# RJO Previews and Perspectives for Thursday, March 22

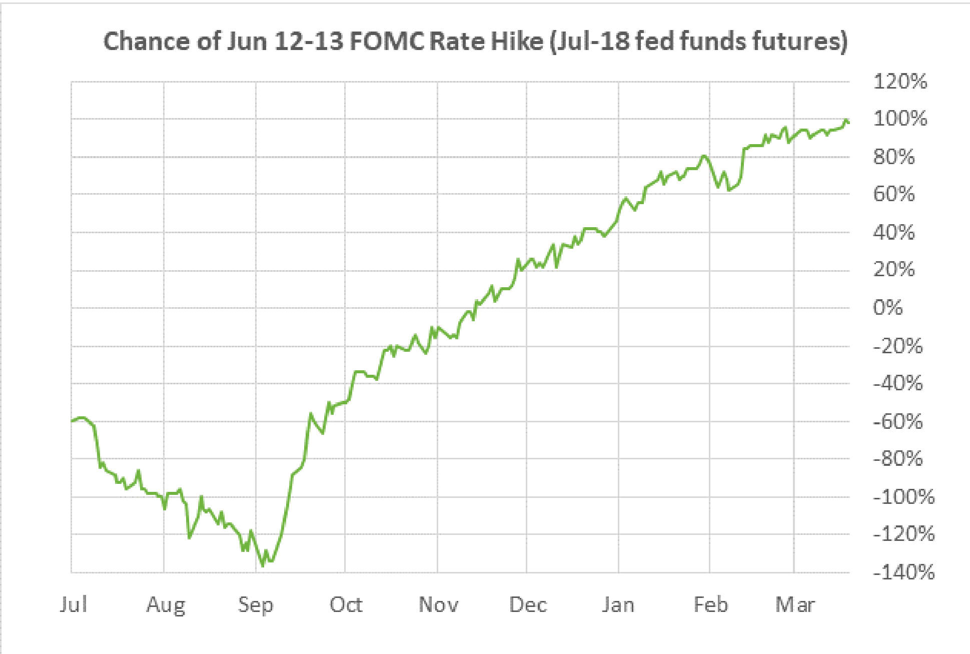
Posted on 3/21/2018 10:41:05 PM

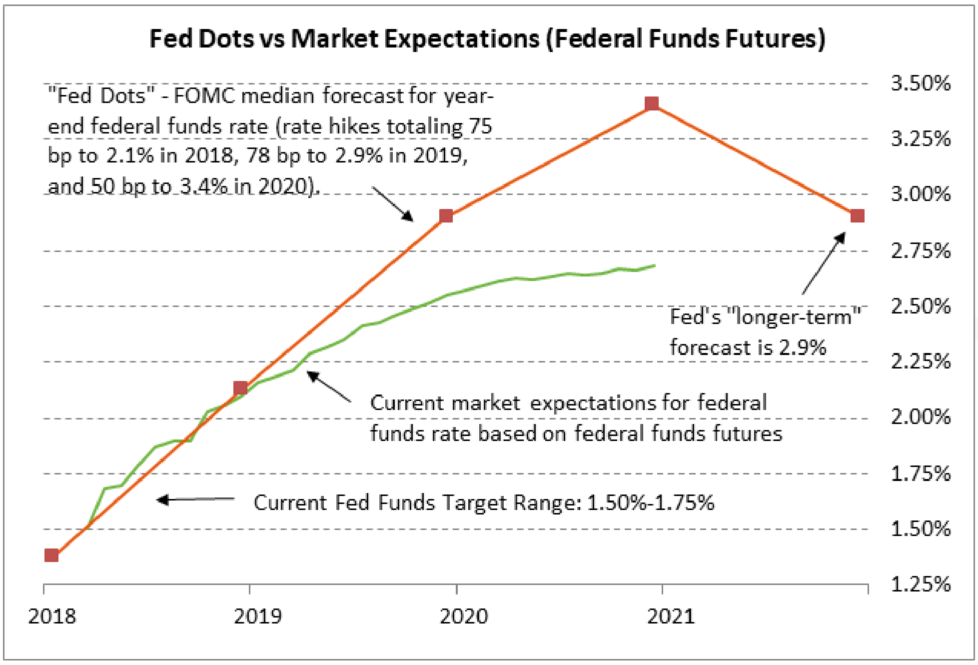
**Markets take in stride an extra Fed-dot rate hike in 2019-2020** -- The markets generally took in stride Wednesday's increase in the Fed-dot forecast for the funds rate for 2019/20. The Fed-dot median rose by +20 bp for 2019 to 2.9% from 2.7%, and by +30 bp for 2020 to +3.4% from +3.1%. The Fed-dot forecast now calls for two more rate hikes in 2018, three rate hikes in 2019, and two rate hikes in 2020, leaving the funds rate at 3.40% by the end of 2020. The Fed-dot median also rose for the forecast for the "longer-term" funds rate by +10 bp to 2.9% from 2.8%, illustrating that the Fed thinks the U.S. economy is strong enough to deserve a slightly higher neutral rate.

