Institutional Insights

James Hotchkiss | September 22, 2022

DISCUSSION TOPICS

- Weekly Interest Rate Comparisons
- Economic Data Releases
- Inflation
- Recession Outlook
- FOMC Meeting Decision
- Preview of the Coming Week
- Q and A

WEEKLY INTEREST RATE COMPARISONS

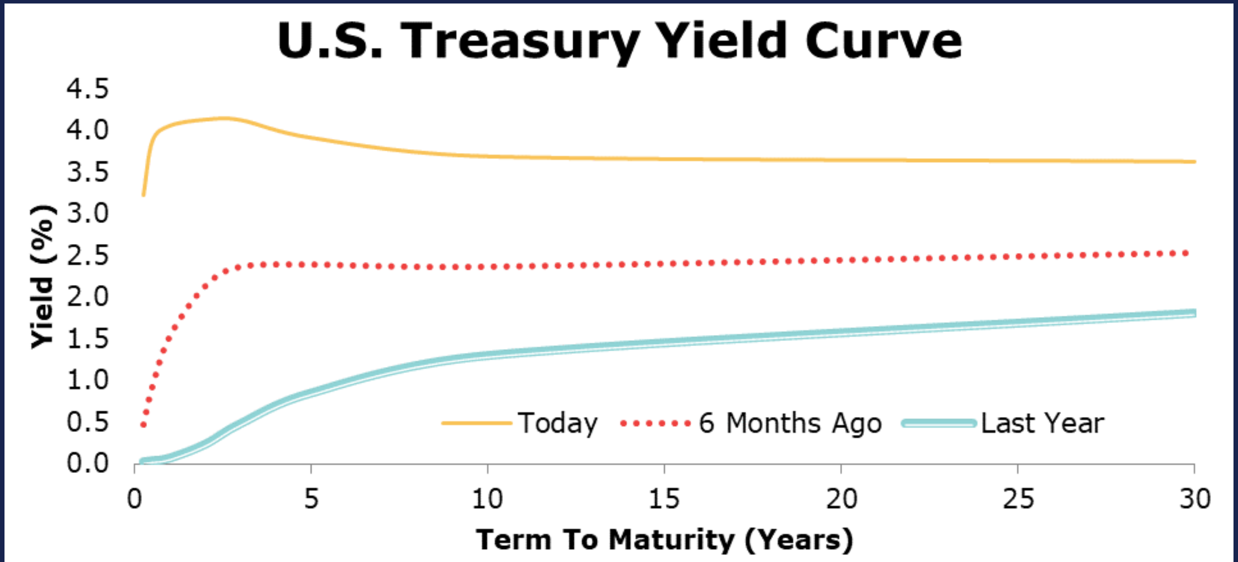
U.S. Treasury Yields

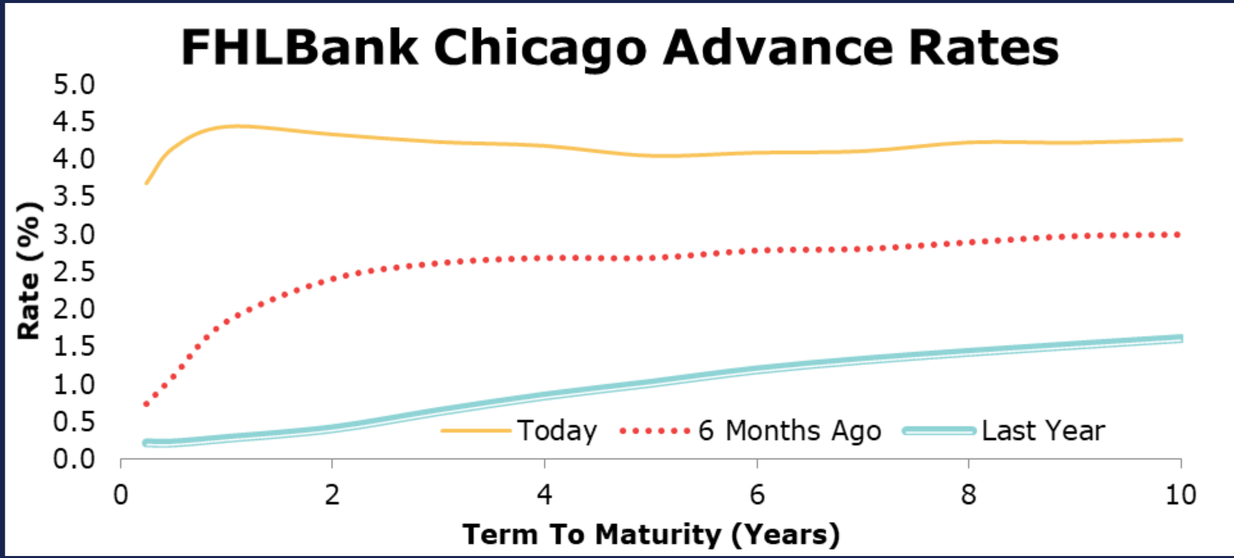
	9/14/22	9/22/22
3 mo	3.24%	3.22%
2 yr	3.78%	4.13%
5 yr	3.60%	3.91%
10 yr	3.41%	3.69%

FHLBank Chicago Advance Rates

	9/14/22	9/22/22
3 mo	3.49%	3.69%
2 yr	4.02%	4.31%
5 yr	3.79%	4.03%
10 yr	4.02%	4.25%

