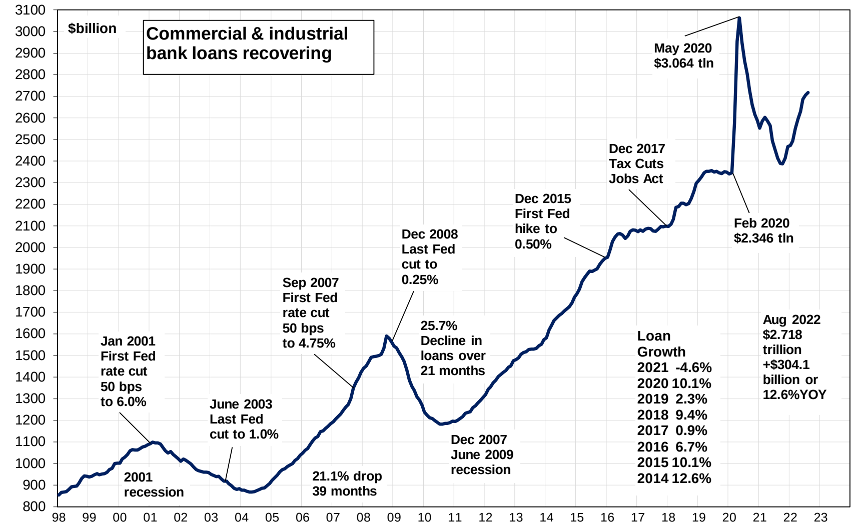
Financial Markets This Week

16 SEPTEMBER 2022

Christopher S. Rupkey, CFA
Chief Economist
crupkey@fwdbonds.com

BANKS PROVIDING CREDIT



Bank loans have turned back up and are back in sync with the economy. During the pandemic, commercial and industrial (C&I) loans jumped $718 billion or 30.6% from $2.346 trillion in February 2020 before the pandemic to $3.064 trillion in May 2020, the magnitude of the increase was something the economy had never experienced before looking back over two decades. Large corporations accessed their bank credit lines in the financial panic, but it was really the CARES Act (signed into law March 27, 2020) PPP loans that was responsible for the surge. Most PPP loans are commercial and industrial bank loans. C&I loans would have been up more sharply in the last year had it not been for the Paycheck Protection Program (PPP) loan forgiveness and repayment.

FDIC Banks and S&Ls	2022	2021	2020	2010	2000
Number	4,771	4,950	5,066	7,830	10,102
Employees	2.100	2.058	2.077	2.034	1.904
Deposits	19.563	18.730	16.962	9.141	4.689
C&I loans	2,487	2,335	2,696	1,165	1,062
Credit cards	903.5	792.0	801.2	692.1	234.5
4,771 banks in June 2022, 2.100 million employees, $19.563 trillion in deposits, $2.487 trillion C&I loans, $903 billion credit card loans					

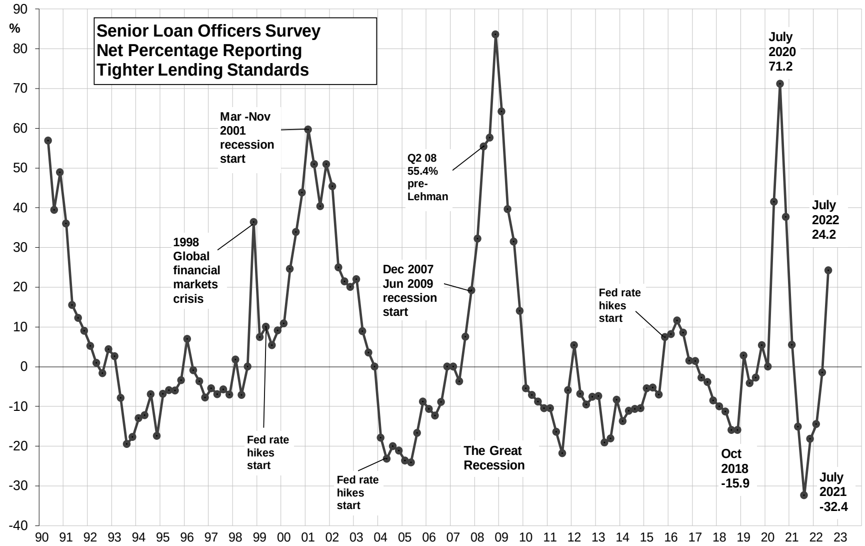
While it certainly isn't a leading indicator of recession, a decline in commercial & industrial bank loans is normally consistent with lackluster economic growth where companies' investment spending and need for working capital are not all that strong during and immediately following recessions. Commercial & industrial bank loans fell 21.1% in the 2001 recession and Iraq War slowdown in 2003. Commercial & industrial bank loans declined 25.7% in the Great Recession.

