Financial Markets This Week

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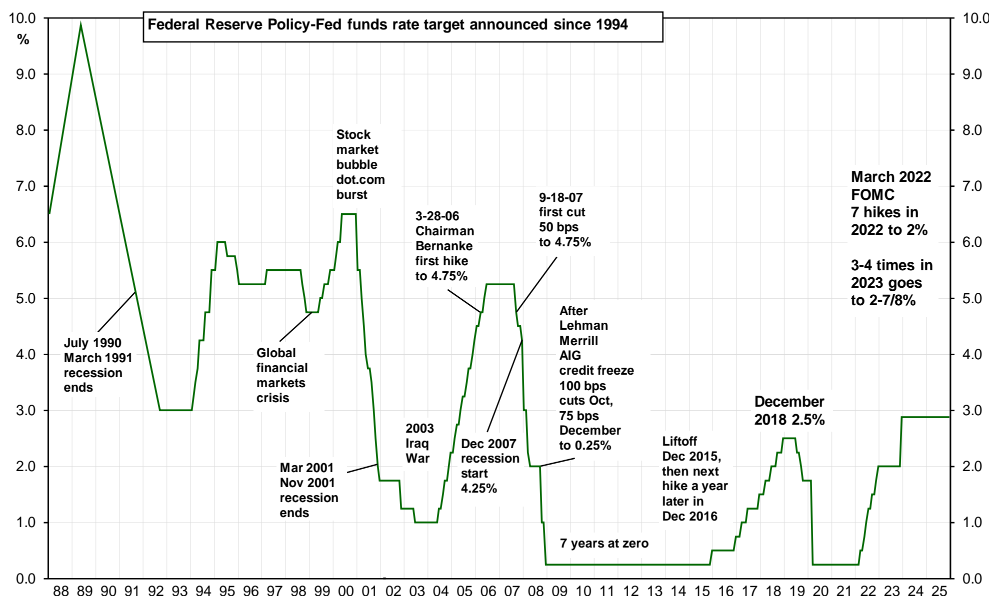
FED TAKES ONE SMALL STEP AND PLANS A ZILLION MORE



The first rate hike in years is big news. 10-year Treasury yields were 2.19% at 2pm ET on Wednesday and closed the week at 2.15%. Yields reached a new high of 2.24% for the year around the time Powell started speaking at 230pm ET. We guess 2.15% prices in 7 Fed rate hikes ending the year at a Fed funds rate of 2%. The peak Fed rate in every cycle has matched the peak 10-year Treasury yield in recent cycles. The S&P 500 was 4,316.21 at 2pm Fed Time on Wednesday and closed Friday 3.4% higher at 4,463.12. Don't ask.

Inflation higher but only 2.8% Fed rate needed versus 3.4% projection last time

Memo: Projected appropriate policy path								
Fed Meeting	2018	2019	2020	2021	2022	2023	2024	Longer run
Mar 22					1.9	2.8	2.8	2.4
Dec 21				0.1	0.9	1.6	2.1	2.5
Sep 21				0.1	0.3	1.0	1.8	2.5
Jun 21				0.1	0.1	0.6		2.5
Mar 21				0.1	0.1	0.1		2.5
Dec 20			0.1	0.1	0.1	0.1		2.5
Sep 20			0.1	0.1	0.1	0.1		2.5
Jun 20			0.1	0.1	0.1			2.5
Mar 20	No meeting: 150 bps rate cuts between Jan and Mar (scheduled)							
Dec 19		1.6	1.6	1.9	2.1			2.5
Sep 19		1.9	1.9	2.1	2.4			2.5
Jun 19		2.4	2.1	2.4				2.5
Mar 19		2.4	2.6	2.6				2.8
Dec 18	2.4	2.9	3.1	3.1				2.8
Sep 18	2.4	3.1	3.4	3.4				3.0
Jun 18	2.4	3.1	3.4					2.9
Mar 18	2.1	2.9	3.4					2.9

