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# **RISKS TO THE MARKETS' VIEW OF FED POLICY:** IF YOU EXPECT NOTHING, PREPARE TO BE SURPRISED

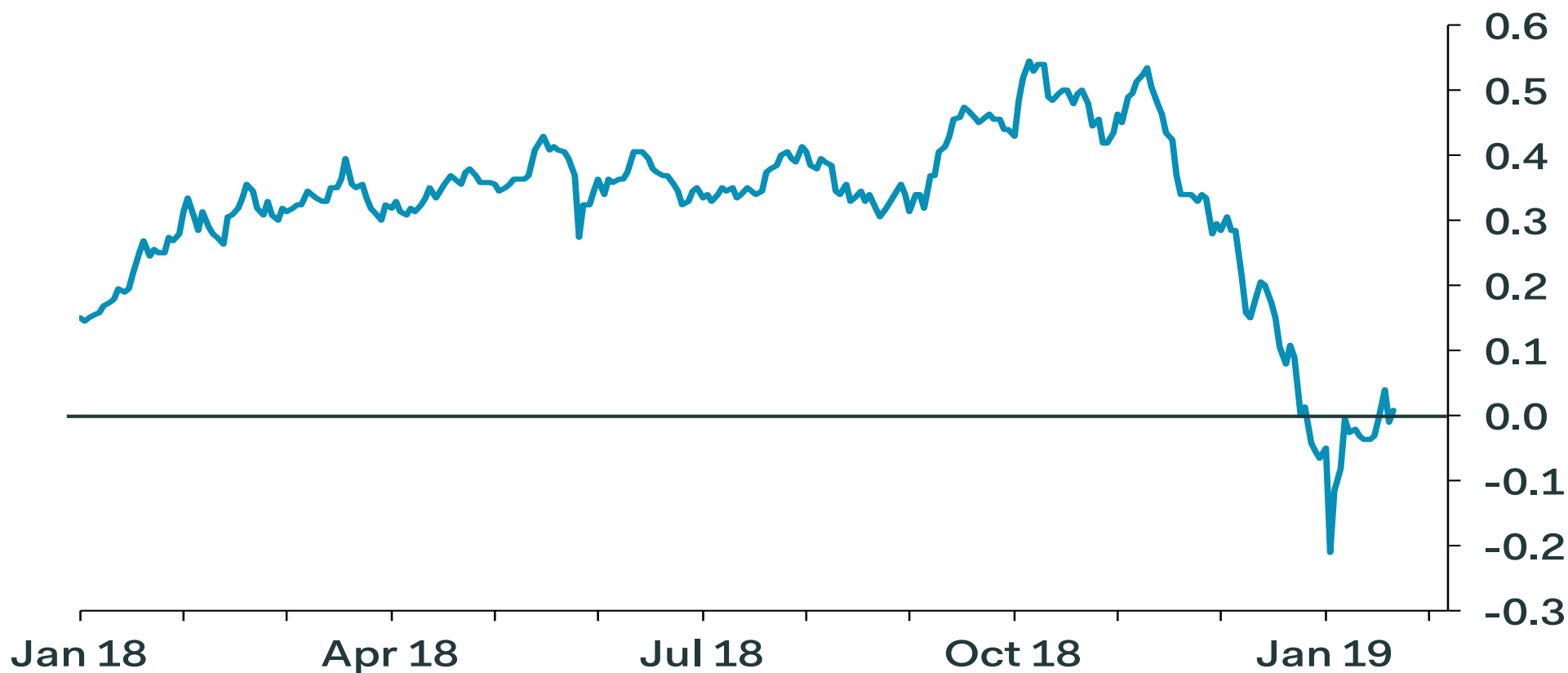
**U.S. WEBINAR, JANUARY 24, 2019**

IAN C. SHEPHERDSON, CHIEF ECONOMIST  
[WWW.PANTHEONMACRO.COM](http://WWW.PANTHEONMACRO.COM) | +1 914 610 3830



