Financial Markets This Week

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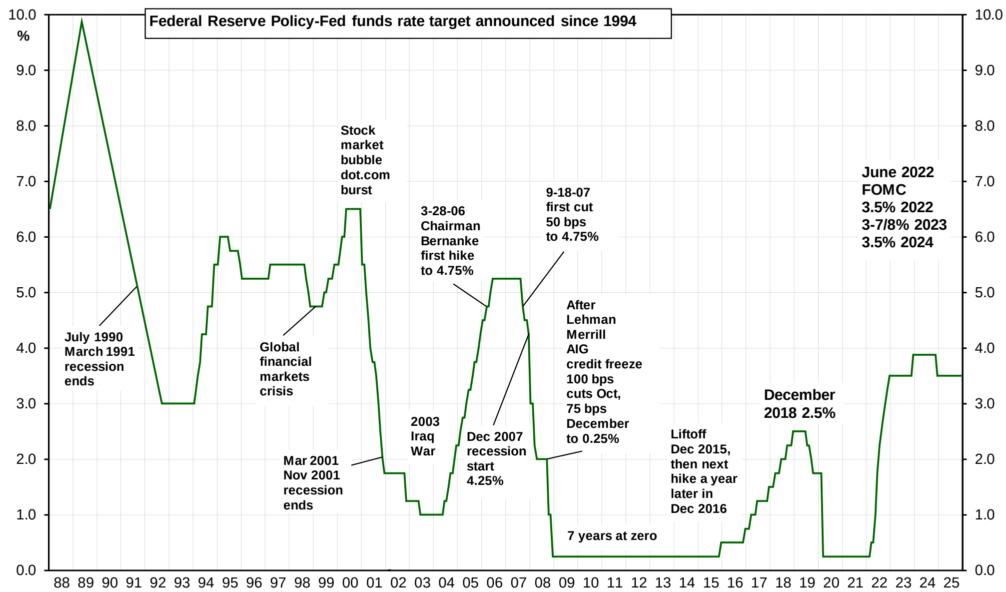
ALL FED FORECASTS SEE 3.25% RATES THIS YEAR

Quite remarkable about Fed officials being all in agreement that rates need to move to at least 3.25% by the December 2022 meeting. Rates were 0.25% at the end of 2021 so that is a 300 bps increase. Economists used to think 200 bps of tightening in a year was enough to bring down the economy's house and slow growth to the point of recession.



Breaking economy news Wednesday. The Fed looks to cut rates in 2024. Hang on, we're a coming. The S&P 500 rose 1.5% Wednesday and fell back 3.3% to a new 2022 low Thursday. Went to www.federalreserve.gov at 2pm ET Wednesday and only got a notice "The service is unavailable" which shows you this was the most hotly anticipated Fed meeting press statement in years. They made history with the first 75 bps rate hike since 1994, which should have been big news, but someone in the building at 20th and C Streets leaked it to the press ahead of time. The Fed is finding it isn't easy to hike their way out of a storm of their own making. It is unclear about how the discussions went at this month's meeting, but Kansas City Fed President George, thought to be a hawk, dissented wanting just a 50 bps hike. It will be interesting to hear her reasons. Perhaps she didn't like how the Fed Chair shared the 75 bps rate hike news Monday afternoon with the press. **She later said on Friday the speed of recent Fed tightening was the issue as monetary policy affects the economy with a lag and if too abrupt, the public, "households and small businesses" can't make the

Memo: Projected appropriate policy path

Fed Meeting	2018	2019	2020	2021	2022	2023	2024	Longer run
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

necessary adjustment. We would tell her she could help the public adjust better if bank deposits paid interest equivalent to the brand, spanking new 1.75% Fed funds rate.

