Financial Market Weekly

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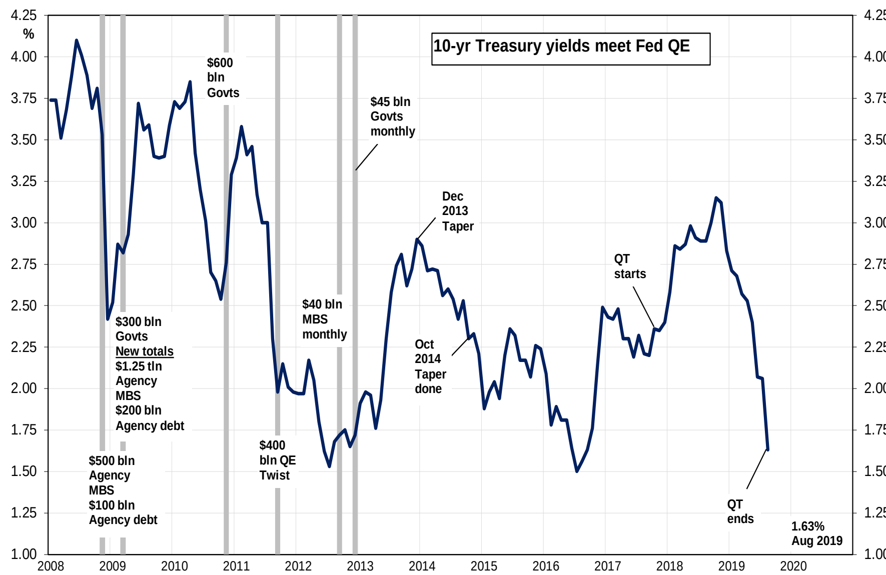
ECB RESTARTS QE, COULD THE FEDERAL RESERVE BE NEXT?