It's still hard to believe it, but the Fed forecasts look for a 2% Fed funds rate at the end of this year where at the December meeting they looked for just 1%. Back to the Bernanke speed of rate hikes that helped bring about the worst prolonged recession since the Great Depression. The market had penciled in 7 rate hikes this year, but it is still something to see it there in black and white. Actually we can't fault Bernanke for tightening the country into a recession because he merely followed the script and continued on with the Greenspan 25 bps every meeting rate hikes having taken over as Fed Chairman in February 2006 when the Fed funds rate was already 4.5%; Bernanke only raised it three more 25 bps steps to 5.25% in June 2006 which proved too much for the economy, the proverbial straw that breaks the camel's back. Let's hope Fed forecasts for a 2% Fed funds rate

at the end of 2022 don't do the same. At the very least, Washington senior monetary officials should make sure banks raise the interest they pay on the depositor's savings. Geez.

Net, net, the market wanted blood and Fed officials gave traders the red meat of another 100 bps of rate hikes this year to try to contain the inflation fire that shows signs of persisting at a higher than expected level. In December they said rates would be 1% at the end of 2022 and now they are saying 2% is likely. 7 rate hikes in 2022 even if the forecasts are not a plan and it is not something the Committee voted on as Powell reminded us Wednesday. Nevertheless, it looks like the rate hikes need to be faster than the last time the Fed lifted off from zero in 2015 because CPI inflation is almost 8% where back then it wasn't even 1%. Time will tell if this is too much for the American economy that is facing the risks of a gigantic slowdown in world economic growth from Europe and China at the same time the stock market has crashed from record highs in the first days of the year. Fed tightening to put the brakes on inflation has caused recessions before and it will be a miracle if the economy can stay away from cliff's edge in the months to come. We don't want to be too dramatic. The Fed raised rates mighty high in the mid-90s without causing a recession. The only real worry we have is the Fed funds rate needs to be above the inflation rate, CPI inflation 7.9% year-over-year in February, and of course, banks have to match the Fed funds rate when it comes to paying interest on their deposits. How and when this takes place is unknown. If the Federal Reserve does not bring back a risk-free rate of return, inflation will slowly reduce the retirement savings of 55 million Americans over the age of 65 to pennies. Maybe the Fed can do a Fed Listens tour for seniors later on this year.

P.S. As Powell said at the press conference there are some on the committee who want to go higher than 2% on the Fed funds rate this year which would mean throwing in some 50 bps moves at some of the meetings. 9 votes for 2% or lower this year and 7 votes for higher than 2%.

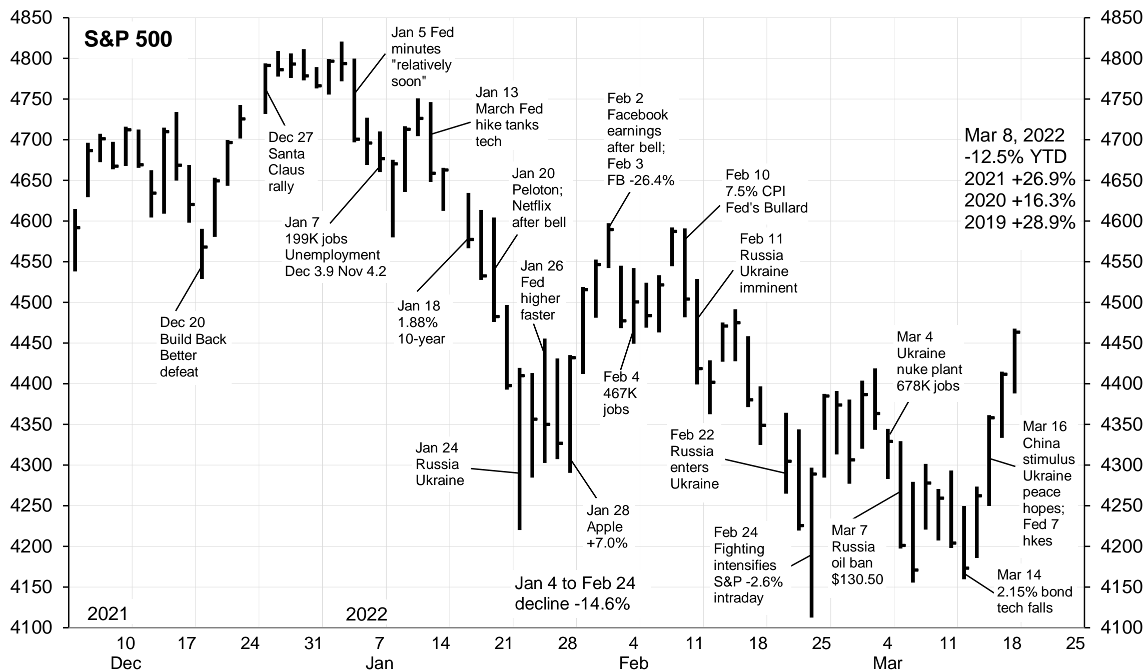
Much depends on inflation we guess. The committee looks for Core PCE inflation of 4.1% at the end of the year. They look for PCE inflation of 4.3%, but this is dependent on Russia Ukraine which has the power to push food and energy prices higher.