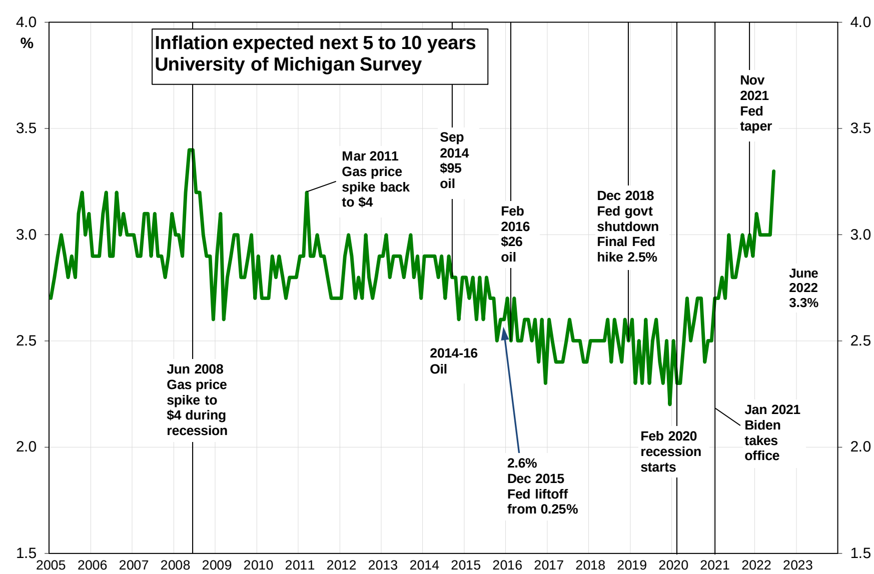
Fed Policy-key variables	2022	2023	2024	Long Term
Fed funds	3.4	3.8	3.4	2.5
PCE inflation	5.2	2.6	2.2	2.0
Core inflation	4.3	2.7	2.3	
Unemployed	3.7	3.9	4.1	4.0
GDP	1.7	1.7	1.9	1.8
June 2022 median Fed forecasts				

The interest rate projections show policymakers are front-loading even more rate hikes all into the current year, so much so, they think they may well need to cut rates in 2024 as the economy slows with inflation under control. A 3.5% Fed funds rate at the end of this year now is projected after just a 2% year-end Fed funds rate forecast at the March 2022 meeting just three months ago. We don't know. Guess it could be three more 50s in July, September, November, with a cherry-on-top finish of 25 bps in December to end 2022 at a 3.5% Fed funds rate. In 2023, they look for two more 25 bps moves more or less to a statistical 3-7/8% and then cutting rates back somewhat in 2024. This monetary policy tightening episode of 325 bps from 0.25% in December 2021 to 3.5% in December 2022 is faster than the 1994-1995 rate hikes from 3 to 6 percent that caused the economy's near-miss recession.

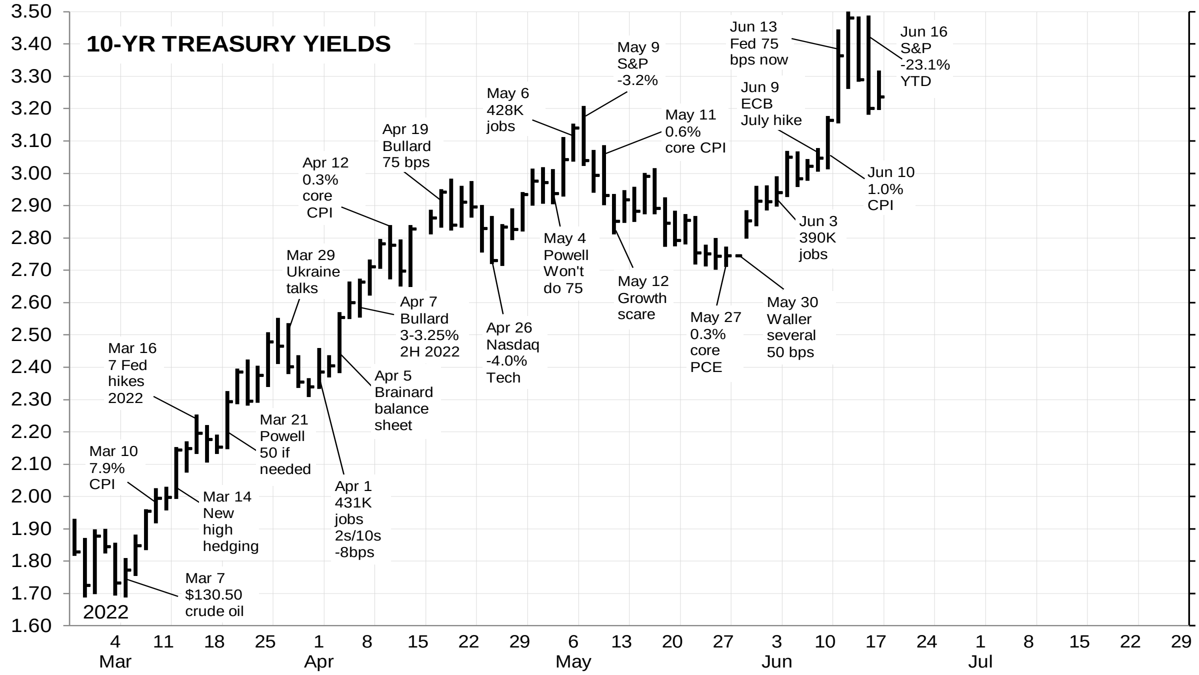
Fed Individual Forecasts				
Fed funds rate at year-end				Longer
Votes	2022 End	2023 End	2024 End	run
1	3.125	2.875	2.125	2.000
2	3.125	3.375	2.250	2.250
3	3.125	3.625	2.875	2.250
4	3.125	3.625	2.875	2.250
5	3.125	3.625	3.125	2.250
6	3.375	3.625	3.125	2.250
7	3.375	3.625	3.375	2.250
8	3.375	3.625	3.375	2.375
9	3.375	3.625	3.375	2.500
10	3.375	3.875	3.375	2.500
11	3.375	3.875	3.375	2.500
12	3.375	3.875	3.375	2.500
13	3.375	3.875	3.375	2.500
14	3.625	4.125	3.375	2.500
15	3.625	4.125	3.625	2.500
16	3.625	4.125	3.625	3.000
17	3.265	4.125	3.875	3.000
18	3.875	4.375	4.125	
Median	3.375	3.750	3.375	2.500
Meeting	Jun 22	Jun 22	Jun 22	Jun 22