C&I Loans Domestically Chartered Commercial Banks

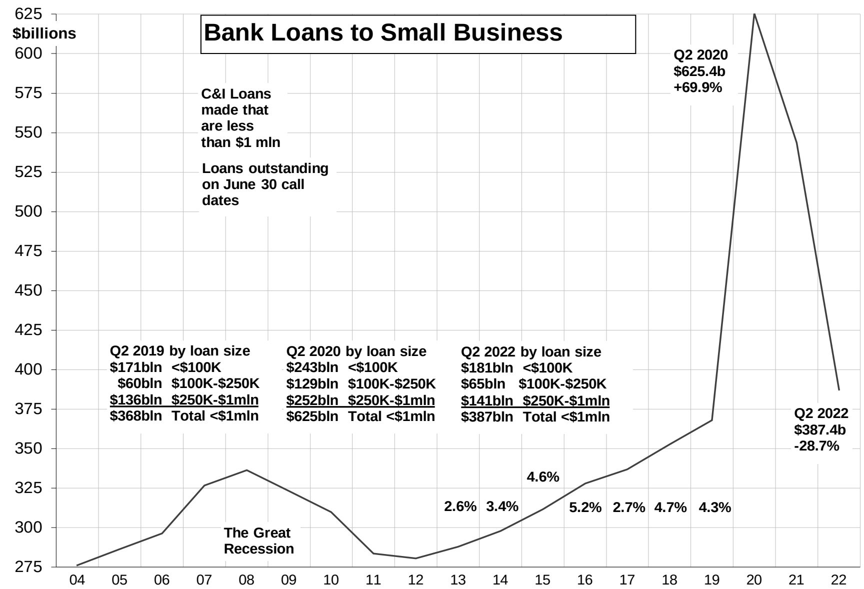
$ bln	Aug 2022	Jun 2022	Jun 2021	Jun 2020	Jun 2019	Jun 2018
Large	1,448.1	1,428.4	1,266.4	1,529.2	1,322.4	1,237.8
% Chg	1.4	12.8	-17.2	15.6	6.8	3.4
Small	811.2	800.3	851.3	932.3	637.4	589.7
% Chg	1.4	-6.0	-8.7	46.3	8.1	11.6
Total	2,259.3	2,228.7	2,117.7	2,461.5	1,959.8	1,827.5
% Chg	1.4	5.2	-14.0	25.6	7.2	5.9

The table illustrates the strength in large bank C&I loans up 12.8% between the 2021 and 2022 June call report dates, while small bank loans fell for a second year past the PPP loans.

The Fed's latest Senior Loan Officer Opinion Survey on Bank Lending Practices for July shows greater caution. The net percentage reporting tighter lending was 24.2 in July after the easiest lending standards in history the year before. Banks cited a less favorable or more uncertain economic outlook, the worsening of industry-specific problems, and reduced tolerance for risk.



The FDIC [Quarterly Banking Profile](#) for Q2 2022 released September 8 also provides the bank loans to small business, loans less than $1 million with a substantial number of loans less than $100,000. Small loans outstanding were still plummeting in Q2 2022 from the PPP surge two years ago, so it is hard to find a trend-do small firms need credit or not after the first half of 2022 with its negative real GDP.

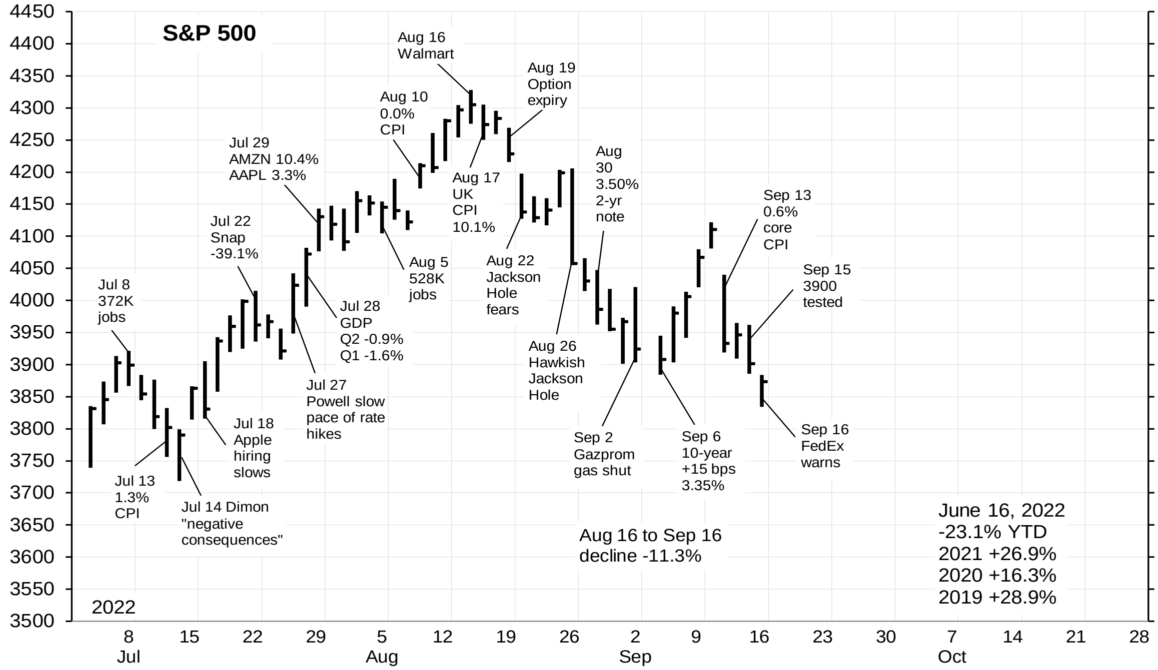


Net interest margin (NIM) 2.80 in Q2 2022 from 2.54 in Q1 2022 and 2.50 in Q2 2021. Some think this will offset future credit losses, but not sure. Presumably, the ratio would be much smaller if interest was paid on savings deposits as was the case before the Great Recession when the Fed funds rate peaked at 5.25% in June 2006 a year and a half before the recession started. Interest income this quarter was $164.978 billion ($138.560 billion year-ago), Interest expense was $13.852 billion ($9.300 year-ago); the Fed raised rates for the first time in March this year.