## 1. MARKETS NOW EXPECT NOTHING FROM THE FED THIS YEAR...

— Spread fed funds future Feb. 19 - Feb. 20





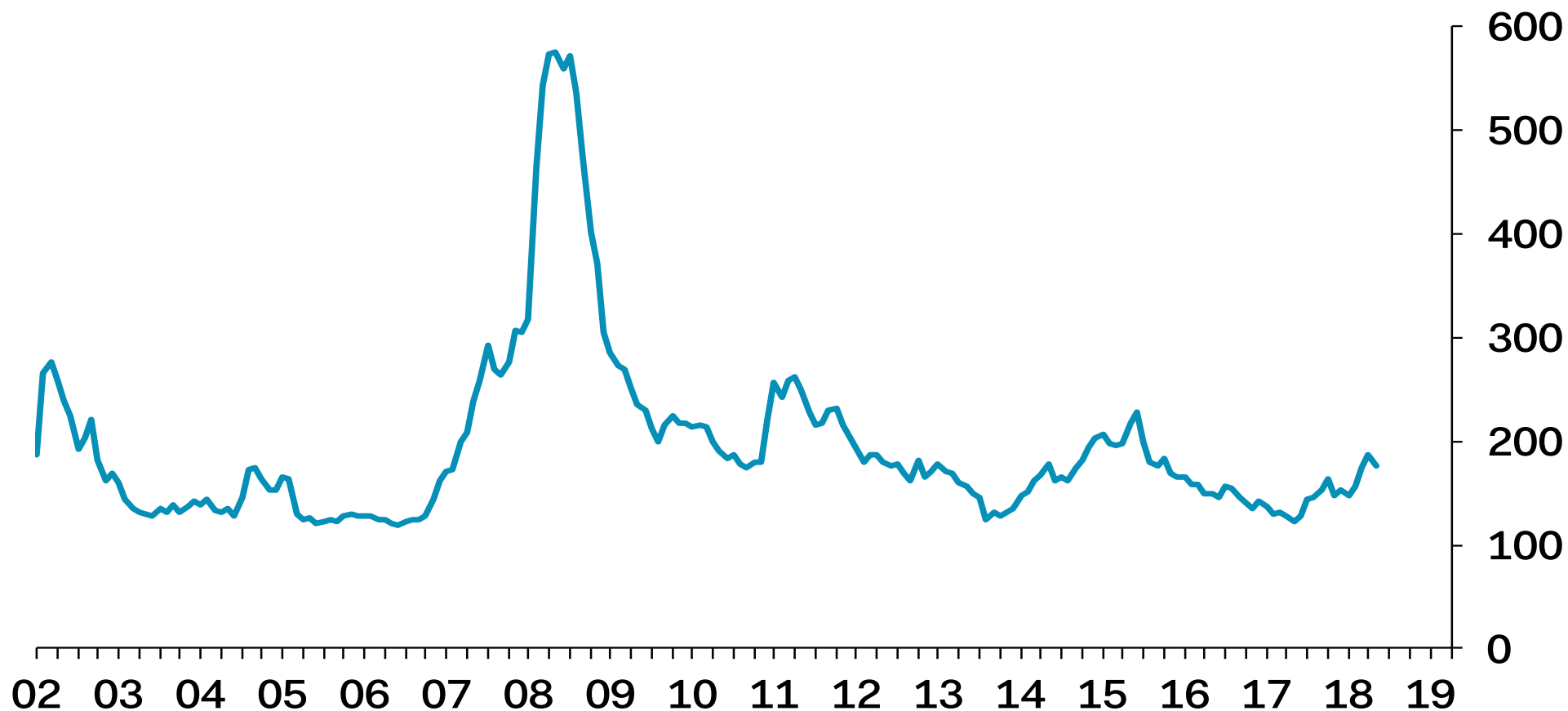
## 2. ...EVEN THOUGH STOCKS HAVE RETRACED HALF THEIR Q4 DROP





### 3. ...CREDIT SPREADS HAVE WIDENED BUT ARE NOT AT THREATENING LEVELS

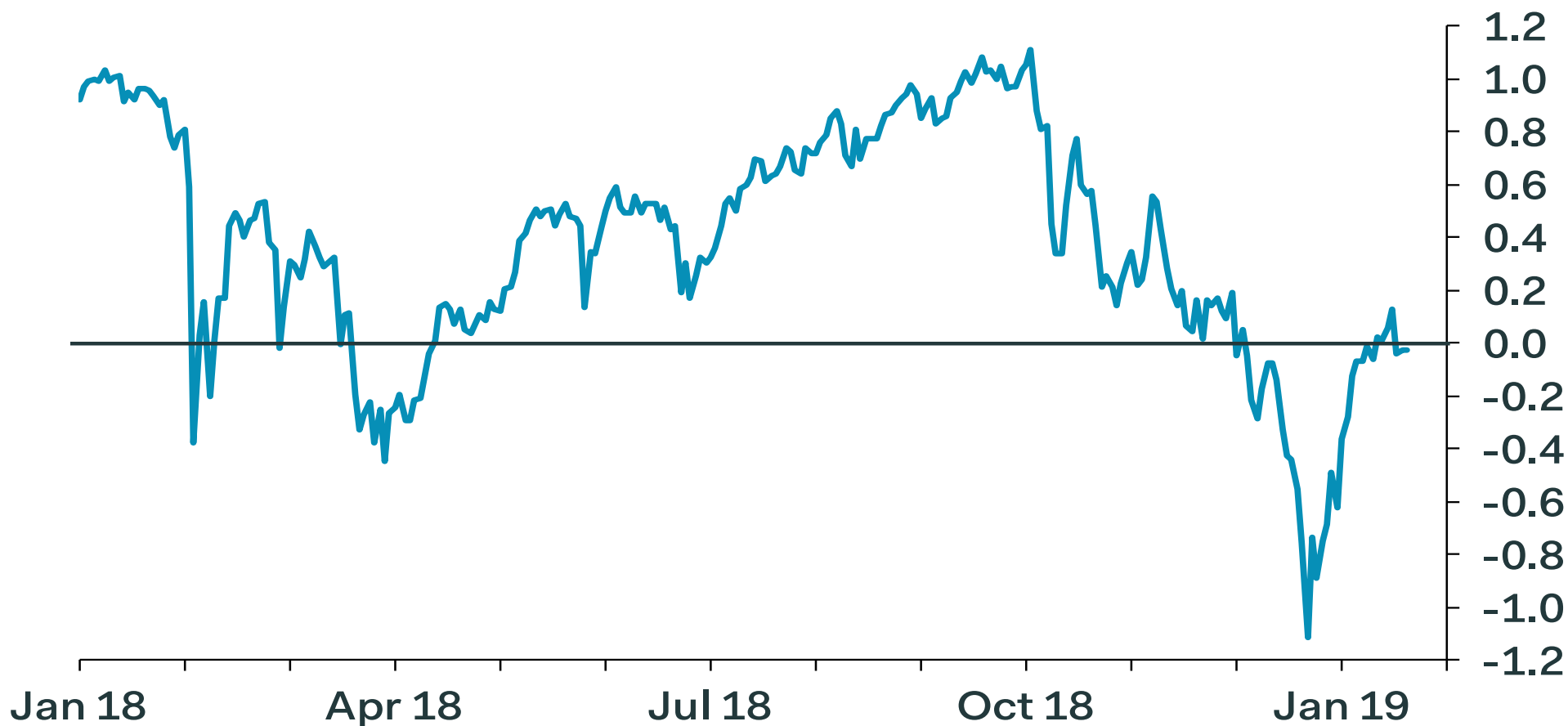
— Spread, BBB corporates - 10-year Treasury, bp