In conclusion, the inflation fires looked more out of control to Fed officials, so they tried to shock the market with a bigger 75 bps rate hike and higher forecast of 3.5% on the Fed funds rate at the end of the year. Neutral rates for the economy are 2.5% they say, so the forecasts are for significantly tighter monetary policy for the end of this year. Unfortunately, real short-term rates are still negative with inflation of 8% and will likely be so at the end of the year as well so monetary policy isn't as tight as it could be. How could they ever get the Fed funds rate up to 5 or 6 percent, let alone 8%. Nevertheless, the catch-up move this week for Fed officials, going bigger and higher on rates this year, makes it more likely that the economy will slow sooner than we had thought. We can't be sure whether a 3.5% Fed funds rate will engineer a soft-landing or a hard landing for the economy. But either way, start watching all the leading economic indicators you can get your hands on because the Fed is tightening the screws and this means the outlook will get darker and darker as the year goes on. Bet on it.

P.S. Powell at the press conference said the public's inflation expectations moved up quite a bit in the report at 10am ET Friday, June 10, and this is why he called the WSJ to leak a 75 bps rate hike was coming. This particular question on inflation 5 to 10 years from now has a lot of follow-up "probes" by the questioner trying to make sure they get the right response. It is 3.3% now and was 3.0%.



