

Financial Markets This Week

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NORMAL INTEREST RATES

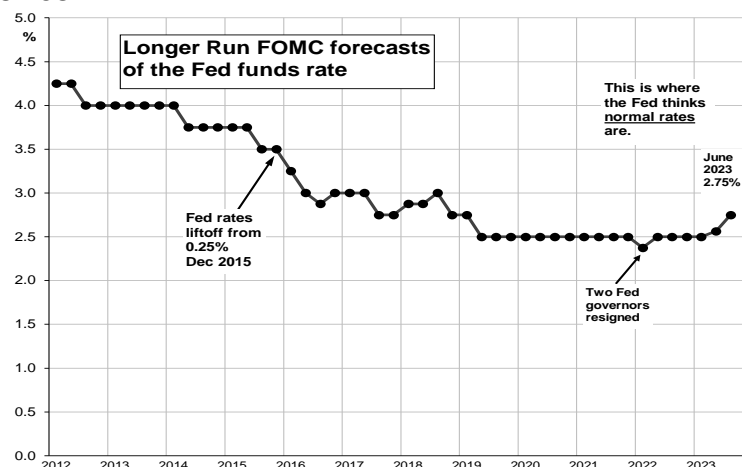
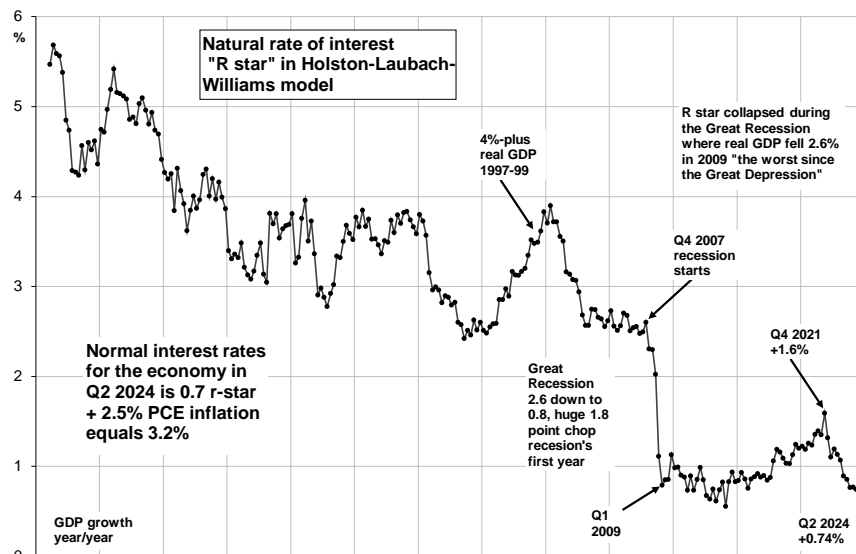
Powell at Jackson Hole said the time has come for a change in interest rates which have been sitting at what we used to think were restrictive levels of 5.5% since July 2023. The economy is still growing, but rate cuts are coming, so how low does the Fed funds rate go? Does anyone remember the 80s concept of the risk-free level of interest rates? Doesn't matter if you don't, but it seems like the economy needs at least a 3% risk-free

(somewhere safe to park money in a financial markets storm) rate to ensure its continued sailing on to destinations with calm waters and sunny skies.