Core PCE inflation forecast is 4.1% and in January it is rising 5.2% year-on-year. Core PCE inflation has been rising 0.5% in every month starting last October and shows no sign of slowing yet. Only our cell phone bill isn't going up. 0.5 X 12 is 6.0%. Hard to predict.

Fed Policy-key variables				Long
	2022	2023	2024	Term
Fed funds	1.9	2.8	2.8	2.4
PCE inflation	4.3	2.7	2.3	2.0
Core inflation	4.1	2.6	2.3	
Unemployed	3.5	3.5	3.6	4.0
GDP	2.8	2.2	2.0	1.8
March 2022 median Fed forecasts				

Fed Individual Forecasts				
Fed funds rate at year-end				Longer
Votes	2022 End	2023 End	2024 End	run
1	1.375	2.125	2.125	2.000
2	1.625	2.375	2.125	2.250
3	1.625	2.375	2.250	2.250
4	1.625	2.375	2.375	2.250
5	1.875	2.375	2.375	2.250
6	1.875	2.625	2.375	2.250
7	1.875	2.625	2.625	2.250
8	1.875	2.625	2.625	2.375
9	1.875	2.875	2.875	2.500
10	2.125	2.875	2.875	2.500
11	2.125	2.875	2.875	2.500
12	2.375	3.125	3.125	2.500
13	2.375	3.125	3.375	2.500
14	2.375	3.375	3.375	3.000
15	2.625	3.625	3.625	3.000
16	3.125	3.625	3.625	
17				
18				
Median	1.875	2.750	2.750	2.375
Meeting	Mar 22	Mar 22	Mar 22	Mar 22

