# *Financial Markets This Week*

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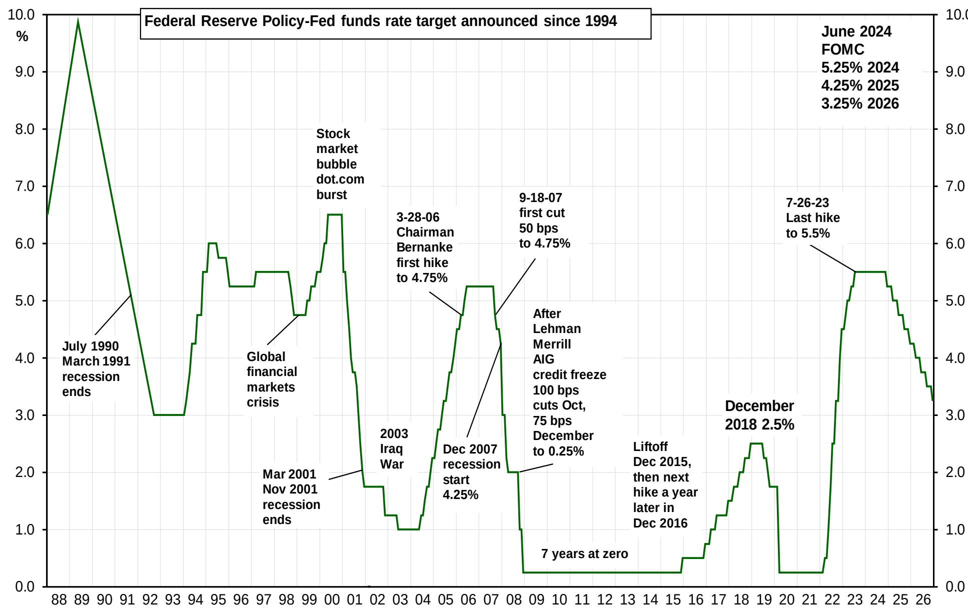
## QUARTERLY FED UPDATE