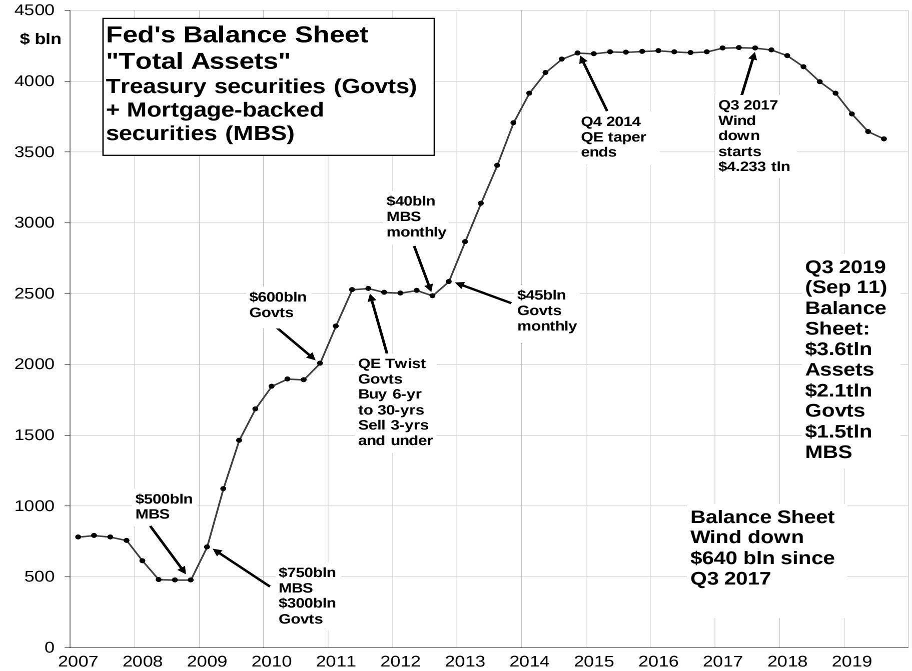


The White House certainly would welcome some QE in addition to the rate cuts down to zero now or even negative to match our European trading partners. Did QE work in the first place? Markets have short memories. The stock market seemed to like the announcement effect of QE where the Fed shouts they are riding to the rescue. The QE announcements in the 2010 to 2012 period certainly bolstered the stock market and so improved financial conditions. We wouldn't think that would work again. QE doesn't really do anything to help the real economy. QE probably helped bring down bond yields 8 or 9 years ago and that helped the economy. But QE bond purchases are no longer necessary in this day and age where the bond market deflation junkies are more than happy to be long bonds and take that one last ride down to zero rates. You want bond rates to go down to zero to stimulate the economy, the bond market is more than happy to do it for you. Doing it for you in large part because the bond market thinks that you the Federal Reserve wants it. Lower rates. All that talk from policymakers of R-star and zero natural rates which supposes the economy isn't strong enough right now to handle higher rates. Sure. We find your research most credible.

> FOMC minutes policy tools discussion
> In their discussion of policy tools, participants noted that the experience acquired by the Committee with the use of forward guidance and asset purchases has led to an improved understanding of how these tools operate; as a result, the Committee could proceed more confidently and preemptively in using these tools in the future if economic circumstances warranted.

What did the July 30-31 FOMC meeting minutes say about the review of QE? "They judged that forward guidance and balance sheet actions had provided policy accommodation during the ELB [Effective Lower Bound] period and had supported economic activity and a return to strong labor market conditions while also bringing inflation closer to the Committee's longer-run goal of 2 percent than would otherwise have been the case." Supporting economic activity and bringing down the unemployment rate is not the same thing has having caused the improvement. These policies are unlikely to have the same effect twice. The first time it's an experiment and markets are willing to hold their breath and see if it works. The second time around too many people do not believe it will work and part of that judgment comes from the QE experience in Japan and Europe where the record shows little improvement. The basic problem with QE is that it is a policy where if everyone thinks it is working, then it is working.

Hard to believe wind down in Fed balance sheet, QT, could have done that much to the real economy

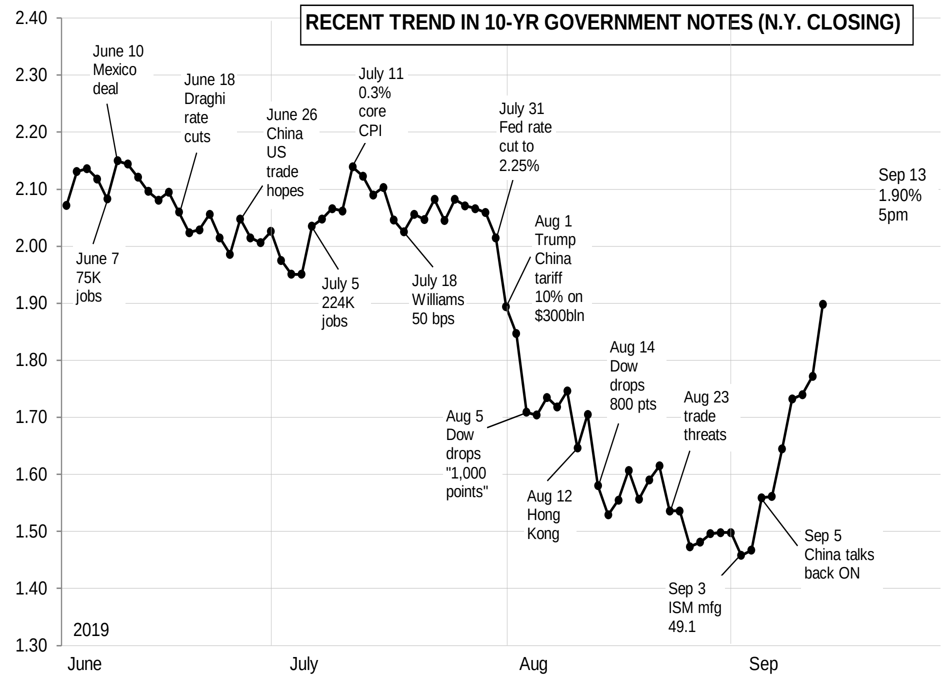


Conclusion: A new round of American QE is just as likely to boost the economy like a rocket ship here as the ECB QE restart buying €20 billion a month is likely to help the economy of the Euro area. Didn't Draghi already do what it takes back in July 2012? The European sovereign debt crisis is over with unemployment there falling from 11.1% in May 2012 to 7.5% today. Mission accomplished. Monetary policy has done enough. Monetary stimulus helped put millions back to work. That's all anyone can ask of you. Quit bringing up the ELB and scaring people by telling them the interest rate the economy requires has fallen below zero.