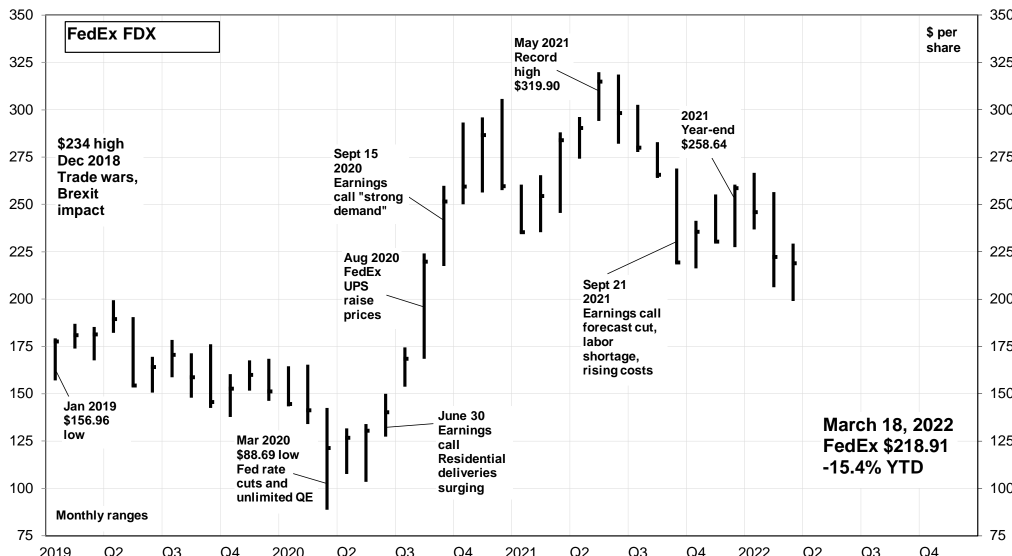
INTEREST RATES



You think we make this up. Stocks were up 1.26% on the day at 2pm ET Wednesday (China stimulus measures and Russia-Ukraine peace talk hopes) before the Fed “7 rate hikes in 2022” announcement and the S&P 500 kept going after selling off and making a bottom right before Powell’s soothing-words press conference starting at 230pm ET. The lack of (major) Russia-Ukraine headlines about an intensification of the war as the week progressed was part of the strong rally overall by the time of Friday’s close with the S&P 500 closing down 6.4% year-to-date after 2022’s worst day finish of down 12.5% on March 8. Curve thinks Fed risks recession: 2-yr/10-yr spread closed at 21 bps Friday.

FedEx $218.91, down 15.4% YTD

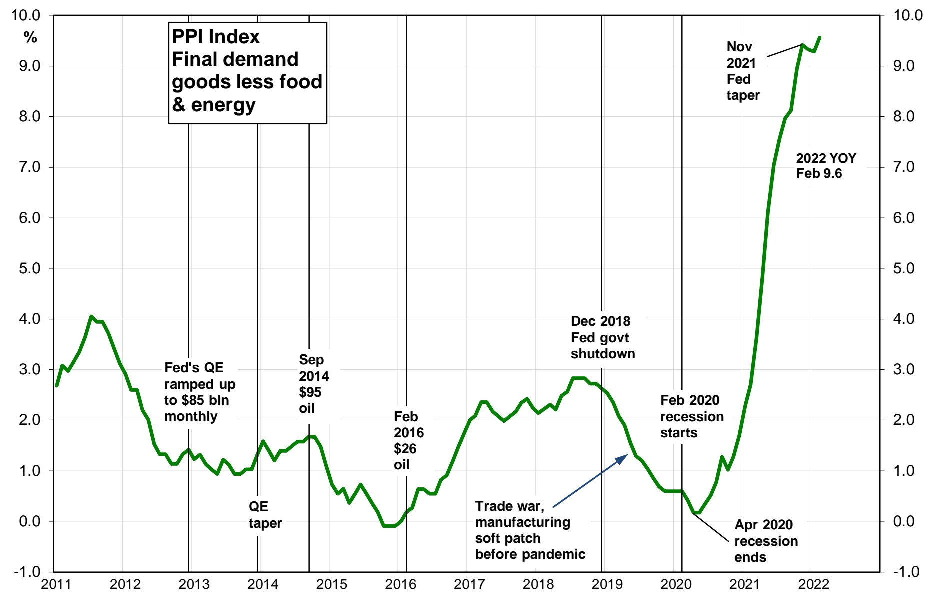
FedEx rallied strongly coming out of the pandemic as residential deliveries surged even as commercial orders fell. The pandemic was a long time ago. The stock price peaked in May 2021 just short of $320 per share. After earnings were released Thursday, March 17 after the bell, the stock fell 4.0% on Friday. Earnings missed forecasts. Labor shortages partly from Omicron boosted costs and second half margins on the Ground business won’t meet earlier expectations of the company.



OTHER ECONOMIC NEWS

PPI inflation near the peak (Tuesday)

Breaking economy news. PPI total final demand prices rose 0.8%, 10.0% year-over-year, with goods prices up 2.4%, the most since the index was created in December 2009 as energy prices jumped 8.2%. The good news comes from seeing final demand services prices were unchanged in February for the first time in at least a year. Inflation isn't under control by any means, but the tide may be turning where inflation broadly speaking doesn't grow any worse. The million dollar question is how far inflation falls after the spike in energy prices starts to fade. We are also concerned that the consumer may not see as much of an impact as transportation and warehousing costs jumped 1.9% in February. Truck transportation of freight increased 2.0%.