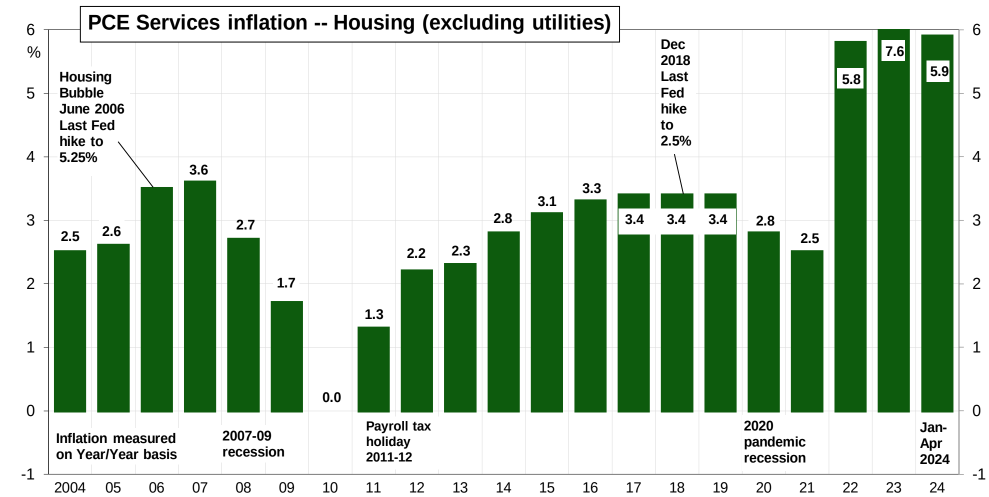

The Fed met on Wednesday and agreed to do nothing again (maybe they should run for Congress) as Powell explained at Wednesday's 230pm ET press conference. The Fed funds rate has been at a recession-level 5.5% rate since July 26, 2023. Recession level meaning a 5.25% Fed rate peak that broke the bank and brought down the House ahead of the 2007-09 recession. Actually, it wasn't just a do-nothing meeting; there was no change in rates this week, but new quarterly forecasts brought the three rate cuts promised this year, crashing down to just one is the loneliest number which pushes a rate cut out to the December 17-18, 2024 meeting. Powell says these forecasts are not operational and they do not vote on them, but perhaps they should the way the forecasts move the markets. Only one rate cut now this year; maybe the Fed chickened out ahead of the 800 pound gorilla in the room, the November presidential elections like so many other Washington institutions who are battening down the hatches and holding their breath.

The CPI inflation number was dramatic, suggesting the inflation surge is over, and we expect the Committee would have left two rate cuts on the table this year if they had known the CPI report a week ago. Powell said he gave them a chance to change their forecasts, but few did so, which is understandable, the CPI release was 830am ET and the forecast tables sent out at 2pm ET. Let the record show that as it stands, 4 said no cuts, 7 said one cut and 8 said two cuts. Looks like an agreement on exactly how to proceed. At least Powell said no rate hike and perhaps the stock market made a new high on Wednesday after he said this.

**Memo: Projected appropriate policy path**

| Fed Meeting | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | Longer run |
|---|---|---|---|---|---|---|---|---|---|---|
| Jun 24 | | | | | | | 5.1 | 4.1 | 3.1 | 2.8 |
| Mar 24 | | | | | | | 4.6 | 3.9 | 3.1 | 2.6 |
| Dec 23 | | | | | | 5.4 | 4.6 | 3.6 | 2.9 | 2.5 |
| Sep 23 | | | | | | 5.6 | 5.1 | 3.9 | 2.9 | 2.5 |
| Jun 23 | | | | | | 5.6 | 4.6 | 3.4 | | 2.5 |
| Mar 23 | | | | | | 5.1 | 4.3 | 3.1 | | 2.5 |
| Dec 22 | | | | | 4.4 | 5.1 | 4.1 | 3.1 | | 2.5 |
| Sep 22 | | | | | 4.4 | 4.6 | 3.9 | 2.9 | | 2.5 |
| Jun 22 | | | | | 3.4 | 3.8 | 3.4 | | | 2.5 |
| 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 |

There were a couple of questions on the cost of shelter in the consumer inflation reports. Powell attempted to answer why shelter inflation has not come down as expected: “So, I think if you go back a couple of years, we know that there were renters. And then, there're, you know, people who own their houses, and we have OER, which is owners’ equivalent rent. And so, when market base rents go up sharply, as they did at the beginning of the of when the economy reopened, they really went up sharply. Those play into rollover rents much more slowly for existing tenants than they do for new tenants. And so, we've so we've found…” Okay, that’s enough. All we know is shelter inflation did not come down very fast during the 2007-09 recession when the housing bubble burst, and home prices were actually dropping a lot back then instead of making record highs like today despite the recession-magnitude 5.5% Fed funds rate.

