Financial Markets This Week

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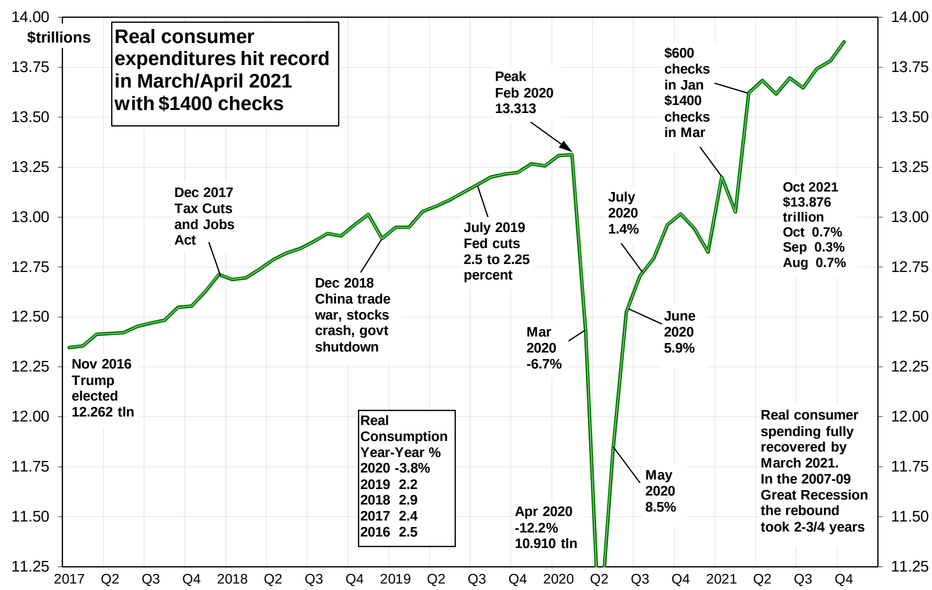
INFLATION RAGING AT CONSUMER LEVEL WITH UNPRECEDENTED DEMAND FOR DURABLE GOODS

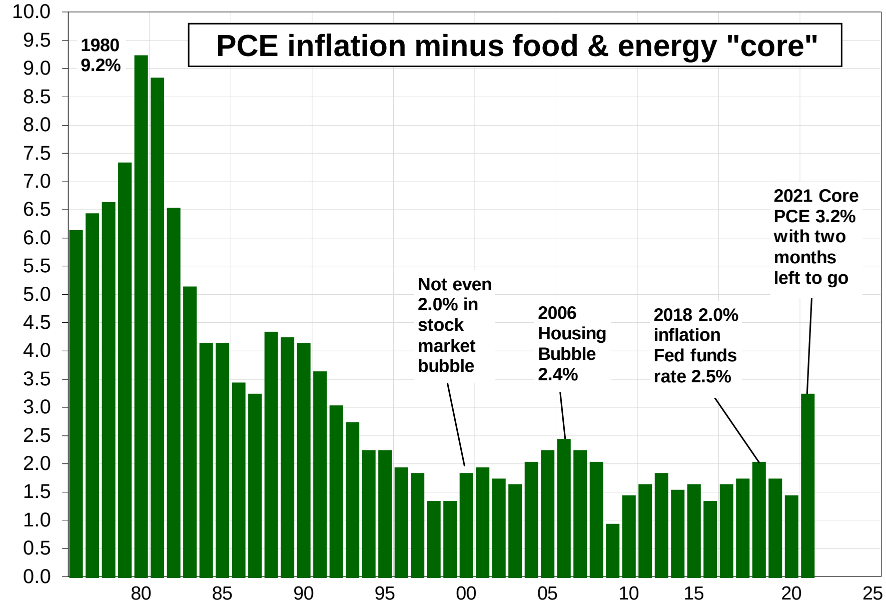
Personal income report for October was released Wednesday before the South Africa variant crashed the stock market on Friday. The economy was doing well. The consumer's got the income and boy are they ever spending it with demand that outstrips supply and sends inflation soaring high into the clouds and there isn't anything Washington can do to bring prices back down to earth for the American people. If we can stop the hyperbole for a moment, real consumer expenditures are lifting again, on its own power if you will, without the help of the $600 and $1400 checks from Washington in January and March which gave Americans one month's worth of retail sales to spend.