## 4. FINANCIAL CONDITIONS ARE LESS LOOSE, BUT ARE NOT *TIGHT*

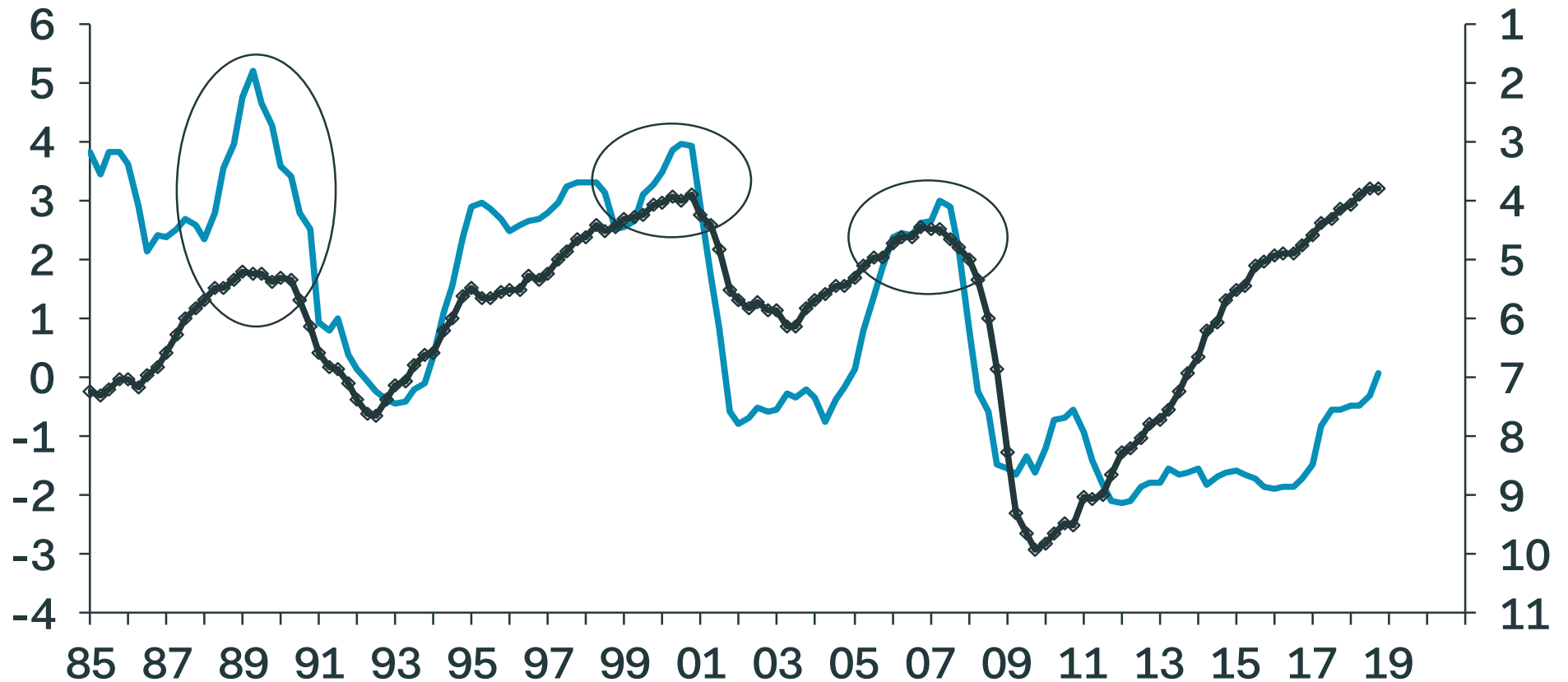
— Bloomberg U.S. financial conditions index