FOMC minutes policy tools discussion II
If policymakers are not able to provide sufficient accommodation at the ELB through the use of forward guidance or balance sheet actions, the constraints posed by the ELB could be an impediment to the attainment of the Federal Reserve's dual-mandate objectives over time… Bingo!

MARKETS OUTLOOK

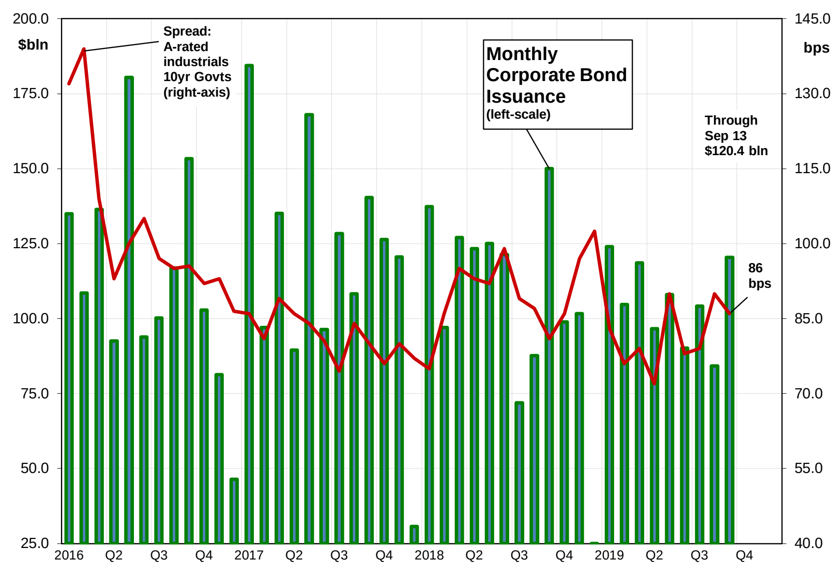
	29-Mar 2019	28-Jun 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.81	2.53	2.25	2.30	2.40	2.50	2.50	2.70
10-Yr Note	2.41	2.01	1.75	1.80	2.00	2.10	2.20	2.40
5-Yr Note	2.23	1.77	1.50	1.55	1.80	1.90	2.00	2.20
2-Yr Note	2.26	1.76	1.50	1.60	1.70	1.80	2.00	2.20
3-month Libor	2.60	2.32	2.00	2.00	2.00	2.00	2.00	2.00
Fed Funds Rate	2.50	2.50	2.00	2.00	2.00	2.00	2.00	2.00
2s/10s spread	15	25	25	20	30	30	20	20



Bond yields closed at 1.90% this week with "negative rates" 190 bps away. Whew. People counting the number of internet searches of "recession" should maybe shift to searches of "zero rates." That worry sure changed by Friday with the yield rally gaining steam. The rally seemed to get going after yields fell 5 bps to 1.67% on the ECB announcement Thursday morning that they were cutting rates to even more negative levels. Yields started back up quickly however as the thought began to dawn on people that the ECB had nothing left. 10-yr yields were 1.79% Friday ahead of the stronger retail sales number and the sell-off just kept going. Fed's up next. Stay tuned.

CORPORATE BONDS: KRAFT HEINZ, DEERE, AIR LEASE, PERKINELMER

Corporate offerings were $46.1 billion in the September 13 week versus $75.2 billion in the September 6 week. On Wednesday, Expedia Group Inc. priced a $1.25 billion 3.25% 10-yr (m-w +25bp) at 160 bps (Baa3/BBB). The online travel services company will use the proceeds for general corporate purposes, including the repayment of a $750 million 2020 note. Corporate bond yields (10-yr Industrials rated A2) were 86 bps above 10-yr Treasuries Friday versus 88 bps last Friday.