Credit provision expense was $11.1 billion this quarter, $5.2 billion in the first quarter, and -$10.8 billion a year ago. The swing in year-year credit provision explains the reduction in quarterly net income of $64.4 billion, down 8.5% from last year's second quarter.

To conclude, bank lending officers are starting to become more cautious about providing credit to their customers and the economy. No reduction in the loans outstanding is seen in the data yet if that's what Fed officials are hoping for, but C&I loans are normally a lagging indicator of current economic conditions and don't tend to decline until the recession is well along.

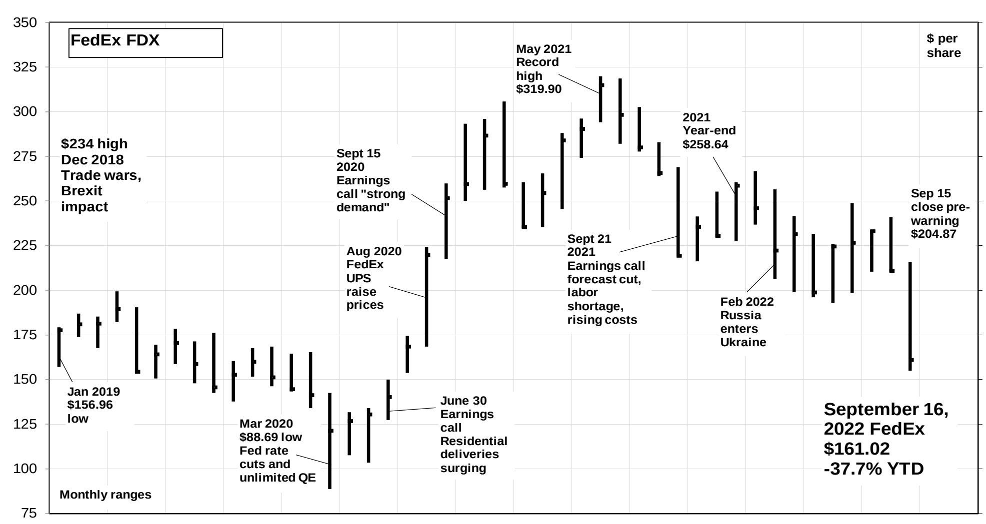
INTEREST RATES



We thought the stock market's reaction to Powell at Jackson Hole was bad enough, but now the one-day reaction to the 0.6% core CPI news for August on Tuesday eclipses that. The market reaction seems to be, forget the recession, there's too much inflation here now and still coming, so the Fed is going to raise rates higher than 4%, at least in their outer-year forecasts next week. The CPI headline miss was -0.1 expected and 0.1 actual, core CPI miss 0.3 expected and 0.6 actual. Market reaction seems typical for events like this: Target with too many inventories, and FedEx withdrawing forecasts (didn't they just raise the earnings forecast in June?). Stocks look like an over-reaction, but the problem remains how high will the Fed funds rate go, only 2.5% at the moment. 10-year yields volatile, but amidst the chaos closed the week at 3.45%, still below where Fed says its target rate is going.

FEDEX SINKS 22% AT THE OPEN IN BIGGEST DROP SINCE AT LEAST 1980

FedEx offered some preliminary first quarter financial results and updated outlook after the close Thursday that the already CPI weakened market did not need. News headlines said FedEx warned of a worldwide recession. Thanks for the update and notice of the upcoming earnings call with even more details at 530pm ET on September 22. Global volumes softened faster in the final weeks of the August 31 quarter so the company withdrew its FY2023 earnings forecast. Among other cost measures, they are closing 90 FedEx Office locations, hopefully not in our town. The stock fell 21.4% on Friday, but you still got a 2.9% dividend.



FEDERAL RESERVE POLICY

The Fed meets September 20-21, 2022 to consider its monetary policy. A 75 bps rate hike to 3.25% is expected and market is discounting 4.5 bps more into the final 25 bps of a “surprise” 100 bps move. Not sure 100 bps buys them any additional credibility or how this would work to slow food inflation at the grocery store unless rate hikes mean fewer shoppers as they become unemployed.

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	14-Sep	7-Sep	31-Aug	24-Aug	3/11/20*	3/11/20
Factors adding reserves						to Sep 14
U.S. Treasury securities	5687.031	5690.760	5694.997	5700.628	2523.031	3164.000
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2718.526	2709.291	2709.288	2725.906	1371.846	1346.680
Repurchase agreements	0.000	0.005	0.000	0.000	242.375	-242.375
Primary credit (Discount Window)	6.158	3.677	5.251	3.570	0.011	6.147
Paycheck Protection Facility	14.399	14.744	14.969	15.188		
Main Street Lending Program	25.969	25.950	25.933	25.917		
Municipal Liquidity Facility	5.559	5.558	5.556	5.554		
Term Asset-Backed Facility (TALF II)	2.146	2.145	2.144	2.160		
Central bank liquidity swaps	0.203	0.197	0.171	0.166	0.058	0.145
Federal Reserve Total Assets	8882.6	8872.2	8874.9	8901.2	4360.0	4522.578
~~3-month Libor %~~ SOFR %	2.27	2.28	2.29	2.27	1.15	1.120
Factors draining reserves						
Currency in circulation	2280.792	2284.279	2278.728	2276.186	1818.957	461.835
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	617.997	582.921	669.911	530.196	372.337	245.660
Treasury credit facilities contribution	17.940	17.940	17.940	17.940		
Reverse repurchases w/others	2225.579	2206.987	2251.025	2237.072	1.325	2224.254
Federal Reserve Liabilities	5723.910	5600.835	5759.087	5630.283	2580.036	3143.874
Reserve Balances (Net Liquidity)	3158.694	3271.336	3115.846	3270.912	1779.990	1378.704
Treasuries within 15 days	52.038	48.969	59.696	78.233	21.427	30.611
Treasuries 16 to 90 days	358.104	366.228	317.001	324.425	221.961	136.143
Treasuries 91 days to 1 year	810.627	809.289	852.012	819.487	378.403	432.224
Treasuries over 1-yr to 5 years	2010.470	2010.475	2010.480	2017.728	915.101	1095.369
Treasuries over 5-yrs to 10 years	1000.928	1000.932	1000.936	1009.321	327.906	673.022
Treasuries over 10-years	1454.864	1454.868	1454.871	1451.434	658.232	796.632
Note: QT starts June 1	Change	14-Sep	1-Jun			
U.S. Treasury securities	-83.748	5687.031	5770.779			
Mortgage-backed securities (MBS)	11.080	2718.526	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