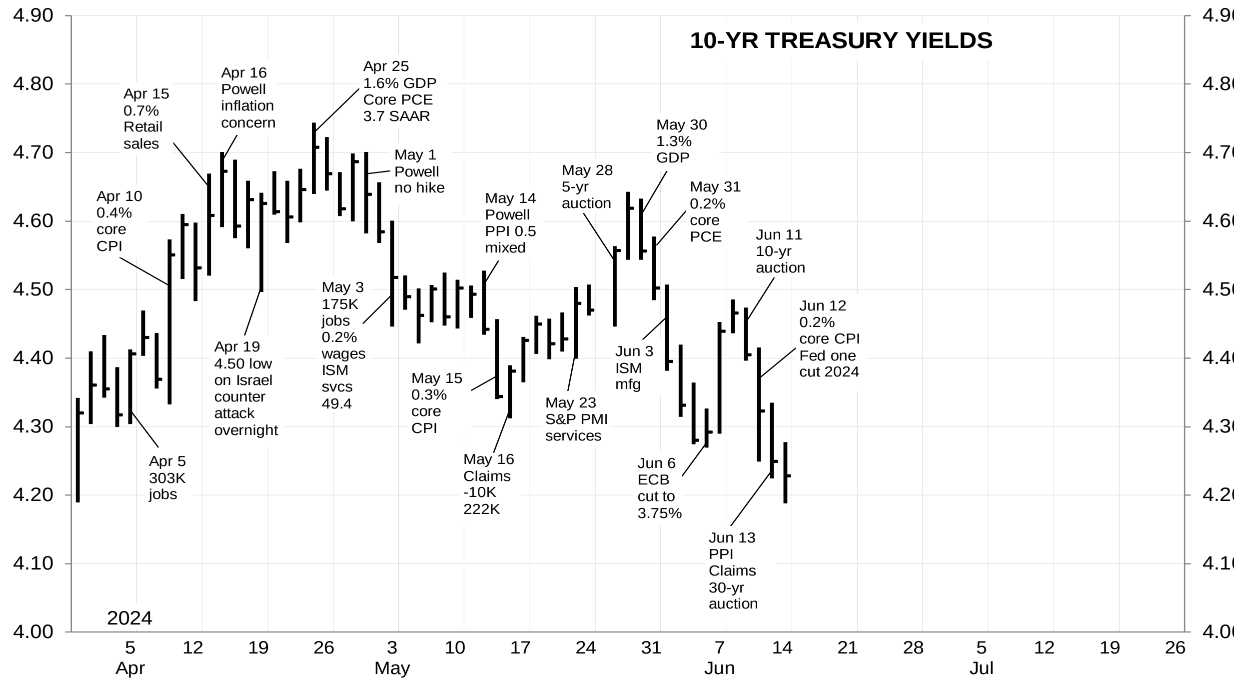



There was also a tongue-tied explanation of why the Committee still wants to cut rates this year even though the core PCE inflation forecast was revised up to 2.8% in Q4 2024 from the 2.6% forecast made at the March meeting. Makes you wonder about the confidence the Committee says it needs to be sure inflation is heading to 2.0. And Powell’s answer to the question illustrates how precise the measurement of the 2.0% inflation target has become. Down to tenths and hundredths. It is also more difficult for the Fed to achieve 2.0% exactly although to some extent this is already implied in that the core PCE inflation forecasts move down ever so slowly to 2.3% in 2025 and 2.0% in 2026. Anyway, the table here shows what happens to year-on-year (YOY) core PCE inflation if the monthly changes run 0.2 percent for the rest of 2024, or 0.1 percent, or 0.15%. If 0.2% which sounds good enough for anybody, core PCE inflation ends the year at 2.96% or 3.0% rounded (Fed forecast is Q4 2024, so the average of Oct, Nov, Dec), and if it runs 0.1% for the rest of the year, the December core PCE is 2.16% or 2.2% rounded.

| Inflation | 2024 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Changes | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC |
| Monthly | 0.48 | 0.27 | 0.33 | 0.25 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| YOY | 2.91 | 2.81 | 2.81 | 2.75 | 2.67 | 2.69 | 2.77 | 2.88 | 2.75 | 2.80 | 2.91 | 2.96 |
| Monthly | 0.48 | 0.27 | 0.33 | 0.25 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| YOY | 2.91 | 2.81 | 2.81 | 2.75 | 2.57 | 2.49 | 2.47 | 2.48 | 2.25 | 2.20 | 2.21 | 2.16 |
| Monthly | 0.48 | 0.27 | 0.33 | 0.25 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 |
| YOY | 2.91 | 2.81 | 2.81 | 2.75 | 2.62 | 2.59 | 2.62 | 2.68 | 2.50 | 2.50 | 2.56 | 2.56 |
| | Where core PCE inflation ends 2024 with 0.2, 0.1, or 0.15 percent monthly changes | | | | | | | | | | | |
| 2023 | 0.51 | 0.36 | 0.34 | 0.31 | 0.29 | 0.17 | 0.12 | 0.10 | 0.33 | 0.14 | 0.09 | 0.15 |
| | Monthly changes in 2023 that did or soon will drop out of the equation with new data this year. | | | | | | | | | | | |

