Financial Markets This Week

15 APRIL 2022

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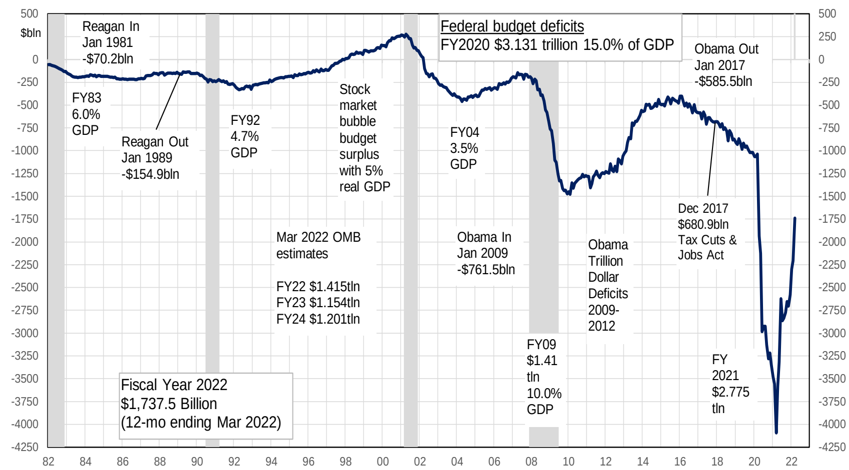
FY2023 FEDERAL BUDGET DEFICIT ONE PIECE OF THE PUZZLE ON INTEREST RATES



While we wait for the next recession caused by the Fed's fight against too much inflation, the 2020 pandemic recession is long gone if we look at the Federal budget deficit. From less than a trillion dollars in FY 2019, the Federal deficit was $3.132 trillion in FY 2020 and $2.775 trillion in FY 2021. Some think Federal government spending not matched by revenues is inflationary. The President's FY 2023 budget was released on March 28, and this week we got the March 2022 Federal budget deficit data which is the halfway point of the current fiscal year ending in September. The Office of Management and Budget (OMB) says the deficit this year will come down to $1.415 trillion. In the 12-months ending March 2022, the deficit is running $1.737 trillion. The bond market escaped the Treasury's financing demands during the pandemic as the Fed QE bought $80 billion Treasury securities per month or $960 billion annually. Now the shoe is on the other foot and the market is worried about the Fed's QT (quantitative tightening) plans that will add to the Treasury's financing demands. God giveth and taketh away. The March Fed meeting minutes said QT will be $60 billion monthly or $720 billion per year. The Biden FY2023 Federal budget deficit estimate is $1.154 trillion so 720 + 1,154 means $1.874 trillion of Treasury bond auctions next year starting October 1, the first day of FY 2023. Seems like a fundamental factor that could send bond yields up, but then they are up a lot already (10-year 2.83% at Thursday's close for the week) with Fed officials saying the Fed funds rate could end this year as high as 2.5%; it's 0.50% today. Pretty fast. Hope the central bankers know what they are doing.