FEDERAL RESERVE POLICY

The Fed meets September 17-18 to consider its monetary policy. Trump tweeting he wanted zero rates early in the morning on Wednesday was all the talk. Reminds one of a bad print on the trading screen in bond futures, once it's there, no matter how far off the market, bond futures tend to trade there eventually. It was just on April 30 that Trump tweeted, how about a one-point cut in rates which means 1.5%. We are resigned to a second cut on September 18 to 2.0%, 50 bps in total, but don't want to forecast another one beyond that. Also out there like a bad print on a trading screen is the three so-called insurance rate cuts done twice in the 90s that some Fed officials can't stop talking about how wonderful they were. Three cuts in 1995 from 6.0 to 5.25 percent after the economy's near recession miss. Three cuts in 1998 from 5.5 to 4.75 percent during the Global financial markets crisis. Those 90s rate cuts weren't for insurance, the 1995 cuts were because of recessionary economic data, the 1998 cuts were due to a severe global financial market crisis. Protectionist American policies and too low inflation don't require rate cuts, especially ones from such a low 2.5% starting level that won't do anything to boost jobs or business investment. Back to reality. One rate cut (23.5 bps) is discounted September 18. Two rate cuts in total (46 bps) are discounted by the December 11 Fed decision date.

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	11-Sep	4-Sep	28-Aug	21-Aug	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2101.169	2095.164	2095.130	2088.920	479.782
Federal agency debt securities	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	1489.605	1489.605	1489.605	1500.670	0.000
Primary credit (Discount Window)	0.002	0.002	0.005	0.075	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	0.040	0.872	0.069	0.043	62.000
Federal Reserve Assets	3817.8	3089.0	3807.9	3813.0	961.7
3-month Libor %	2.13	2.11	2.12	2.15	2.82
Factors draining reserves					
Currency in circulation	1765.344	1765.745	1754.962	1751.265	834.477
Term Deposit Facility	0.000	0.000	1.668	0.000	0.000
Reverse repurchases w/others	3.612	1.425	4.255	15.153	0.000
Reserve Balances (Net Liquidity)	1458.666	1454.454	1504.243	1517.820	24.964
Treasuries within 15 days	0.050	0.050	14.674	14.674	14.955
Treasuries 16 to 90 days	78.951	78.951	70.603	70.603	31.549
Treasuries 91 days to 1 year	265.487	265.484	268.484	268.484	69.272
Treasuries over 1-yr to 5 years	837.872	836.987	830.985	826.882	170.807
Treasuries over 5-yrs to 10 years	297.554	295.006	291.712	289.608	91.863
Treasuries over 10-years	621.254	618.685	618.672	618.670	101.337

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

Donald J. Trump 9-11-19 6:42AM EDT
@realDonaldTrump
The Federal Reserve should get our interest rates down to ZERO, or less, and we should then start to refinance our debt. INTEREST COST COULD BE BROUGHT WAY DOWN, while at the same time substantially lengthening the term. We have the great currency, power, and balance sheet..... The USA should always be paying the the lowest rate. No Inflation! It is only the naïveté of Jay Powell and the Federal Reserve that doesn't allow us to do what other countries are already doing. A once in a lifetime opportunity that we are missing because of "Boneheads."

Odds of Rate Cuts	
Fed funds futures	
F9-13-2019	
	Fed meeting
23.5	September 18
46.0	December 11
BPS of cuts discounted at future Fed meetings	

Eurodollar futures say many more Fed rate cuts				
Year-ends for Interest Rates				
Percent %	2019	2020	2021	2022
Eurodollar futures	2.055	1.65	1.585	1.63
Fed's June forecast	2.5	2.25	2.5	--

Eurodollar futures price where 3-month Libor will be in the future.
Friday, September 13, 2019 3-month Libor 2.14%