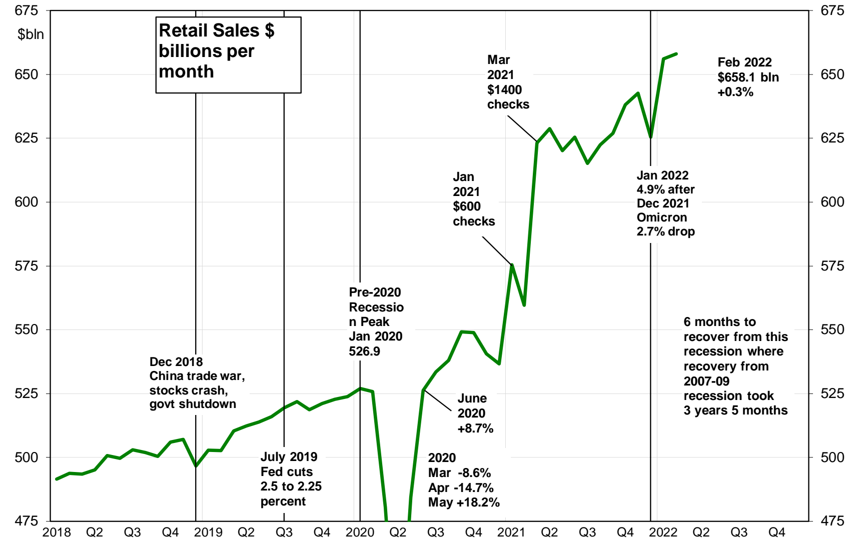


Net, net, factory prices may be nearing the peak as the prospects for strong world economic growth this year fades with the war in Europe taking a toll and new Covd-related shutdowns in China likely to slow the economy there. Producers who need to pass on the costs of higher energy prices will see some relief next month with the round-trip in crude oil prices after Russia invaded Ukraine late in February. Crude oil started March like a lion rising from $95 to $130, but now they are down like a lamb at $95 this morning. Stay tuned. Story developing. You can't have inflation if energy prices are dropping like a stone. Bet on it.

Once we get to last year's big monthly increases in April, year-year inflation rate may come back down.

PPI Total Final Demand Inflation-- Monthly Percent Changes												
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2021	1.2	0.7	0.7	1.0	1.0	0.8	0.9	0.9	0.5	0.7	0.9	0.4
2022	1.2	0.8										
PPI Total Final Demand Inflation-- Year/Year Percent Changes												
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
2021	1.6	3.0	4.1	6.5	7.0	7.6	8.0	8.7	8.8	8.9	9.9	9.9
2022	10.0	10.0										

Retail sales positive but it was all cars and gasoline (Wednesday)



Breaking economy news. Retail sales rose 0.3% in February after rising 4.9% in January. Last month's January estimate was 3.8%. This points out the fact that this is a report for advance retail sales before they get all the results in and there can be large revisions. The news headlines for the consumer turned grim late in February as Russia entered Ukraine on February 22 and the stock market crashed almost 15% from record highs during the day on February 24 so the revision to sales could be downward. The sales in February were all at the car dealers and petrol stations with retail sales excluding autos and gas down 0.4%, but this is after a 5.2% jump in January to start the year off with a bang.

Nevertheless, despite some choppiness, Fed officials are likely to take comfort in today's retail sales report and seeing the consumer is spending more than expected, they will stay on plan to raise rates 25 bps at today's meeting, the first rate hike since the final one last cycle in December 2018. Today's rate hike is likely to be a shot across the bow with more to come and market expectations have hardened into a belief they will raise rates at every meeting this year now. Stay tuned at 2pm ET for the announcement.

Retail spending, actual dollars, each month

	$million Feb 2022	% to Total	Percent Changes % Feb	Jan	Year/year
Total Retail Sales	658,128	100.0	0.3	4.9	17.6
Motor vehicles/parts	135,249	20.6	0.8	6.9	17.2
Furniture/furnishings	12,320	1.9	-1.0	7.5	7.4
Electronics/appliances	7,273	1.1	-0.6	2.1	2.6
Building materials/garden	43,615	6.6	0.9	2.7	14.8
Food & beverage	78,099	11.9	-0.5	1.0	7.9
Health/personal care	32,284	4.9	-1.8	0.2	8.9
Gasoline stations	57,495	8.7	5.3	-1.7	36.4
Clothing/accessories	26,463	4.0	1.1	1.4	30.6
Sporting goods, books	8,970	1.4	1.7	-1.3	11.7
General merchandise	71,044	10.8	-0.2	4.5	12.8
Department stores	12,162	1.8	1.6	9.8	22.8
Miscellaneous retailers	15,536	2.4	1.9	2.1	25.4
Nonstore retailers (internet)	95,849	14.6	-3.7	20.6	13.8
Eating & drinking places	73,931	11.2	2.5	-1.0	33.0