To conclude, perhaps the Fed is putting inflation under a microscope too much, there must be a way to maintain a 2% target, but not talk about it so much. Monthly core PCE inflation changes have not been too different from last year until the upcoming May report: 0.10% expected vs 0.29% last year.

## INTEREST RATES



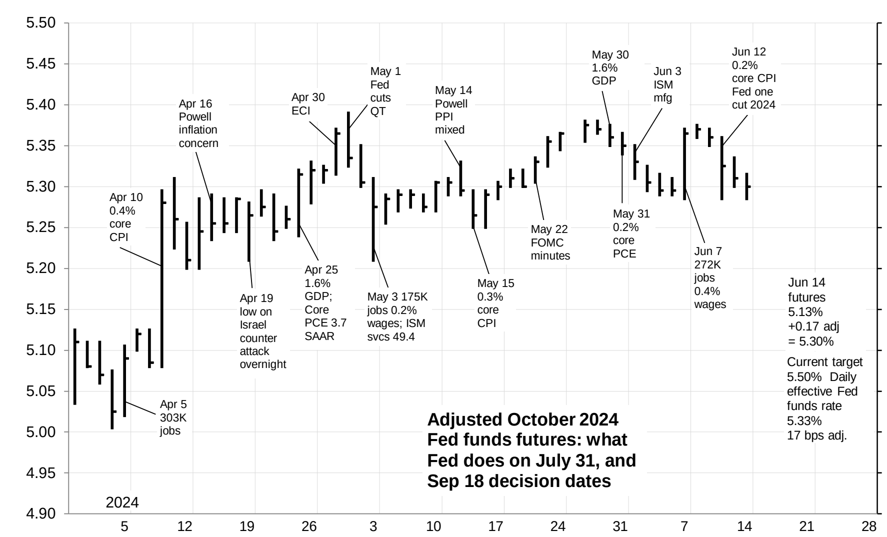

Bond yields got wacked this week despite some momentary yield backup on Wednesday afternoon when the Fed said just one rate cut this year (which more or less means December) instead of the three rate cuts they forecast at the March meeting. Another week where the rising national debt is sustainable with a couple of solid Treasury bond auctions. The three major news events that brought yields down were the 10-yr auction on Tuesday, 0.2% core CPI on Wednesday (which after PPI on Wednesday means a May 0.1% core PCE number released Friday, June 28), and on Thursday the PPI inflation report and 13K increase in weekly jobless claims to 242K. Stocks were less volatile than bonds and just kept making new all-time highs. Stocks rallied Tuesday with the 7.3% jump in Apple. Wednesday was the 0.2% core CPI rally, giving some back on the Fed seeing just one 2024 rate cut.

## More Federal Reserve news/developments

In case you wondered, the all-knowing market sees two 25 bps rate cuts by December. At the September meeting, 19 bps of a 25 bps rate cut to 5.25% is discounted. Fed forecast sees a 4.0% or higher unemployment rate which forecasters used to think meant a recession had begun.

| **Fed funds futures call Fed policy** | | |
|---|---|---|
| Current target: June 14 -- 5.50% | | |
| Rate+0.17 | Contract | Fed decision dates |
| 5.465 | Aug 2024 | July 31 |
| 5.310 | Oct 2024 | Add Sep 18 |
| 4.995 | Jan 2025 | Add Nov 7, Dec 18* |
| Last trade, not settlement price | | |
| * Not strictly true, Jan 2025 contract has Jan 29 as the expected Fed decsion date | | |

| Fed Policy-key variables | 2024 | 2025 | 2026 | Long Term |
|---|---|---|---|---|
| Fed funds | 5.1 | 4.1 | 3.1 | 2.8 |
| PCE inflation | 2.6 | 2.3 | 2.0 | 2.0 |
| Core inflation | 2.8 | 2.3 | 2.0 | |
| Unemployed | 4.0 | 4.2 | 4.1 | 4.2 |
| GDP | 2.1 | 2.0 | 2.0 | 1.8 |
| June 2024 median Fed forecasts | | | | |