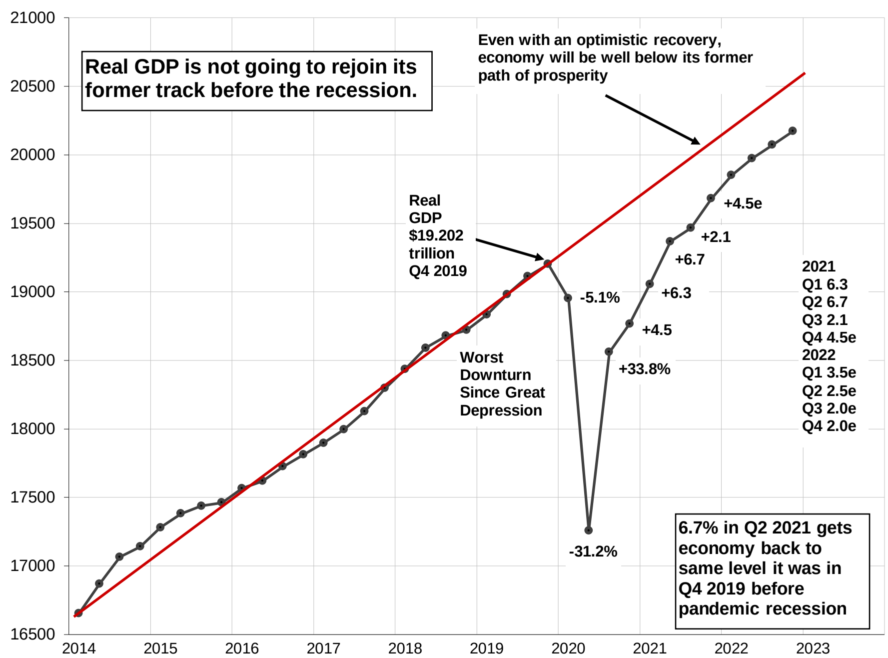
Personal income was up 0.5%, but it is consumer spending getting ramped back up after the third quarter slowdown that is the real story. Durable goods hit it out of the park with real spending of 2.0% just for the month of October. Real consumer spending was down in the dumps, perhaps the Delta variant restrictions, slowing to 1.7% in the third quarter, but now the sun is out and the consumer's sails are full again with a growth spurt of 4.5% real consumer expenditures in the fourth quarter and we still have November and December data left to go.

Inflation? The Fed was once worried about too little inflation, well they got it right between the eyes. There is no sign that inflation is temporary this month with core PCE inflation rising 0.4% in October, the most since 0.5% in June. The inflation genie is back and bigger and more worrisome than ever before. CPI headline inflation was 6.2% year-year in October and now PCE headline inflation is closing the gap by rising 5.0% in October year-year. Wages were up 4.9% year-year in October, so the consumer has to spend their paychecks quick before inflation erodes the value of money even further.

The inflation story may be closer to the start than it is to the end. Core PCE inflation was 9.2% in 1980 and right now inflation is the most seen since the 1990s. This graph is annual averages, so with November and December reports left to go, it looks like core PCE inflation will be 3.2% this year,and it will certainly be over 2.0% in 2023 based on the law of averages. Inflation was 2.0% in 2018 as the Fed was busy moving the Fed funds rate to 2.5%. Right now, the Fed funds rate is 0.25% if you needed a reminder and millions of baby boom retirees are getting no interest on the money they parked at the bank for safe keeping. This chart reminds us why we never liked the PCE inflation measure since Greenspan made us look at it over two decades ago: the reason why is core PCE inflation never went above 2.0% in the late 90s during the stock market bubble with 5% real GDP apparently due to its faulty design or construction… it often cannot find any inflation out there in the country even while millions of consumers are screaming about it.

