Financial Markets This Week

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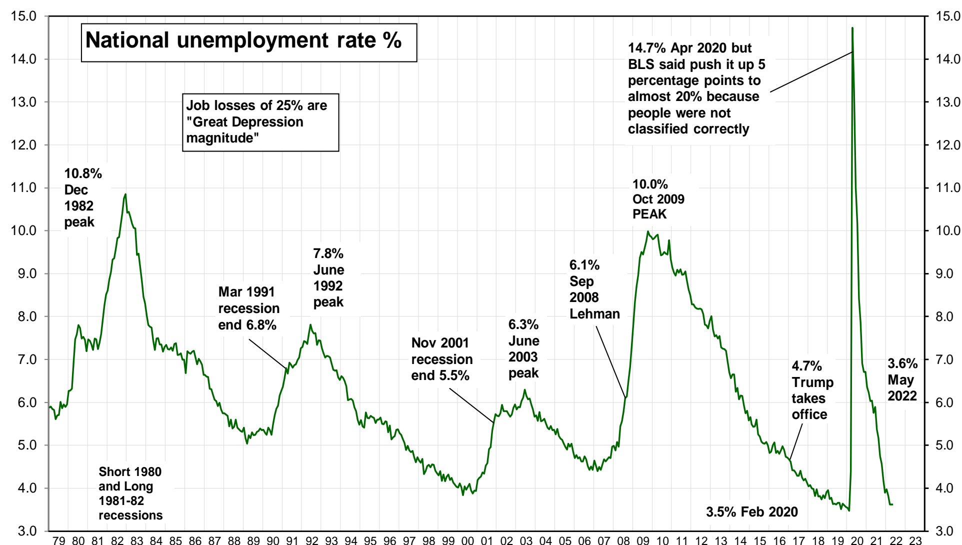
FED SEES RECESSION



The recession forecast is there in the June 2022 FOMC meeting key variables forecast if you know where to look. The unemployment rate is 3.6% today and Fed officials say (see Federal Reserve Policy page 4) it will rise 0.5 percentage points to 4.1% in Q4 2024. 0.5 is a recession. Powell said on Thursday in questioning before the House Financial Services Committee that there's a risk unemployment moves up from an "historically low level." He added, "A labor market with 4.1% or 4.3% unemployment is still a very strong labor market." That's not correct. It's not a very strong labor market, it's a recession. It takes a lot of economic distress to send the unemployment rate up 0.5 percentage points and every time since the 1970s that unemployment rate rose by 0.5, the economy went into cardiac arrest, we mean recession. 0.5 over the cliff. That's it. The economy moves from the best of best times to the worst of times, an economic downturn or recession, extremely fast.

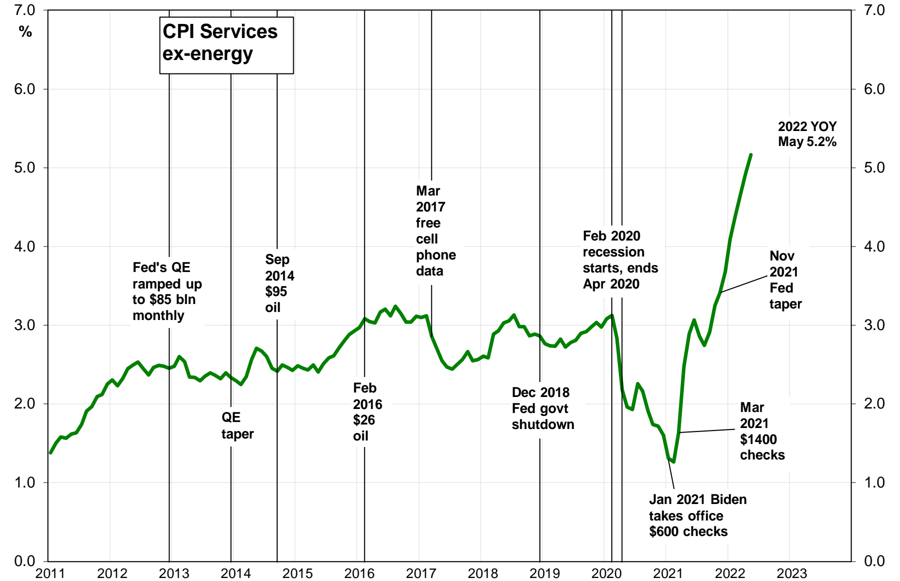
Unemployment Rate rises 0.5 percentage points in a recession