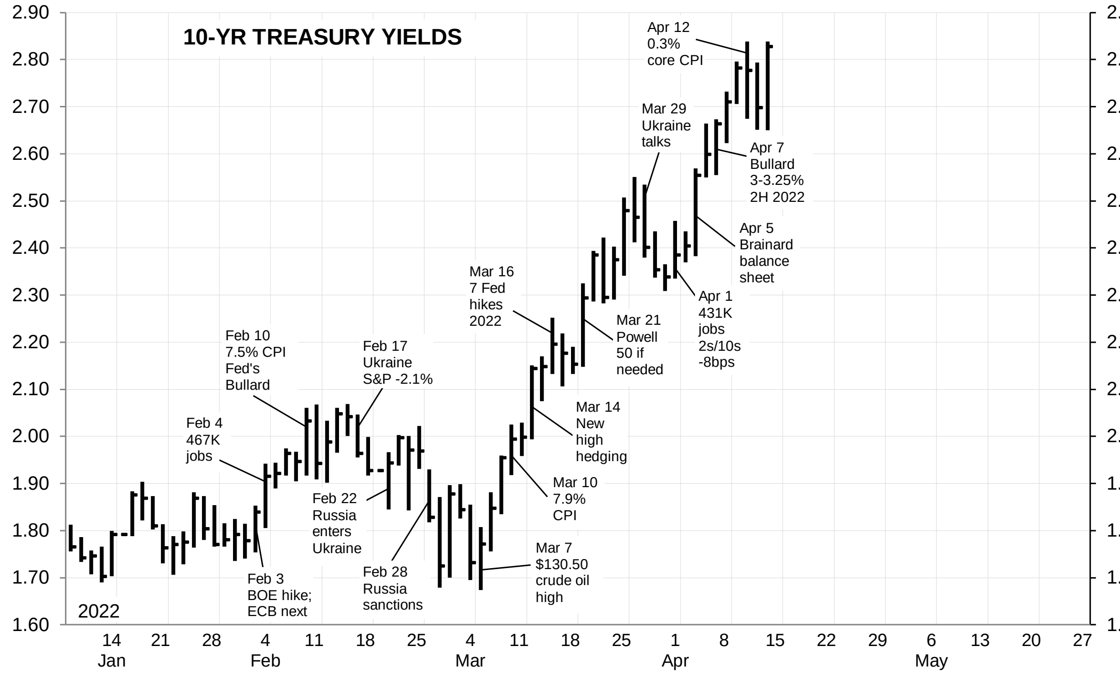
The Biden budget proposed outlays are more normal for a second year if normal is $5.8 trillion in FY2023 versus an estimated $5.9 trillion for this fiscal year ending September. Pandemic/recession outlays were $6.8 trillion in FY2021 and $6.6 trillion in FY2020. At the midway point of FY2022, outlays are down $620 billion or 18.2% from the prior year: unemployment benefits are almost $200 billion lower, the Economic Impact Payments, the $600 and $1400 checks in January/March last year, are responsible for $479 billion of the difference in FY 2022 outlays versus FY2021, and the Small

Business Administration (SBA) Paycheck Protection Program (PPP) ended in May 2021 and is responsible for $165 billion of the reduction in outlays so far this year. The SBA wasn't all PPP, there were other large programs like Covid Economic Injury Disaster Loans, and Shuttered Venues Operator Grants. There were 6.681 million PPP loans approved in 2021 totaling $277.7 billion. The number one lender was JPMorgan Chase with 158,345 loans approved worth $12.189 billion with average loan size of $76,978.

Federal Government Spending ($bln) Where to cut?	2 Qtrs FY22 Q4 21-Q1 22	2 Qtrs FY21 Q4 20-Q1 21	Fiscal Year Changes	Fiscal Year % chg	Full Year FY 2021
TOTAL BUDGET OUTLAYS	2,790.254	3,410.204	-619.950	-18.2	6,821.554
Legislative	2.854	2.670	0.184	6.9	5.263
Judicial	4.224	4.141	0.083	2.0	8.310
Agriculture	131.391	117.346	14.045	12.0	235.193
Commodity Credit Corporation	8.039	11.990	-3.951	-33.0	10.548
Food Stamps	79.027	55.551	23.476	42.3	134.527
Child Nutrition	20.500	12.243	8.257	67.4	25.798
Commerce	6.334	8.097	-1.763	-21.8	13.134
Defense	358.398	363.426	-5.028	-1.4	717.585
Military Personnel	94.941	94.032	0.909	1.0	172.580
Operation Maintenance	137.812	139.753	-1.941	-1.4	286.181
Procurement	68.793	68.617	0.176	0.3	141.446
Research Development	53.365	53.822	-0.457	-0.8	105.665
Military Construction	4.698	4.684	0.014	0.3	9.147
Education	70.493	52.095	18.398	35.3	260.452
Office of Federal Student Aid	19.542	19.160	0.382	2.0	170.400
Energy	15.817	17.222	-1.405	-8.2	33.694
Health Human Services	793.880	717.850	76.030	10.6	1466.673
Medicare	452.873	422.135	30.738	7.3	875.361
Medicaid States Grants	137.268	123.491	13.777	11.2	520.588
Homeland Security	40.600	46.466	-5.866	-12.6	91.069
Housing Urban Development	26.056	22.268	3.788	17.0	35.083
Interior	6.642	7.350	-0.708	-9.6	15.788
Justice	18.945	18.396	0.549	3.0	39.261
Labor	28.564	212.864	-184.300	-86.6	404.771
State Unemployment Benefits	15.993	133.174	-117.181	-88.0	222.335
Fed Additional Unemployment	3.687	70.837	-67.150	-94.8	162.697
State	15.656	16.069	-0.413	-2.6	35.814
Transportation	54.140	47.574	6.566	13.8	104.936
FAA	11.626	25.552	-13.926	-54.5	37.022
Federal Highway Admin.	138.401	34.420	103.981	302.1	61.218
Treasury	534.009	860.110	-326.101	-37.9	1633.747
TARP	0.052	0.235	-0.183	-77.9	0.370
Coronavirus Relief Fund	2.436	0.000	2.436	--	243.460
IRS	228.998	588.344	-359.346	--	817.462
Earned Income Credit	46.111	33.141	12.970	39.1	60.757
Child Tax Credit	104.878	18.499	86.379	--	78.959
Economic Impact Payments	8.000	487.000	-479.000	--	570.000
Interest on Public Debt	290.289	228.632	61.657	27.0	562.388
Veterans Affairs	126.035	115.064	10.971	9.5	233.781
Corps of Engineers	4.438	4.357	0.081	1.9	7.936
Other Defense Civil Programs	30.012	34.224	-4.212	-12.3	58.085
Environmental Protection	4.727	4.014	0.713	17.8	8.309
Exec. Office of President	0.212	0.209	0.003	1.4	0.427
International Assistance	12.075	12.373	-0.298	-2.4	20.047
NASA	11.248	11.353	-0.105	-0.9	22.249
National Science Foundation	3.649	3.310	0.339	10.2	7.354
Personnel Management	56.597	53.251	3.346	6.3	108.552
Small Business Admin.	18.247	183.668	-165.421	--	322.721
Social Security Admin.	622.933	589.379	33.554	5.7	1192.453
Retirement Benefits	519.985	486.586	33.399	6.9	982.673
Federal Disability Payments	70.504	70.565	-0.061	-0.1	140.774
Other Independent Agencies	15.642	8.430	7.212	85.6	13.554