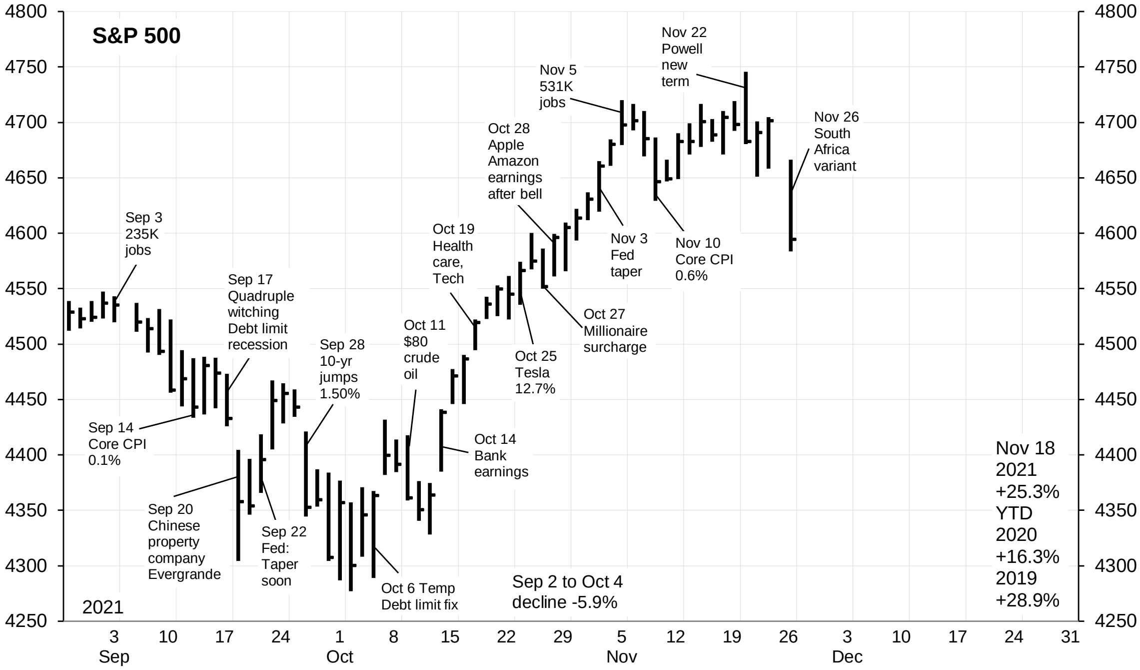


By the way, we didn't change our 4.5% real GDP forecast for Q4 2021 like many economists did this week. There's plenty of time to raise our estimate later on as the first look at Q4 real GDP is not out until Thursday, January 27, 2022.



In conclusion, consumer spending is off the charts with red hot demand that is sending prices soaring and inflation is at a level not seen in decades. Economic growth is coming at a price because the strong economic demand is fattening paychecks and putting Americans back to work, but the cost to society is growing with an inflation outbreak that threatens to undo all those hard won gains. Fed officials say not to worry, they have the tools to fight inflation, but the public isn't so easily fooled. Restrictive monetary policy to rein in inflation in the past has actually hit demand so hard that the economy slowed to the stall speed and then went over the cliff into recession. Recession shouldn't be in any central banker's tool kit. Stay tuned. Story developing. Watch here where the world goes next.