Source: U.S. Treasury, FHLBank Chicago





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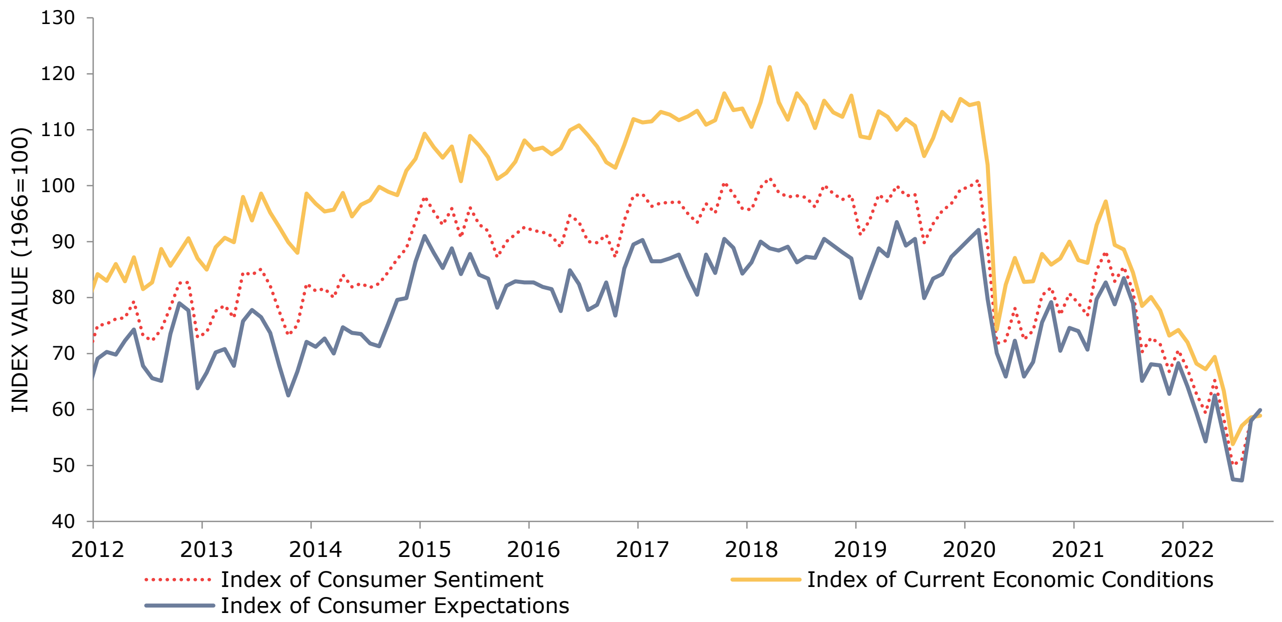
ECONOMIC DATA RELEASES

Consumer Sentiment

September: 59.5 vs. August: 58.2

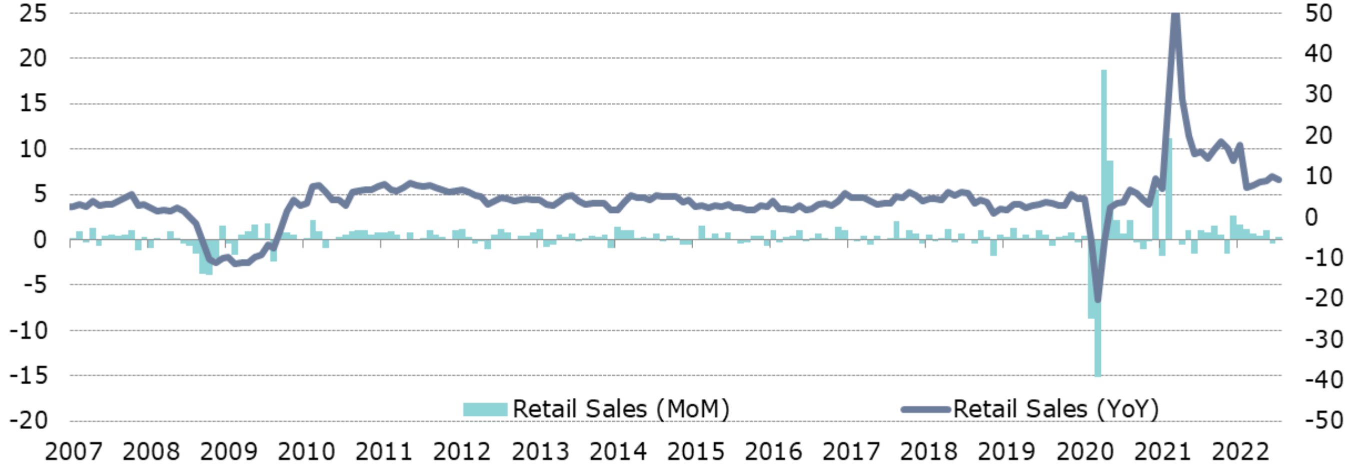
Edged 1.3 points higher to 59.5 in September, slightly below expectations of 60. The decline in energy prices has given consumers some relief from upward prices. The current conditions index improved by a modest 0.3 point while the index of consumer expectations increased 1.9 points to 59.9.



Retail Sales

August: 0.3% vs. July: -0.4%

Rose 0.3% in August, beating expectations but follows July's downwardly revised reading of a 0.4% decline. The increase was driven by a 2.8% gain in auto sales. Excluding auto and gas, retail sales are up 0.3% month-over-month.