The path of interest rates is most important as markets want to know where this madness stops. There's never been a Fed in history that says a recession is possible as they fight inflation with higher interest rates. We keep dancing around it, but it is hard to ignore the history of the last time the economy went into a long recession in the housing bubble over a decade ago. The Fed pushed rates to 5.25% back then, inflation is much higher now, why are markets thinking the Fed will stop the rate hikes anytime soon? Our call is 75 bps in September then two 50 bps rate hikes in November and December ending the year at 4.25% (which is more or less how January 2023 Fed funds futures call it). It has been hard to judge the market reaction to the Fed recently. For all we know, the Fed forecasts with a new dot out in 2025 could be for a lower Fed funds rate, so the market can conclude there is light at the end of the tunnel and the rate hikes won’t be forever. On the other hand, we worry the Fed’s current 3-7/8% peak Fed funds rate in the forecast could be moved much, much higher. 4.5, 5.5, anyone, anyone. There was only one forecast for a peak 4.5% Fed funds rate next year when they did this back in June.

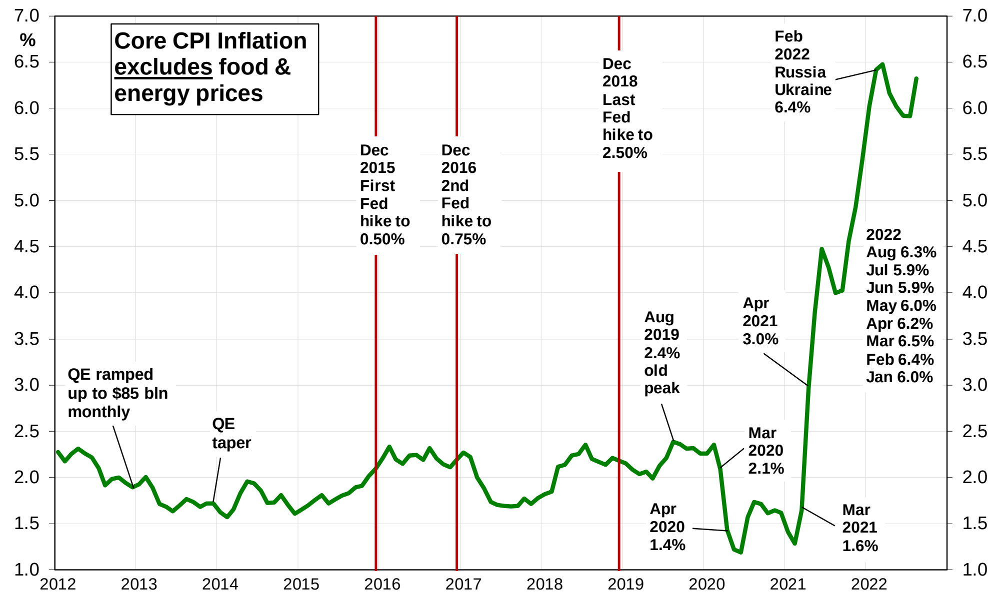
Fed Policy-key variables				Long
	2022	2023	2024	Term
Fed funds	3.4	3.8	3.4	2.5
PCE inflation	5.2	2.6	2.2	2.0
Core inflation	4.3	2.7	2.3	
Unemployed	3.7	3.9	4.1	4.0
GDP	1.7	1.7	1.9	1.8
June 2022 median Fed forecasts				

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	3.625	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

OTHER ECONOMIC NEWS

Who's afraid of the big bad inflation wolf (Tuesday)

Breaking economy news. August CPI rose 0.1% which is 8.3% higher than a year ago. The 10.1% collapse in gasoline prices at the pump couldn't bring down inflation to match the 0.0% change in July and the market's hopes for a negative headline inflation report were dashed. The report was a disappointment and strangely not consistent with the softer price increases seen recently in the personal consumption deflator. Core CPI jumped back 0.6% in August after taking July off with a weaker 0.3% rise. If 0.3% is the minimum monthly underlying inflation rate, the Fed's progress in fighting inflation is less than one could have hoped.



Net, net, the Fed has more to do to keep inflation from rising and a 75 bps rate hike is a virtual certainty at next week's meeting. The market was going straight up in the days, hours and minutes before the report today, showing no fear at all and making some wonder if there was a data leak. There obviously wasn't a leak. Stocks were up 0.7% at 830am ET CPI release time and down 1.3% five minutes later.

