Market Update

Economic News

June 28, 2019

The market awaits headlines from the G-20 meetings, but with the Trump/Xi meeting not taking place until tomorrow the full market reaction from the G-20 will likely be next week. That being said, we're not expecting a breakthrough in the weekend talks, other than a promise to continue negotiations, so the market reaction next week may be limited. We discuss in more detail below the possible scenarios from the G-20 but in the meantime we did get first-tier economic data in the form of May personal income and spending numbers this morning. Incomes rose 0.5% matching the gain in April while personal spending rose 0.4% versus an upwardly revised 0.6% the prior month. Adjusted for inflation, real personal spending was up 0.2% matching the gain in April. The Fed's preferred inflation measure, core PCE, was up 0.2% for the month and remained at 1.6% year-over-year for the second straight month. Core PCE was 2.0% at the beginning of the year so the Fed's removal of the "transitory" label regarding the move lower in inflation in last week's FOMC statement looks to be spot-on. While the spending numbers point to a rebound in second quarter consumer consumption the continued softness in inflation pressures likely keeps a July rate cut firmly on the table.

While we await word on the fate of US/China trade talks, we do have some economic numbers to sink or teeth into today. As mentioned above, the nice boost in personal spending numbers for May came just as first quarter consumer spending was revised lower. In the second estimate of first quarter GDP consumer spending, which is two-thirds of the economy, grew at a 0.9% annual pace compared to the prior estimate of 1.3%. Keeping first quarter GDP unchanged at 3.1% was nonresidential fixed investment which rose at a 4.4% rate, almost double what was previously reported, as spending on intellectual property was revised sharply higher. With personal spending posting a solid 0.4% gain in May and 0.6% in April, a nice rebound in second quarter consumption seems on track. Weakness in other sectors, however, is expected to slow second quarter GDP to a modest 1.8% as net exports and inventory run-off hamper growth.

The other data point from the personal income and spending report is the Fed's preferred inflation measure, core PCE, is still indicating soft inflation. For the month, core PCE was up 0.2% (actually 0.190%)which matched expectations and prior month results (actually 0.249%) and the year-over-year print was 1.6% (1.600%) versus 1.6% (1.617%) in April and 2.0% at the beginning of the year. The Fed's increased concern and removal of the "transitory" label regarding the move lower in inflation in last week's FOMC statement looks to have been prescient. Thus, a rate cut in July still looks to be firmly on the table as the disinflationary trend for this year continues. As long as inflation pressures remain sluggish, the Fed has a green light to cut rates, especially with "uncertainties" remaining from trade war headwinds and resultant waning global growth and confidence.

Speaking of uncertainties, the G-20 meetings are ongoing in Osaka, Japan but the spotlight of the gathering will be the one-on-one meeting between President Trump and China President Xi on Saturday. While nothing has been certain in this ongoing trade affair, the most likely outcome is we're about to enter another period of trade-war truce and a return to the negotiating table. While markets may politely golf-clap that outcome, the good feelings may be short-lived.

If President Trump and Xi announce a new round of trade talks Saturday, optimism should be balanced with a healthy dose of clear-eyed reality. Talks fell apart six weeks ago, not over a few paragraphs of disagreement, but over fundamentally different views on how best to secure the economic futures for their respective country's. Those views haven't really shifted in the interim. The two sides had little contact during the stalemate, and plans for this weekend's meeting came together only after a series of last-minute phone calls.

According to the Wall Street Journal, which cited unidentified Chinese officials, Xi's terms for a trade truce will include the U.S. lifting its ban on the sales of technology to Huawei, that could be a deal-killer right there. In addition, other Chinese demands reportedly include: the removal of all extra tariffs, set targets for Chinese purchases of goods in line with real demand and ensure that the text of the deal is "balanced" to ensure the "dignity" of both nations. U.S. lead trade negotiator Robert Lighthizer responded that China's trade, investment, and regulatory practices had been a problem for decades and that China must offer much more than the U.S.. Thus, the differences in what a trade deal will or will not include continue and both sides seem increasingly hemmed in by political considerations which may prevent much movement.

The Chinese don't want to appear to be caving to U.S. demands with little offset while the U.S. feels the hardline approach is winning political points with Trump's base. The Chinese too are weighing the prospects of stalling until after the 2020 elections on the hope they may have a different administration to deal with. Thus, it seems the best that can be hoped for this weekend is an agreement to resume talks, but as long as the larger issues remain unresolved the "uncertainties" alluded to by the Fed will remain and that seems, with docile inflation, will put the Fed squarely in easing mode.

Dec. '19 Fed Funds Futures Still See 75bps in Easing

The Fed came out of last week's FOMC meeting not wanting to disabuse the market of its prediction of 75bps in rate cuts by year-end. Instead, the only push back was by St. Louis Fed President James Bullard that a single 50bps cut in July would be excessive. The market said, " ok then, how about a 25bps cut in July followed by two more 25bps cuts before year-end?" As the graph shows there has been very little movement in the year-end fed funds estimate coming into and out of the Fed meeting. At 1.69%, the futures market still sees 75bps in cuts and whatever the combination the market, and the Fed, seem comfortable with that right now.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	2.13%	+0.01%	1 Mo LIBOR	2.40%	+0.02%	FF Target Rate	2.25%-2.50%	3 Year	1.752%
6 Month	2.10%	+0.08%	3 Mo LIBOR	2.33%	-0.06%	Prime Rate	5.50%	5 Year	1.776%
2 Year	1.76%	+0.05%	6 Mo LIBOR	2.20%	-0.10%	IOER	2.35%	10 Year	1.976%
10 Year	2.02%	+0.03%	12 Mo LIBOR	2.18%	-0.08%	SOFR	2.42%		