Fed Policy-key variables	2019	2020	2021	Long Term
Fed funds	2.4	2.1	2.4	2.8
PCE inflation	1.5	1.9	2.0	2.0
Unemployed	3.7	3.8	3.9	4.3
GDP	2.1	1.9	1.8	1.9

June 2019 median Fed forecasts

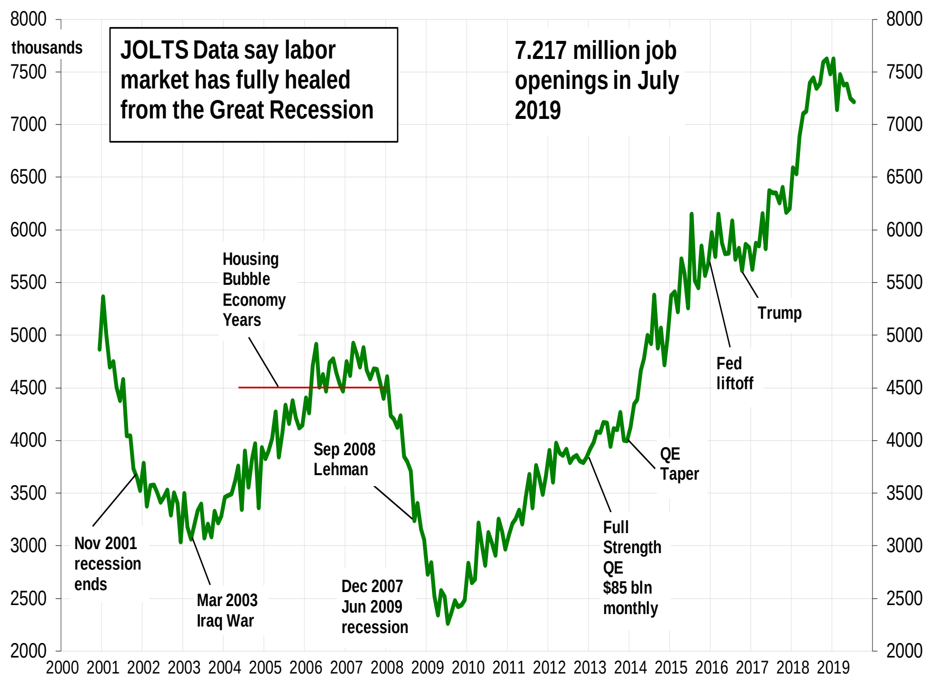
Fed funds rate by year-end				Longer
Votes	2019 End	2020 End	2021 End	run
1	1.875	1.875	1.875	2.375
2	1.875	1.875	1.875	2.500
3	1.875	1.875	1.875	2.500
4	1.875	1.875	1.875	2.500
5	1.875	1.875	1.875	2.500
6	1.875	1.875	2.125	2.500
7	1.875	1.875	2.125	2.500
8	2.125	2.125	2.375	2.500
9	2.375	2.125	2.375	2.500
10	2.375	2.375	2.375	2.750
11	2.375	2.375	2.375	2.750
12	2.375	2.375	2.375	2.750
13	2.375	2.375	2.625	3.000
14	2.375	2.375	2.625	3.000
15	2.375	2.625	2.625	3.250
16	2.375	2.625	2.875	3.250
17	2.625	3.125	3.125	
Median	2.375	2.125	2.375	2.500
Meeting	June 19	June 19	June 19	June 19

OTHER ECONOMIC NEWS THIS WEEK

More jobs than workers cushions the trade blow (Tuesday)

Breaking economy news. 7.217 million job openings in July which is astounding for this late stage of the business cycle which should help cushion the blow to the economy and keep the trade war winds at bay. The level of unemployment may have lost its signal properties that tell policy makers which way the economic winds are blowing. It's possible unemployment may not even rise if the economy turns down because employers would first cut back on the number of workers they need to hire out there posted on the internet job boards. 6.063 million unemployed in July shows one of the biggest skills or geographical mismatches in economic history. Even the trade and export hobbled manufacturing sector is trying to hire 522 thousand workers right now. If factories can't get them then those jobs really will go to China or Mexico or Vietnam.