The FOMC meeting outcome was a little less hawkish than the markets were expecting for 2018-19 but more hawkish for 2020. Specifically, the federal funds futures curve turned more dovish by 1-2 bp for the 2018-19 futures contracts, but turned more hawkish by 3-6 bp for the 2020 contracts.

Regardless of the hike in the Fed dots, the markets are still substantially undershooting the Fed-dot forecasts. The market is 30 bp below the Fed for 2019 and 36 bp below the Fed for 2020, according to federal funds futures pricing.

Regardless of what the Fed might do in the next several years, however, there is no doubt that another Fed rate hike is assured within the next three months. The markets are discounting less than a 50/50 chance of a rate hike at the next meeting on May 1/2, but are discounting nearly a 100% chance of a rate hike at the following meeting on June 12/13.

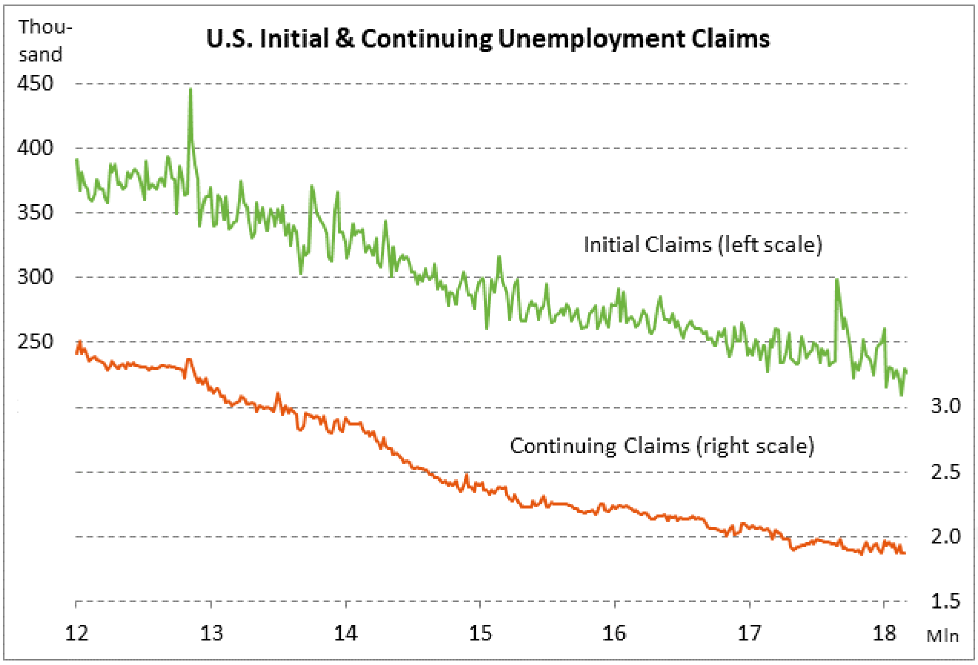




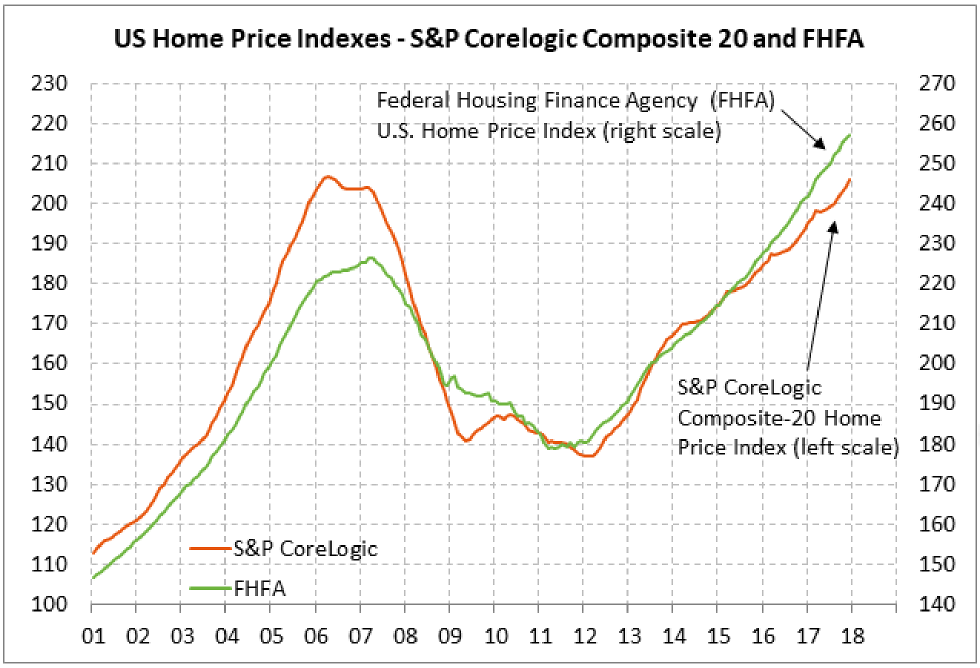

**Trump IP retaliation announcement against China expected today** -- There are widespread reports that the Trump administration on Thursday will announce its retaliation package against China for intellectual property violations. However, the composition of the package was in flux and could be delayed altogether by the east coast snow storm. The tariff package could be anywhere from $30-60 billion. The package is also likely to include restrictions on Chinese investment in the U.S.