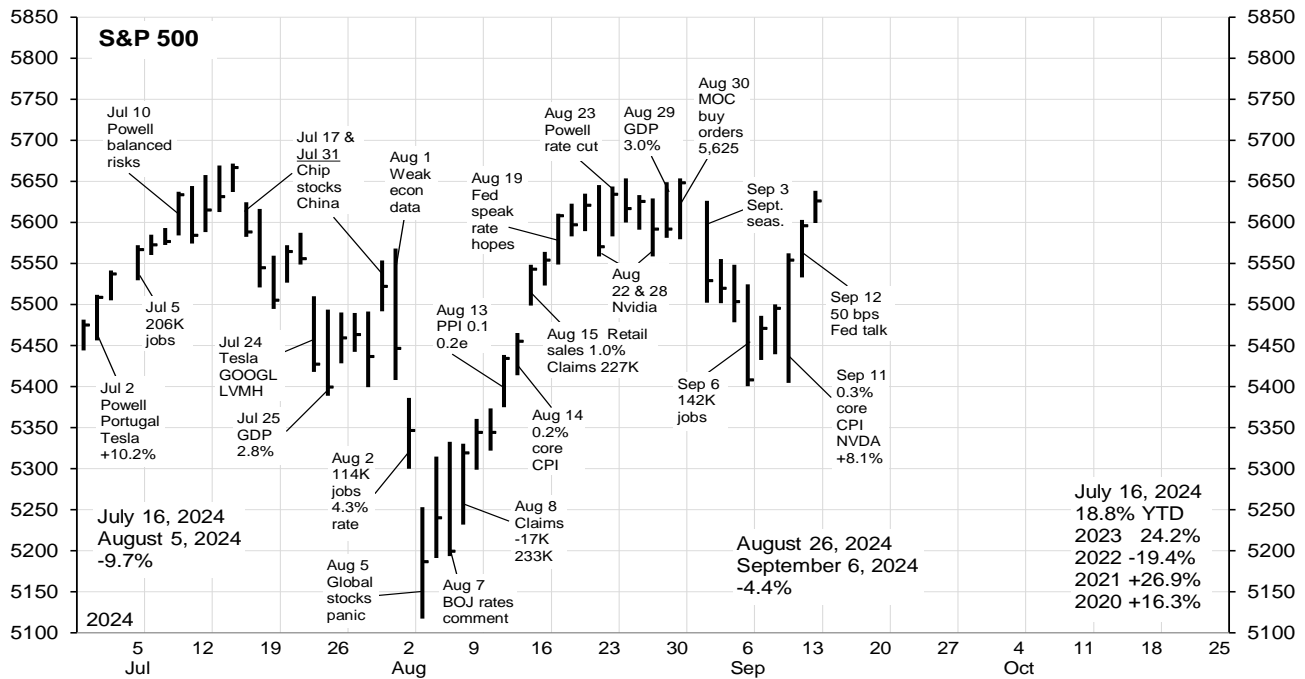
The neutral rate for the economy that does not slow economic growth or speed it up was 2.75% according to the FOMC and that will be updated at next week's meeting. [New York Fed President Williams](#) has done a lot of work on the natural rate of interest which when added to the latest PCE inflation reading of 2.5% year-on-year in July gives you a neutral rate of 3.2%. We will take this as a place for policymakers to stop their rate cuts at, and then stand down. They have moved rates up

and down repeatedly and perhaps have broken the only real tool they have, even if rates were never guiding the economy with much precision. This natural rate has made some odd movements over time. It certainly picks up when the economy is strong like in 1997 to 1999 when real GDP averaged over 4.5% those three years. The R-star complete collapse in the Great Recession makes it look like the economy could not withstand higher interest rates, and we are not sure that was the case.

The Fed itself has changed its thinking on where neutral rates lie as their first forecasts in January 2012 started by Bernanke said a 4.25% Fed funds rate would neither slow growth nor push it forward at breakneck speed. We would be fine if they brought rates down to 4.25% and let it sit there, but policymakers probably have their own ideas. Stay tuned. Fed meeting dead ahead.