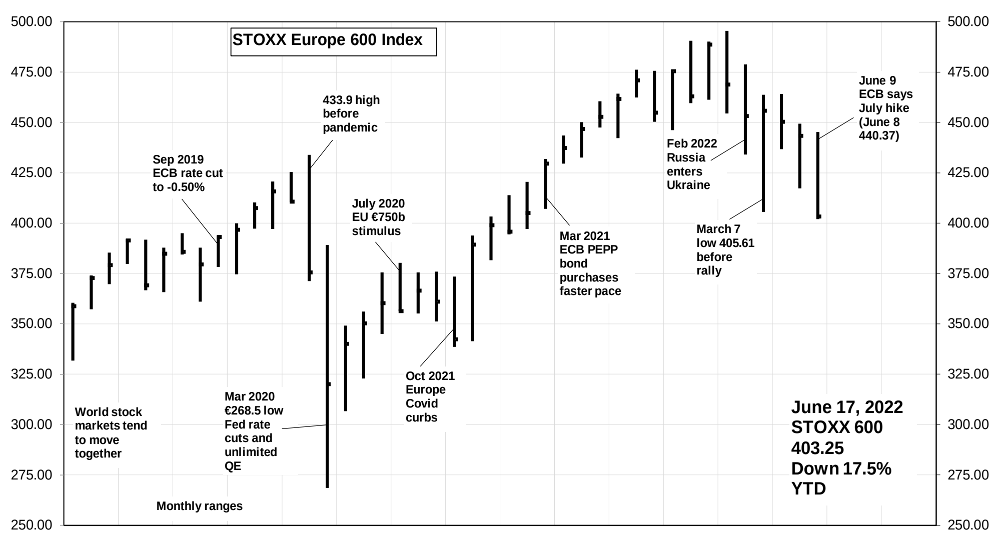
INTEREST RATES



Bonds closed at 3.24% after being as high as 3.50% Tuesday, the day before the Fed meeting. Several wide-range days this week. Yields were already 3.37% Monday before the Fed 75 bps leak and went higher to 3.44% after the news at 3:16pm ET. If Powell was trying to help stocks before the close, the rally lasted for two minutes. Yields came down Thursday on some recession fears perhaps as the Fed stock market rally faded. The [S&P 500 closed down] 23.1% year-to-date Thursday. Powell said the Fed could go 50 or 75 bps at the July 26-27 meeting. It isn't just all about how fast they go, it is also about where they are going. Where should yields trade if the Fed funds rate is 3.5% at the end of the year? 3.5% is the median forecast of all 18 participants. If recession is around the corner and 10-year yields have already matched 2022's 3.5% Fed forecast, maybe that is high enough for now.

Europe STOXX 600 down 17.5% YTD

European stocks were able to rally after falling as low as €405.61 on March 7 after Russia invaded Ukraine in February. Stocks were holding on despite war in Europe and closed €440.37 on June 8 before the ECB meeting. The ECB said Thursday, June 9 it would raise rates at the July meeting. U.S. and Europe stocks move together, but U.S. is still 8.5% above the pre-pandemic high close.



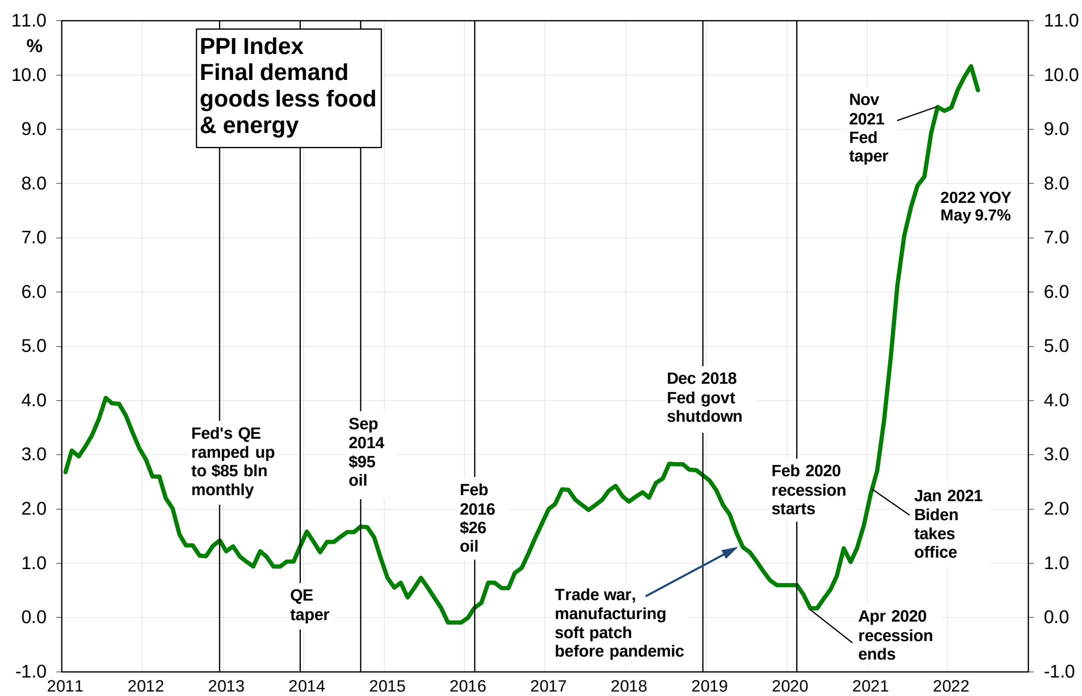
OTHER ECONOMIC NEWS

PPI pressures continue to cost-push inflation on to the consumer (Tuesday)

Breaking economy news. The Producer Price Index for final demand rose 0.8% in May and is 10.8% higher than a year ago. A lot of the PPI inflation doesn't bode well for consumers shopping at the grocery store and the mall as the prices for truck transportation of freight jumped 2.9% in May. At the core level of final demand goods less foods and energy, prices jumped 0.7% in May which is some relief if you call it that from 1.1% increases in March and in April. One thing is certain and that is PPI pressures will continue to cost-push inflation on to the consumer. Bet on it. Peaking inflation is meaningless with factory prices running at double digit rates.