Event	Rising 0.5 pct pts Unemployment Rate Low	High	Economic recession dates	Jobless Peak	Total Jobs Lost
#7	MAY 07	DEC 07	December 2007 - June 2009	OCT 09	8.586mln
	4.4	5.0		10.0	
#6	APR 00	APR 01	March 2001 - November 2001	JUN 03	3.785mln
	3.8	4.4		6.3	
#5	MAR 89	JUL 90	July 1990 - March 1991	JUN 92	3.835mln
	5.0	5.5		7.8	
#4	JAN 86	FEB 86	No recession. Unemployment had just dropped 7.0 Dec 85 to 6.7 in Jan 86. Fed did cut rates.	JUN 86	713K
	6.7	7.2		7.2	
#3	DEC 80	OCT 81	July 1981 - November 1982	DEC 82	4.333mln
	7.2	7.9		10.8	
#2	MAY 79	JAN 80	January 1980 - July 1980	JUL 80	2.523mln
	5.6	6.3		7.8	
#1	OCT 73	JAN 74	November 1973 - March 1975	MAY 75	4.289mln
	4.6	5.1		9.0	

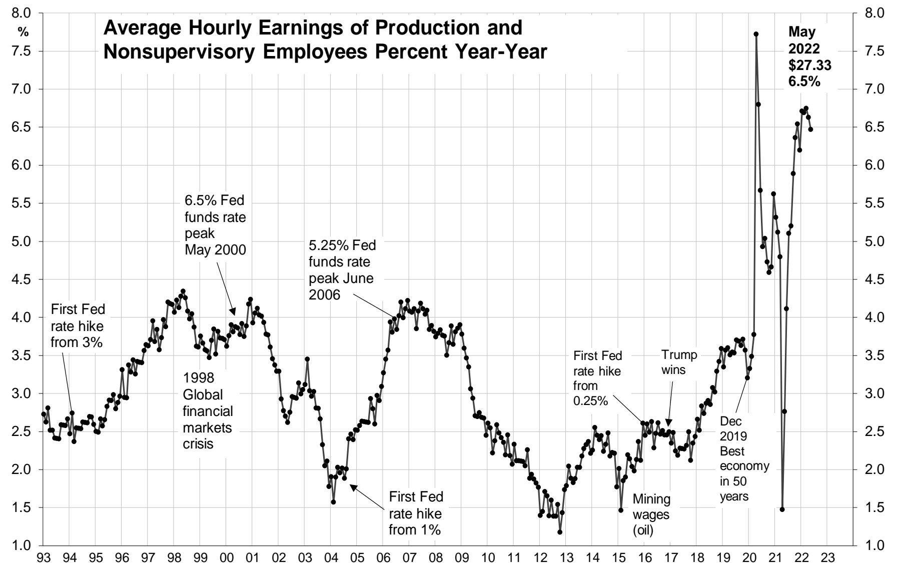
Recessions: http://www.nber.org/cycles.html

In the so-called Great Recession, unemployment was 4.4% in May 2007 and moved to 5.0% in December 2007 which was the sign the economy had gone into recession. The last non-pandemic recession:was December 2007 to June 2009 where joblessness kept rising after hitting the 0.5 threshold, peaking at 10.0% in October 2009 with 8.586 million workers losing their jobs. 0.5 is the trigger for all the recessions since the mid-70s.

Only once was there a false signal in early 1986, but that was due to special factors. It can take a while to get the recession going with the best of times low in the unemployment rate changing over to recession after rising 0.5 percentage points: 7 months before the Great Recession, a one year buildup before the 2001 recession, a year and four months before the 1990-91 recession. But the unemployment rate is very cyclical historically, and the economy tends to run out of steam and become vulnerable if the unemployment rate stops declining showing an improving labor market trend.