INTEREST RATES

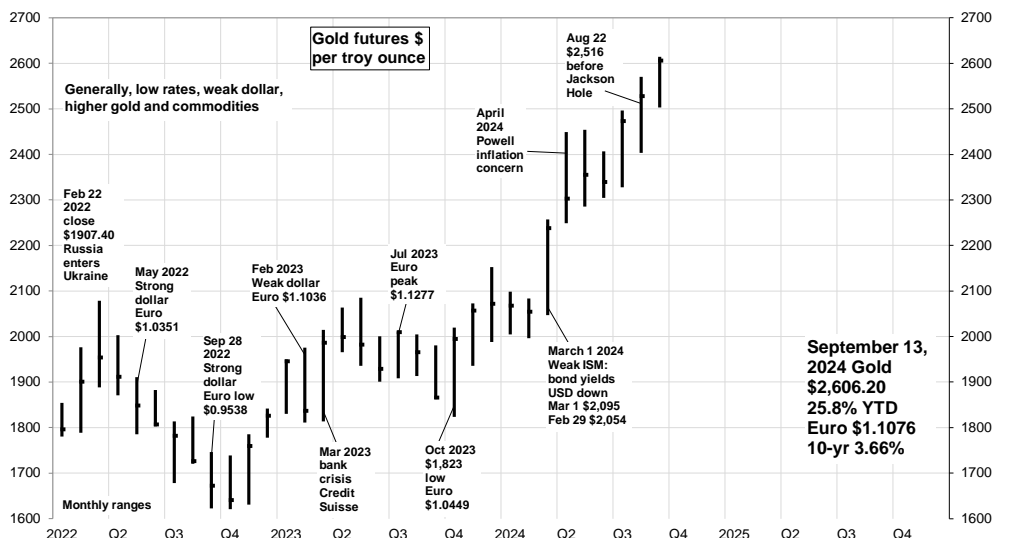


Turns out you didn't need to know why stocks fell last week, the seasonal September selling notwithstanding because stocks rallied back. Almost seems like the market wants a 50 bps rate cut whether the result of hard-landing economic data, like last Friday's payroll jobs number was not, or whether it is 50 bps for risk management, just for the heckuva it, bank regulator reasons. The rally started on Wednesday after 0.3% core CPI where 0.2% was expected, but AI said the higher inflation story did not matter. A gossipy newspaper story Thursday that a 50 bps rate cut was still possible seemed to help equities. The adjusted yield on October Fed funds futures on Friday was 5.14% which means it is a coin toss on whether they go 50 or 25 bps: the 25 bps bets will win 11 bps, and the 50 bps bets will win 14 bps. 10-yr yields closed 3.66%, waiting for Fed rates forecast for 2024-2025.

Gold futures up 25.8% YTD; S&P 500 up 18.0% YTD

Gold futures were last down at \$2,300 after the surprise, big jobs report of 272K on June 7. It has not been straight up, but futures crossed \$2,600 today after moving to a new 2024 high Thursday on PPI, jobless claims news; little reaction to 0.3% core CPI on Wednesday. Sky's the limit with Fed rate cuts on the way. \$2,606.20 Friday last trade.

S&P 500 Weights	
Top 6: 29% of S&P	
6.83	AAPL
6.75	MSFT
6.24	NVIDIA
3.64	AMZN
1.93	GOOGL
1.62	GOOG
2.45	Meta