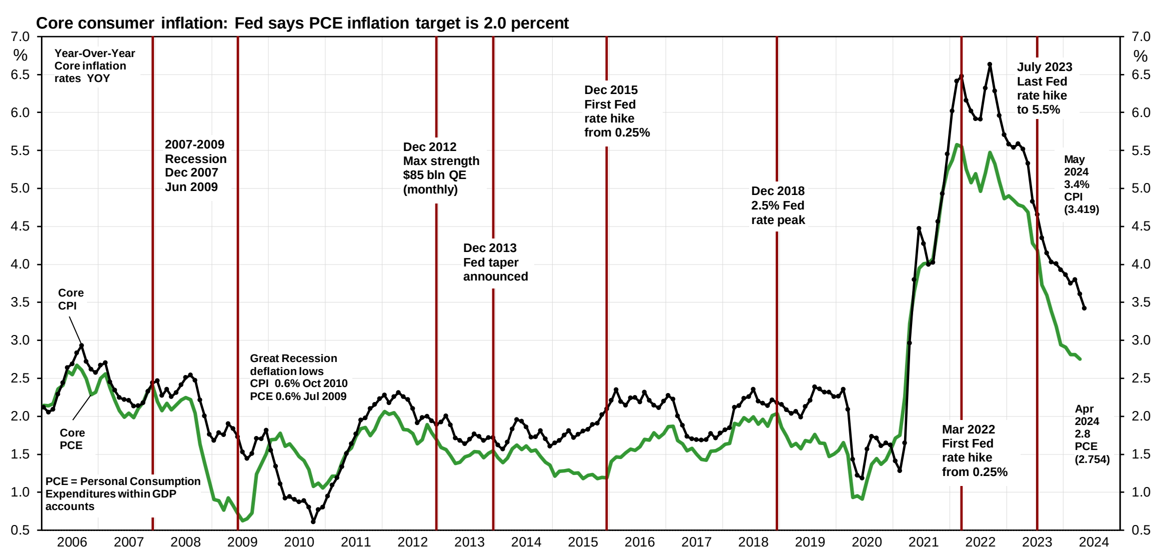
# OTHER ECONOMIC NEWS

## Inflation cools down (Tuesday)

Breaking economy news. CPI inflation was unchanged in May and increased 3.3% from last year. Core CPI inflation increased 0.2% (0.205%) in May and is 3.4% above prior year levels. First deflation since the 2020 pandemic year with extra core CPI which subtracts out shelter and used vehicles, in addition to the normal food and energy, falling 0.1%. Looking back on it, that inflation burst in the first quarter was a temporary blip, although the reason it might have been temporary is because economic demand is slowing dramatically.