Source: U.S. Census Bureau

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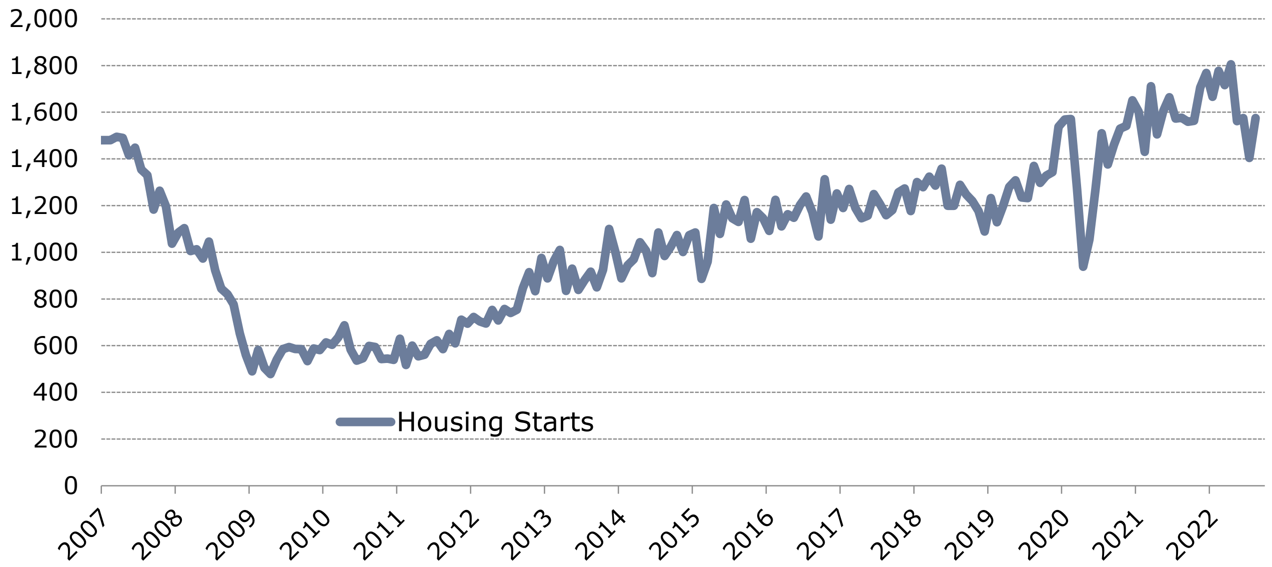
Housing Starts

August: 1575K vs July: 1404K

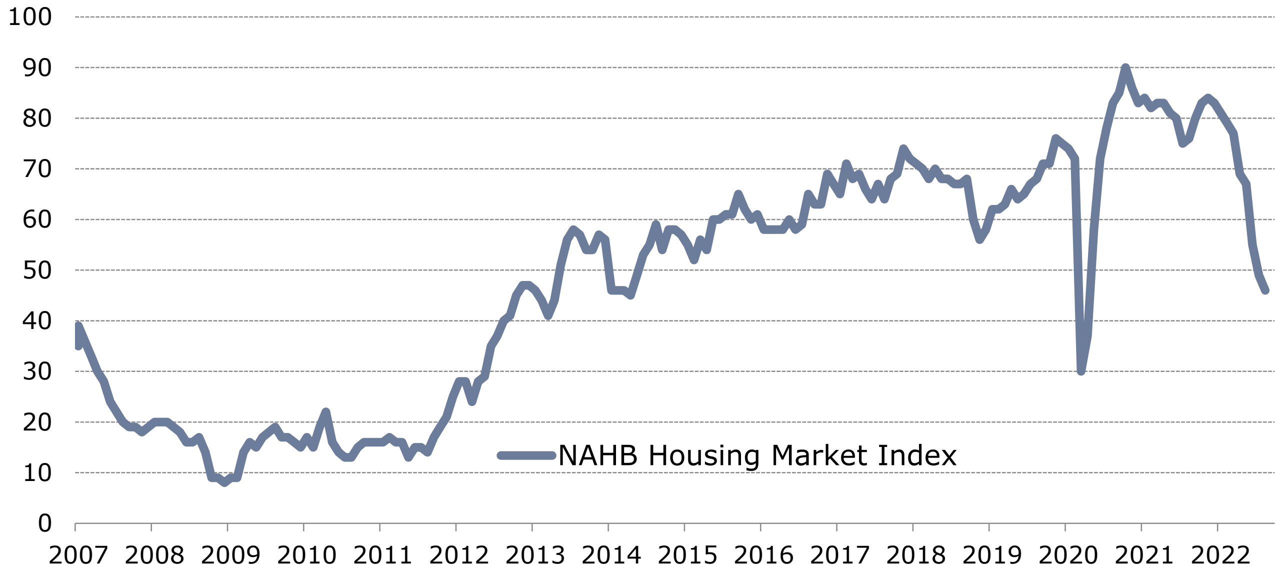
Housing starts increased month-over-month to 1575K in August after a downward revision to 1404K units in July. It vastly exceeded the consensus expectation of 1440K units, and is in line with the levels seen in August 2021. Starts for single-family homes are up 3.4% and multi-family starts are up 28% in August.



NAHB Housing Market Index

September: 46 vs August: 49

The index fell 3 points to 46 in September, slightly below the expected reading of 48. Overall, homebuilder optimism has been on the decline since early 2022. Expected sales in six months declined 1 point, suggesting that the downward slide is expected to level off in the near future.