Jun 22		Monthly Percent Changes			YOY %
Weight	CPI inflation	Jun 2022	Jul 2022	Aug 2022	Aug 2022
100.0	Total	1.3	0.0	0.1	8.3
13.372	Food	1.0	1.1	0.8	11.4
5.077	Food away from home	0.9	0.7	0.9	8.0
9.200	Energy	7.5	-4.6	-5.0	23.8
77.428	Ex-food & energy	0.7	0.3	0.6	6.3
3.999	New vehicles	0.7	0.6	0.8	10.1
4.008	Used cars/trucks	1.6	-0.4	-0.1	7.8
2.419	Clothing	0.8	-0.1	0.2	5.1
1.465	Medical care goods	0.4	0.6	0.2	4.1
32.065	Shelter	0.6	0.5	0.7	6.2
23.502	Owner equiv. rent	0.7	0.6	0.7	6.3
5.900	Transportation	2.1	-0.5	0.5	11.3
6.772	Medical care services	0.7	0.4	0.8	5.6
	Special: Where inflation might come back down to				
56.306	Services ex-energy	0.7	0.4	0.6	6.1

The report answered the question, who's afraid of the big bad inflation wolf? The market wasn't and had its hand slapped by the worrying inflation outlook at the core level where housing, and medical care services prices look unstoppable; even the modest 0.1% drop in used cars and trucks was less than expected. The supply chain disruptions are starting to fade with delivery times falling but apparently not enough as consumer commodities less food and energy bounced back with a 0.5% gain after a 0.2% rise last month. The Fed isn't winning the inflation battle yet so big rate hikes are on the horizon, bet on it. The cost of living crisis is literally exploding and investors are heading for the hills.

Core Consumer Inflation and stickier services prices ex-energy

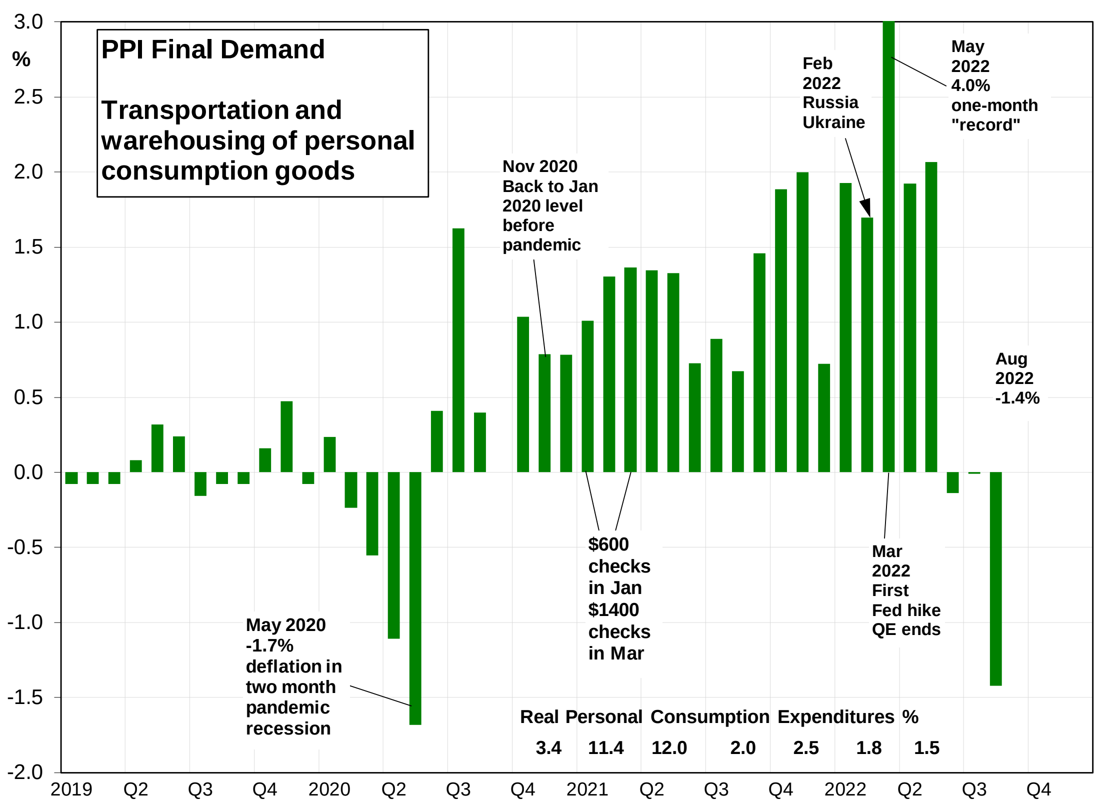
Monthly	2022						2022	2021									2021
% Changes	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr
Core CPI inflation	0.6	0.3	0.7	0.6	0.6	0.3	0.5	0.6	0.6	0.5	0.6	0.3	0.2	0.3	0.8	0.7	0.9
Services x-energy	0.6	0.4	0.7	0.6	0.7	0.6	0.5	0.4	0.3	0.4	0.4	0.2	0.1	0.3	0.4	0.4	0.5
Core PCE inflation		0.1	0.6	0.4	0.3	0.3	0.3	0.5	0.5	0.5	0.5	0.2	0.3	0.3	0.5	0.6	0.6
Services x-energy		0.1	0.6	0.4	0.4	0.4	0.3	0.3	0.4	0.5	0.3	0.2	0.3	0.4	0.4	0.4	0.4

Producer inflation starting to look more contained (Wednesday)

Breaking economy news. Pipeline pressures at the factory level of the economy that increase the costs of consumer goods look less intense today which counts as welcome news after yesterday's CPI inflation report that shocked the world and led the S&P 500 to fall 4.3%. PPI Total Final Demand prices fell for a second month in a row so cost-push inflation onto the backs of consumers will be easier for the economy and markets to bear in months to come. Transportation and warehousing prices fell 0.2% in August after a decline of 0.8% in July which means the cost of getting products from the factory to the store is coming down finally.