| Dec 23 | | Monthly Percent Changes | | | YOY % |
|---|---|---|---|---|---|
| Weight | CPI inflation | Mar 2024 | Apr 2024 | May 2024 | May 2024 |
| 100.0 | Total | 0.4 | 0.3 | 0.0 | 3.3 |
| 13.555 | Food | 0.1 | 0.0 | 0.1 | 2.1 |
| 5.388 | Food away from home | 0.3 | 0.3 | 0.4 | 4.0 |
| 6.655 | Energy | 1.1 | 1.1 | -2.0 | 3.7 |
| 79.790 | Ex-food & energy | 0.4 | 0.3 | 0.2 | 3.4 |
| 3.684 | New vehicles | -0.2 | -0.4 | -0.5 | -0.8 |
| 2.012 | Used cars/trucks | -1.1 | -1.4 | 0.6 | -9.3 |
| 2.512 | Clothing | 0.7 | 1.2 | -0.3 | 0.8 |
| 1.489 | Medical care goods | 0.2 | 0.4 | 1.3 | 3.1 |
| 36.191 | Shelter | 0.4 | 0.4 | 0.4 | 5.4 |
| 26.769 | Owner equiv. rent | 0.4 | 0.4 | 0.4 | 5.7 |
| 6.294 | Transportation | 1.5 | 0.9 | -0.5 | 10.5 |
| 6.515 | Medical care services | 0.6 | 0.4 | 0.3 | 3.1 |
| | Special: Where inflation might come back down to | | | | |
| 60.899 | Services ex-energy | 0.5 | 0.4 | 0.2 | 5.3 |
| 18.891 | Commodities (core) | -0.2 | -0.1 | 0.0 | -1.7 |

Net, net, Fed officials have won an important battle against inflation by messaging they would be patient on interest rate cuts, but now it looks like core consumer inflation pressures are slowing dramatically after a first quarter flare-up. It appears that economic growth is slowing in the first half of the year and right on cue, so are price pressures. Expectations ahead are key and food prices that the public looks at most closely have not risen significantly since January, and high-visibility gasoline prices for the public are falling in May and will fall again in June based on weekly reports. The Fed's recession-level rate hikes are working, and as demand and inflation slow, it is time to reduce interest rates marginally. The inflation data are sending the Federal Reserve a message, and it looks like they better keep a couple of interest rate cuts on the table this year because the market sure is. We continue to bet on a rate cut in September. We don't know if the Fed has engineered a soft landing yet, but the economy is slowing and price pressures are sure to follow. Inflation has turned the corner, and the first quarter blow-up is looking like it was an anomaly as inflation is cooling down, not heating up and up and up.



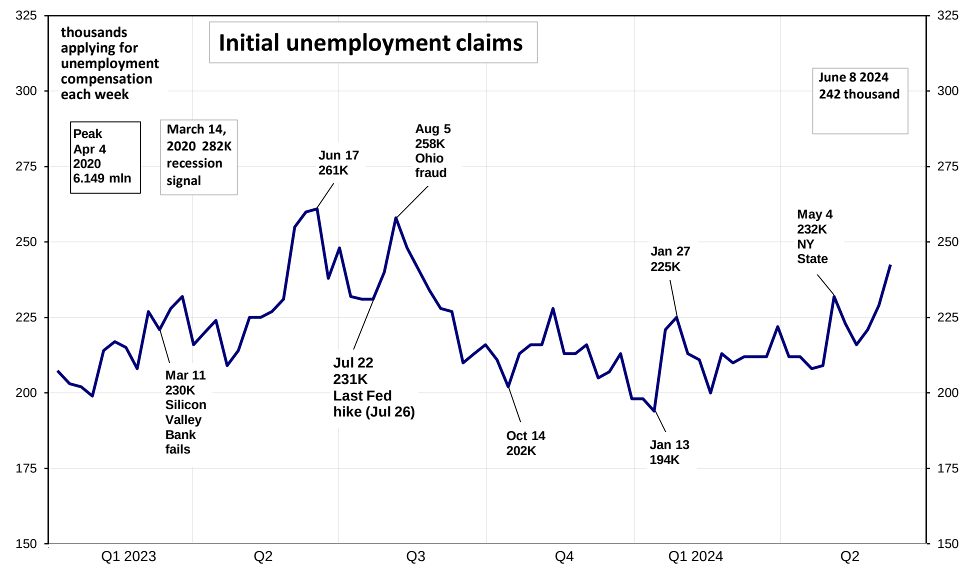
## Job layoffs up, PPI inflation down (Thursday)