To conclude, the Federal budget deficit is coming down close to $1 trillion, however, the Fed's QT could add another $1 trillion to the amount the U.S. Treasury has to auction to the public. Not a lot of the budget proposals will survive Congress. The Administration says no one earning less than $400,000 will pay more taxes. The corporate tax rate is going to rise from 21% to 28%: it was 35% before the Tax Cuts and Jobs Act in December 2017. There is a new tax proposed on the more than 700 billionaires which picks up about $40 billion annually going forward. Stay tuned. Congress didn't finalize the FY2022 budget until March this year.

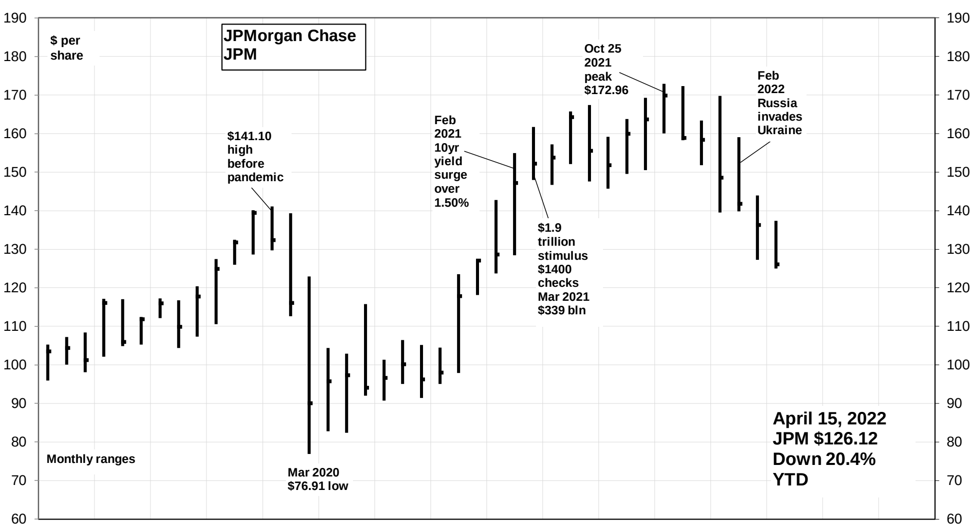
INTEREST RATES



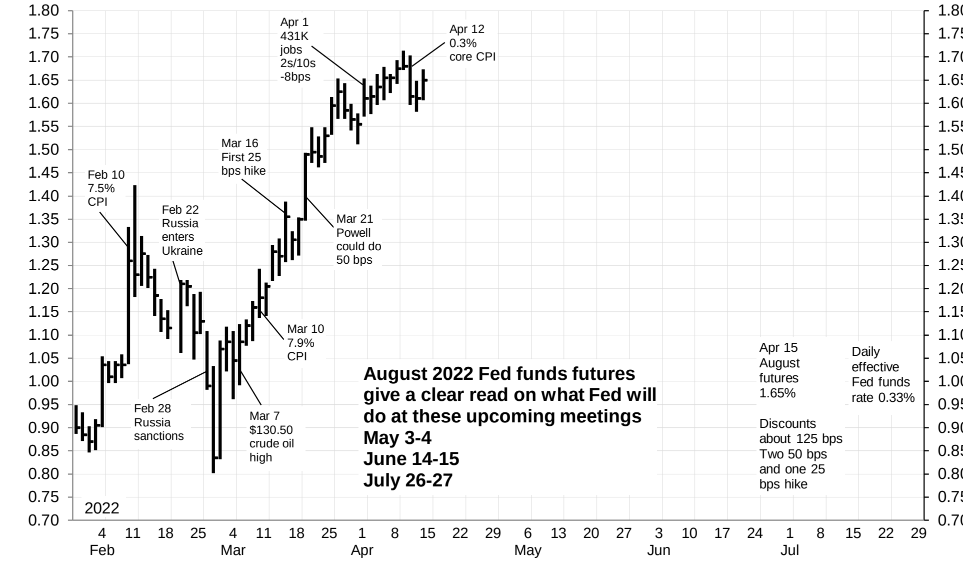
Forget waiting for the Fed to do something and raise rates, the hawkish message has been accepted by the market as a done deal, sending 10-year yields over 100 bps higher since the early March Russia-Ukraine war yield lows. 10-yr yields closed 2.83% Thursday for the holiday-shortened week. Sudden 100 bps moves historically have often been enough to slow the economy down. If the Fed thinks they are going back to the 2.5% Fed funds rate peak in December 2018, where should the 10-year yield go? Well, the highest monthly average 10-year yield last cycle was 3.15% in October 2018, so not far to go now. 10-year yields are almost where they were last time and the Fed has just begun.