Notably, the Wall Street Journal on Wednesday said that the tariffs will not take effect immediately, giving U.S. companies time to express their views on which products should be covered by tariffs and for China to come to the bargaining table. Meanwhile, WSJ also reported that China is planning on taking countermeasures against U.S. tariffs, targeting U.S. exports of soybeans, sorghum, and live hogs. Market reaction to the Trump tariff announcement will key on the size and timing of the tariffs and whether China quickly announces retaliation, thus kicking off at least a limited U.S.-Chinese trade war.

**U.S. unemployment claims expected to remain favorable** -- The market consensus is for today's weekly initial unemployment claims report to show a -1,000 decline to 225,000, adding to last week's -4,000 decline to 226,000. The consensus is for continuing claims to fall -6,000 to 1.873 million, more than reversing last week's small +4,000 rise to 1.879 million. Claims remain near 4-decade lows, illustrating the extremely low level of U.S. layoffs. The initial claims series is only +16,000 above the 48-year low of 10,000 posted in late February and the continuing claims series is only +11,000 above the 44-year low of 1.868 million posted in November 2017.




**U.S. home prices continue to rise** -- The consensus is for today's Jan FHFA house price index to show another solid increase of +0.4% m/m following Dec's report of +0.3% m/m. The FHFA index has risen sharply by +6.5% y/y and by an overall +44% from the housing bust low. Housing prices continue to see upward pressure from strong demand and limited supplies.