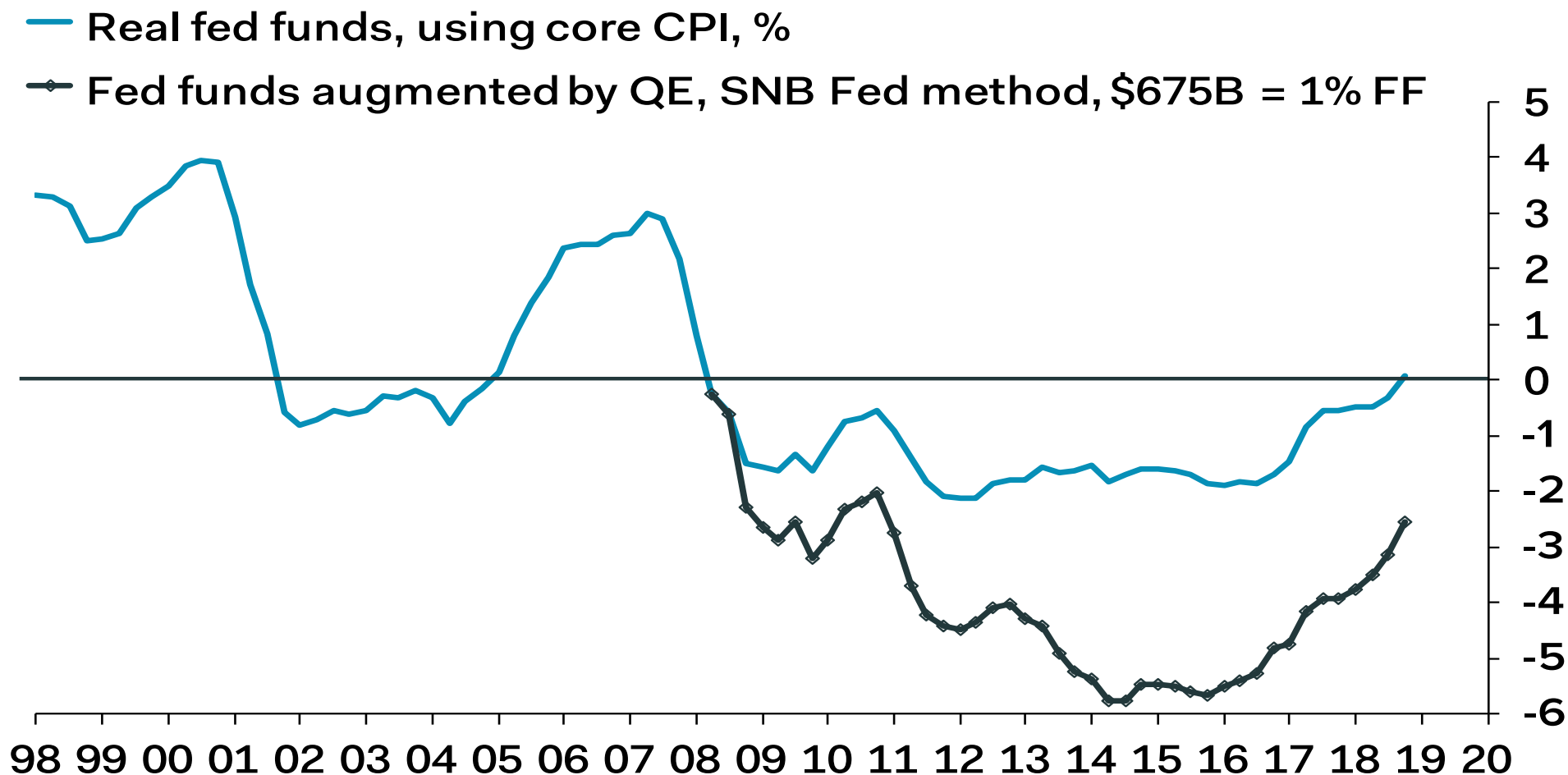
## 5. THE U.S. USUALLY NEEDS 2%-PLUS REAL RATES TO TRIGGER A DOWNTURN

- Fed funds less core CPI y/y, % (Left)
- Unemployment rate, inverted % (Right)