INTEREST RATES

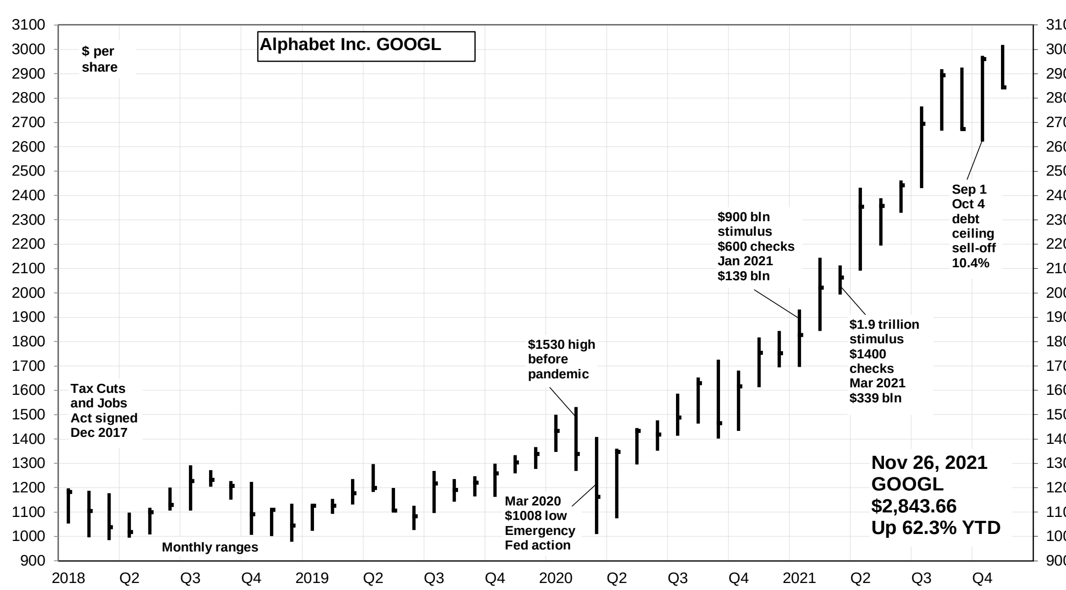


Bond yields and the stock market rose and fell together this week. Some thought it was a good idea that Powell was given four more years on Monday, and then the new Covid outbreak originating in South Africa brought the show right back down on Friday. Friday was the worst daily sell-off for US stocks this year, helped along by the especially steep decline in European shares along with the early US close after Thanksgiving at 1pm ET Friday so stocks didn't have time to rethink it. On Friday, DAX -4.2%, CAC 40 -4.8%, S&P 500 -2.3%. Bond yield 16 bps collapse Friday to 1.48% helped along by $10.22 drop in January 2022 crude oil futures to $68.17. $100 oil talk=inflation gone for now.

Alphabet Inc. GOOGL up 62.3% YTD

Earnings for the September 30, 2021 quarter were released October 26, 2021 after the bell. Revenues were $65.173 billion, 41% above last year. Google Cloud revenues were $4.990 billion, also up about 40%. Operating income up 32% to a record $21.031 billion, so no wonder the stock is up. Before the pandemic, operating income never broke $10 billion in a quarter. The Sep-Oct debt ceiling "recession" equity market sell-off was 10.4% for GOOGL versus 5.9% for the entire S&P 500. Forgotten now.

S&P 500 Weights	
Top 6: 25% of S&P	
6.37	MSFT
6.37	AAPL
3.91	AMZN
2.27	TSLA
2.04	Meta
2.21	GOOGL
2.07	GOOG
25.24	Top 6



FEDERAL RESERVE POLICY

Selected Fed assets and liabilities					March 11
Fed H.4.1 statistical release					2020**
billions, Wednesday data	24-Nov	17-Nov	10-Nov	3-Nov	pre-Covid
Factors adding reserves					
U.S. Treasury securities	5578.900	5573.525	5552.607	5533.219	2523.031
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347
Mortgage-backed securities (MBS)	2609.726	2603.431	2593.366	2527.824	1371.846
Repurchase agreements	0.000	0.000	0.000	0.000	242.375
Primary credit (Discount Window)	0.315	0.355	0.449	0.259	0.011
Paycheck Protection Facility	41.934	43.681	46.471	48.047	
Corporate Credit Facility (CCF)	0.002	0.515	0.515	0.515	
Municipal Liquidity Facility	7.953	9.786	9.785	9.783	
Main Street Lending Program	29.576	30.466	30.516	30.507	
Term Asset-Backed Facility (TALF II)	2.650	4.491	4.491	4.490	
Central bank liquidity swaps	0.268	0.265	0.328	0.332	0.058
Federal Reserve Assets	8731.2	8724.5	8712.5	8624.3	4360.0
~~3-month Libor %~~ SOFR %	0.05	0.05	0.05	0.05	1.15
Factors draining reserves					
Currency in circulation	2219.525	2215.367	2213.872	2207.681	1818.957
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	141.042	178.972	231.421	241.627	372.337
Treasury credit facilities contribution	21.258	26.397	26.397	26.397	
Reverse repurchases w/others	1452.897	1520.000	1448.623	1343.985	1.325
Reserve Balances (Net Liquidity)	4172.807	4188.837	4178.586	4149.830	1779.990
Treasuries within 15 days	70.490	77.857	110.097	127.192	21.427
Treasuries 16 to 90 days	322.968	315.439	285.678	273.726	221.961
Treasuries 91 days to 1 year	715.450	715.588	707.348	702.180	378.403
Treasuries over 1-yr to 5 years	2129.829	2127.892	2131.956	2121.068	915.101
Treasuries over 5-yrs to 10 years	1009.204	1008.848	1005.551	1001.373	327.906
Treasuries over 10-years	1330.959	1327.901	1311.978	1307.680	658.232
**March 11, 2020 start of coronavirus lockdown of country					