Source: U.S. Census Bureau

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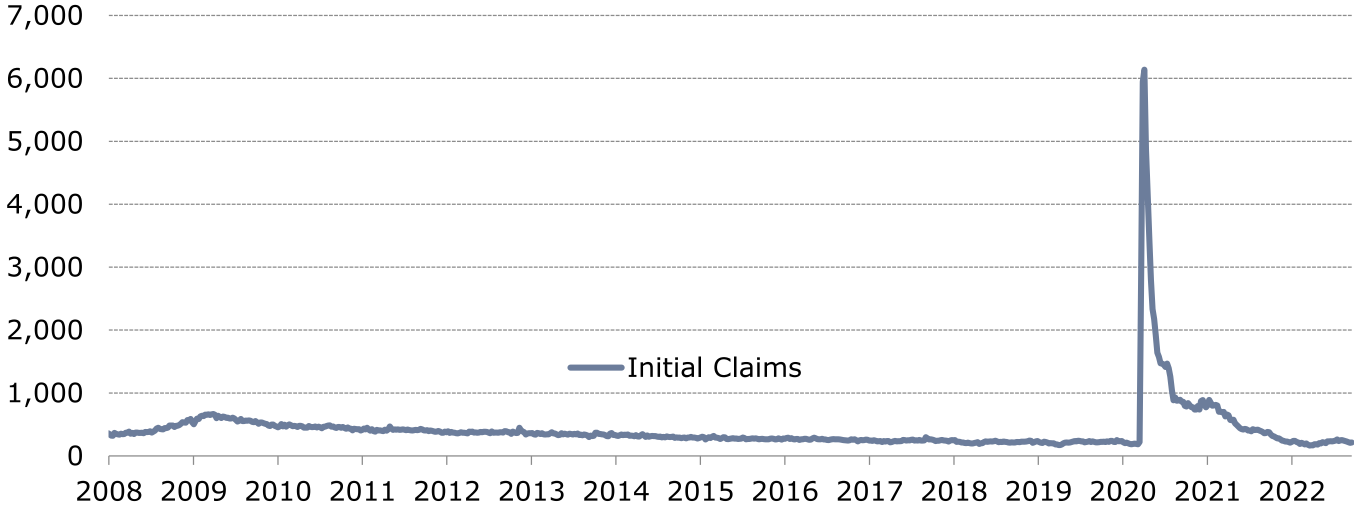
Initial Jobless Claims

September 17: 213K vs. September 10: 208K

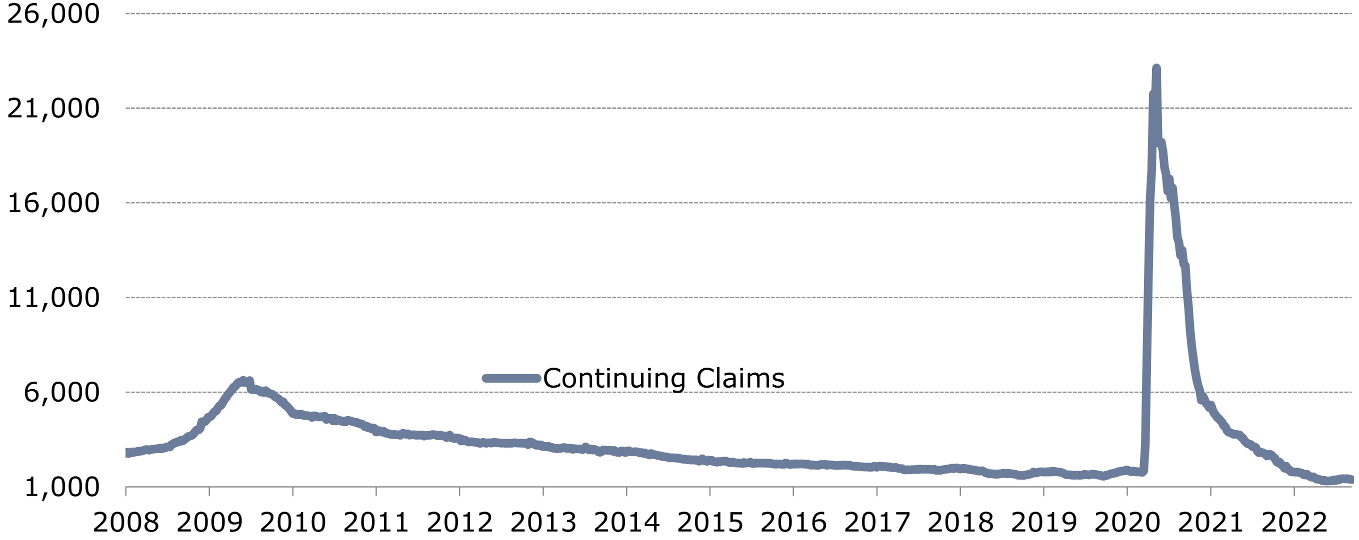
Increased by 5K to 213K in the week ending September 17, below the market estimate of 253K. The four week moving average fell to 216.75K, down 6K from 222.75K.



Continuing Claims

September 10: 1,379K vs. September 3: 1,401K

Decreased to 1,379K in the week ending September 10, down 22K from the week prior. The four week moving average declined to 1,404.75K from the prior week's reading of 1,413K.



Source: U.S. Department of Labor

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Inflation

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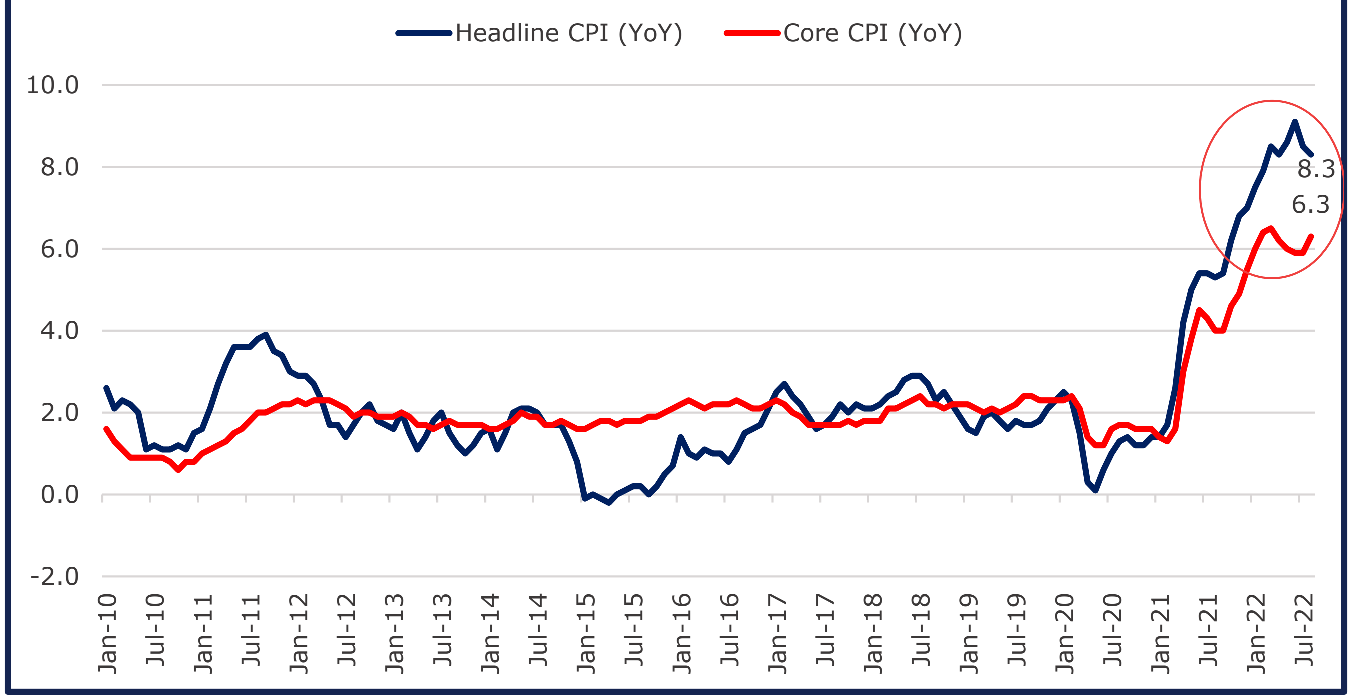
HEADLINE CPI FALLS WHILE CORE CPI UNEXPECTEDLY RISES