## 6. QE-AUGMENTED REAL RATES ARE STILL WELL BELOW ZERO...

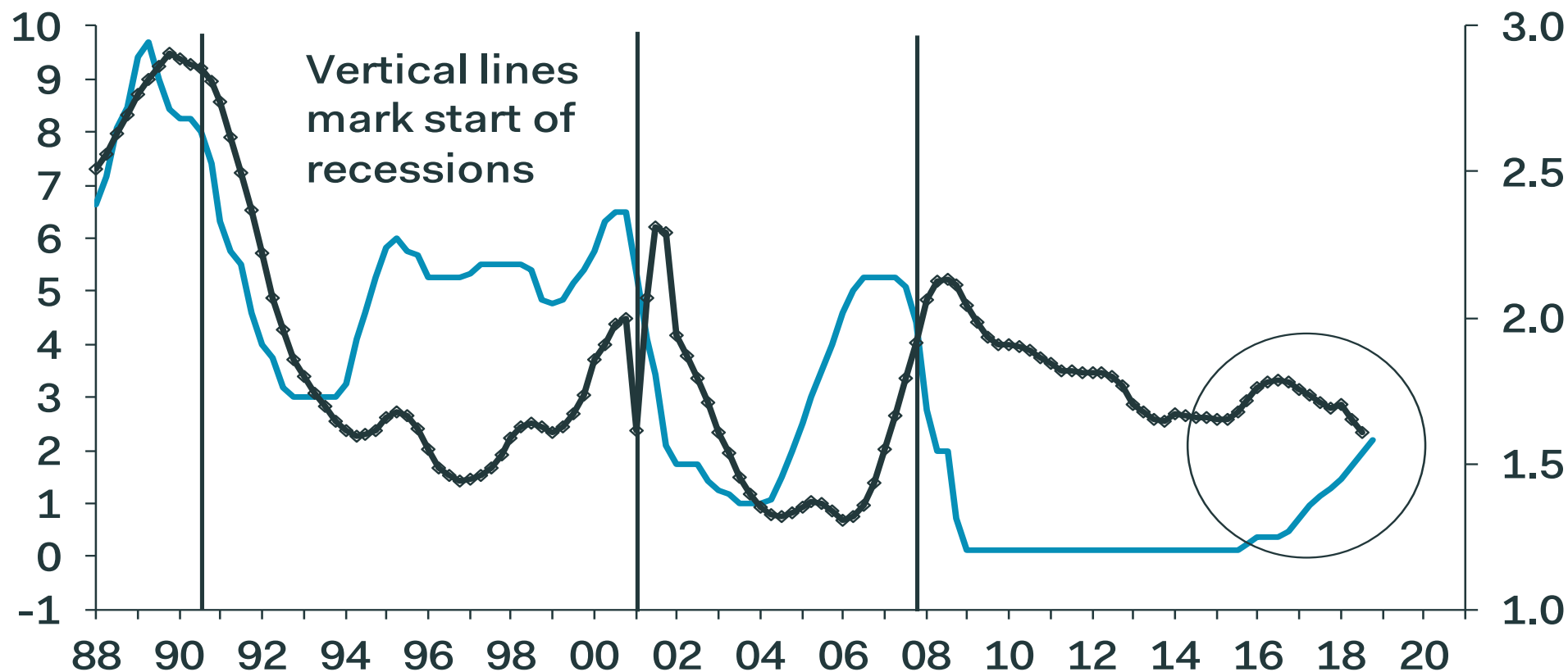




## 7. ...AND CORPORATE DEBT SERVICE RATIOS ARE STILL FALLING

— Fed funds rate, % (Left)

◆ Net interest paid by non-fin. corporations, % GDP (Right)