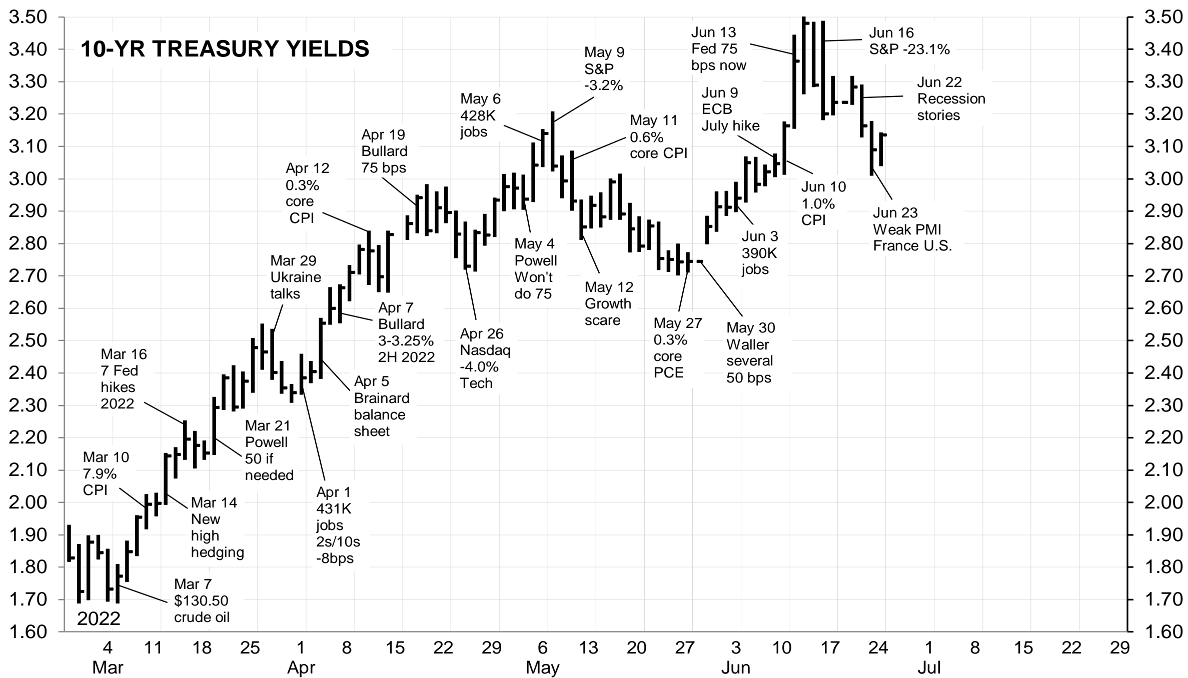


The 1995 soft-landing for the economy after the Fed raised rates 300 bps in one year to 6.0% missed becoming a recession with the unemployment rate rising only 0.3 percentage points from the low. The rate hikes in 1994-95 didn't do much to lower inflation, maybe policymakers thought the monetary policy tightening kept inflation from increasing. One reason for the soft landing where the unemployment rate stopped rising was the Fed backed off and cut rates 25 bps three times. Inflation is higher now and Powell says it's no biggie if unemployment rises 0.5 to 0.7 percentage points, so it doesn't sound at the moment anyway that another policy reversal like in the 1995 soft landing is in the cards.



Still, we could miss a recession. But we could also miss seeing inflation return to the Fed's 2% target any time soon which might be a worse outcome for the country. Commodity prices could fall if economic demand weakens. Energy prices could fall like they often do and bring headline inflation down below core inflation… until commodity prices bottom out—then headline inflation returns to the core inflation level. But then what brings down core inflation that subtracts food and energy? Time, a long time brings it down. We are afraid now the inflation genie is out, wage increases and services inflation will keep inflation from returning to 2% for a long while. Wage increases could stop feeding inflation eventually, but workers ask for a raise in salary each year based on inflation the year before so this will take some time to wind down. Services companies could stop passing on the higher cost of energy at some point, but energy prices have to fall first. Once inflation psychology takes hold, it can be a long time before it gets wrung out of the system. Like a decade or more was how long it took after the double-digit inflation of the early 80s.