JPMorgan drops Wednesday after earnings, 12th largest company in S&P 500

JPMorgan Chase dropped 3.2% Wednesday after its early morning earnings report. The stock is down 27.1% from the October 25, 2021 record high. The bank is back to building reserves against potential credit losses, $902 million, as it sees downside risks… “significant geopolitical and economic challenges ahead due to high inflation, supply chain issues and the war in Ukraine.” Long-term investors still regard the stock a buy if shares fall on a credit event. The $4 dividend forward is 3.2%.



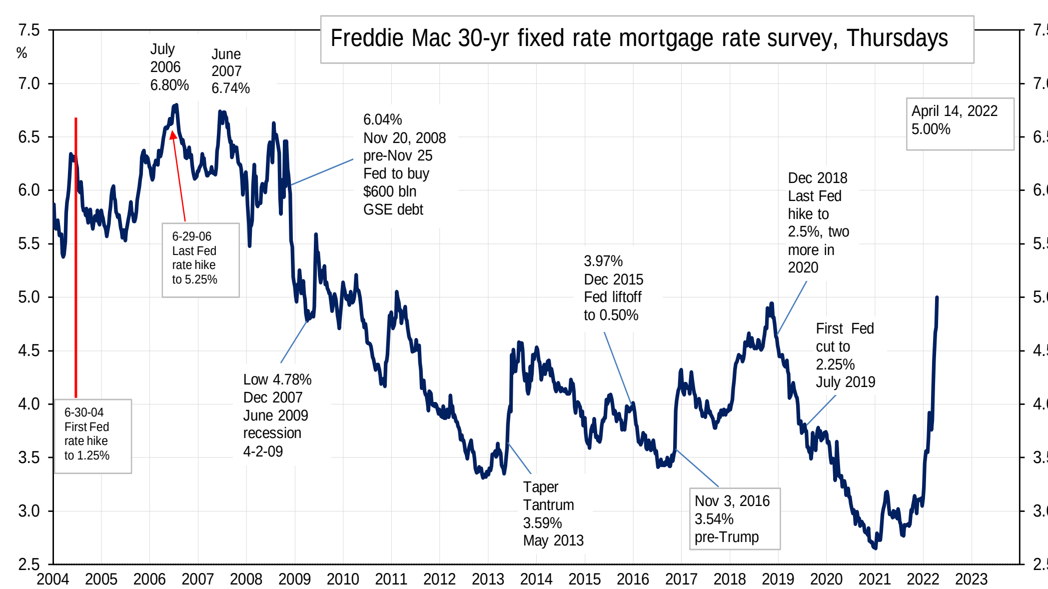
FEDERAL RESERVE POLICY



The Fed meets on May 3-4, 2022 to consider its monetary policy. The market has been expecting about 125 bps of rate hikes over the next three Fed meetings for a while: front-loaded with two 50s, followed by a 25 bps move at the end of July perhaps. That would put the Fed funds rate at 1.75%. 25 bps moves at the remaining three meetings of the year would then give us a Fed funds rate of 2.5% in December 2022 if it doesn't wreck the economy first.