Though the August headline Consumer Price Index (CPI) reading was lower than previous months with a 0% change month-over-month, core CPI (excluding food and energy) still increased 0.5% month-over-month.

As energy prices are very volatile, core CPI is a stronger indicator to how high inflation is. Therefore the fed gives it more weight in interest rate decision making.

Energy CPI decreased from a 32.9% year-over-year increase in July to a 23.8% year-over-year increase in August.

CPI/CORE CPI YOY CHANGE (%)



1. Bloomberg

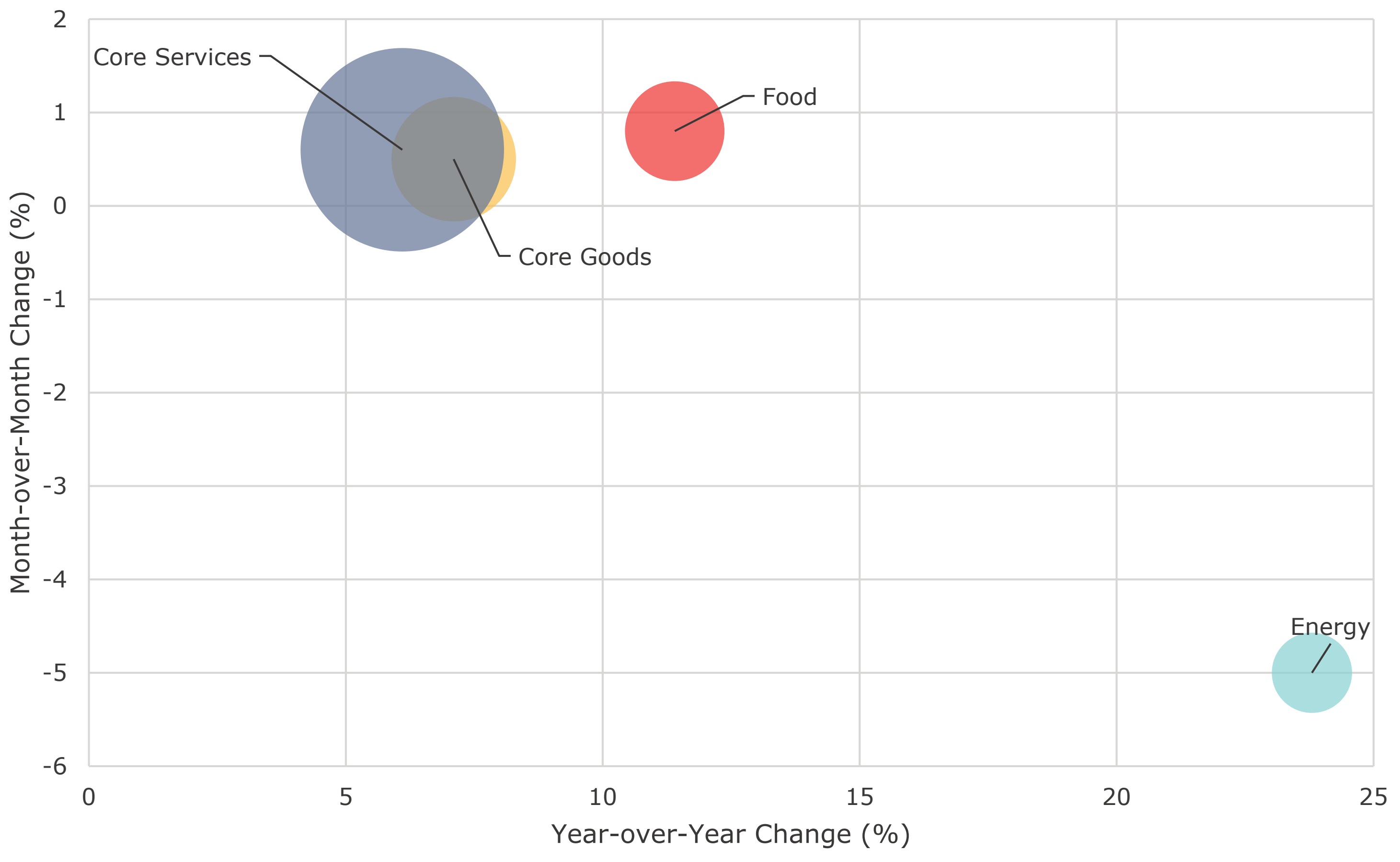
BREAKING DOWN HEADLINE CPI

(BUBBLE SIZE = RELATIVE WEIGHTING)

Core services have the greatest weight on inflation.