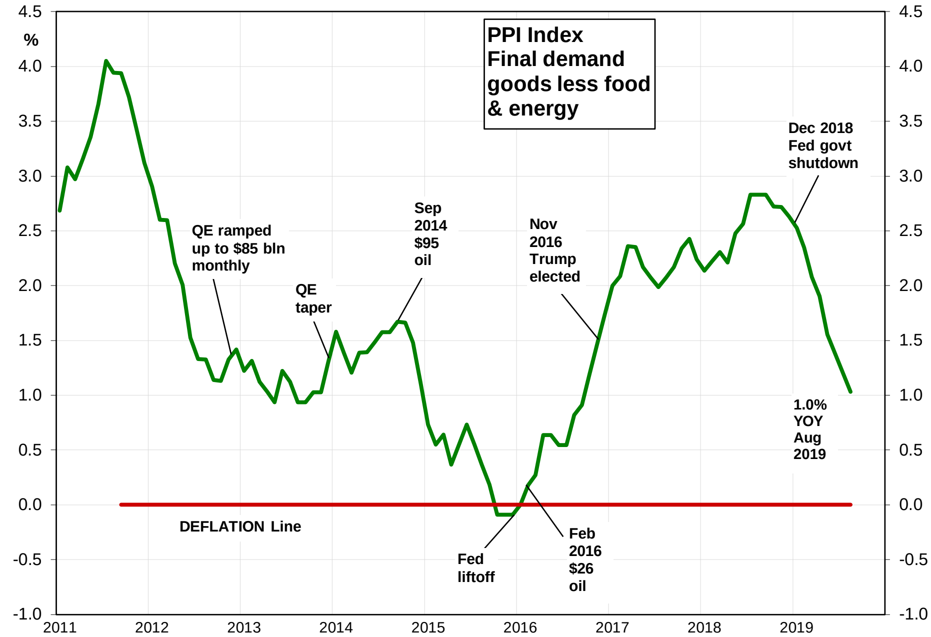
Net, net, job openings are in the millions which should cushion the blow to the economy later on this year if the US and China talks fail and the tariffs continue to escalate. The US has never entered into a recession with so many help wanted signs out there across the country meaning the labor force is already lean and mean with few surplus workers to cut. Stay tuned. This could be the first recession in history where unemployment doesn't soar into the stratosphere.



Less than 2% inflation at the producer level green lights Fed rate cut (Wednesday)

Breaking economy news. Those naïve, boneheads at the Federal Reserve, as a presidential tweet called them this morning before 7 o'clock, can start cutting interest rates down to zero as the president wants as there is no inflation. Final demand producer prices rose just 0.1% in August which is 1.8% higher than a year ago. The tariffs on imported goods from China are still getting phased in, but at the moment, the tariffs are not pushing up the prices of producer goods made at factories in the USA.

Producers aren't completely in the clear because core producer prices jumped 0.4% in August after no inflation at all the prior two months in June and July. Core producer prices less food, energy and trade are rising 1.9% year-to-year in August which is quite a slowdown from the 3.0% year-to-year inflation rate back in August 2018. Transportation and warehousing and other producer services prices are responsible for most of the jump in August.