We think we know where they are going, could they speed it up? At the start of the pandemic Powell struck twice between regularly scheduled meetings early in 2020; a 50 bps cut to 1.25% on March 3 and then a 100 bps whopper to 0.25% on March 15. When thinking about that final cut, we were wondering if Powell would just go all the way by 100 bps in one move to get "there." He did, and now we wonder if getting there is now 2.5%, could they get there even faster, speed it up again? The Treasury curve, market interest rates are already assuming 2.5% more or less. The 2-year note closed at 2.45% this week and could be priced appropriately for a 2.5% Fed funds rate if the market thought 2.5% was the terminal point for Fed funds. Fed Governor Waller, a fairly conservative member from the St. Louis Fed originally, was asked this week on TV would the Fed entertain a "shock and awe" policy move? He said, "Not this central banker." So we guess they are not going to speed it up, the moves to 2.5%, but we don't know what Powell is thinking.

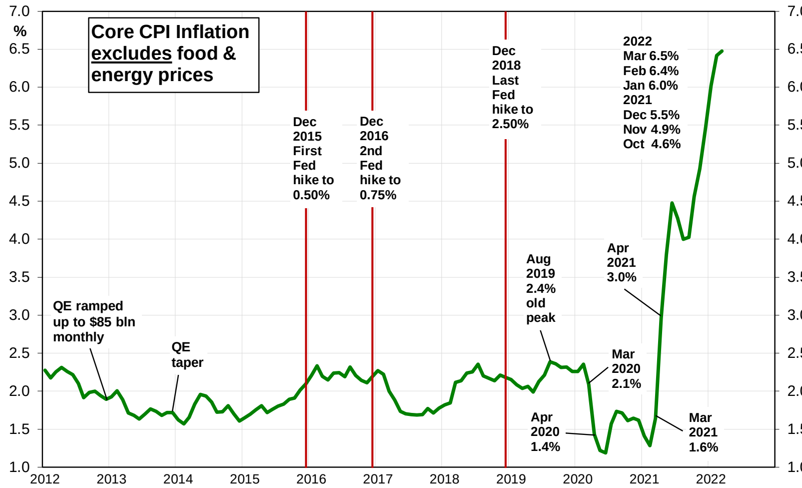
Mortgage rates have not gone up this fast in decades. It will take a miracle to keep the housing sector from slowing.



OTHER ECONOMIC NEWS

Inflation hits new record this cycle on energy spike (Tuesday)

Breaking economy news. CPI inflation rose 1.2% to 8.5% year-year in March. Core CPI inflation rose 0.3% to 6.5% year-year in March. The market was relieved that core consumer inflation was less than expected after the last couple days of worrying about how high the Federal Reserve might move interest rates up to fight the inflation battle. The inflation fire is still out of control even if the heat is not quite as intense and who knows how high interest rates will have to go to put the fire out. It's not just core inflation that was good news as the March CPI report has the Russian-Ukraine war written all over it with energy prices up 11.0% and gasoline prices up 18.3%; the good news is gasoline prices are down in April and will subtract from overall inflation in next month's report. AAA gasoline prices are $4.098 today versus $4.326 a month ago, a decline of 5.2%.