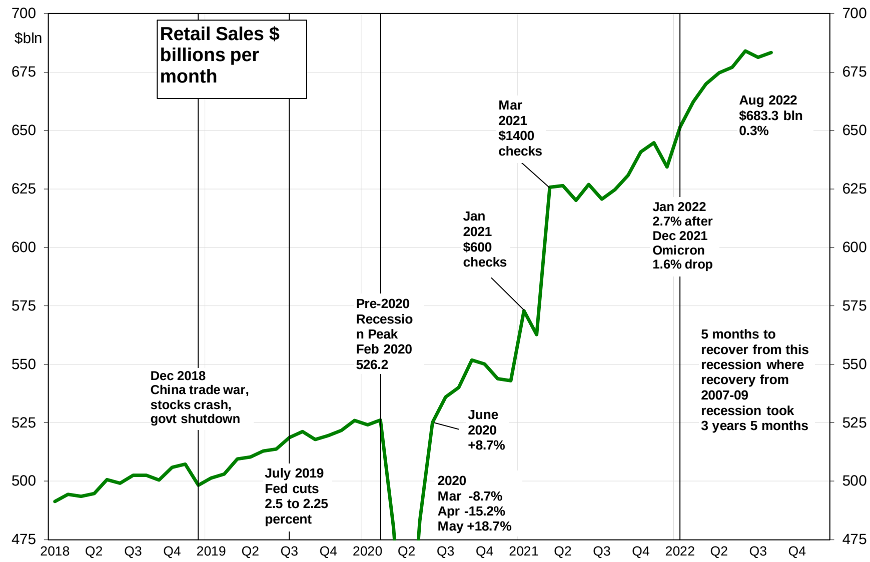
Net, net, factories aren't manufacturing as much inflation for a second month in a row, so while inflation isn't completely contained, there is hope that the diminished pressures on PPI goods prices will lead to less inflation in the future for the goods sitting on store shelves that consumers buy. Inflation at the producer level looked out of control earlier this year for PPI final demand goods prices less foods, energy and trade with huge 1.1% jumps in March and April. Now PPI final demand core goods prices have slowed to gains of just 0.2% in August and in July.

Maybe the Fed's pivot in March, ending QE and lifting rates the first time played a part in slowing factory inflation down. The Federal Reserve still has many miles to travel on the path to higher interest rates, but finally today offers a bit of good news that the economy's supply chain headwinds are starting to diminish. Notably, the cost of truck transportation of freight collapsed 1.9% in August. A 75 bps rate hike next week is completely discounted and about 8 bps of another 25 bps higher rate hike totaling 100 bps is currently discounted. Stay tuned. Story developing. 75 bps is done and 100 bps may never get there.



Where have all the jobless gone? To the mall, shopping? (Thursday)

Breaking economy news. Retail sales were up 9.1% in August from year-earlier levels, but the real results don't look quite as rosy with CPI inflation reported yesterday up 8.3%. Money illusion is back where it looks like people have more money in their purses and wallets, but it actually buys fewer goods and services. We will see if the public is fooled or perhaps who will be blamed at the midterm elections on Tuesday, November 8. In any event, most of the rise in August came from the 2.8% rise in motor vehicle & parts sales, ex-auto sales fell 0.3% this month.