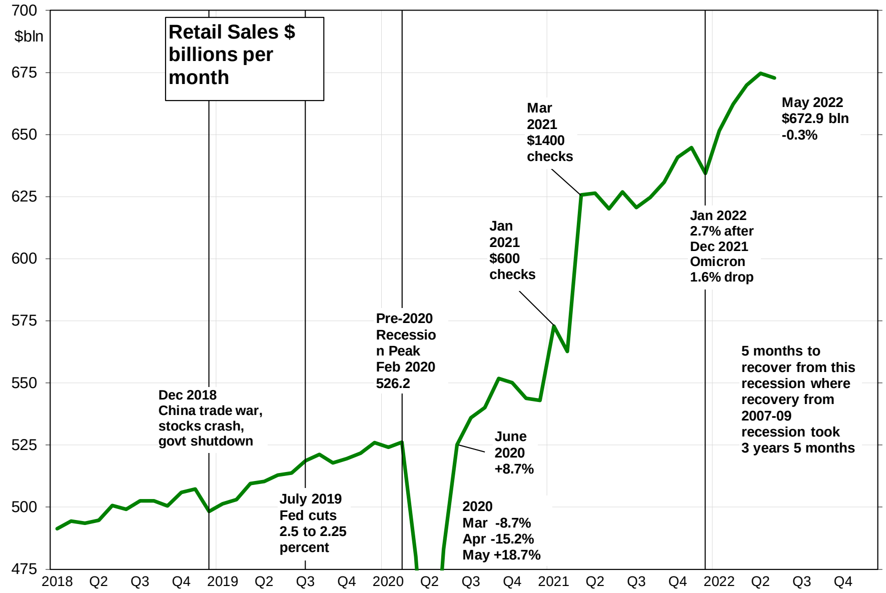
Net, net, producer price increases continue to shoot higher which means even more pipeline pressures for the consumer in the months to come. Transportation and warehousing costs are an astounding 2.9% higher in May meaning the supply chain disruptions will continue to cost-push inflation on to the consumer. There is no relief coming for the consumer in this month's PPI inflation report.

PPI inflation argues for a strong response from Fed officials when they meet today to somehow get out in front of market expectations and tell the public they are winning the inflation fight. A rate hike bigger than 50 bps may be in the offing however the jury is out on whether the market will applaud this move or whether it simply shows the Fed has lost patience and is trying to shut down the economy too quickly by hitting the brakes and sending consumers through the windshield into joblessness. Fed officials let the inflation genie out of the bottle after decades and it is not going back in the bottle any time soon. Whether the central bank can regain the public's trust is an open question after making one of the worst mistakes in the institution's history.



Economy starting to tip, tip, toe over the edge (Wednesday)

Breaking economy news. Retail sales fell in May, and surprisingly nonfuel import prices fell as well. Shocking evidence of a slowdown before the Fed decision today with consumers backing away from purchasing hyperinflated goods and services and even importers are cutting their prices possibly due to weaker domestic demand. The irony is maybe the economy is starting to tip, tip, toe over the edge right before the Fed delivers the biggest rate hike since the 90s.



Nonfuel import prices have fallen 0.3% in May which is the first decline of imported inflation since November 2020. Consumer goods imports prices are falling just like retail sales this month which fits the demand destruction story hand and glove or something like that. This isn't a China story with import prices from China rising 0.1% in May.

Retail sales fell 0.3% in May, the first decline since Omicron hit the consumer in December 2020. The April increase of 0.9% was revised to a gain of 0.7% today, and the March increase of 1.4% was revised to a gain of 1.2%. Consumer spending is slowing in the second quarter, but not enough at the moment to slide the economy over the cliff into recession. Second quarter real GDP should remain in positive territory after the recession-warning 1.5% drop in the first quarter to start the year. Getting a handle on consumer spending is tricky with big swings in motor vehicle sales which fell 3.5% offset by a 4.0% increase in sales at gasoline stations. You know gas stations weren't selling more coffee at Dunkin' Donuts. Retail sales ex-gas and motor vehicles squeaked out a gain of 0.1% down from a 0.8% increase in April.