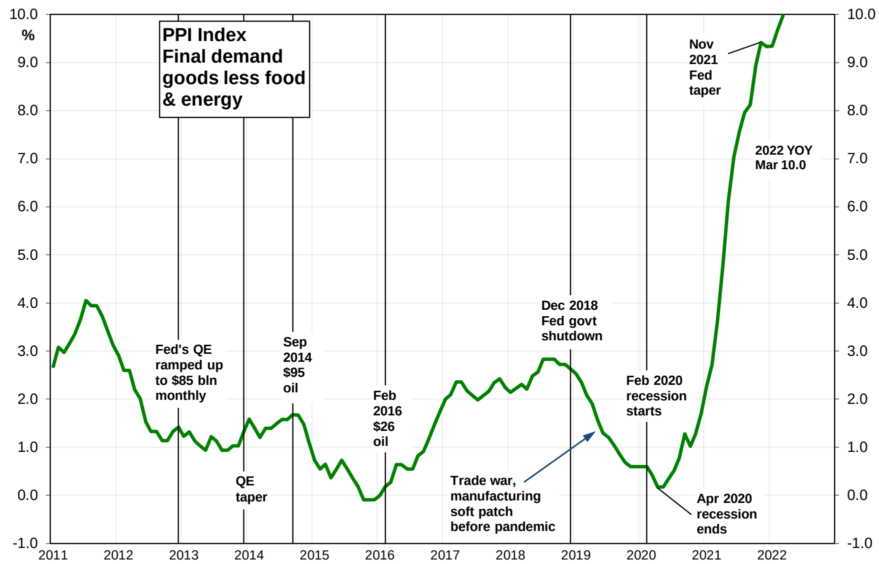
Used car and trucks prices fell a second month, -3.8% in March and -0.2% in February, which counts as evidence that the extraordinary consumer demand triggered in part by last year's economic impact payments in January and March is starting to wane. The drop in used car and trucks prices lowers core inflation by about 0.2 so the 0.3% core CPI monthly change would have been 0.5% this month if used car and trucks prices had not dropped so much. This shows you that other prices have not stopped moving higher. It may also mean low-income consumers are cash-strapped from out-of-control inflation in goods like food and gasoline and don't have the money left over to buy a used car.

		Monthly Percent Changes			YOY %
Weight	CPI inflation	Jan 2022	Feb 2022	Mar 2022	Mar 2022
100.0	Total	0.6	0.8	1.2	8.5
13.990	Food	0.9	1.0	1.0	8.8
6.269	Food away from home	0.7	0.4	0.3	6.9
7.542	Energy	0.9	3.5	11.0	32.0
78.468	Ex-food & energy	0.6	0.5	0.3	6.5
3.884	New vehicles	0.0	0.3	0.2	12.5
3.419	Used cars/trucks	1.5	-0.2	-3.8	35.3
2.669	Clothing	1.1	0.7	0.6	6.8
1.487	Medical care goods	0.9	0.3	0.2	2.7
32.393	Shelter	0.3	0.5	0.5	5.0
23.509	Owner equiv. rent	0.4	0.4	0.4	4.5
5.046	Transportation	1.0	1.4	2.0	7.7
6.987	Medical care services	0.6	0.1	0.6	2.9
	Special: Where inflation might come back down to				
57.700	Services ex-energy	0.4	0.5	0.6	4.7

Net, net, inflation shows some early signs of topping out this month despite the scary 8.5% year-on-year change. None of this lets Fed officials off the hook for the mess they caused by printing money too late into the economic recovery. The Fed's final QE purchases didn't finish up until the second week of March and Fed jawboning is working overtime to correct the easy monetary policy by messaging a 2 to 2.5 percent Fed funds rate level is likely to be appropriate for the end of the year. Core CPI inflation rose just 0.3% in March which was the lowest monthly change seen since last September, but don't get carried away as this good news is offset by the inflation cancer spreading elsewhere in the economy. The monthly change in services prices ex-energy jumped the most yet this cycle by 0.6% in March (most since August 1990 the month when Iraq invaded Kuwait sending gasoline prices to the sky) and stands 4.7% above prior year levels. If services prices are going up it means the Federal Reserve is too late to this inflation fight and the danger is interest rates will have to be hiked to too-high levels to meet too-high inflation and bring economic demand crashing back down to the line between growth and contraction. You can flip a coin on guessing whether the economy will miss a recession in the next 12 to 18 months. Bet on it.

PPI inflation and more (Wednesday)