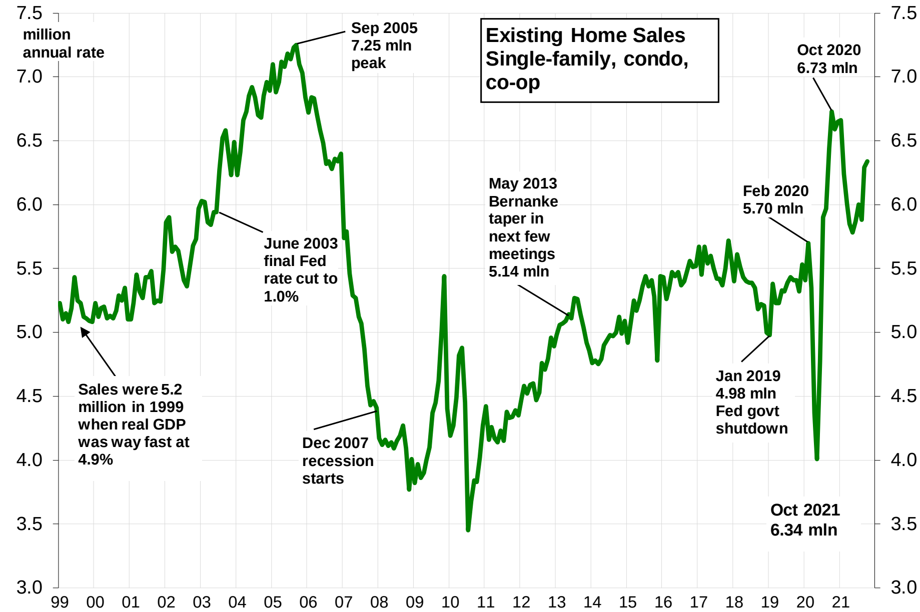
The Fed meets on December 14-15, 2021 to consider its monetary policy. Inflation is the worst it has been in decades, the public and so politicians are up in arms about it; it's not just bond market professionals. What better time to announce another four-year term at the helm of the Federal Reserve for Chair Powell so he can get after it. Inflation. We think. They are tapering their asset purchases. But he does have a much more stringent test that needs to be met first by the economy before they raise interest rates. He doesn't think it's time to raise interest rates because he is waiting for the labor market to heal further. We guess he is waiting for unemployment to fall from 4.6% in October back down to 3.5% before the pandemic before lifting rates. We thought the idea was to have the Fed funds rate at 2.5% normal by the time unemployment was normal. We fail to see how lifting interest rates from 0.25% to 0.50% stops anyone from hiring workers. All of this of course ignores the evidence that there are massive labor market shortages for almost every industry: over 10 million job openings where the number of unemployed is 7.419 million.

The November 2-3 Fed meeting minutes were released Wednesday before Thanksgiving to an audience of none. No mention of interest rates in the Committee Policy Action section. It was all tapering talk including saying they added a reference to their "holdings of securities" in the press statement to emphasize the "elevated securities holdings would continue to support accommodative financial conditions" even after the QE monthly purchases go to zero next year. They seem to be unable to switch gears from accommodation to tightening. Not sure how holding onto $8 trillion of securities supports accommodative financial conditions.