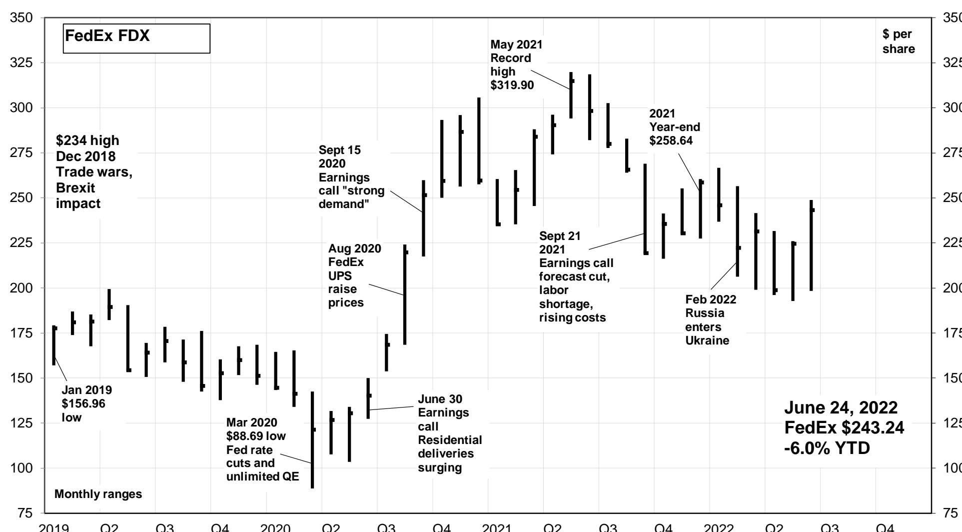
INTEREST RATES



Economic weakness and recession stories drove bond yields lower even if the stock market recovered. The purchasing manager indexes (PMI) of business sentiment were weaker on Thursday with France reported at 3:15am ET and the U.S. PMI reported at 9:45am ET. A lot of the decline in U.S. bond yields is following European bond yields that dropped before New York opened. Stocks rebounded but the S&P 500 closed down 17.9% year-to-date on Friday. Markets reacted Friday 10am ET to long-term inflation expectations from the University of Michigan survey of consumers (why would the public know what inflation will average over the period 5 to 10 years from now). Powell said the 3.3% reading versus 3.0% the month before was one reason for going 75 bps, and Friday it was revised down to 3.1% from 3.3%. Stocks were up Friday 1.5% before Michigan and +3.1% at close.

FedEx Corporation (FDX) $243.24, down 6.0% YTD

The FedEx earnings announcement beat expectations and the stock jumped 7.2% Friday. Earlier in a month of changes, the stock jumped 14.4% on June 14 on the news of adding two directors and boosting its dividend over 50% in an agreement with a hedge fund. The company boosted its earnings guidance for next year assuming “no additional adverse geopolitical developments.”



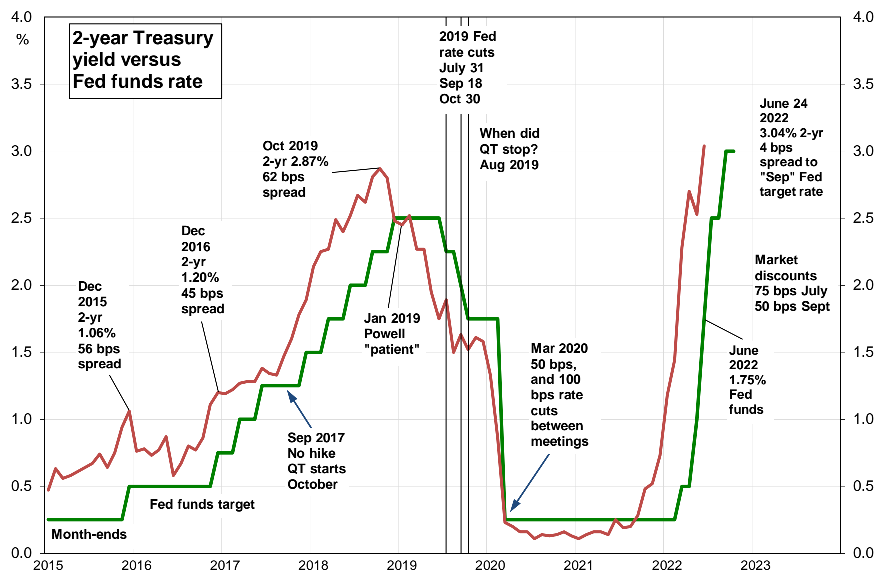
FEDERAL RESERVE POLICY

The Fed meets on July 26-27, 2022 to consider its monetary policy. Powell said at the press conference on June 15 they could move 50 or 75 bps. A 75 bps rate hike would put the Fed funds rate at 2.5% neutral. Fed funds futures say 75 bps on July 27 to 2.5% and another 50 bps to 3.0% on September 21. Looks like one [Fed governor, Bowman](), a quiet one normally, has gone off the reservation and is saying 75 bps July, and at least 50 bps in September, November, and December if the data supports it. That would be 4% at year end. The June meeting forecasts show four participants saying 3.75% at year-end and one is the loneliest number, we guess Bowman, saying 4.0%.