FEDERAL RESERVE POLICY

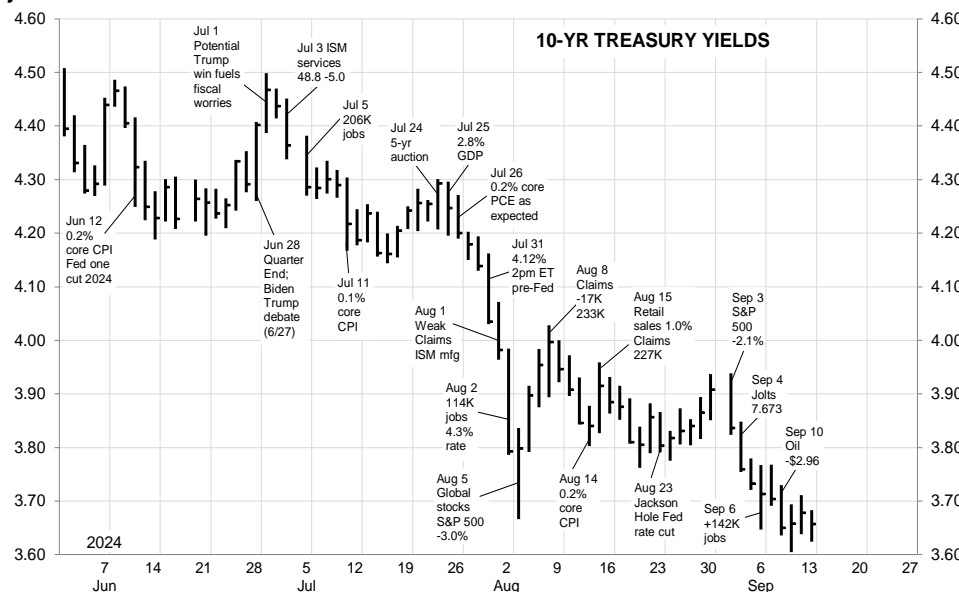
The Fed meets September 17-18, 2024 to consider its monetary policy. Stories Thursday afternoon citing Fed officials on the need for a first rate cut of 50 bps rather than 25 bps next week have moved the market-based odds closer to 50/50 between the two choices. The last two times they cut interest rates for the first time from the peak, before the last two recessions, they went 50 bps. These were emergency rate cuts from 6.5% in 2000 and 5.25% in 2007 as they were announced between regularly scheduled FOMC meetings. We don't see the need for 50 bps, there is no emergency, and it would immediately lead to the question of whether they are going to go every meeting at a breakneck 50 bps pace. We know Powell was surprised and not in a good way by unemployment rising 0.2 percentage points to a new high of 4.3% two days after his July 31 meeting press conference, but we hope he does not feel like Fed officials are behind the curve and need to unwind their monetary restraint more quickly. Real consumer spending in GDP is running 3.0% in the third quarter and about a million miles away from recession. The other issue is those first 50 bps rate cuts in 2000 and 2007 were in a different era when the Fed did not provide forward guidance on rates with forecasts made to the public every quarter. Markets should have a good idea about where monetary policy is heading with the latest Fed forecasts saying 100 bps of rate cuts next year and another 100 bps of cuts in 2026. Going faster than 100 bps seems unwise with the outlook uncertain and latest economic reports not hinting a recession is just around the corner.

Selected Fed assets and liabilities						Change from 3/11/20 to Sep 11
Fed H.4.1 statistical release billions, Wednesday data	11-Sep	4-Sep	28-Aug	21-Aug	3/11/20*	
Factors adding reserves						
U.S. Treasury securities	4389.017	4388.817	4398.721	4398.736	2523.031	1865.986
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2299.798	2299.798	2299.798	2314.079	1371.846	927.952
Repurchase agreements	0.009	0.000	0.000	0.001	242.375	-242.366
Primary credit (Discount Window)	1.568	1.517	1.679	2.061	0.011	1.557
Bank Term Funding Program	97.667	98.335	98.872	99.488		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	2.459	2.497	2.524	2.566		
Main Street Lending Program	10.674	10.663	10.647	10.635		
Municipal Liquidity Facility	0.000	0.000	0.000	0.000		
Term Asset-Backed Facility (TALF II)	0.000	0.000	0.000	0.000		
Central bank liquidity swaps	0.137	0.137	0.145	0.151	0.058	0.079
Federal Reserve Total Assets	7166.2	7163.2	7174.2	7191.1	4360.0	2806.177
3-month Libor %	5.32	5.35	5.35	5.31	1.15	4.170
SOFR %						
Factors draining reserves						
Currency in circulation	2353.156	2356.084	2350.572	2347.140	1818.957	534.199
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	725.577	771.047	757.077	734.727	372.337	353.240
Treasury credit facilities contribution	4.958	4.958	4.958	4.958		
Reverse repurchases w/others	279.215	337.312	388.890	321.329	1.325	277.890
Federal Reserve Liabilities	3806.461	3898.603	3929.217	3832.031	2580.036	1226.425
Reserve Balances (Net Liquidity)	3359.741	3264.604	3244.959	3359.078	1779.990	1579.751
Treasuries within 15 days	11.920	12.163	41.339	50.292	21.427	-9.507
Treasuries 16 to 90 days	240.015	240.316	211.970	202.574	221.961	18.054
Treasuries 91 days to 1 year	537.050	536.489	535.637	536.076	378.403	158.647
Treasuries over 1-yr to 5 years	1482.818	1482.687	1492.601	1492.585	915.101	567.717
Treasuries over 5-yr to 10 years	590.261	590.245	591.554	591.550	327.906	262.355
Treasuries over 10-years	1526.953	1526.917	1525.619	1525.659	658.232	868.721
Note: QT starts June 1, 2022	Change	9/11/2024	6/1/2022			
U.S. Treasury securities	-1381.762	4389.017	5770.779			
Mortgage-backed securities (MBS)	-407.648	2299.798	2707.446			