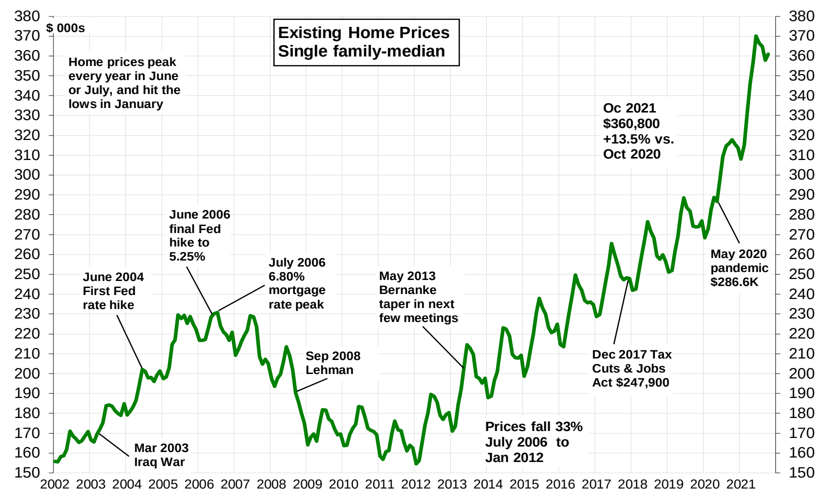
Inflation isn't a threat to the economy as they still think it is temporary, but they did agree to mention the path of inflation was more uncertain. They must really think we read their press statements closely. To reflect the uncertainty, they changed the September 21-22 sentence, "Inflation is elevated, largely reflecting transitory factors" to "Inflation is elevated, largely reflecting factors that are <u>expected</u> to be transitory" in the November 2-3 press statement. That was a good idea because after the November 2-3 meeting, core CPI inflation went from 4.0% year-year to 4.6% year-year on November 10 and core PCE inflation went from 3.6% year-year to 4.1% year-year on November 24. If core PCE inflation falls back to 2.5% next year, it doesn't mean it was temporary or transient: it's still too high because 2.5% erases 10 percent of the value of paper money in just five years. Gone, poof.

OTHER ECONOMIC NEWS

Powell named to inflate the housing bubble for another four years (Monday)



Breaking economy news. He's baack! Powell has been reappointed by President Biden in an announcement shortly before existing home sales were released which means the housing bubble will continue to inflate from the Federal Reserve's policy of zero interest rates. If the choice was only between Powell and Fed governor Brainard, we guess we would choose Powell too as interest rates would probably go up less quickly under Brainard. The economics profession loses when the nation's "Chief Economist" is not an economist however. The President's decision may have been dictated by politics as the Senate remains split 50-50 between Republicans and Democrats. If you can't get your Build, Back, Better plan through the Senate, it is better to stick with the same o', same o' when it comes to appointing a central bank chief.



Existing home sales? You mean the biggest asset that American families own? October existing home sales rose 0.8% to a 6.34 million annual rate. The pace of sales is still above the 5.34 million sold in 2019 and the 5.64 million sold in 2020. This month's sales were held down by a 2.6% drop in Northeast sales.

Single-family home prices are still going up and setting new records in the biggest market down South rising 3.3% in October and 16.5% the last year. Home prices in the Northeast and Midwest were down, and prices in the West up modestly.

Net, net, the stock of existing housing in America continues to turn over at an accelerated pace as the pandemic has done a once in a lifetime reset of home buyer attitudes about just how close they need to be to their place of work. The economy will continue to grow more quickly because the purchase of a new home also leads to more buying of carpets, appliances, and furniture. The pandemic has caused many to rethink their lives and where they live is a key consideration. Change is good if you are in the real estate profession as the buying and selling of homes remains elevated even if it is somewhat below the housing bubble turnover rate way back over a decade ago in 2005. Stay tuned. Story developing.