Food prices rose to an 11.4% increase year-over-year. This is the largest 12-month increase since 1979.

Though energy has the smallest weight of the four indicators, it's changed the most drastically this year and decreased month-over-month leading to the slight decline in headline CPI.



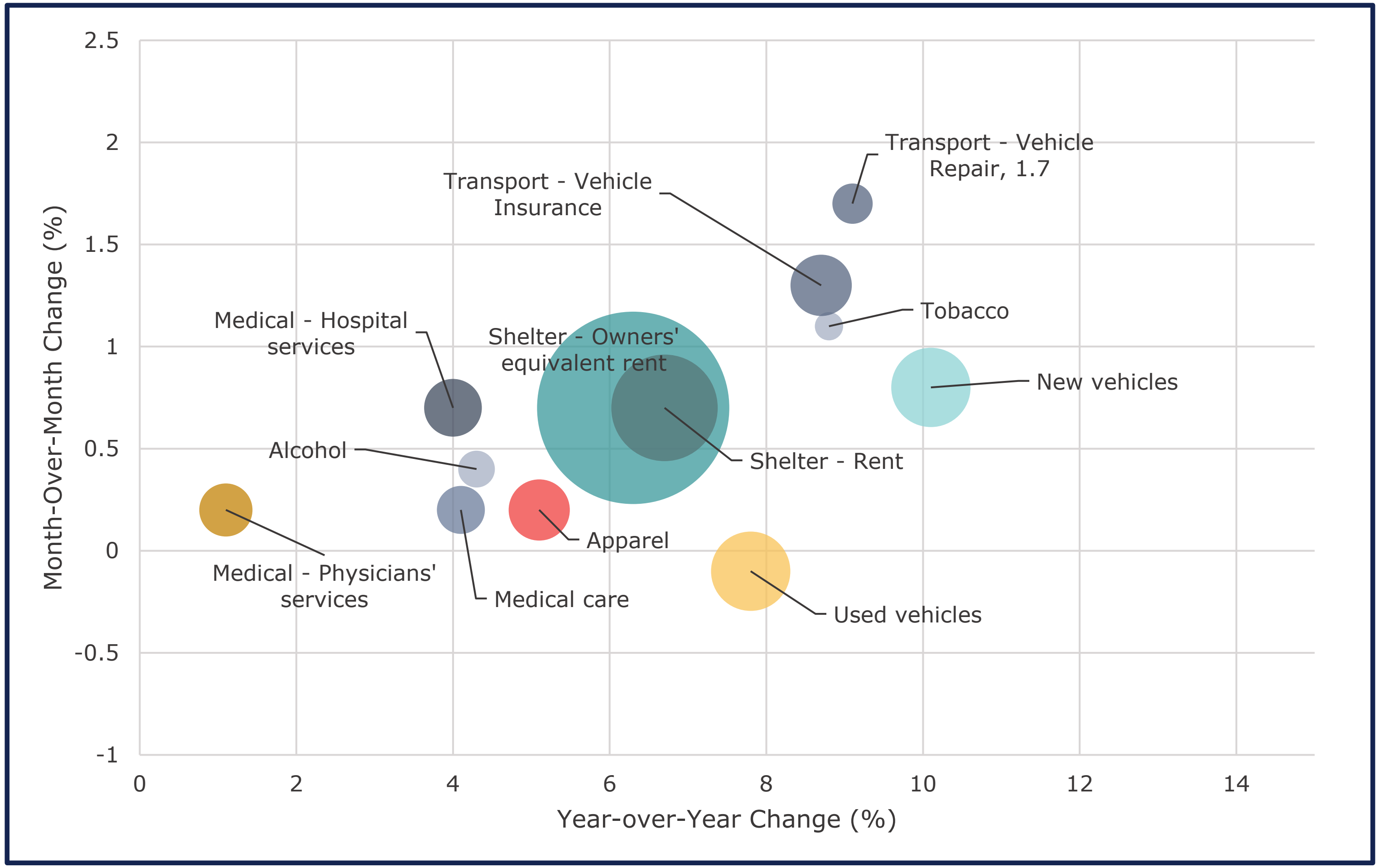
1. Bureau of Labor Statistics
2. Person, and Lucia Mutikani. "Stubbornly High Rents, Food Prices Boost U.S. Inflation in August." Reuters, Thomson Reuters, 13 Sept. 2022,

BREAKING DOWN CORE CPI

(BUBBLE SIZE = RELATIVE WEIGHTING)

Increases in rent inflation have had the greatest impact on core CPI increases. As rents are sticky, this is a sign that core CPI could remain elevated for some time.

As mortgage rates are higher and housing demand remains elevated, demand for rental accommodation remains high which further stokes rent inflation.