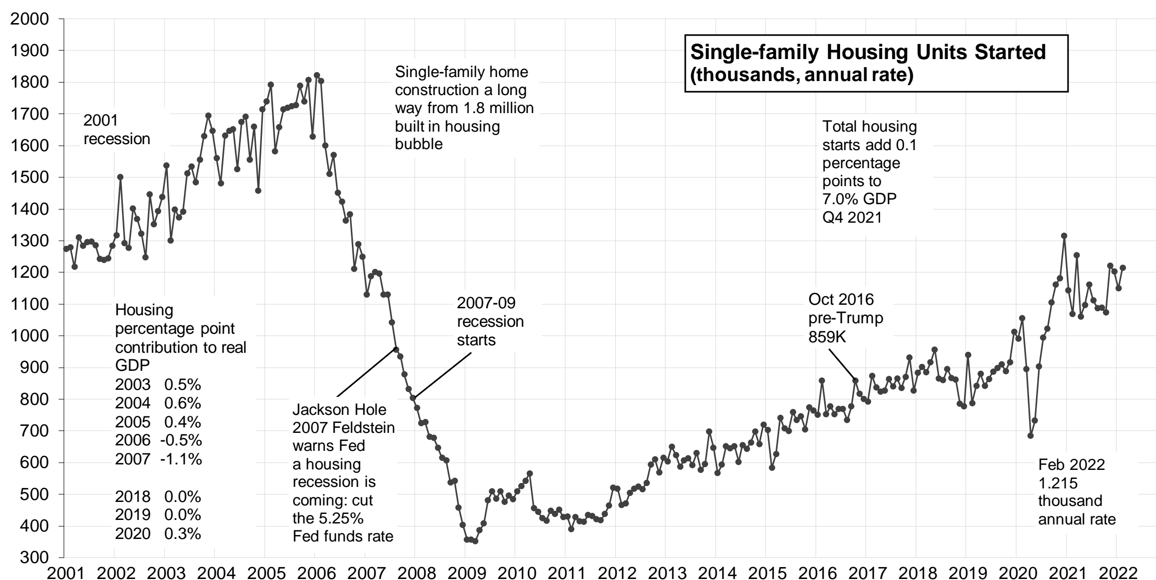
Net, net, the economy is off recession watch with shoppers at the malls stronger than we thought in the first couple of months of 2022 after revisions. The first quarter will see growth tumble from 7.0% in Q4 2021 as the enormous 4.9 percentage point contribution from inventories reverses, but consumer demand is robust enough to to keep growth positive. The omicron virus, financial market turbulence and worrying headlines from the war in Europe have not had a negative impact on consumers yet. A big part of the story is more sales at the motor vehicle dealers which is partly the result of higher prices. Retail sales in February of motor vehicles is 17.2% higher than last year while CPI for new vehicles is 12.4% higher. Out of control inflation came on suddenly and is making it hard to get an accurate read on current economic activity. Retailers are welcoming the ring of cash register sales, but the money coming in will not have the same spending power going out.

Jobless claims, housing construction okay, but for how long (Thursday)

Breaking economy news. Residential housing starts bounced back after January's sudden pullback. The data are mixed across the nation however, and by the way, housing permits, the indicator of where construction will go in the future, saw no such decline in January. For the record, housing starts in February rose 6.8% to 1.769 million at an annual rate after a decline of 5.5% in December. Northeast up 28.7%, Midwest up 15.3%, South up 11.4%, West down 11.4%. A picture of confusion.