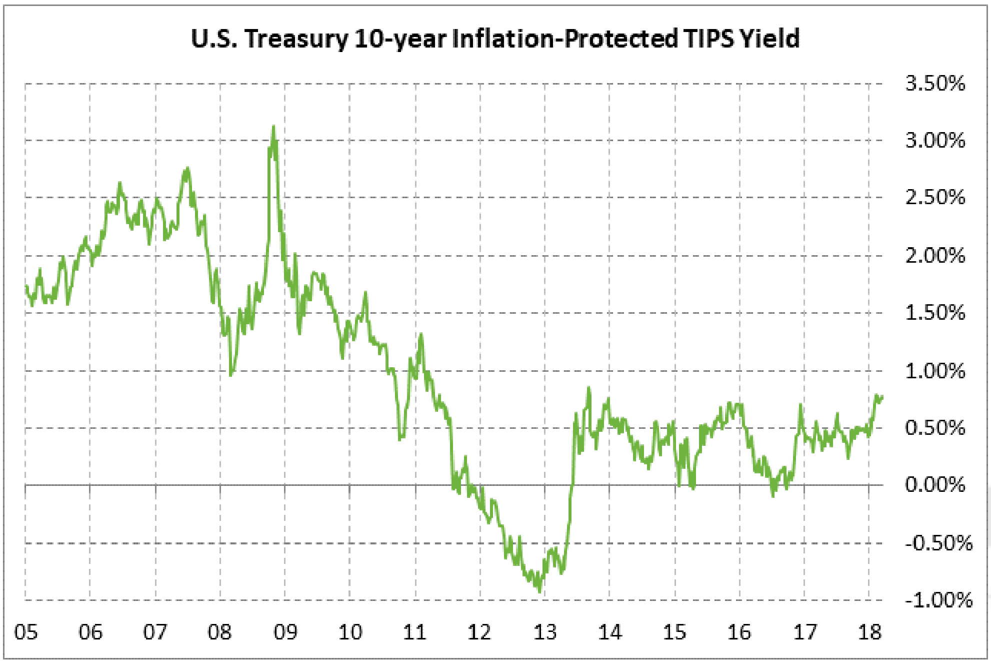



**U.S. leading indicators expected to remain strong** -- The consensus is for today's Feb leading indicators index to show another solid increase of +0.5%. Since last October, the LEI has been very strong with an overall 4-month rise of +3.4%. The LEI in January showed very strong year-on-year growth of +6.2%, the strongest pace in 3-1/2 years. The strong LEI bodes well for near-term U.S. GDP growth aside from what appears to be another seasonally weak Q1.


**March U.S. PMIs expected to show small gains** -- The markets are expecting today's Markit U.S. PMIs to show small increases and indicate solid confidence among U.S. businesses. Specifically, the consensus is for today's Mar Markit manufacturing PMI to show a small +0.2 point rise to 55.5, reversing Feb's -0.2 point decline to 55.3. The consensus is for today's Mar Markit U.S. services PMI to show a +0.1 point increase to 56.0 after Feb's sharp +2.6 point rise to a 6-month high of 55.9.

**10-year TIPS auction** -- The Treasury today will sell $11 billion of 10-year TIPS in the first of two reopenings of the 0.50% 10-year TIPS of 2028 first sold in January. That benchmark 10-year TIPS was trading at 0.78% late yesterday afternoon. The 10-year TIPS has been trading basically sideways in the past month after the sharp 30 bp upward move seen in early 2018 in the wake of the Republican tax cut bill, which bolstered expectations for the economy and investment demand.

The 12-auction averages for the 10-year TIPS are: 2.38 bid cover ratio, $25 million in non-competitive bids, 6.0 bp tail to the median yield, 12.8 bp tail to the low yield, and 54% taken at the high yield. The 10-year TIPS is the second most popular security behind 30-year TIPS among foreign investors and central banks. Indirect bidders, a proxy for foreign buying, have taken an average of 69.3% of the last twelve 10-year TIPS auctions, well above the average of 63.4% for all recent Treasury coupon auctions.


U.S. Treasury 10-year Inflation-Protected TIPS Yield
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
-0.50%
-1.00%
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