1. Bureau of Labor Statistics
2. Person, and Lucia Mutikani. “Stubbornly High Rents, Food Prices Boost U.S. Inflation in August.” Reuters, Thomson Reuters, 13 Sept. 2022,

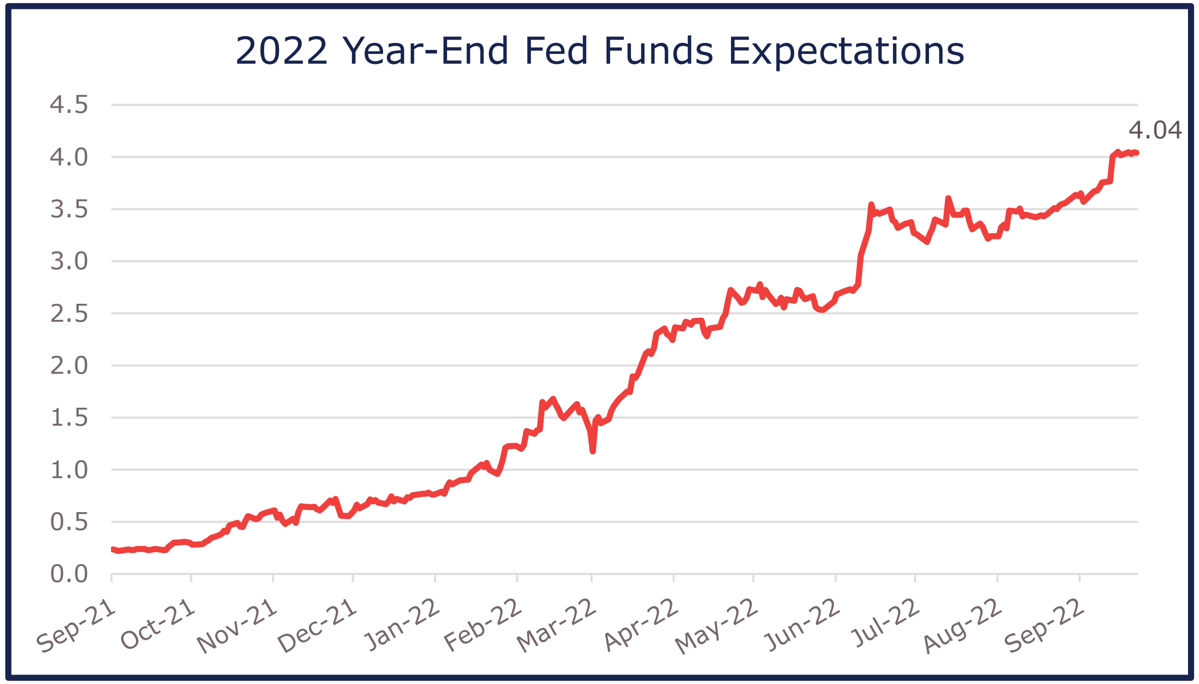
RECESSION OUTLOOK

Where Is the Fed Going With Rates?

Does the Fed know?

Meeting Date	Median[1]	Central Tendency[2]	Range[3]
September 2021	0.3	0.1 - 0.4	0.1 - 0.6
December 2021	0.9	0.6 - 0.9	0.4 - 1.1
March 2022	1.9	1.6 - 2.4	1.4 - 3.1
June 2022	3.4	3.1 - 3.6	3.1 - 3.9
September 2022	4.4	4.1 - 4.4	3.9 - 4.6

Does the market know?



Does anyone know?

Source: https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm
1. For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections.
2. The central tendency excludes the three highest and three lowest projections for each variable in each year.
3. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

Yield difference between the December 2022 FF futures contract and January 1 FF rate, divided by 25bps. We've already experienced twelve 25 bp hikes in 2022, and the market is currently pricing in an additional 4 hikes to approximately 4.0%.

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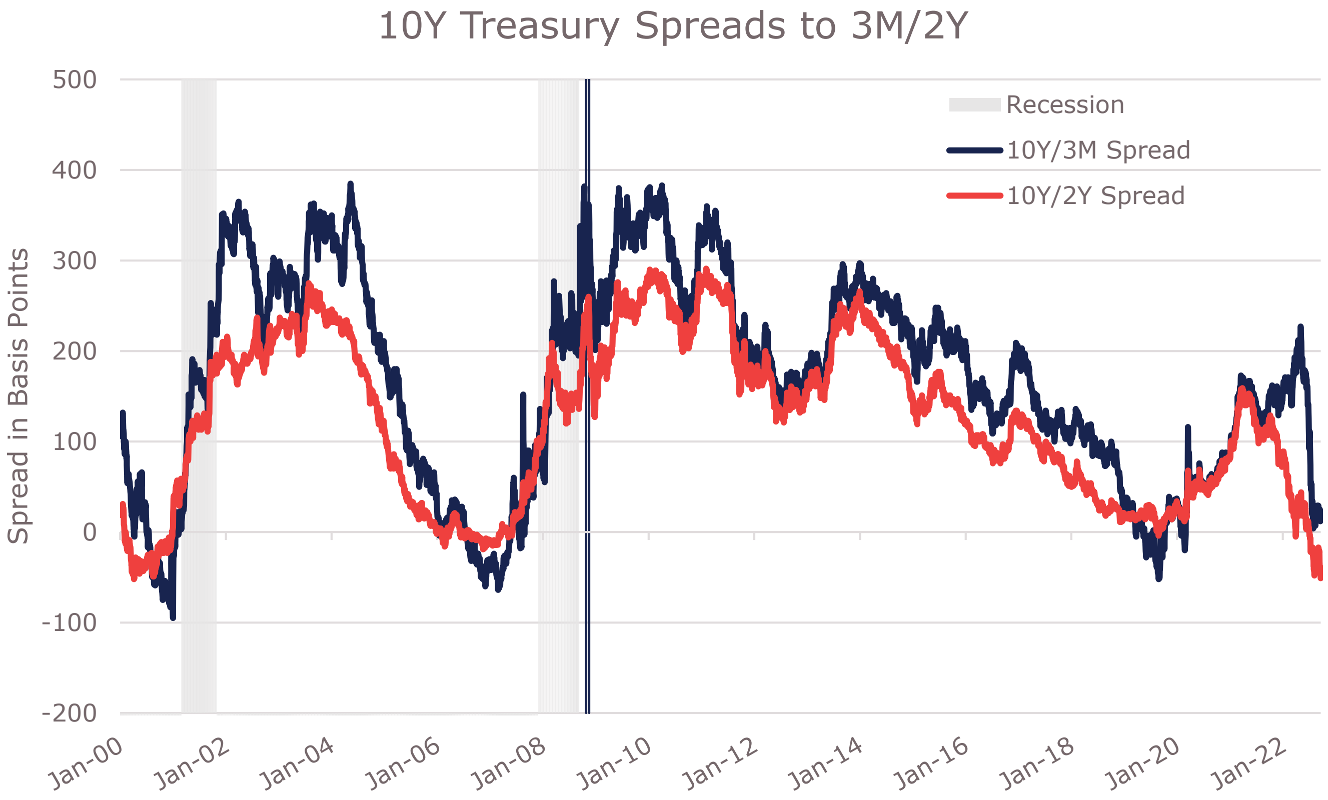
Yield Curve Inversions Pointing to a Recession

With continued hawkish commentary from Fed officials that additional aggressive rate hikes may be needed to combat inflation. However, can the Fed do so while avoiding a recession?