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				

We hardly know what to say. The criticism of Powell is intensifying, but it's too late and the animals have already left the barn. Economics isn't a science and experiments on the American economy can't be repeated, but a first rate hike in 2021 would have been better. Economic theory says normal 2.5% rates when unemployment gets back to 3.5% normal; Powell did not want to lift off the first time until 3.5% unemployment. St. Louis Fed President Bullard said this week they did about an extra year of QE that was unnecessary. Nice to be Chair with someone like Bullard on your board. But they are all colleagues.

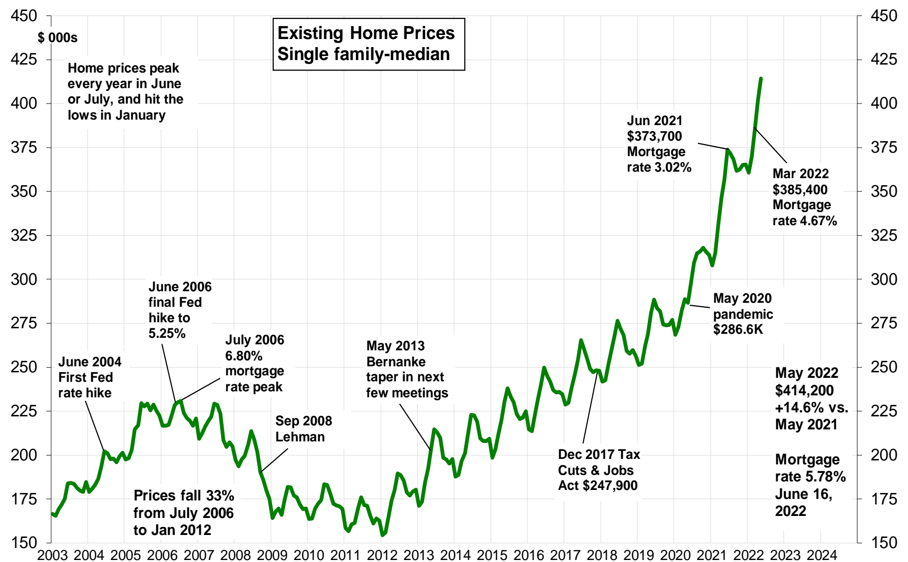
It's a puzzle why the 2-year Treasury yield was 3.04% on Friday against the 3.0% Fed funds rate the market discounts by the September meeting. The 2-year note yield high for 2022 was 3.45% on June 14. A 2-year note will be a one-year maturity this time in 2023 and the Fed says the Fed funds rate will be 3.5% by the end of 2022 so 2-year note yields should be higher. There was a lot of talk about rising recession odds this week which means perhaps the market doesn't believe the Fed will get rates up to, well, won't get rates up to 3.5% by December this year or at least will have to quickly reverse the rate hikes with rate cuts. Leaning on the 1995 near-recession miss again and again and again, the last rate hike to 6.0% was February 1, 1995 and the first 25 bps rate cut to 5.75% was July 6, 1995.



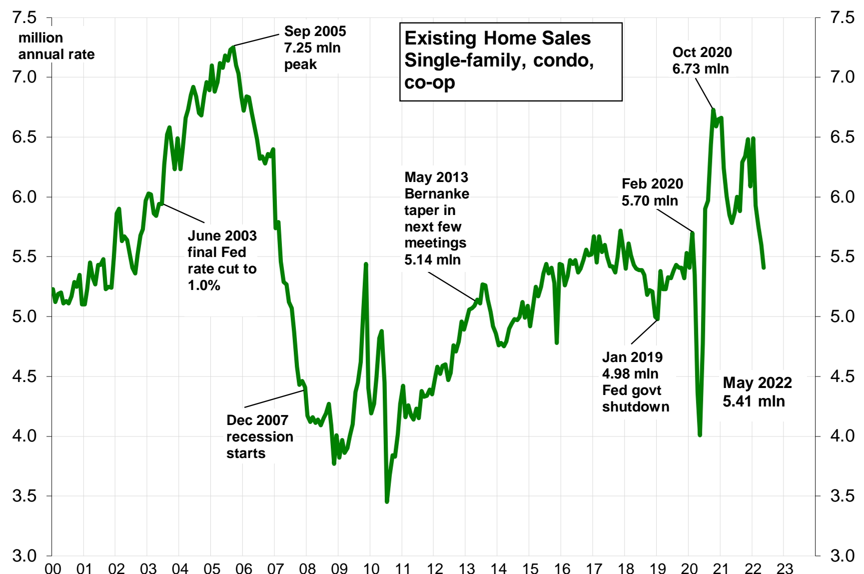
OTHER ECONOMIC NEWS

Housing market bending not breaking (Tuesday)