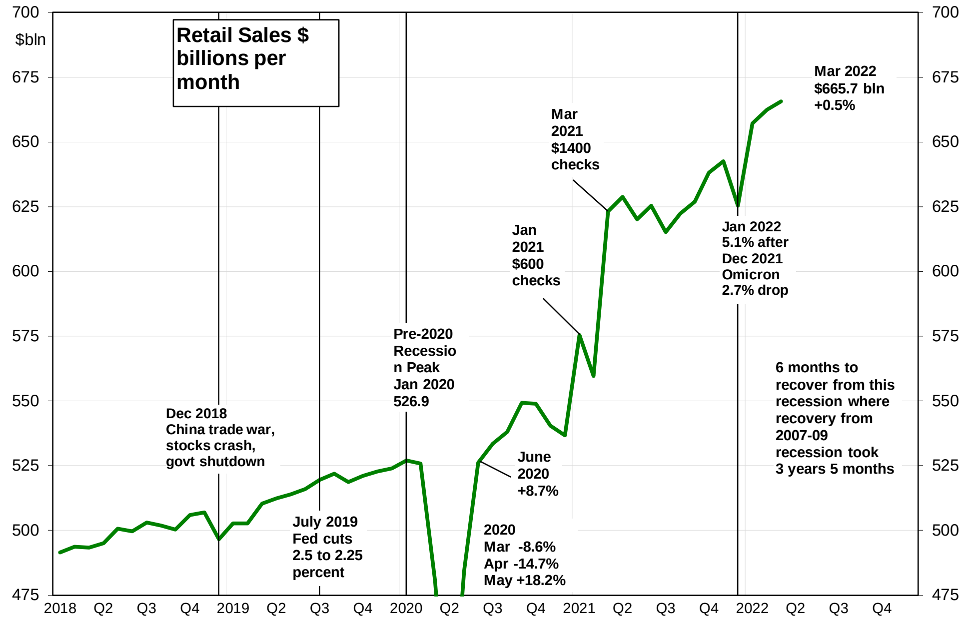
The pipeline is literally chock full of inflation at the lower stages of production which means the consumer's nightmare of steadily rising prices of everything they buy is not over yet. What started as an inflation outbreak related to the pandemic and supply chain shortages has turned into a nightmarish cost-of-living crisis with no way out but for the Fed to engender a sharp cutback in consumer demand which is a polite way of saying economic downturn or recession. As long as producers keep passing on their rising costs to consumer goods, there is literally no way out for this economy. There is a blame game down in Washington every time inflation rears its ugly head, but it isn't the President, or the Democrats or Republicans in Congress, or the U.S. Treasury, the blame lies squarely on the shoulders of the Federal Reserve. Too much money chasing too few goods, it is the Fed's fault, always has been and always will. They blew it. They were too worried about the labor market, cybersecurity, Bitcoin, ESG issues, bank regulation, and took their eyes off the ball, and now all Americans will have to pay the price.



	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	1.0	0.6
2022	1.2	0.9	1.4									
	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	6.4	6.9	7.5	7.8	8.6	8.8	8.9	9.9	10.2
2022	10.2	10.4	11.2									

Retail sales are all higher gasoline prices (Thursday)

Breaking economy news. First we want to get jobless claims out of the way. As the Fed readies its rate hikes, they could always tip the boat to one side and cause a recession. Not yet. Unemployment claims remain below 200 thousand in the April 9 week, even if the number rose 18K to 185K.



How is the consumer doing? They are spending selectively this month and the gasoline price spike from the Russian-Ukraine war was where most of the expenditures were made. Retail sales were up 0.5% in March, but actually fell 0.3% if we take out gasoline sales. Gasoline station sales (not the donuts at the convenience store on the property) jumped 8.9% in March and will reverse somewhat as prices fell in April. Gasoline sales are 9.6% of total retail sales.

Don't worry too much about the consumer yet, as substantive upward revisions to January and February mean first quarter 2022 retail sales are rising 17.7% at an annual rate, and if it sounds big, it is, as we have not seen sales this brisk since the first half of 2021 that was boosted by the economic impact payments from the Federal government, those $600 and $1400 checks everyone in Congress voted for. Real GDP should be about 2.0% in the first quarter, thanks to the consumer, even if the inventories, which added 5.3 percentage points to Q4 2021's 6.9% real GDP, come back down.

