CenterState
— CORRESPONDENT DIVISION —

Market Update

Economic News

October 11, 2019

You couldn't have asked for a clearer example of what is driving yields at the present time than what we are seeing as the week draws to a close. The only first-tier economic report of the week, September CPI, came and went with almost little notice yesterday as rumors of a possible U.S./China trade deal garnered all the attention. With President Trump meeting with China's Vice Premier Liu this afternoon, indications are that some type of trade deal could well be announced after senior level officials from both countries wrap up two days of negotiations in D.C.. The rumors and body language have been enough to ignite another equity rally and Treasuries have been the victims in the risk-on trade. Despite a very docile CPI read, Treasuries are on the back foot with the 10-year down another 10/32nds today to yield 1.70%. The next level of support looks to be 1.75% while the prevailing 1.43% to 1.90% range still holds sway. While we possess no particular skill in predicting political outcomes, we think a trade deal announced today will be somewhat limited in scope and as a consequence any yield back-up off the headlines will eventually present a buying opportunity as the force of slowing economies, both global and domestic, reasserts itself.

Despite the market not paying much attention to yesterday's September CPI release it certainly allows the Fed to continue to contemplate a rate cut at the October 30th FOMC meeting. The odds of a rate cut currently sits around 67% while the drop from 80% earlier in the week is more to do with the aforementioned U.S./China trade deal rumors as the CPI numbers were certainly friendly to those contemplating an October rate cut.

The core consumer price index, which excludes food and energy, increased 0.1% in September and that came in below the 0.2% expectation and compares to 0.3% gains that occurred for the three prior months. The annual gain of 2.4% matched projections as well as the August increase. Overall CPI was unchanged on the month which was below the 0.1% forecast and up 1.7% versus 1.8% projected. As mentioned above, the subdued monthly readings will keep an October rate cut on the table, but for now the report is taking a backseat to the potential of a trade deal with China.

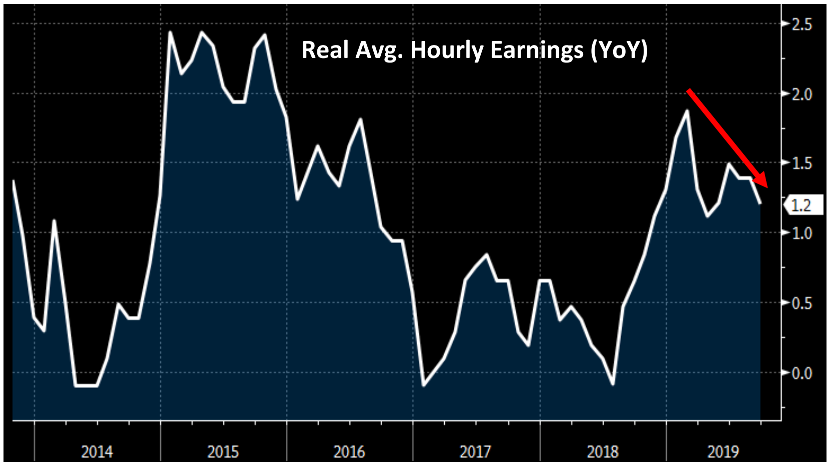
Given the CPI release, Fed members favoring a reduction will see little risk that inflation will jump above the central bank's 2% target. As if to accentuate where the inflation numbers fit in the Fed's rate cutting calculus, the September FOMC minutes revealed a lot more discussion on extending the economic expansion and less on the inflation question. Even so, additional tariffs could still pass through to prices paid by consumers. Tariffs are expected to increase from 25% to 30% on $300 billion of Chinese imports beginning next Tuesday if no deal is reached. Another set of tariffs on $112 billion in Chinese goods are expected December 15th, again subject to any changes stemming from the ongoing trade talks. While a bump in inflation has been expected from prior tariffs, the impact at the consumer level remains minimal. If the final round of tariffs does go into effect, the consumer-heavy goods under that tariff schedule are likely to bump consumer inflation but the Fed would likely wave off any increases as transitory.

Digging inside the details of the CPI release, there was a notable drop in used-car prices which fell 1.6% during the month while new cars dropped 0.1%. Also notable was the that shelter expenses continue to drive most of what core inflation there is. Shelter expenses rose 0.3% for the third month in the last four. As an example of shelter costs driving core CPI, CPI ex-food, energy and shelter was flat on the month and 1.5% year-over-year. That being said, with mortgage rates low, shelter expenses may continue clocking in at 0.3% month-over-month gains like we've seen more much of this year. However, real weekly and hourly earnings decelerated to 0.9% and 1.2% YoY from 1.1% and 1.4%, respectively so the slightly softer earnings may begin to limit shelter expense increases at some point in the near future.

Finally, Fed speak continues hot and heavy today (Kashkari, non-voting dove, Rosengren, voting hawk, Kaplan, non-voting dove) and into next week, but as we mentioned, if the Fed objects to the market's pricing for a rate cut later this month, they haven't voiced that many objections other than from the usual hawks. Eric Rosengren has dissented over the last two rate cuts and will likely provide a hawkish view today, but the other speakers are doves and Powell, earlier this week, didn't object to the current rate cutting odds.

Thus, time is running out if the Fed is looking to "adjust" market expectations. Given the focus in the September FOMC minutes were more on ways to extend the economic expansion and less on inflation, it seems the Fed is inclined now to err on the side of being overly accommodative rather than limiting rate cuts due to inflationary risks.

Gains in Real Average Hourly Earnings Slowing



Real average hourly earnings for September were released yesterday and continued a 2019 trend of slowing year-over-year gains. The softening trend is really a result of two factors: increasing inflation readings which subtract from real wage gains and decreasing nominal wage increases. Those nominal wage increases peaked in February at 3.4% YoY while the September figure was 2.9% YoY. If the consumer is going to continue to spend and carry the economy the trend in real earnings will need to reverse at some point.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	1.68%	-0.03%	1 Mo LIBOR	1.93%	-0.07%	FF Target Rate	1.75%-2.00%	3 Year	1.563%
6 Month	1.70%	+0.05%	3 Mo LIBOR	1.98%	-0.08%	Prime Rate	5.00%	5 Year	1.526%
2 Year	1.59%	+0.18%	6 Mo LIBOR	1.94%	-0.08%	IOER	1.80%	10 Year	1.629%
10 Year	1.71%	+0.17%	12 Mo LIBOR	1.88%	-0.07%	SOFR	1.85%		

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