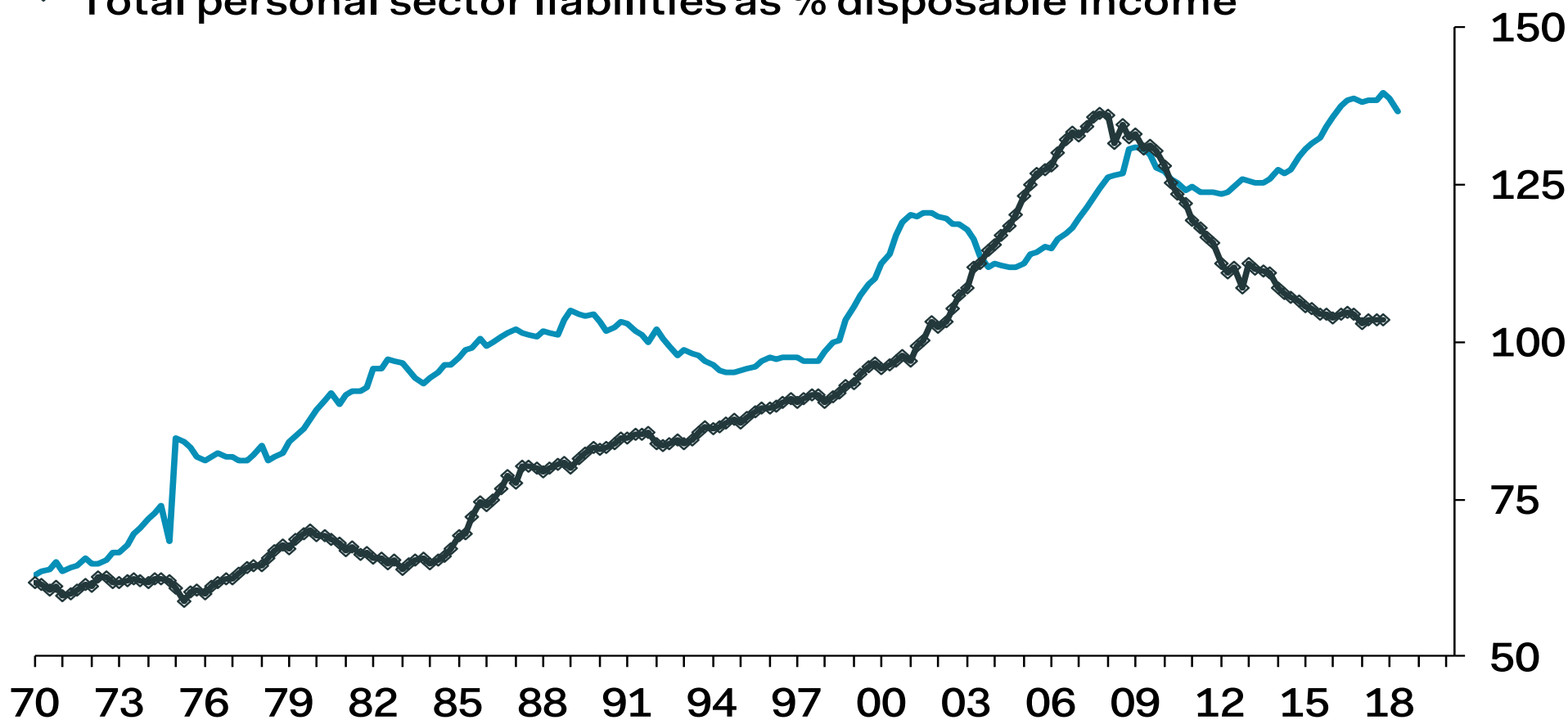






## 8. THE DEBT STOCK HAS RISEN...

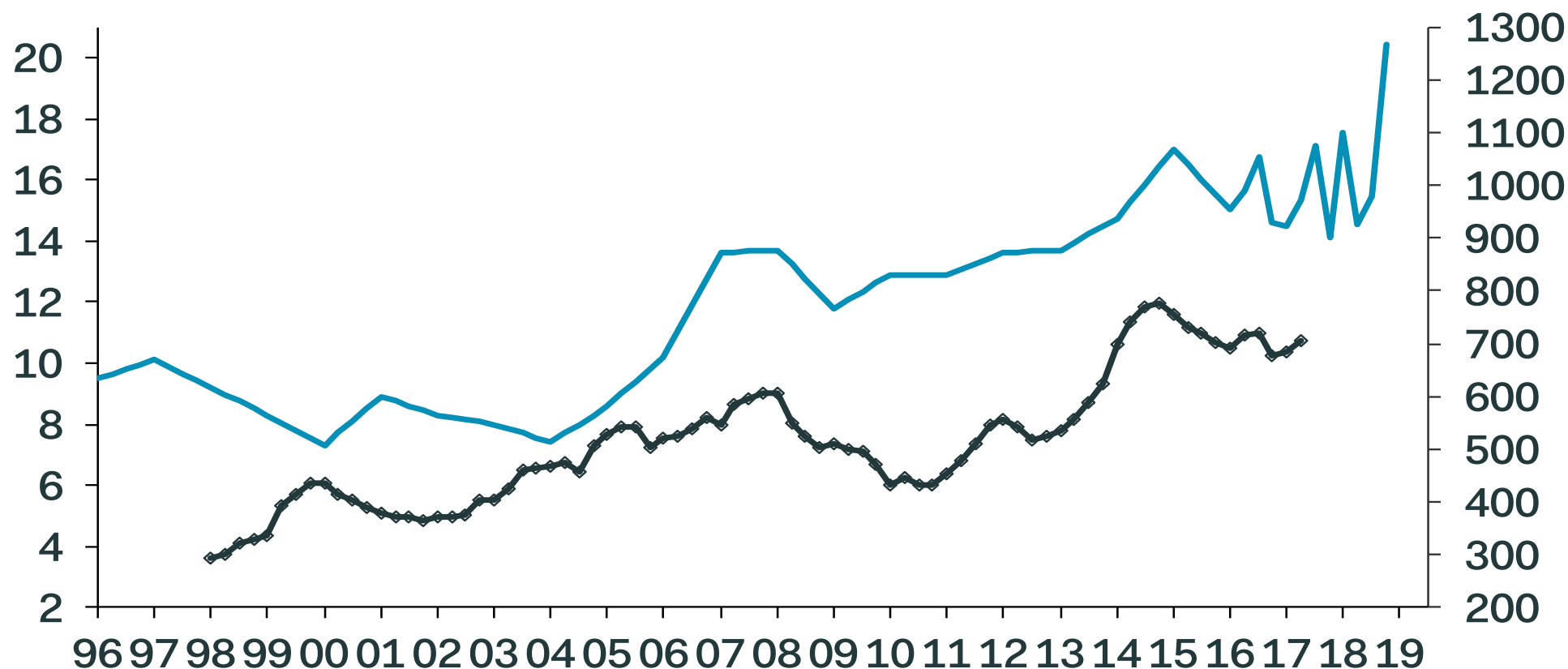
- Total non-financial business liabilities, % GDP
- Total personal sector liabilities as % disposable income





## 9. ...BUT IT'S LONGER THAN IN THE PAST

- Corporate bond weighted average maturity at issue, years (Left)
- ◆ Bank C&I loans, maturity at issue, days (Right)

