more and more that this quarter is going to turn out to be another soft patch for the consumer much like it was in the final quarter of last year and the first quarter of 2019 when purchases were also weak. Back then there was a financial crisis with stocks tumbling and a Federal government shutdown and right now the consumer is plainly worried about the on-again, off-again China-U.S. trade talks. The presidential election may be injecting an air of uncertainty, making consumers less confident, as well.

The Fed is on the sidelines after cutting rates three times this year, but it won't be for long if the consumer doesn't return to the shops and malls because right now with business investment spending cool, the consumer is doing all the heavy lifting when it comes to keeping the U.S. economy afloat.

Manufacturing recession deepens thanks to GM strike (Friday)

Breaking economy news. The manufacturing recession just dug itself a deeper hole with the help of the GM strike in October. The strike is over and let's hope the damage done to the economy will not be longer lasting. Manufacturing industrial production tumbled 0.6% in October which counts as bad news even if the number would have declined just 0.1% if not for the 7.1% drop in the output of motor vehicles and parts during the GM strike.

Industrial production overall fell 0.8% showing the economy is not in a good place with mining and utility output pulling the index down in addition to the drop in manufacturing output. The trade war still seems to have cooled the manufacturing sector and existing factories have dimmed their lights. All the talk of factories coming back to America is just a lot of hot air. Manufacturers are not building enough new factories to make a difference to overall production and output. It remains an open question whether a manufacturing recession will continue to be a drag on the overall economic outlook next year and make a 3% growth economy into a 2% growth economy at best. The economic outlook in 2020 is not out of the woods so stock market investors have been warned.



Net, net, monetary policy is in a good place but the road ahead for the economy looks rockier with the manufacturing recession deepening and consumers spending less this quarter than they did earlier in the year. The question is whether the economy is in a good place and whether stock market investors are blithely ignoring today's real economic data news in favor of their hopes and dreams for a better tomorrow with a phase one U.S.-China trade deal in sight. The smart people aren't clapping today. The risks the economy faces remain a threat to the longest expansion in U.S. history and it will be a miracle if growth continues on its present course.

Percent changes			Industrial Production October 2019		
Aug	Sep	Oct	YOY		Weight
0.7	-0.3	-0.8	-1.1	Total Index	100.0
0.6	-0.5	-0.6	-1.5	Manufacturing	75.1
2.6	-0.8	-0.7	2.7	Mining	14.6
-0.6	1.9	-2.6	-4.1	Utilities	10.4
			Manufacturing payroll jobs 12.8 million +49K YOY 9.9% of Private Payroll Jobs		

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