The Federal Reserve is looking to raise short-term interest rates another 150 bps by the end of the year and that will send mortgage rates soaring which risks throwing housing back into its own recession. Monetary policy tightening is never viewed as successful unless it stops interest rate sensitive sectors of the economy like housing and autos in its tracks. We hope the Fed doesn't overdo it as the public is close to going on a buyer's strike already because of the sky-high costs of buying a new home or a new car. Maybe inflation will cool economic demand before the Fed can do it with rate hikes.

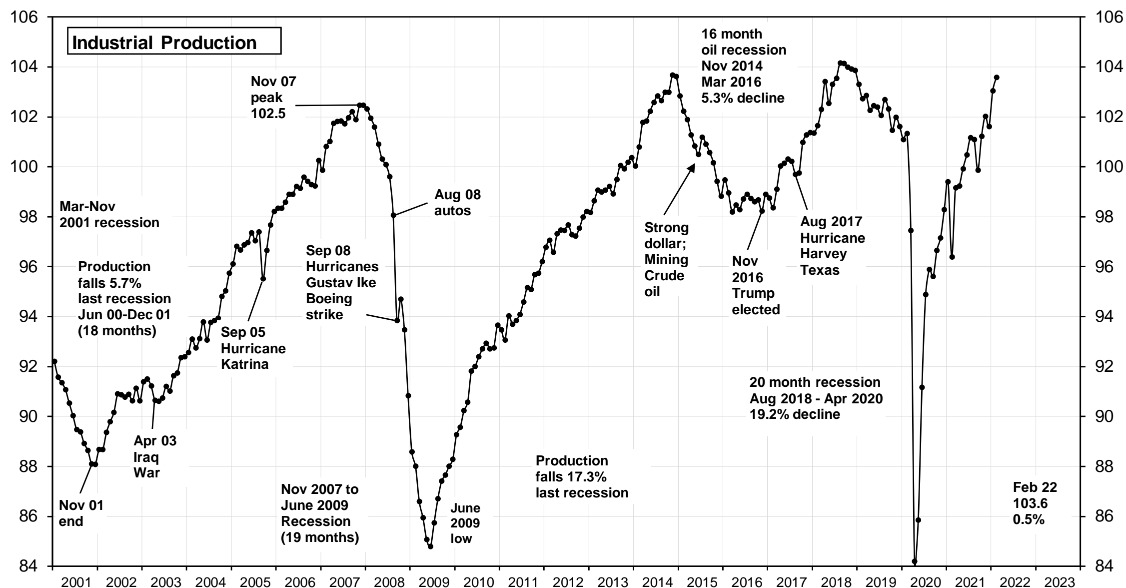
Net, net, currently, residential housing construction is exhibiting no sign of weakness, but for how long is the question with Fed officials doubling their efforts to slow interest sensitive sectors of the economy with plans for a massive hike in rates this year. Housing is in the crosshairs of the Federal Reserve's battle to bring inflation back down to earth and policymakers won't be satisfied until the latest housing bubble stops inflating and economic growth slows.



Factory output recovers further from pandemic recession and trade wars (Thursday)

Breaking economy news. Industrial production increased 0.5% in February after a 1.4% trick gain in January that was due to warmer than seasonal temperatures that sent Utility output soaring 10.4%. Manufacturing industrial production, or so-called factory output, jumped 1.2% which was the biggest gain since October and it was not driven just by motor vehicle assemblies.