The inversion of the 10-year Treasury yield vs. the 2-year and 3-month are often viewed as precursors to a recessionary period. However, the inversion often occurs several months to 1-2 years before the recessionary period.

The 10Y/2Y spread has remained inverted since July. On September 21 the spread was at -51 basis points (bps). The 10Y/3M spread has not inverted yet but remains around 20 bps.



*Shaded areas are recessionary periods

Source: The Federal Reserve Bank of St. Louis

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FOMC MEETING DECISION

FOMC Meeting Decision

- As widely expected, the Fed increased the federal funds rate by 75 bps to a range of 3.00 – 3.25%. This is the third such hike in a row and avoids the full percentage point increase that some had called for at this meeting. Interest on reserve balances also increased by 75 bps to 3.15%.
- A little less-expected was the forecast, extremely hawkish with the FOMC says it “anticipates that ongoing increases in the target range will be appropriate”, signaling additional large increases are likely at upcoming meetings. Also notable was Powell’s answer to the last question from Market News’ Jean Yung about raising rates to 4.6% next year. His answer further highlights the FOMC’s aggressive, with Powell noting that 4.6% is the median and adding, “Let’s assume we get to that level, which, I think is likely…”
- The median forecast shows rates at 4.375% by year end 2022 (an additional 125 bps of hikes spread across the next two meetings), 4.625% in 2023, and 3.875% in 2024. The terminal rate of the hiking cycle is now 4.625%, up from 3.8% at the June meeting.
- The most hawkish dots now see the federal funds rate reaching nearly 5% in 2023. In June, the highest dot was at 4.4% by the end of 2023. Fed does not see inflation returning to 2% until 2025.
- GDP forecasts were revised down substantially, with the median estimate for growth this year at just 0.2%, down from 1.7% forecast in June.
- No major changes to unemployment forecasts, up slightly to 4.4% for both 2023 and 2024. Long-run rate unchanged at 4%.

Source: The Federal Reserve

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This and That

Since Russia invaded Ukraine in February, Europe has seen shocks to their oil and natural gas supply lines and therefore increased world prices of crude and natural gas. Europe spent the past decade reducing their domestic energy outlets (Nuclear and Coal) and becoming more dependent on Russian natural gas. This plan has been more cost effective due to proximity of Russia to Europe as well as better for the environment as natural gas releases less CO_2 than coal. The Nord Stream 1 pipeline is the largest pipeline (running from Russia to Germany) supplying Europe with natural gas. Russia has weaponized this pipeline for political gain by reducing and cutting off the flow of natural gas, pushing Europe towards energy shortages as we reach the winter months.

As a result, the U.S. has seen an increase in exports of oil and gas supplies to Europe. U.S. oil production has increased and recently stagnated at about 12.1 million barrels a day. Though higher than production volumes during the pandemic, this is still far from the 13 million barrels a day the U.S. was producing pre pandemic. U.S. oil executives have said they will not increase production more than they already have due to capital constraints.

Europe is currently seeking other sources for energy such as Norway, Algeria, Australia, and others. However, they do not have the supply chain infrastructure in place to support movement of liquefied natural gas throughout the continent. So, what does this mean in the short term? We are going to continue to see high volatility in the energy markets as we approach the winter months and demand becomes higher.

Source: Financial Times: https://www.ft.com/content/2fbbe104-93e3-48bb-8d69-211c79069624
https://www.ft.com/video/60ad6091-4162-49a1-a89d-c63870eb9b3d?playlist-name=editors-picks&playlist-offset=2
Forbes: https://www.forbes.com/sites/daneberhart/2022/09/19/why-us-shale-producers-arent-riding-to-the-rescue-despite-tight-oil-supplies/?sh=636da8a36456

Economic Data Release Calendar

Next week, economic data will be released on Consumer Confidence, Chicago PMI, and GDP.

Housing data will also be released next week in the New and Pending Home Sales reports, as well as the FHFA House Price Index.

September 2022				
Monday	**Tuesday**	**Wednesday**	**Thursday**	**Friday**
			1 Export Sales Jobless Claims PMI Manufacturing	2 Factory Orders
5	6 ISM Services Index	7 MBA Mortgage Applications Redbook Beige Book	8 Jobless Claims Consumer Credit	9 Export Sales Wholesale Inventory
12 Crop Progress	13 Redbook CPI NFIB Index	14 MBA Mortgage Applications PPI - Final Demand	15 Jobless Claims Retail Sales Export Sales Business Inventories	16 Consumer Sentiment
19 Housing Market	20 FOMC Meeting Begins Housing Starts and Permits Redbook	21 MBA Mortgage Applications Existing Home Sales FOMC Announcement	22 Jobless Claims Export Sales	23
26 Chicago Fed Index	27 Durable Goods Orders Consumer Confidence FHFA House Price Index New Home Sales	28 MBA Mortgage Applications Pending Home Sales	29 Jobless Claims GDP Export Sales	30 Chicago PMI Consumer Sentiment

Questions?

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