**March 11, 2020 start of coronavirus lockdown of country

Fed Policy-key variables				Long Term
	2024	2025	2026	
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



October Fed funds futures say 14 bps to go before a 50 bps rate cut is discounted on September 18. Last week they said 17.5 bps. Less change in odds despite Fed 50 bps chatter.

Fed funds futures call Fed policy	
Current target: September 13 -- 5.50%	
Rate+0.17 Contract	Fed decision dates
5.140 Oct 2024	Sep 18
4.330 Jan 2025	Add Nov 7, Dec 18*
Last trade, not settlement price	
* Not strictly true, Jan 2025 has Jan 29 Fed date, so 2 days could be a new interest rate	

Next up: August PCE inflation report Friday, September 27															
Monthly	2024												2023		
% Changes	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun
Core CPI inflation	0.3	0.2	0.1	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.2	0.3	0.2	0.2	0.2
Core PCE inflation	0.2e	0.2	0.2	0.1	0.3	0.3	0.3	0.5	0.2	0.1	0.1	0.3	0.1	0.1	0.2
Core PCE YOY	2.8e	2.6	2.6	2.6	2.8	2.8	2.8	2.9	2.9	3.2	3.4	3.6	3.7	4.2	4.3
Core CPI YOY	3.2	3.2	3.3	3.4	3.6	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.3	4.7	4.8

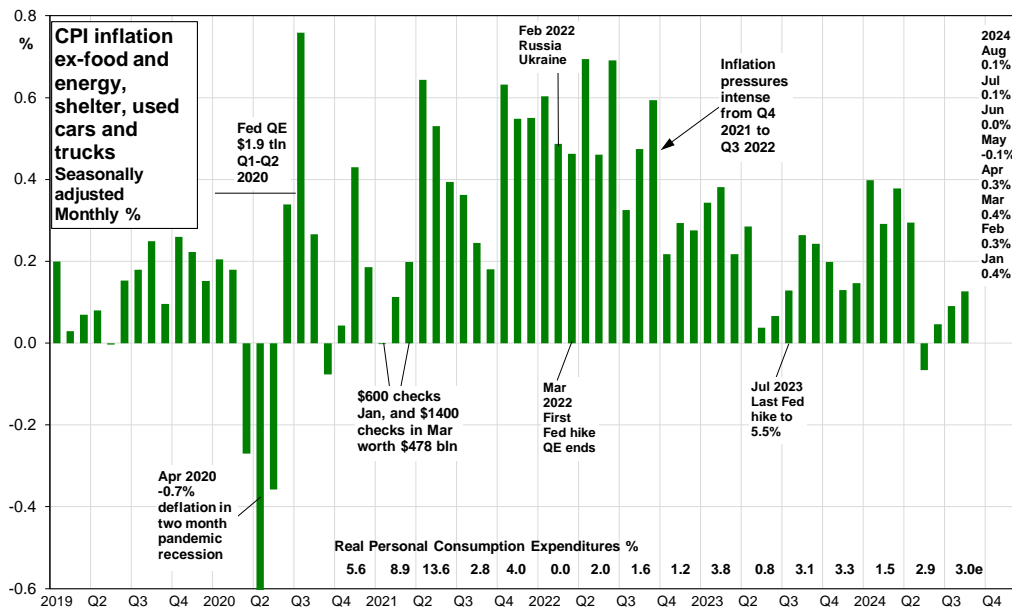
OTHER ECONOMIC NEWS

CPI inflation embers not out (Wednesday)