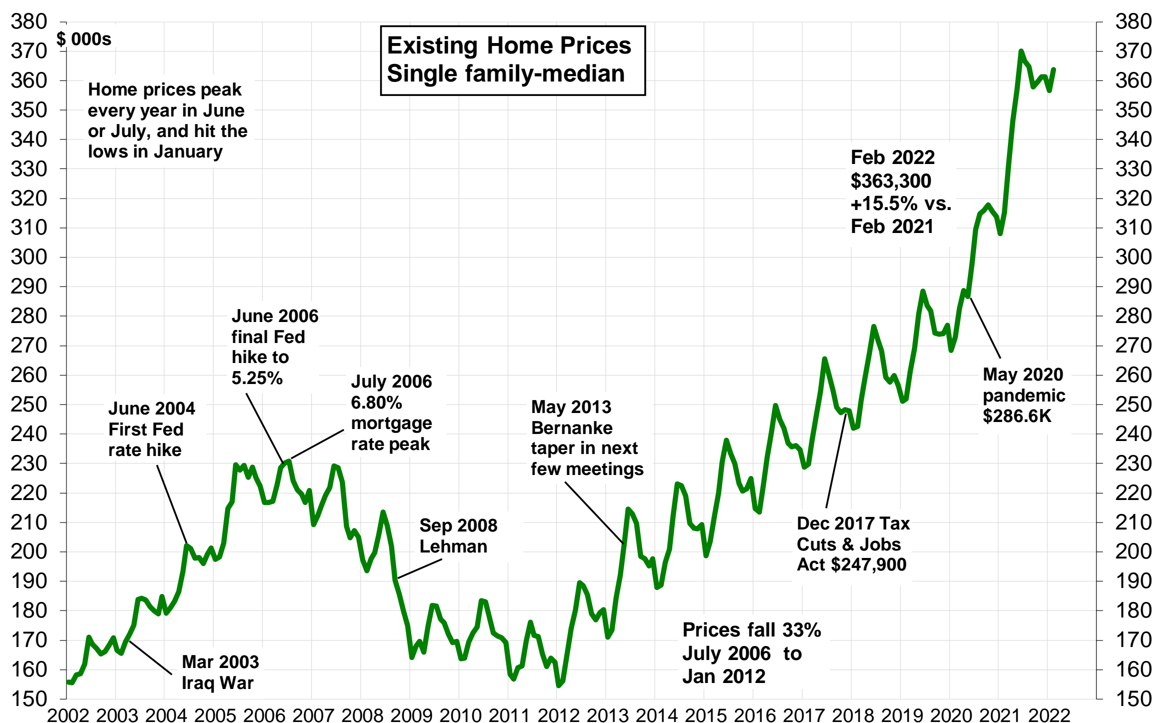
Net, net, it may be the calm before the storm but manufacturing output jumped 1.2% in February showing the economy is not rolling over yet from the lingering effects of the Omicron outbreak or financial turbulence at the start of the year. The early headlines about Russia's imminent invasion of Ukraine also didn't hurt factory output. There have been concerns about supply disruptions and the inability of many manufacturing plants to get needed parts, but no matter how many ships are anchored off Long Beach, factory output is steaming ahead. Calm before the storm indeed. If factories were concerned about higher borrowing costs ahead of the Fed's news yesterday raising rates to 2% now at the end of the year, they are showing no sign of backing down. Production is strong and getting closer to full recovery from the one-two punch slowdown associated with the China-U.S. trade war and then the pandemic recession. Stay tuned. Story developing.



Home price bubble still inflating for now (Friday)

Breaking economy news. Existing home sales fell 7.2% in February with double-digit losses for the smaller regional markets in the Northeast and Midwest. Sales in the South fell 5.1% and there was a 4.7% drop out West. Single-family home prices rebounded after a seasonal decline in January and are up 15.5% over last year levels. If you want to know where prices are going check out the 5.1% rise in wages from the February employment report and do the math. It doesn't add up and we would be surprised if prices of homes continue to advance at double-digit rates after getting hit with the double-whammy of higher borrowing costs and stagnant incomes relative to runaway housing price inflation. If you must look, go down South for some of the cheapest homes nationwide costing $326,900, but you better hurry as prices down South are up the most of any region the last year with a gain of 18.1%.

Net, net, home sales went into reverse in February exhibiting the worst turnover rate since August last year. It looks like the rise in mortgage rates has cooled the demand from home buyers and if that's the case, a further reduction in sales activity is likely as mortgage rates have moved even higher in March. The Freddie Mac survey rate was 4.16% for March 17 for 30 year mortgages versus 3.89% in the last week of February. Home prices are inflating with higher interest rates together is a toxic brew that forces us to downgrade our forecast for housing sales later this year. One thing is for certain, the Fed won't stop tightening until the housing market folds so more bad news is coming your way if you are actively trying to buy a new home. Home prices are holding up for now, but for how long is the question. Stay tuned. Story developing. Home prices have only two directions, either up or down, with no sideways movement detected.



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