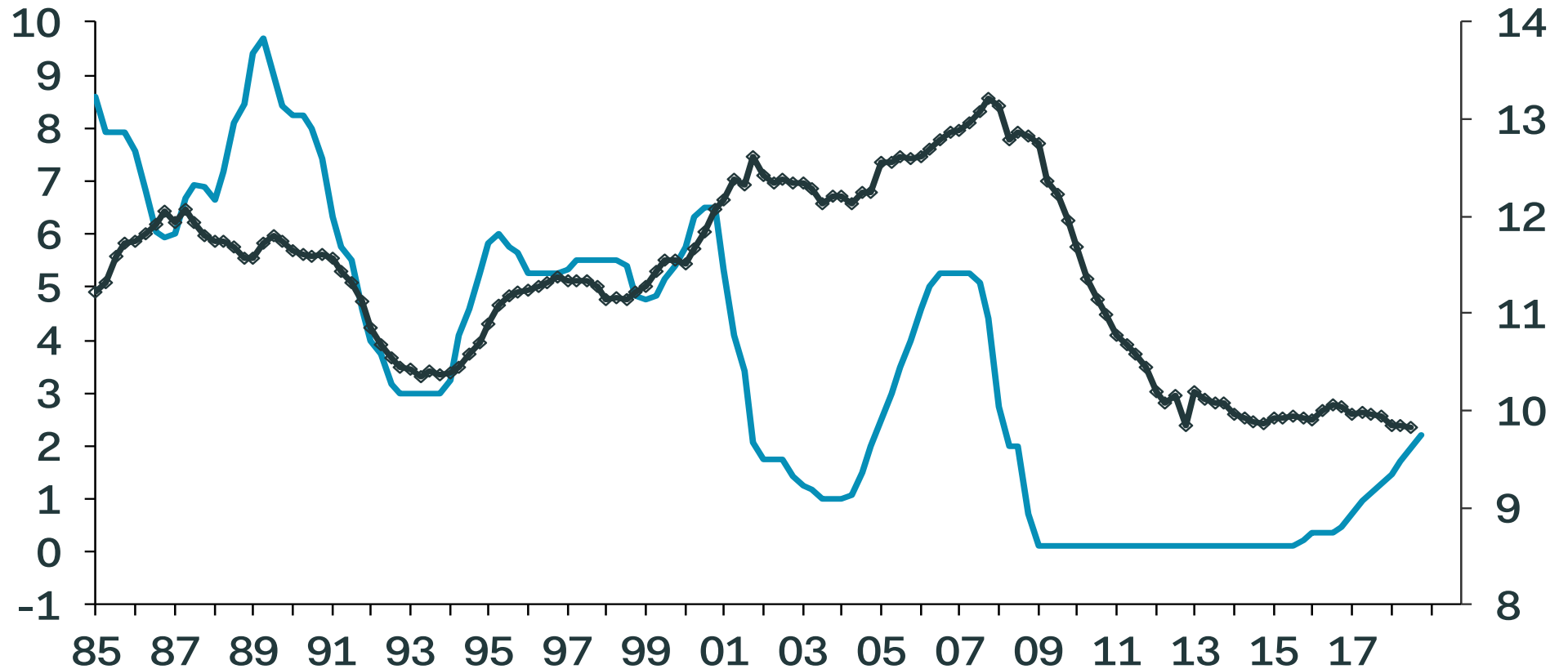




## 10. HOUSEHOLDS ARE UNDER NO PRESSURE, EITHER...

— Fed funds rate, % (Left)

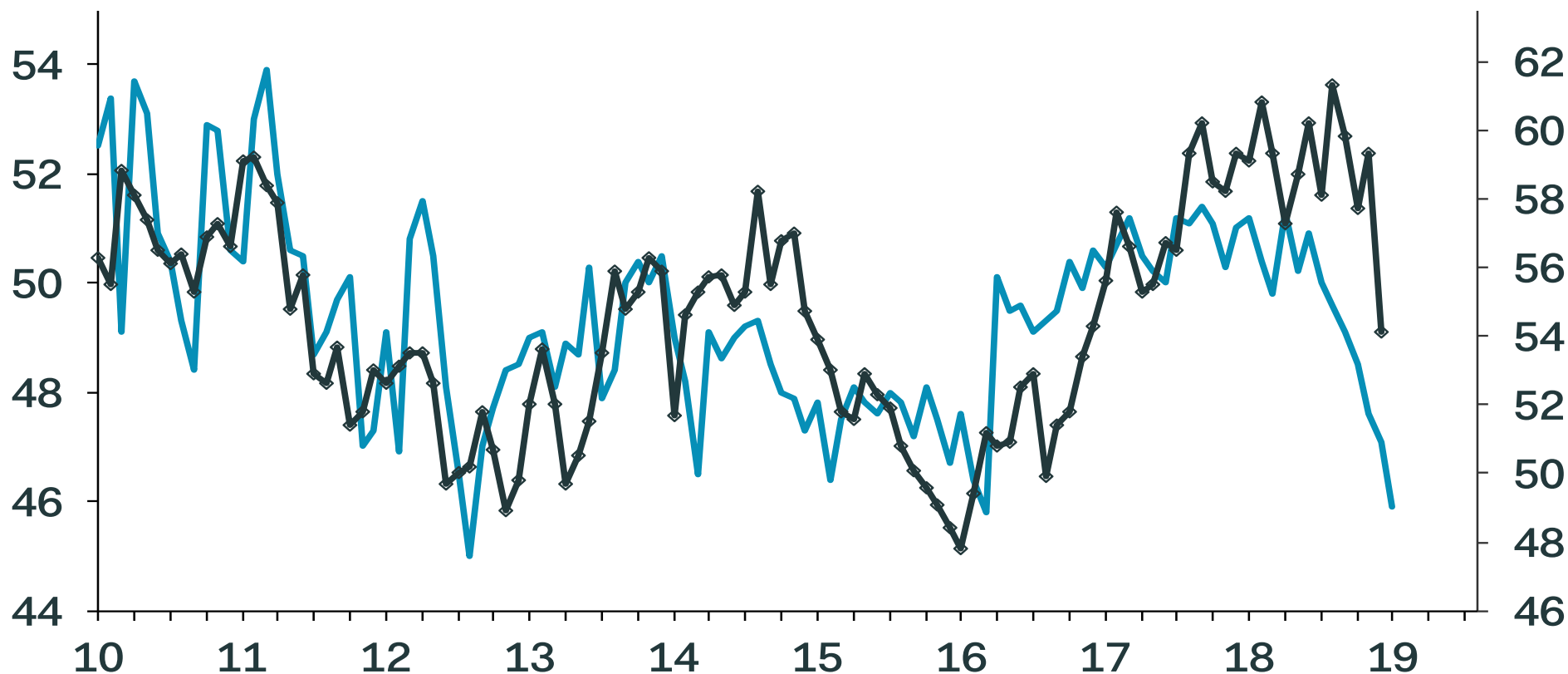
— Household debt service ratio, % PDI (Right)