Breaking economy news. Existing home sales fell 3.4% in May to 5.41 million at an annual rate. Realtors have reported home buyers have stepped back in May, but historically, the drop off is not all that much yet, despite the Fed's ferocious messaging on rates. Existing home sales were 4.98 million in December 2018 with the Fed pushing rates to 2.5%, the financial market turbulence and Federal government shutdown. Home sales activity at 5.41 million is still elevated from back then even with some similarities for the period with the S&P 500 loss as much as 20.2% and mortgage rates just over 4.9% at the peak. Stocks are down in the dumps today again, but mortgage rates were 5.78% last week and yet existing home sales are still resilient. Recession level existing home sales turnover is more like 4 to 4.5 million at an annual rate and the economy ain't there yet.



Housing bubble? All the King's horses and all the King's men haven't done enough to stop the housing bubble from inflating. The higher it goes, the greater the danger if the bubble pops. Home prices set another record high in May at $414,200, up 14.6% the last year. The year-year change in median prices of existing single-family homes: South +20%, West +13.4%, Midwest +9.6%, and Northeast +5.8%.



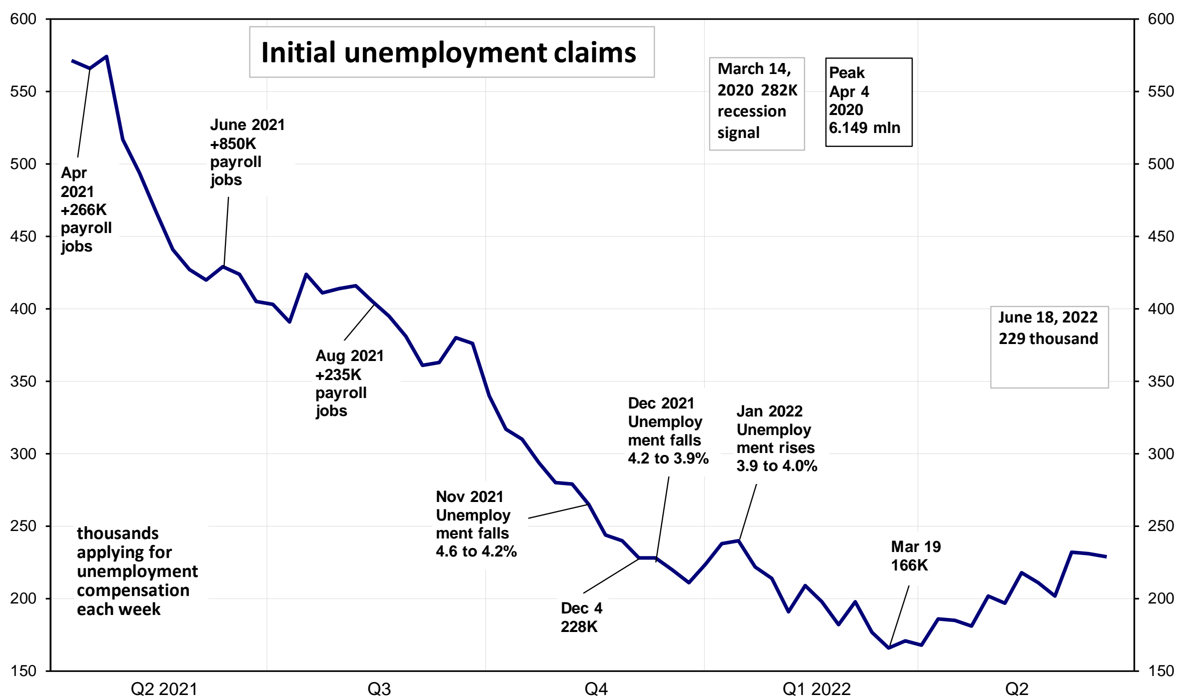
Net, net, the Fed isn't trying hard enough as it looks today like the housing market is bending not breaking. Fed officials are trying to slow the economy with front-loaded rate hikes, but the housing market remains amazingly resilient. The Fed knew there was a housing bubble in 2005 and that's why it started pushing interest rates eventually to the 5.25% peak in the summer of 2006. In the summer of 2022, the Fed funds rate is 1.75% currently even if Powell is saying another 50 or 75 bps hike is on the table in July. Single-family existing home prices are up 14.4% the last year and the rise since the pandemic certainly fits the description of a bubble. Just look at it. Just a thought. The Fed's anti-inflation strategy isn't going to push rates up until home prices crack are they? Stay tuned. Story developing. Policymakers say no recession, but everything else is on the table. It looks like the Fed is coming for your wages and your jobs and the value of your homes. All so you can afford to put gas in your tank. Bet on it.