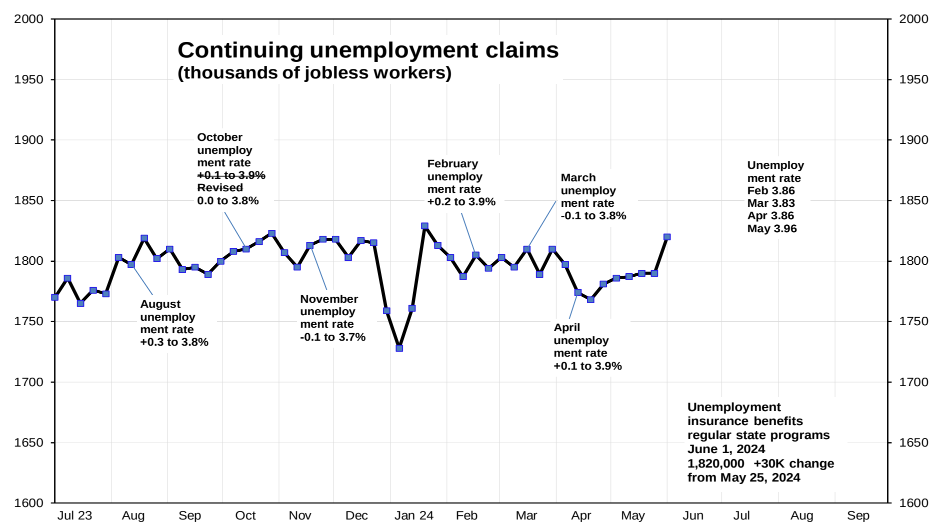
Breaking economy news. PPI inflation fell 0.2% in May following April's 0.5% advance. The number was weaker than expected so bonds rallied. If we look at just Final demand goods prices less foods and energy, the trend looks similar to the elevated readings from the first quarter this year which would be worrisome, but at the moment the year-to-year change is just 1.7%.

| | PPI Final demand goods less foods/energy-- Monthly Percent Changes SA | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Jan** | **Feb** | **Mar** | **Apr** | **May** | **Jun** | **Jul** | **Aug** | **Sep** | **Oct** | **Nov** | **Dec** |
| 2023 | 0.6 | 0.3 | 0.2 | 0.1 | 0.1 | -0.1 | 0.0 | 0.1 | 0.3 | 0.1 | 0.1 | 0.1 |
| 2024 | 0.3 | 0.3 | 0.0 | 0.2 | 0.3 | | | | | | | |
| | PPI Final demand goods less foods/energy-- Year/Year Percent Changes NSA | | | | | | | | | | | |
| | **Jan** | **Feb** | **Mar** | **Apr** | **May** | **Jun** | **Jul** | **Aug** | **Sep** | **Oct** | **Nov** | **Dec** |
| 2023 | 5.6 | 5.1 | 4.3 | 3.3 | 2.7 | 2.0 | 1.9 | 1.8 | 2.1 | 2.1 | 2.0 | 1.9 |
| 2024 | 1.6 | 1.6 | 1.5 | 1.6 | 1.7 | | | | | | | |

Meanwhile, weekly jobless claims were higher than expected, an increase of 13K to 242K in the June 8 week. Looking at the not seasonally adjusted increase of 38,530, California was responsible for 10,311 of the jump. Job layoffs need to be monitored closely as the economy could be starting to slip over the edge.

Net, net, it looks like the Fed's monetary policy restraint has overstayed its welcome as the economic skies grow darker with job layoffs surging and producer prices falling.The better readings on inflation this month look like they are only occurring because economic growth has stalled and the country is in danger of going over the proverbial cliff. Producer prices are inputs to many consumer products so falling factory prices may spell relief for consumers, but it is coming at too high of a cost. Stay tuned. This is exactly what an economy looks like when the country enters a recession and it will be a miracle if we miss one. The Fed missed the inflation outbreak and now it looks increasingly like they misread the risks of recession and soaring job losses.



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