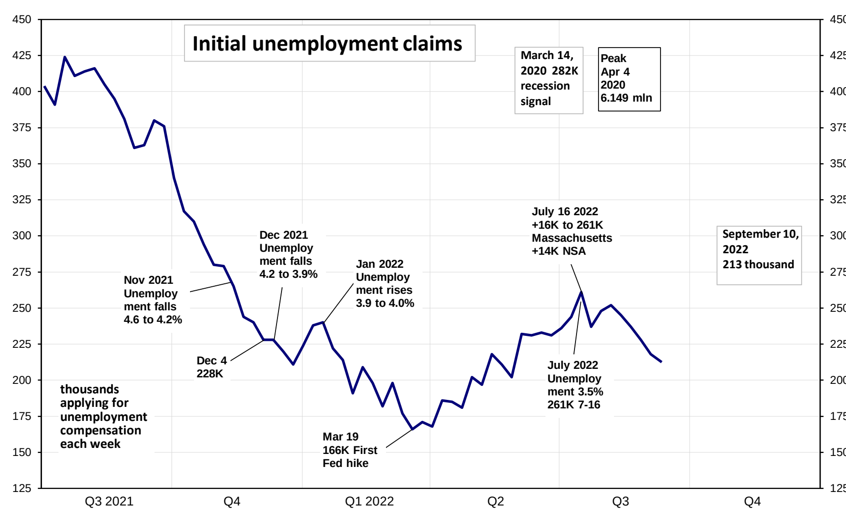


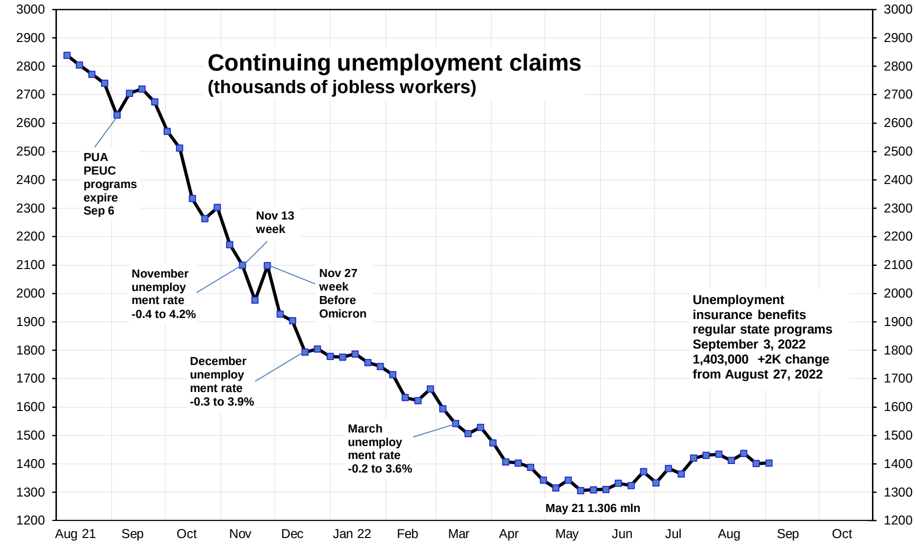
After a bunch of crazy revisions, consumer spending in nominal terms is not as strong for the third quarter as it looked in last month's report. June was up 0.8% now it is up 1.0%, but July was 0.0 and now -0.4%. The net result is consumer spending is slowing, as Fed officials are praying for, where nominal retail sales is running 2.2% in Q3 versus a much stronger 10.9% in Q2. Now if there were only job losses. Don't forget the Fed's forecast is for the unemployment rate to move up from 3.7% today to 4.1% by the end of 2024. Darn. Not yet.

Retail spending, actual dollars, each month

	$million Aug 2022	% to Total	Percent Changes % Aug	Jul	Year/year
Total Retail Sales	683,291	100.0	0.3	-0.4	9.1
Motor vehicles/parts	127,999	18.7	2.8	-2.0	6.7
Furniture/furnishings	11,783	1.7	-1.3	-0.5	-1.6
Electronics/appliances	7,589	1.1	-0.1	0.5	-5.7
Building materials/garden	43,165	6.3	1.1	1.3	10.5
Food & beverage	79,466	11.6	0.5	0.1	7.2
Health/personal care	33,362	4.9	-0.6	0.4	1.5
Gasoline stations	64,383	9.4	-4.2	-2.3	29.3
Clothing/accessories	25,898	3.8	0.4	-0.8	3.5
Sporting goods, books	9,281	1.4	0.5	0.0	5.5
General merchandise	69,700	10.2	0.5	-0.4	3.6
Department stores	11,392	1.7	0.9	-0.4	0.7
Miscellaneous retailers	16,189	2.4	1.6	-1.1	15.3
Nonstore retailers (internet)	108,315	15.9	-0.7	1.8	11.2
Eating & drinking places	86,161	12.6	1.1	-0.8	10.9

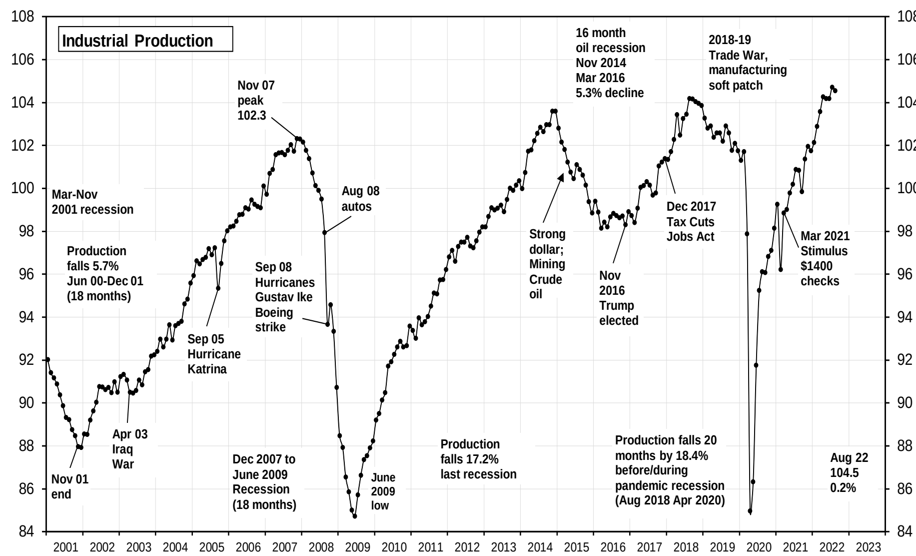
Speaking of job losses, don't look now but someone let some more air out of the recession balloon, the party the market had been throwing in celebration the Fed could soon stop its slow-it-down interest rate hikes. Weekly jobless claims are now just 213K in the September 10 week, and the week before revised down 4K to 218K. Where have all the jobless gone? To the mall, shopping perhaps? Maybe it's the baby boomers retiring and not getting any unemployment benefits. Even the nation's unemployment rolls fell sharply 1.403 million in the September 3 week and ready for this, the week before whacked by 72K down to 1.401 million. The Bureau of Labor Statistics can't seem to count.