Job layoffs elevated for three weeks now (Thursday)

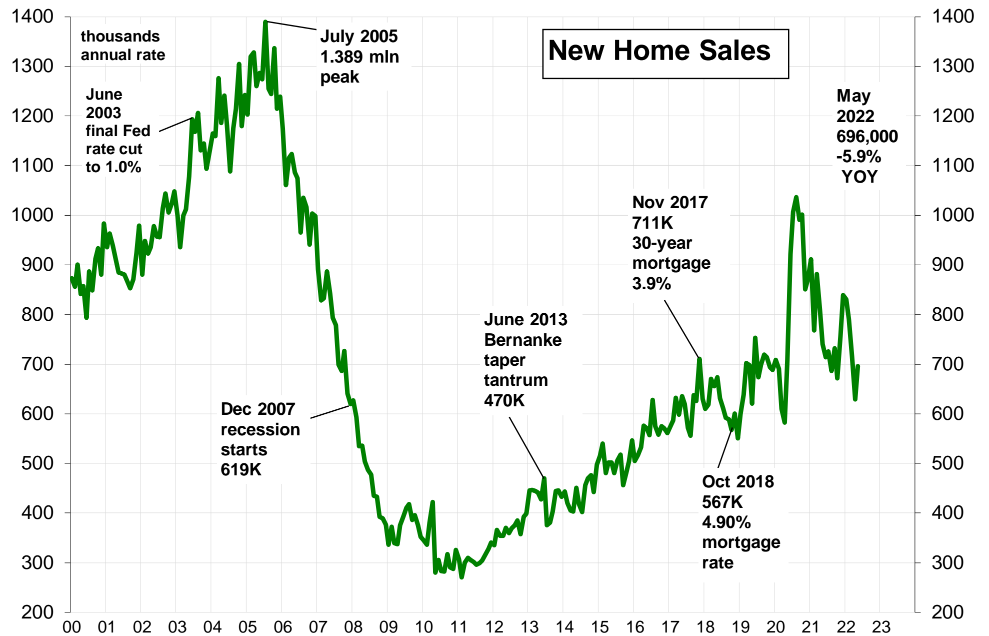
Breaking economy news. The big bond market rally this week sees recession in the cards later this year, but company layoffs cannot quite confirm that a downturn is imminent. Everything screams that recession is likely from $5 gasoline to almost 6% mortgage rates, but the heart of every recession is sharply higher unemployment and the data cannot make the call yet that we are doomed.

Initial unemployment claims were 229K in the June 18 week, down slightly from 231K for June 11 and 232K for June 4. The jobless rolls totaled 1.315 million for the June 11 week and may have bottomed for this cycle a few weeks ago signaling the labor market's best days are behind it. The economy isn't out of the woods yet, not by a long shot.