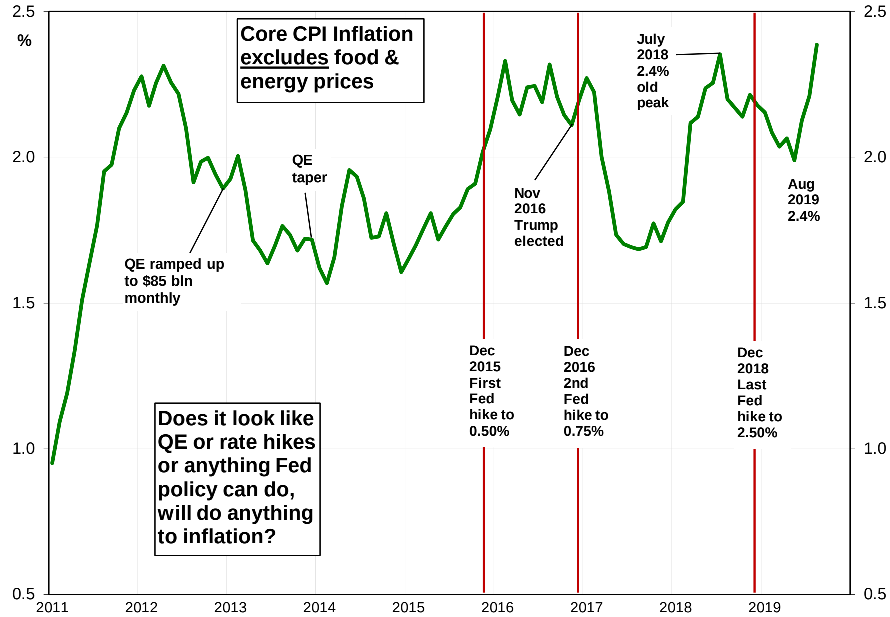


Net, net, so far producers are unable to move the needle on the prices of the goods they make any higher as the tariff costs on many inputs to production keep ratcheting up due to the US trade war with China. There have been 25% tariffs on the first $250 billion of China imported goods since early May. The first installment of the second tranche of roughly $300 billion took effect on September 1 so next month's PPI report may show additional pressure on factory inflation.

Underlying producer price pressures are quite modest and will not give Fed officials any confidence that there is any daylight yet in that long tunnel of stubbornly low inflation. We expect the soft patch for inflation and inflation expectations will allow Fed officials to give the White House the rate cuts it wants starting at next week's meeting where a 25 bps move lower to 2.0% is widely expected in markets. Stay tuned. Story developing. CPI inflation is up next in Thursday's report and if two consecutive months of 0.3 percent increases in core CPI was unable to push up PCE core inflation, then there is little prospect for inflation news that could possibly stop a Fed rate cut in its tracks.

Inflation heating up while trade talks drag on and on and on (Thursday)

Breaking economy news. China wants a deal. Badly. Joking of course, this morning we have two US economic reports, CPI inflation and weekly jobless claims. Core CPI inflation has risen 0.3% again this month and the August year-on-year increase is all the way up to 2.4% which is the highest core CPI inflation rate since the Great Recession if you don't round the data to one decimal point. Weekly jobless claims meanwhile fell 15 thousand to 204 thousand in the September 7 week showing companies are sticking with their employees through thick and thin, through escalating trade wars and growing fears of recession. You can't have a recession if everyone is still working so cheer up, today there's no recession.



Someone must have struck the bond market vigilantes dead because they are not selling bonds with the higher inflation report today.

The market is ignoring the US data and instead bond yields are plunging with the electrifying news that the ECB is providing more stimulus, cutting rates further into the negative abyss and restarting its QE. The 10-yr Treasury yield is down 7 bps from 1.74% to 1.67% as it follows European rates over the cliff. Bond yields are -0.64% in Germany, -0.50% in the Netherlands, -0.36% in France, +0.12% in Spain, and +0.75% in Italy. Rates in the US are still positive but for how long?

Net, net, underlying consumer inflation is the highest since before the Great Recession as the trade tariffs are starting to give companies a little more pricing power. The consumer isn't balking yet at the price increases on store shelves as retail spending is still going strong, and this tells us inflation is going to go even higher especially if the Federal Reserve stokes the fires of economic growth further with more rate cuts.

Fed officials are facing the horns of a dilemma here as the central bank historically has never cut interest rates while inflation pressures are boiling up and three consecutive months of 0.3 percent monthly changes certainly shows underlying consumer inflation is heating up.

Inflation is heating up with the trade war tariffs on imported goods coming ashore and the tightest labor market in history that is forcing companies to shell out more money in their workers' pay checks. The wage-price inflation cycle is back. The cost of business is going up and up and this is going to move inflation higher over time. Never mind what the president wants. This is not an economy that requires monetary stimulus as the jobs market remains tight as a drum with unemployment claims at rock bottom lows for this cycle. If a recession is coming then it will be the first recession without any one losing their jobs in history. Don't laugh. It could happen. Stranger things are happening right now.