Breaking economy news. CPI inflation was worse than the 0.2% expectation for core consumer prices. 0.281% in August after tamer readings the prior three months of 0.165% in July, 0.065% in June, and 0.163% in May. Airline fares, car insurance, clothing prices all contributed, and shelter prices picked up surprisingly to 0.5% for the month.

Net, net, the inflation fire is not out yet, there are a few embers burning still with core consumer prices increasing faster than they were in the prior three monthly reports, so Fed officials are likely to start off their move to cut interest rates the first time cautiously with a 25 bps rate cut. The good news is there is no deflationary pressure in today's inflation report which could herald the approach of economic decline and recession. Bond investors got a little too far out front of where Fed officials see interest rates in coming years and have pulled yields back up as there is no emergency which would require larger or more frequent adjustments in the Federal Reserve's policy rate. Inflation is not dead so Fed officials need to take their time in deciding the course of interest rates over the next year. Stay tuned. Every time is different. The last two times interest rates were this high under Greenspan and Bernanke, the decision was made to start the interest rate cut cycle off with a bang with a larger 50 bps emergency move between meetings. A larger policy adjustment cannot be ruled out, but the inflation data today do not rule a bigger rate cut in. Fed funds futures do not see a 50 bps rate cut at next week's meeting. No way, no how, and the market is always right. Bet on it. The inflation fire is not out yet, pour another bucket of water on it.

Dec 23 Weight	CPI inflation	Monthly Percent Changes			YOY %
		Jun 2024	Jul 2024	Aug 2024	Aug 2024
100.0	Total	-0.1	0.2	0.2	2.5
13.555	Food	0.2	0.2	0.1	2.1
5.388	Food away from home	0.4	0.2	0.3	4.0
6.655	Energy	-2.0	0.0	-0.8	-4.0
79.790	Ex-food & energy	0.1	0.2	0.3	3.2
3.684	New vehicles	-0.2	-0.2	0.0	-1.2
2.012	Used cars/trucks	-1.5	-2.3	-1.0	-10.4
2.512	Clothing	0.1	-0.4	0.3	0.3
1.489	Medical care goods	0.2	0.2	-0.2	2.0
36.191	Shelter	0.2	0.4	0.5	5.2
26.769	Owner equiv. rent	0.3	0.4	0.5	5.4
6.294	Transportation	-0.5	0.4	0.9	7.9
6.515	Medical care services	0.2	-0.3	-0.1	3.2
<u>Special: Where inflation might come back down to</u>					
60.899	Services ex-energy	0.1	0.3	0.4	4.9
18.891	Commodities (core)	-0.1	-0.3	-0.2	-1.9



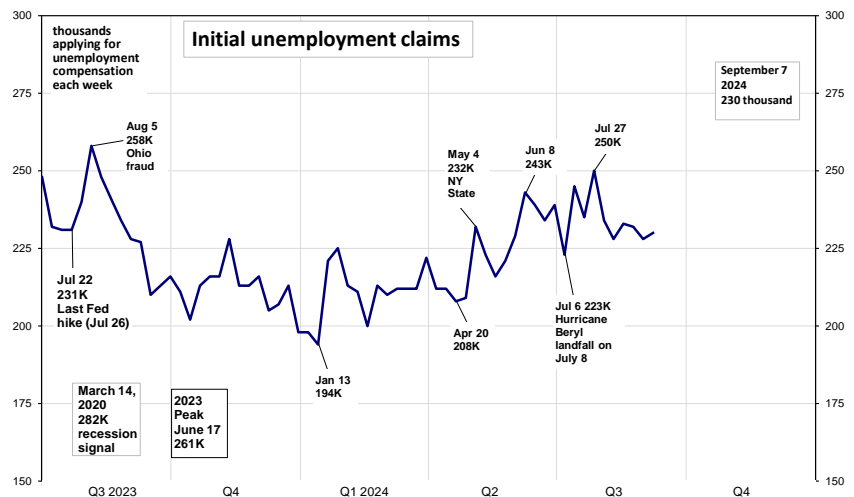
PPI and jobless claims steady (Thursday)