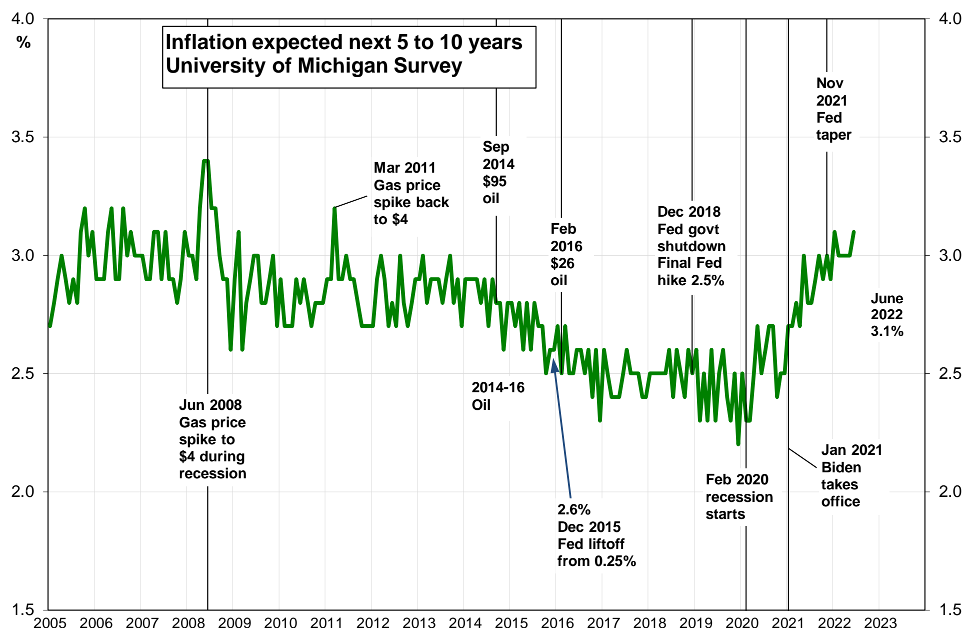
Net, net, the labor market remains in a state of suspended animation waiting on CEOs to shift from talking about the need to be selective about new hiring to moving the economy over the edge by handing out pink slips and letting employees go. The Fed Chair is feeling the heat from both sides of the aisle in Congress, one wanting him to rein in inflation with higher interest rates, the other warning the Fed's tools will only bring job losses and make people poor. But so far the weekly unemployment claims data are just hinting the economy is nearing the recession cliff, and cannot confirm the country is in recession at this time. Jobless claims hit their low this year at 166 thousand in the March 19 week, and the recession alarm would not sound until claims rose closer to 250 thousand. Stay tuned. Story developing. Recession is close, but no cigar. Companies are issuing warnings and pulling job offerings left and right, but it is not clear cut whether enough workers have lost their jobs to make a recession call.



More new homes sold, less inflation expected (Friday)



Breaking economy news. New home sales and the University of Michigan survey of consumers. New home sales were weak at a 591 thousand annual rate in last month's report for April, but now April was revised to 629 thousand and new home sales jumped 10.7% higher in May to 696 thousand at an annual rate. Mortgage rates are making it more costly to buy a new home, but sales activity has steadied and looks less to be in freefall. The new home sales data are notoriously volatile with big revisions, and this month looks to be another unstable reading with sales in the Northeast tumbling 51.1% if that is possible and new home sales in the West jumping 39.3%. As far as the housing price bubble, it is still inflating even if the median sales price is down slightly to $449,000 in May from $454,700 in April. The median sales price was $336,900 in 2020, $397,100 in 2021 and now $449,000 in the month of May 2022. There was home price inflation even before inflation-inflation, and another clue that central bankers missed as they kept on going with their QE purchases longer than they should have. Sorry.



The Michigan survey didn't reveal much in terms of confidence that was already at a record low of 50.2 in the preliminary reading for June and now today the consumer sentiment index is 50.0 in the June final data. What is noteworthy is the public sees inflation averaging 3.1% five to ten years from now, where the public expectations in the preliminary June report was 3.3% which Powell cited as a reason for a go-big 75 bps rate hike on June 15. Guess it worked.

Net, net, the economy isn't in freefall after the new home sales bounce in May and the inflation fire isn't expected to worsen as much down the road after the Michigan survey of consumers. Fed officials will breathe a sigh of relief as Fed Chair Powell has said the jump in long-term inflation expectations was one major reason for policymakers shifting gears and going with a last minute supersized 75 bps rate hike at the June meeting. There is nothing in today's data to change market expectations for another 75 bps rate hike to 2.5% in July and a 50 bps rate hike to 3.0% in September. The only mystery is what the Fed thinks of what the market is thinking because the latest Fed forecasts looked for a 3.5% Fed funds rate by the end of the year with normal 25 bps rate hikes we guess at the final November and December meetings for 2022. The Fed's rate hikes are so front-loaded that it is little wonder why market whispers of recession have changed to outright fear that a downturn in the economy is imminent. Stay tuned. Story developing.

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