Net, net, economic demand in the country appears to be slowing this quarter, but job losses look modest at this point of the economic cycle. The storm clouds of recession threatening the economy have blown further offshore and this will likely convince Fed officials to keep their foot down even harder on the brakes. It took a Fed funds rate of 5.25% back before the housing bubble recession in 2007-09 to take the economy down, and right now, the Fed's interest rate is just 2.5%. We can see where this is going, but we won't say anything with all our money in the stock market and the S&P 500 closing down 17.2% year-to-date last night. Stay tuned, story developing. Consumer spending isn't going off the rails that's for sure and that means a third 75 bps rate hike is coming next week. Bet on it.

Industrial production for manufacturing still below April peak (Thursday)



Breaking economy news. Retail sales and jobless claims were 830am ET, and the Fed's industrial production number was released at 915am ET. (915am, don't know why) Generally, all is not well for the economy when industrial production stops moving up month-to-month, although this economic indicator is famously better at calling the bottom of a recession. Calling the bottom of recessions when no one wants to listen because unemployment is so high. An economic indicator only an economist could love.

Industrial production fell 0.2% in August and the peak was in July. Utility output fell 2.3% in August dragging the whole thing down. Manufacturing production rose 0.1% in August and at 102.2 it is slightly below the all-time high of 102.4 in April. Movement in the so-called Major market groups can be erratic month-to-month, but there is some weakness in Consumer goods and Construction.

Percent changes			Industrial Production Aug 2022		
Jun	Jul	Aug	YOY		Weight
0.0	0.5	-0.2	3.7	Total Index	100.0
-0.5	0.6	0.1	3.3	Manufacturing	74.5
1.9	1.0	0.0	7.9	Mining	13.7
0.3	-1.2	-2.3	-1.6	Utilities	11.8
			Manufacturing payroll jobs 12.9 million +461K YOY 9.8% of Private Payroll Jobs		

Net, net, industrial production has slowed its climb, something it does before recessions, although it can be a very early warning indicator sometimes. Or even a warning of recession, that never comes.

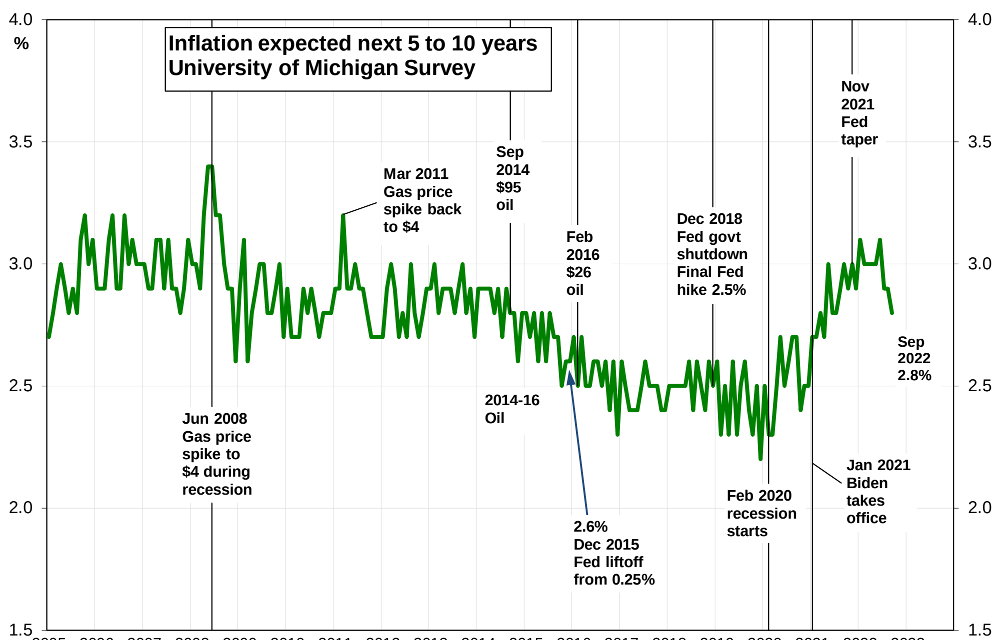
There was an oil crash manufacturing recession where industrial production fell a sharp 5.3% for 16 months starting in late 2014, but no official recession. There was a trade war, manufacturing soft patch starting in the middle of 2018, but no recession until the economy nose-dived during the pandemic. Stay tuned. Story developing. Lots of data on Thursday, but nothing urging the Fed to stop its rate hikes at 2.5%.

Michigan Consumer Sentiment numbers: public inflation expectations fall (Friday)

Breaking economy news. The survey of consumers from the University of Michigan (don't ask) was 10am ET on Friday where most were just waiting for this week to be over. Forget the sentiment index and focus on the public's long term expectations for inflation. CPI inflation year-to-year changes have been 8% or higher since March, yet consumers say inflation in the five-year period beginning five years from now (how on earth would they know) will be just 2.8%. Hey, stocks stopped falling at 10am ET on Friday, maybe this news helped. What a week.

We can't imagine what Fed Chair Powell thinks. It was a 3.3% preliminary June report which Powell cited at the June 15 FOMC press conference this year as a reason for the first go-big 75 bps rate hike at the meeting. Long-term expectations are 2.8% now rather than 3.3%, but there probably aren't any bets being made that this will stop another 75 bps rate hike next week.

> Powell June 15, 2022 press conference
> If we even see a couple of [inflation expectations] indicators that bring that into question, we take that very seriously. We do not take this for granted—we take it very seriously. So the preliminary Michigan [survey] reading—it's a preliminary reading; it might be revised—nonetheless, it was quite eye-catching, and we noticed that.



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