Retail spending, actual dollars, each month

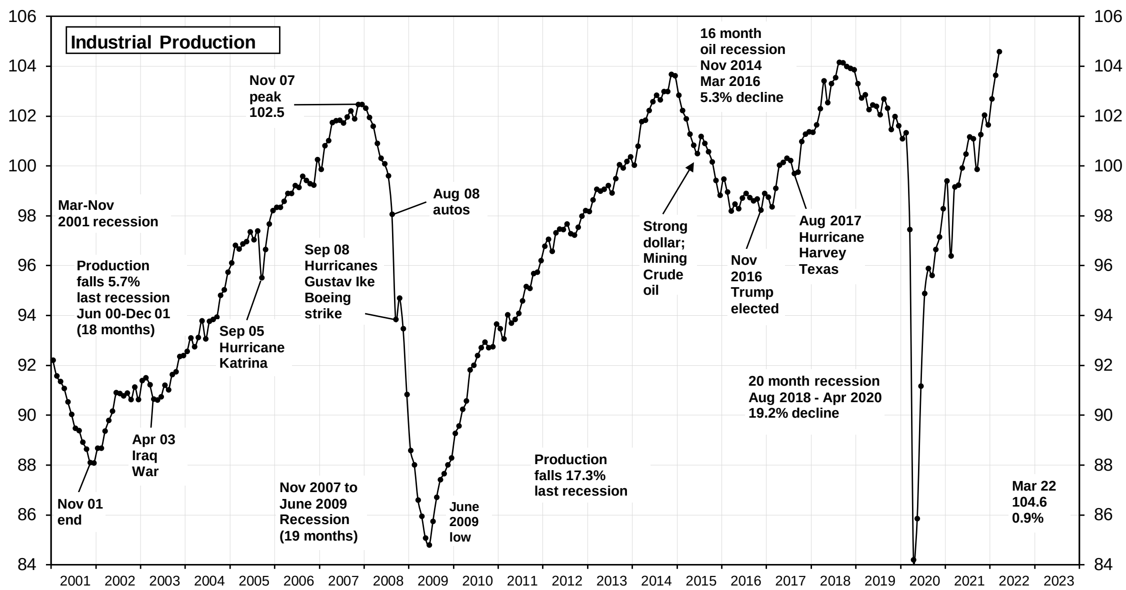
	$million Mar 2022	% to Total	Percent Changes % Mar	Feb	Year/year
Total Retail Sales	665,726	100.0	0.5	0.8	6.9
Motor vehicles/parts	133,715	20.1	-1.9	1.5	-1.2
Furniture/furnishings	12,861	1.9	0.7	2.7	3.6
Electronics/appliances	7,527	1.1	3.3	0.3	-9.7
Building materials/garden	43,602	6.5	0.5	0.9	0.6
Food & beverage	79,069	11.9	1.0	-0.3	8.4
Health/personal care	32,522	4.9	-0.3	-0.6	1.4
Gasoline stations	63,850	9.6	8.9	6.7	37.0
Clothing/accessories	26,936	4.0	2.6	0.6	7.3
Sporting goods, books	9,429	1.4	3.3	3.5	-5.1
General merchandise	74,863	11.2	5.4	-0.2	5.2
Department stores	12,141	1.8	-0.3	1.7	7.4
Miscellaneous retailers	15,641	2.3	0.8	1.3	13.3
Nonstore retailers (internet)	90,350	13.6	-6.4	-3.5	1.8
Eating & drinking places	75,361	11.3	1.0	3.0	19.4

Net, net, economic growth remains positive, but at the end of the first quarter, there are signs the consumer is increasingly tired with most of their paychecks going to put gas in the car. Workers are finding their paychecks don't go as far to meet expenses when inflation is raging out of control. We are surprised the consumer isn't spending as much online. Nonstore retailers saw their sales fall 6.4% in March after falling 3.5% in February. Peak online sales of $100.022 billion in January after the holidays are now just $90.350 billion in March, which is quite a retrenchment. Stay tuned. Story developing. The Fed is draining the punch from the punch bowl at the fastest pace in over two decades and if that doesn't kill off consumer demand in the months ahead then sky-high inflation prices on the store shelves will cause the consumer to cut back. Bet on it.

Full recovery for industrial production (Friday)

Breaking economy news. Nothing going on today with markets closed for the holidays, nothing to do but wait for the U.S. mail to be delivered. But big news. Manufacturing is back. A new all-time high was recorded for industrial production in March rising 0.9% to 104.6. Production collapsed nearly 20% during the pandemic. There was a 16 month oil recession ending in March 2016 where production fell 5.3%. But all these downturns are forgotten with industrial production setting a new record this month. No sign of recession in today's industrial production data.

Today's numbers are a sign that the era of offshoring and globalization is nearing the end and even if many overseas factories will not be coming back to American shores, at least new production facilities being built here will meet an increasing share of the goods that consumers demand going forward. It won't be easy certainly as labor costs are very high in the U.S., but the world is slowly turning. The Russia-Ukraine war has made countries look inward.



				Industrial Production	
Percent changes				Mar 2022	
Jan	Feb	Mar	YOY		Weight
1.0	0.9	0.9	5.5	Total Index	100.0
0.2	1.2	0.9	4.9	Manufacturing	74.5
0.5	1.3	1.7	7.0	Mining	13.7
7.5	-1.0	0.4	7.5	Utilities	11.8
			Manufacturing payroll jobs 12.7 million +389K YOY 9.8% of Private Payroll Jobs		

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