Retail spending, actual dollars, each month

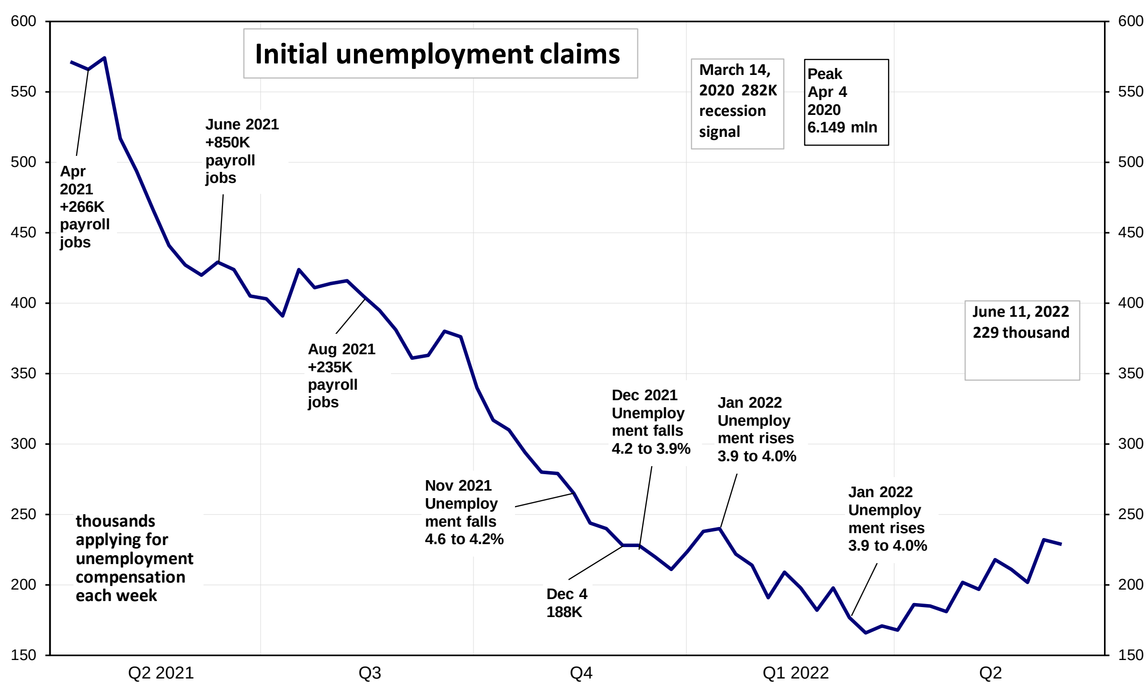
	$million May 2022	% to Total	Percent Changes % May	Apr	Year/year
Total Retail Sales	672,874	100.0	-0.3	0.7	8.1
Motor vehicles/parts	126,246	18.8	-3.5	1.8	-3.7
Furniture/furnishings	12,179	1.8	-0.9	1.6	1.9
Electronics/appliances	7,707	1.1	-1.3	1.8	-4.5
Building materials/garden	42,581	6.3	0.2	-0.2	6.4
Food & beverage	78,170	11.6	1.2	-0.1	7.9
Health/personal care	32,936	4.9	-0.2	0.8	4.8
Gasoline stations	65,982	9.8	4.0	-1.9	43.2
Clothing/accessories	26,320	3.9	0.1	0.5	6.1
Sporting goods, books	9,067	1.3	0.4	0.2	-0.2
General merchandise	68,198	10.1	0.1	-0.5	2.5
Department stores	11,545	1.7	0.9	0.4	0.9
Miscellaneous retailers	15,642	2.3	-1.1	2.1	25.6
Nonstore retailers (internet)	102,865	15.3	-1.0	1.0	7.0
Eating & drinking places	84,981	12.6	0.7	2.5	17.5

Net, net, consumers pulled back on their spending in May as a price shock has curbed their enthusiasm. The weakness was in motor vehicles where new prices in Friday's CPI report were up 12.6% the last year. Maybe retailers have the wrong goods on the shelves, or maybe the Fed's take- the-punch away messaging, "We mean it," is working to slow the economy better than markets had thought. The sudden drop in nonfuel import prices makes us wonder whether the economy has hit an air-pocket and is actually falling, not just slowing. The Fed may deliver the biggest rate hike since the 90s to regain their credibility but the go-big strategy may be the wrong shot at the wrong time if the economy is already starting to slow. Stay tuned. Story developing.