Breaking economy news. Initial unemployment claims rose 2K to 230K in the September 7 week that includes the Labor Day holiday. No volatility here and continuing unemployment claims rose 5K to 1.850 million in the August 31 week, so the nation's unemployment rate at 4.2% is unlikely to rise further. PPI inflation rose 0.2% in July versus 0.1% expected, and we hope the market did sell off on "more inflation." The market is always right, but it sure is stupid in the short-run. PPI inflation in July is 1.7% higher than a year ago. Old-fashioned PPI, final demand goods less foods and energy, rose 0.2% and is 2.1% higher than last year.

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	0.3	0.2	0.0	0.2	0.2				
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	1.4	1.6	1.7	1.9	2.1	2.1				

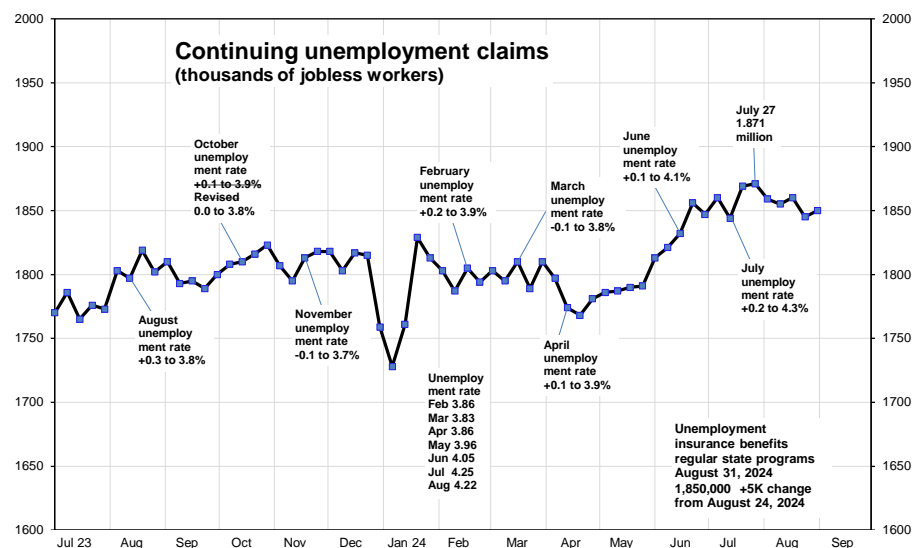
Net, net, producer prices are not too hot and the employment markets are not deteriorating too much either with weekly job layoffs stable at slightly elevated levels so there is probably no need for Fed officials to surprise the markets with a bigger than expected 50 bps rate hike at next week's meeting.

A lot of the impact of monetary policy comes from forward guidance anyway, those multiyear projections of where interest rates are heading, so the decision on whether to start with 25 or 50 bps is less important unless there is a financial crisis, and right now the stock market is recovering from its latest sell-off and is very close to record highs. If the economy is weakening and likely to take a toll on corporate profits, the stock market certainly does not see it.



Fed Chair Powell has drawn a line in the sand when it comes to joblessness and the unemployment rate where he does not want unemployment to rise further, so he can rest easy today with continuing unemployment claims, the total number of Americans receiving benefits, below recent highs. Stay tuned.

PPI inflation has a heartbeat and while prices are increasing modestly, there is no sign that companies have significant pricing power, and the monthly increases are less than those at the start of the year from January through May 2024. Airline fares are dropping and energy prices are too, where the latter should continue to depress PPI inflation in next month's report.