GDP is just 2.1%, but lots to give thanks for with a growth boom expected in the final quarter of the year (Wednesday)

Breaking economy news. Lots of news at 830am today, GDP second revision to Q3 2021, October durable goods orders, weekly jobless claims, and even the advance trade deficit in goods; and at 10am ET the personal income report with inflation and consumer spending for October. GDP is just 2.1%, but there is lots to give thanks for with a growth boom expected in the final quarter of the year

Forget the supply chain, there is a gigantic labor shortage in the country that is driving inflation higher with initial unemployment claims plummeting by 71K to 199K in the November 20 week. There might be some seasonal adjustment problems with not seasonally adjusted claims rising 18K to 258.6K, but still, the handwriting is on the wall and all the anecdotal reports on how companies cannot find the help they need are true. Jobless claims at rock-bottom means the 4.6% unemployment rate is full employment. Fed officials should not be waiting for a return of the best economy in fifty years 3.5% unemployment before the pandemic before tapping the brakes and lifting interest rates. The labor market supply pool is nearly empty and pushing demand pressure and the prices of goods to new heights.

	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21p	Q3 21r
REAL GDP	-5.1	-31.2	33.8	4.5	6.3	6.7	2.0	2.1
REAL CONSUMPTION	-6.9	-33.4	41.4	3.4	11.4	12.0	1.6	1.7
CONSUMPTION	-4.8	-24.1	25.5	2.3	7.4	7.9	1.1	1.2
Durables	-0.9	0.0	5.5	0.1	3.5	1.0	-2.7	-2.5
Nondurables	0.9	-1.9	4.4	-0.2	2.2	2.0	0.4	0.4
Services	-4.8	-22.2	15.6	2.3	1.8	4.9	3.4	3.3
INVESTMENT	-0.9	-9.6	11.7	4.0	-0.4	-0.7	1.9	1.9
Business Plant	0.0	-1.8	-0.5	-0.2	0.1	-0.1	-0.2	-0.1
& Equipment and	-1.3	-2.0	2.7	1.3	0.8	0.7	-0.2	-0.1
Intellectual Property	0.2	-0.5	0.5	0.5	0.8	0.6	0.6	0.5
Homes	0.7	-1.4	2.2	1.3	0.6	-0.6	-0.4	-0.4
Inventories	-0.5	-4.0	6.8	1.1	-2.6	-1.3	2.1	2.1
EXPORTS	-2.0	-8.3	4.6	2.1	-0.3	0.8	-0.3	-0.3
IMPORTS	1.9	9.9	-7.9	-3.7	-1.3	-1.0	-0.9	-0.8
GOVERNMENT	0.6	1.0	-0.2	-0.1	0.8	-0.4	0.1	0.2
Federal defense	0.0	0.2	0.1	0.2	-0.3	0.0	-0.1	-0.1
Fed nondefense	0.2	1.3	-0.4	-0.4	1.0	-0.3	-0.3	-0.3
State and local	0.5	-0.5	0.1	0.1	0.0	0.0	0.5	0.5
Below line: Percentage point contributions to Q3 2021 2.0% real GDP								
Third estimate for Q3 is Wednesday, December 22								