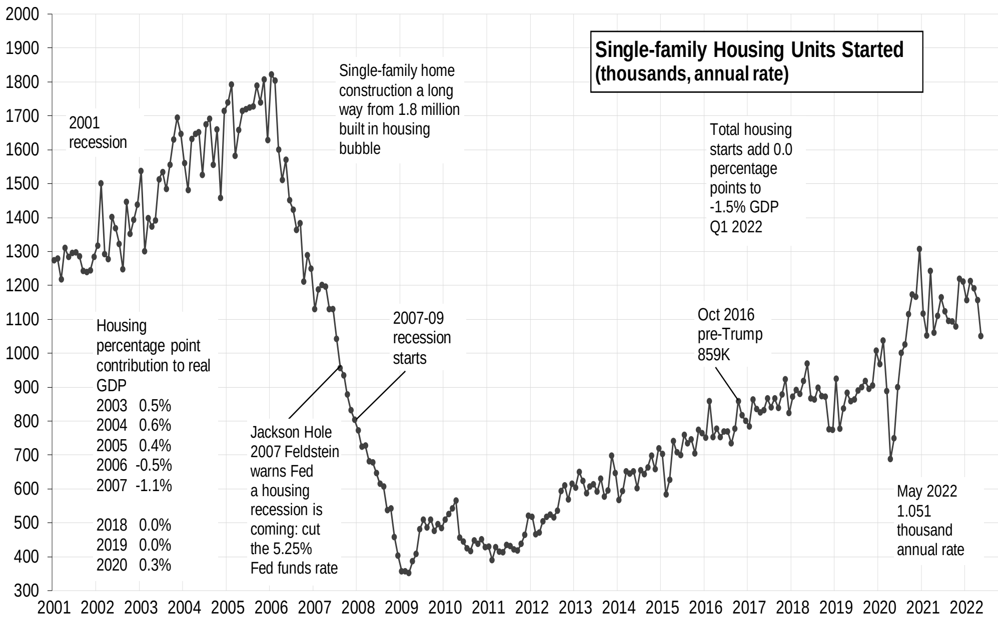
It's starting to look a lot like recession. Jobless claims pointing to recession (Thursday)

Breaking economy news. Jobless claims remained elevated at 229 thousand in the June 11 week after last week's reading was revised to 232 thousand. Layoffs are increasing steadily the last few months which may be just what the doctor ordered when it comes to fighting inflation, but at the same time, this pronounced rise in new filings for unemployment benefits is exactly what we have seen before every recession in modern economic history. The economic outlook is growing darker by the hour and the risk of a hard landing for the U.S. economy has grown exponentially. The Fed's latest 75 bps rate hike and forecast for 3.5% rates at year-end, may be the straw that breaks the economy's back. The Fed is under fire for letting the inflation fire start and now their aggressive and abrupt policy tightening may soon be criticized for letting in the winds of recession.

Net, net, the steady upward climb of job layoffs is just the sort of economic trend we see just before recessions and if the front-loaded, giant-sized interest rate Fed hikes were designed to slow aggregate demand, central bank officials down in Washington may get more than they bargained for. The Fed has lost all credibility by saying they want to bring down inflation and keep the labor market strong. It looks like the latest jobless claims data are showing a deterioration in the labor market which is apparently what Fed officials are banking on. The FOMC forecasts show the unemployment rate rising from 3.6% currently to 4.1% in 2024 which is a recession in all but name. Better hang on to your jobs, because soon there may be no more work available.



Fed wants housing to slow and construction is (Thursday)



Breaking economy news. Housing is starting to buckle and more cutbacks in construction are coming as the Fed tightens the screws which typically hits interest rate sensitive sectors of the economy like housing and auto sales the hardest. Housing starts fell 14.4% in May to 1.549 million at an annual rate. The peak for this recovery from the pandemic was 1.810 million just last month in April. Mortgage rates are high and according to the Fed's forecasts going even higher and this will push the financing costs for the purchase of a new home closer to 7%. Builders are the first to watch interest rates and wake up and smell the coffee. Home buyers will be next to realize the market has suddenly turned which means the housing price bubble is at risk. The Fed wants housing to slow and construction is.

Net, net, residential housing construction, one of the economy's leading indicators that is also the most interest-rate sensitive, is starting to buckle under the weight of higher financing costs being forced up by the Fed's front-loaded rate hikes at a speed not seen in decades. The Fed in the 1990s pushed up rates 300 bps in a year because they didn't know any better. Now they do, and perhaps they don't care where the chips fly. Housing is the canary in the coal mine when it comes to recession forecasting and today's drop in residential housing construction could mean recession is on the way later this year. If recession is coming, it's starting right now, not in 2023 or 2024.