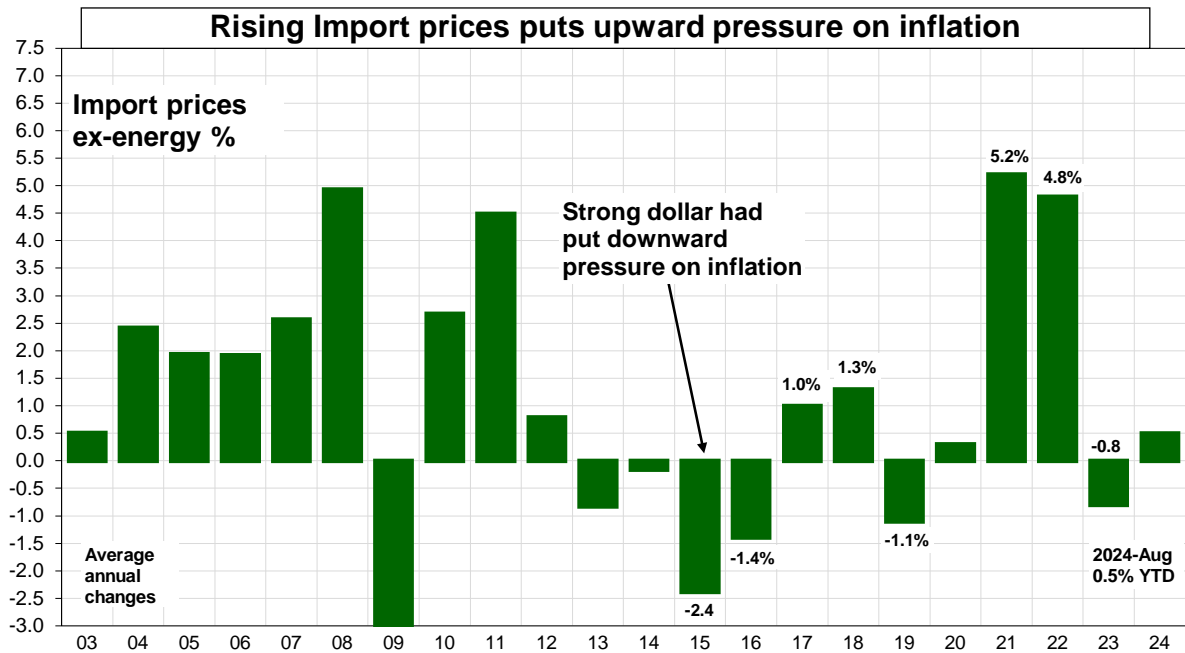


Import prices flat for four months (Friday)

Breaking economy news. Import prices fell 0.3% in August, the most of any month this year, dragged lower by a 3.0% drop in fuel imports. Energy prices are still falling in September by the way. Nonfuel imports fell 0.1%.

Net, net, Americans are getting a bargain on those imported goods coming into the country with little change in prices the last several months, but that could change in a hurry if tariffs are ramped up to new highs on the goods consumers buy from overseas depending on the outcome of the upcoming election. While there is certainly a competition going on between countries, a lot of US companies have purposely moved their manufacturing overseas to China and elsewhere to cut costs for the consumer and to save on their own bottom lines. Stay tuned. The inflation flare-up early in the year is no longer evident in the prices of imported goods coming into the country and this is another reason to believe that the balance of risks have shifted for Fed officials back to downside risks for the economy and labor market from the inflation risks earlier this year. The only question left for Fed officials is whether to go with a 50 bps or a 25 bps rate cut at next week's meeting. At the moment, the market is not discounting a larger 50 bps rate cut, and at this time it is hard to assess whether investors would welcome a bigger start to the Fed rate cut trend or fear it.

Nonfuel Imports prices-- Monthly Percent Changes NSA												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2023	0.2	0.4	-0.5	-0.1	0.0	-0.3	-0.1	-0.2	-0.2	-0.2	0.1	0.1
2024	0.6	0.1	0.2	0.6	-0.2	0.2	0.1	-0.1				



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