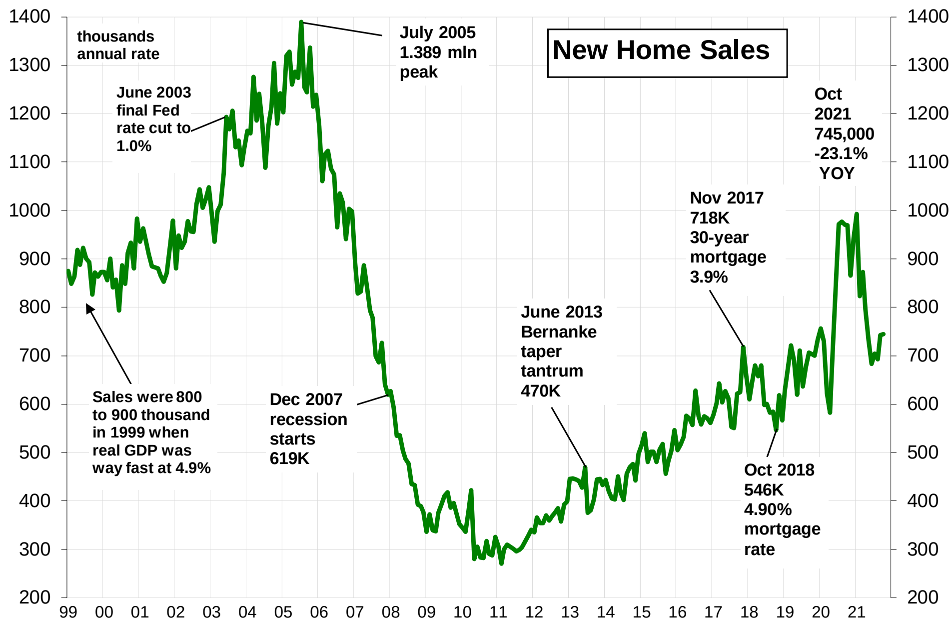
Business spending on core capital goods continues to set new records. We don't know if it is over-ordering or supply chain disruptions from overseas, but nondefense capital goods orders ex-aircraft set another all-time high, increasing 0.6% to $78.588 billion in October to start the fourth quarter off with a bang. Meanwhile, the advance trade deficit plummeted as the Great American export machine kicked into higher gear. Exports of goods jumped 10.7% in October, and with imports slowing to a 0.5% gain, the trade deficit collapsed to $82.9 billion in October from $97.0 billion in September. The trade deficit is finally going to narrow this quarter and start adding to U.S. economic growth instead of subtracting from it.

Net, net, the economy can give thanks this year for the support of millions of consumers that continue to flood the shops and malls and spend the money that made this the shortest recovery from recession in U.S. history. The economy will finish the year with a bang where the vast majority of the public is doing much better than they were at the start of the year. There is more prosperity across America than there is joblessness this Thanksgiving. The economy is back and generating inflation pressures not seen in decades even before the President's Build Back Better plan is passed by Congress.

This is not a reopening of the economy following the lockdowns and restrictions during the pandemic, this is a quantum leap in economic demand and growth from where we were at the end of 2019 before the pandemic. The economy is not back to normal, it is miles and miles above that and the intensification of demand pressures has sent inflation soaring to the highest level in decades. Fed officials are still fighting joblessness, but the fight they need to have should really be against inflation which is a greater worry in all the business and consumer surveys lately.

October New Home Sales barely changed after big 7.3% downward revision to September (Wednesday at 10 AM ET)

Breaking economy news. The news of the economic indicator from the U.S. Census Bureau voted most likely to be the one with the biggest and most frequent revisions didn't disappoint this month. Let's see, there's durable goods, housing starts, retail sales, the trade deficit, construction spending… and then there is new home sales, the worst economic statistic for initial accuracy, calling into question why… Well, we won't say it. And at 10am ET Wedesday, its release played second fiddle to the personal income report, and was not closely reviewed by traders leaving for the Thanksgiving holiday weekend. Anyway, new home sales were 800K in September at an annual rate, but not anymore after a downward revision to 742K and October sales released today were barely changed at 745K. (Don't make us calculate the monthly percent change, and frankly, any earnest, studied analysis of the October data is called into question after that radical revision to September's report.)



What was the peak in new home sales? Answer: 1.389 million in July 2005. Mortgage rates were 5.75% in July 2005 and peaked at 6.8% in July 2006. Makes you think. This week mortgage rates were 3.1%. The peak of the pandemic was 993 thousand in January 2021. Home prices are still rising despite the decline in sales. The median sales price hit a new record of $407,700 which is 21.0% higher than the $336,900 price average in 2020. Stay tuned. Story developing. Watch here where the world goes next.

New Home Sales	Total	Northeast	Midwest	South	West	Median Price $
2019 Year	683	30	72	399	182	321,500
2020 Year	822	37	93	474	218	336,900
May 2021	733	40	92	412	189	390,400
Jun	683	28	96	391	168	374,700
Jul	704	27	70	415	192	406,000
Aug	693	31	64	423	175	407,600
Sep	742	34	73	449	186	404,700
Oct	745	30	81	450	184	407,700
	Thousands at Seasonally Adjusted Annual Rate					

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