Housing Starts Total, Single-Family, Multi-Family

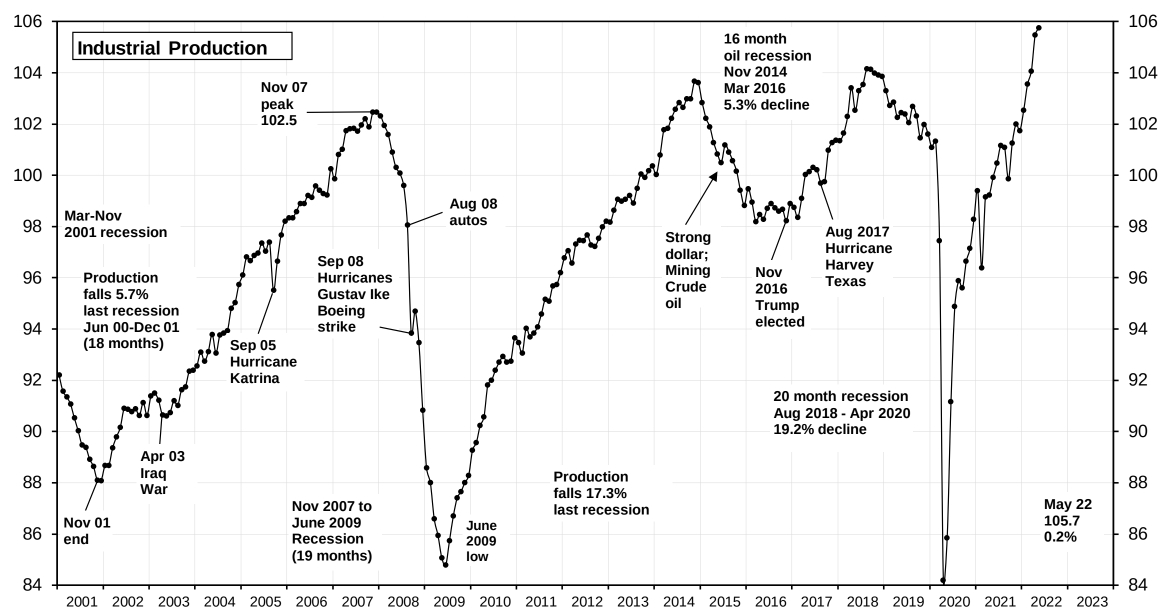
	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
May 2022	1549	1051	469	173	58	217	143	803	596	356	254
Apr 2022	1810	1157	641	151	55	213	152	1013	662	433	288
May 2021	1605	1110	485	137	61	263	164	809	596	396	289
% Chgs											
May/Apr	-14.4	-9.2	…	14.6	5.5	1.9	-5.9	-20.7	-10.0	-17.8	-11.8
May/May	-3.5	-5.3	…	26.3	-4.9	-17.5	-12.8	-0.7	0.0	-10.1	-12.1

Industrial production up today, maybe down tomorrow (Friday)

Breaking economy news. The only recession indicator you will ever need was still going up in May. Industrial production rose 0.2% to a new all-time high, adding to April's 1.4% leap. If you want to believe forward indicators for the economy like the 5.78% new 2022 high for mortgage rates (June 16, 2022 week) or $5.006 gasoline (June 13, 2022 week) mean a recession is here, you could always assume May 2022 is the peak month for the expansion and next month the economy turns down.

Percent changes			Industrial Production May 2022		
Mar	Apr	May	YOY		Weight
0.5	1.4	0.2	5.8	Total Index	100.0
0.8	0.8	-0.1	4.8	Manufacturing	74.5
3.2	1.1	1.3	9.0	Mining	13.7
-4.7	5.5	1.0	8.4	Utilities	11.8
			Manufacturing payroll jobs 12.8 million +500K YOY 9.9% of Private Payroll Jobs		

Yep factories are working overtime even with a shortage of workers. Well, actually they aren't, manufacturing industrial production fell 0.1% in May, it was Mining and Utilities that pushed the whole index higher. So recession forecasters are in luck, maybe May was the first month of the economy's decline. Manufacturing is three-quarters of the industrial production index anyway and generally makes the same recession forecasting moves if that's what they are as the total industrial production index. That is, manufacturing and the total index usually follow closely unless there is a lot of fracking going on in the Mining sector. Stay tuned. Story developing.



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