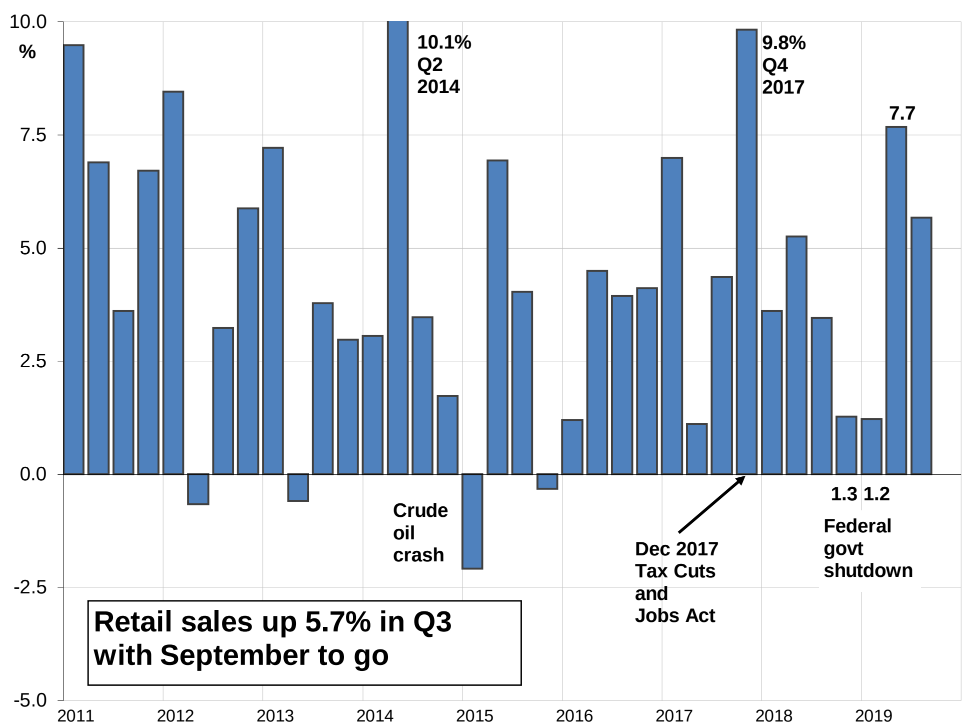
Consumer is still running away with this economy. They own it. (Friday)

Breaking economy news. Retail sales rise 0.4% in August following up on a big 0.8% jump in July. Most of the increase came in auto sales which rose 1.8% in August even though we already knew that unit car sales out at the start of the month rose 1.2% from 16.8 million in July to 17.0 million in August at annual rates.

Retail sales ex-autos were unchanged in August. Clothing, department stores, restaurants and bars were down as some consumers stayed home on their couches as internet sales were strong and are up double-digits from year ago levels.

In other news, import prices were unchanged for a second month if we subtract out fuel imports that bounce around with the price of crude oil. Import prices ex-fuel are down 1.0% the last year which is before tariffs get added to the cost, so don't get your hopes up that China or someone else is footing the bill.

Net, net, the consumer didn't take the summer off as they went on a huge buying spree in July and August that will take this economic expansion into the record books for longevity. With Fed officials poised to give the economy some more fuel with a rate cut next week, the economic outlook looks to be a solid one the trade war headwinds notwithstanding. The truth be told, many of the China tariffs have not reached the consumer's awareness level yet as they are still clearing the store shelves of everything the merchants put out on display.



The winds of recession aren't coming closer to shore if the consumer continues to buy their hearts out. Federal Reserve officials are unlikely to cut interest rates too much deeper as they seek to get out in front of the risks the economy faces acting early instead of being too late. The rate cuts the Fed is contemplating are still likely to be more of a midcycle correction as the economy stands its ground. Recession? What recession. The economy is stronger than you think. The consumer is running away with this economy. They own it.

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