CenterState
CORRESPONDENT DIVISION

Market Update

Economic News

October 18, 2019

Investors have been torn between competing forces this week as weaker-than-expected economic reports have strengthened odds of a month-end rate cut while fluid headlines on trade and Brexit deals have kept pressure on Treasuries. Geo-political forces have been the dominant factor in Treasury trading of late and that's no different this week. For example, the improved prospects of a Brexit deal put Treasuries under some modest pressure despite most economic releases coming in weaker than expected, including September retail sales. So, as we arrive at the end of a tumultuous week the market seems more certain that we'll see a rate cut on October 30, but long-end rates, while feeling some pressure, have held in fairly well and remain within the 1.50% - 2.00% range that has prevailed since July. That being said, the planned Brexit vote tomorrow in the House of Commons will no doubt set the tone when trading opens Monday morning, and right now the fate of the vote is still too close to call.

Markets have been buffeted by cross-currents this week as tentative good news on a couple geo-political uncertainties have met with some less than inspiring economic releases. The early results are that the geo-political forces are overwhelming the tepid economic numbers such that Treasury yields have risen during the week. Mind you, the yield back ups have been modest with the 10-year yield rising 7bps on the week.

The geo-political uncertainties we speak of are a possible Brexit deal and the ongoing fleshing out of a possible U.S./China trade deal. On the Brexit issue the outlook changes almost hourly given the dynamic nature of the negotiations and the fraught politics of the issue. Yesterday morning, Prime Minister Boris Johnson and European Commission President Jean-Claude Juncker announced they'd reached a deal. The deal, however, ran into trouble almost immediately as Boris Johnson's Northern Irish allies in parliament said they could not support it and without the support of the Democratic Unionists Party (DUP) of Northern Ireland Johnson won't have the votes for passage. A vote in the House of Commons is planned for Saturday but it's uncertain if the vote will go ahead without DUP pledging support beforehand.

The contentious Irish question continues to bedevil Johnson just as it did Theresa May before him. The latest bid by Johnson would create a customs union in the Irish Sea and thus keep Northern Ireland tied to EU customs schedules. The DUP is opposed to Northern Ireland being treated any differently than the rest of the U.K., but short of establishing a hard border with the Republic of Ireland (and EU member), which nobody wants, the outcome of a vote remains uncertain. So, the mood rises and falls as headlines develop, but with an October 31st deadline looming, a decision will soon be at hand one way or another. Johnson has said no further extensions will be requested so either a deal is ratified or a hard Brexit happens. If the latter is the case expect plenty of flight-to-safety trades. If a deal is ratified it removes a worst-case scenario and will put some pressure on Treasuries but we think they remain in the range that we've seen since July (1.50% - 2.00%).

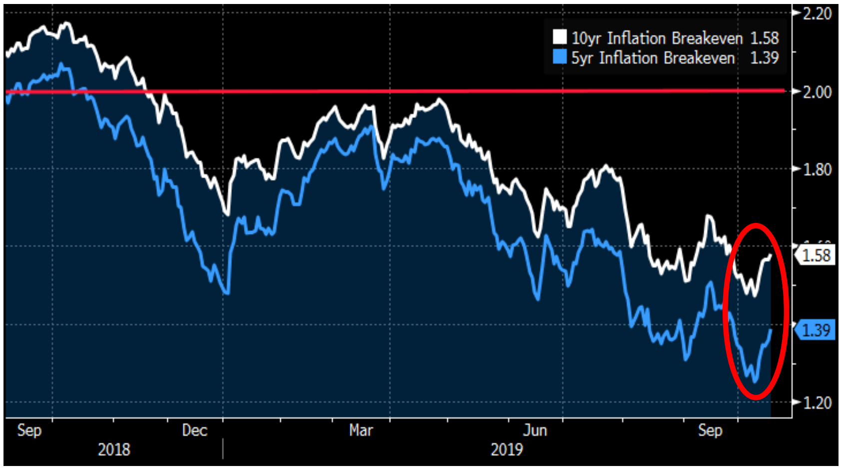
The possible U.S./China trade deal will take time to resolve, and with four weeks to get something in writing, we'll continue to be subject to the waxing and waning of deal prospects. From what we've already seen, however, the scope of a deal appears limited to agricultural purchases and a delay in tariff increases. A deal of that limited nature will likely have only a modest impact on Treasury prices as well.

Moving away from the geo-political September retail sales posted the first decline in seven months, falling 0.3% as a softening in auto sales depressed the headline number. The all-important Control Group (a direct GDP input) was unchanged in September, missing the 0.3% expected gain. Also missing estimates in releases this week: housing starts but that was mostly due to the volatile multi-family sector, industrial production and manufacturing both missed but the GM strike was singled out for blame there, and the Philly Fed Business Outlook disappointed with no excuses provided for that one.

The impact of the mediocre reports has pushed odds of a rate cut on October 30th back to done-deal status. When the week began, odds of a rate cut were at 70%. As the week progressed and the middling economic reports arrived one-by-one the odds increased to 80%. The ebb and flow of trade deal headlines also contributed to increased rate-cutting odds as the scope of a deal began to look more and more limited.

So, as we arrive at the end of a tumultuous week, the market seems more certain that we'll see a rate cut on October 30, and long-end rates, while feeling some pressure, have held in fairly well and remain within the 1.50% - 2.00% range that has prevailed since July. The planned Brexit tomorrow will dictate how the market opens on Monday and right now that's too close to call.

Inflation Breakeven Rates Stop Trending Lower



While odds of a rate cut have increased this week given the vacillating outlook on trade and Brexit deals, and the list of mediocre economic reports, inflation breakeven rates have crept higher. The increase in inflation expectations comes both from the possible trade and Brexit deals and the increased odds of another rate cut. The question now is whether the upward trend is a real reversal of weakening inflation expectations or just a counter-move in a continuing softening in the inflation outlook. The Fed hopes it's the former and they'll be watching to see if that's the case.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	1.65%	-0.03%	1 Mo LIBOR	1.88%	-0.05%	FF Target Rate	1.75%-2.00%	3 Year	1.579%
6 Month	1.61%	-0.09%	3 Mo LIBOR	2.00%	+0.02%	Prime Rate	5.00%	5 Year	1.561%
2 Year	1.59%	UNCH	6 Mo LIBOR	1.99%	+0.05%	IOER	1.80%	10 Year	1.673%
10 Year	1.75%	+0.04%	12 Mo LIBOR	1.99%	+0.11%	SOFR	1.95%		

Thomas R. Fitzgerald
Director, Strategy & Research
400 Interstate North Parkway
Suite 1200
Atlanta, GA 30339