## 11. RISKS ARE MOSTLY EXTERNAL; CHINA'S PAIN IS HURTING THE U.S. TOO

- China PMI imports component, advanced one month (Left)
- ◆ U.S. ISM manufacturing headline index (Right)

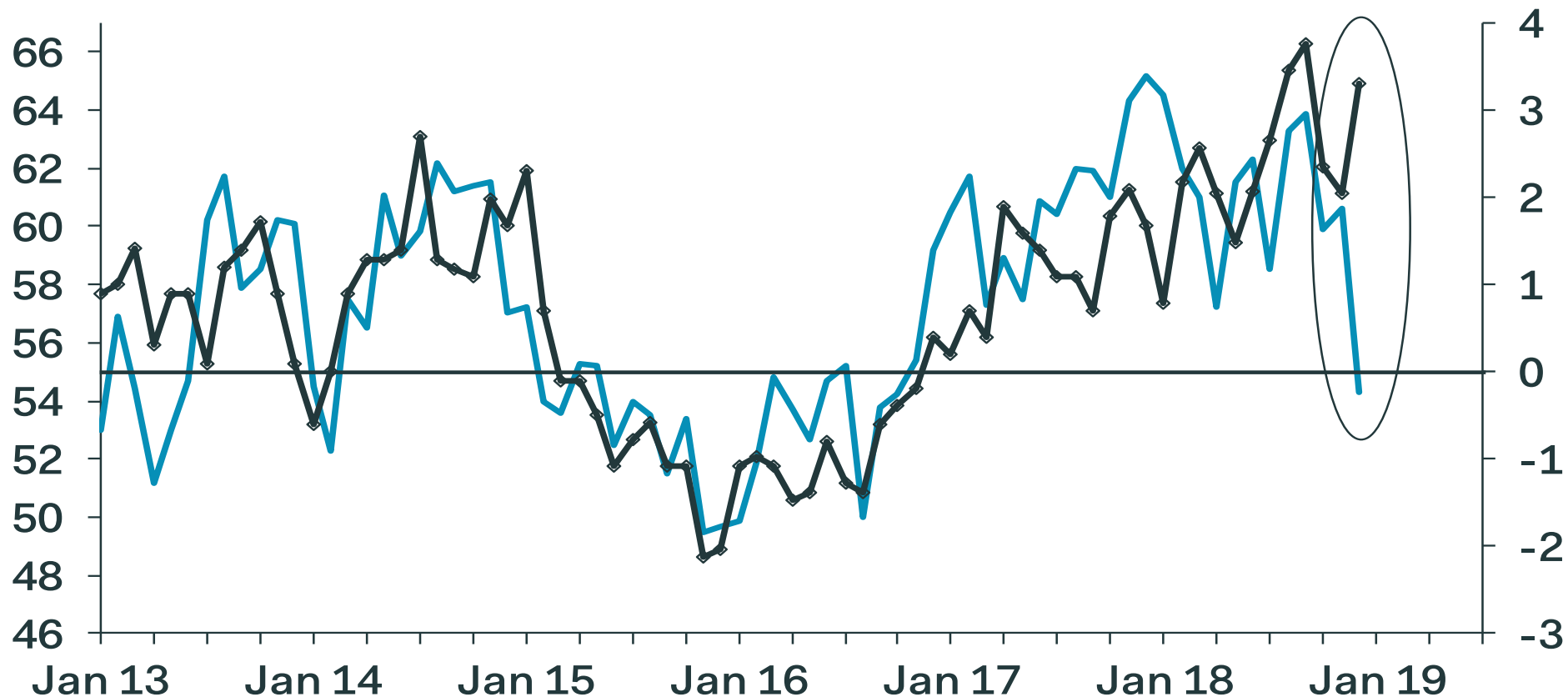




## 12. MANUFACTURING IS LIKELY TO STALL, OR WORSE, IN THE FIRST HALF

— ISM Production index (Left)

— Manufacturing output, y/y % (Right)





### 13. ...CAPEX WILL SLOW FOR A WHILE TOO

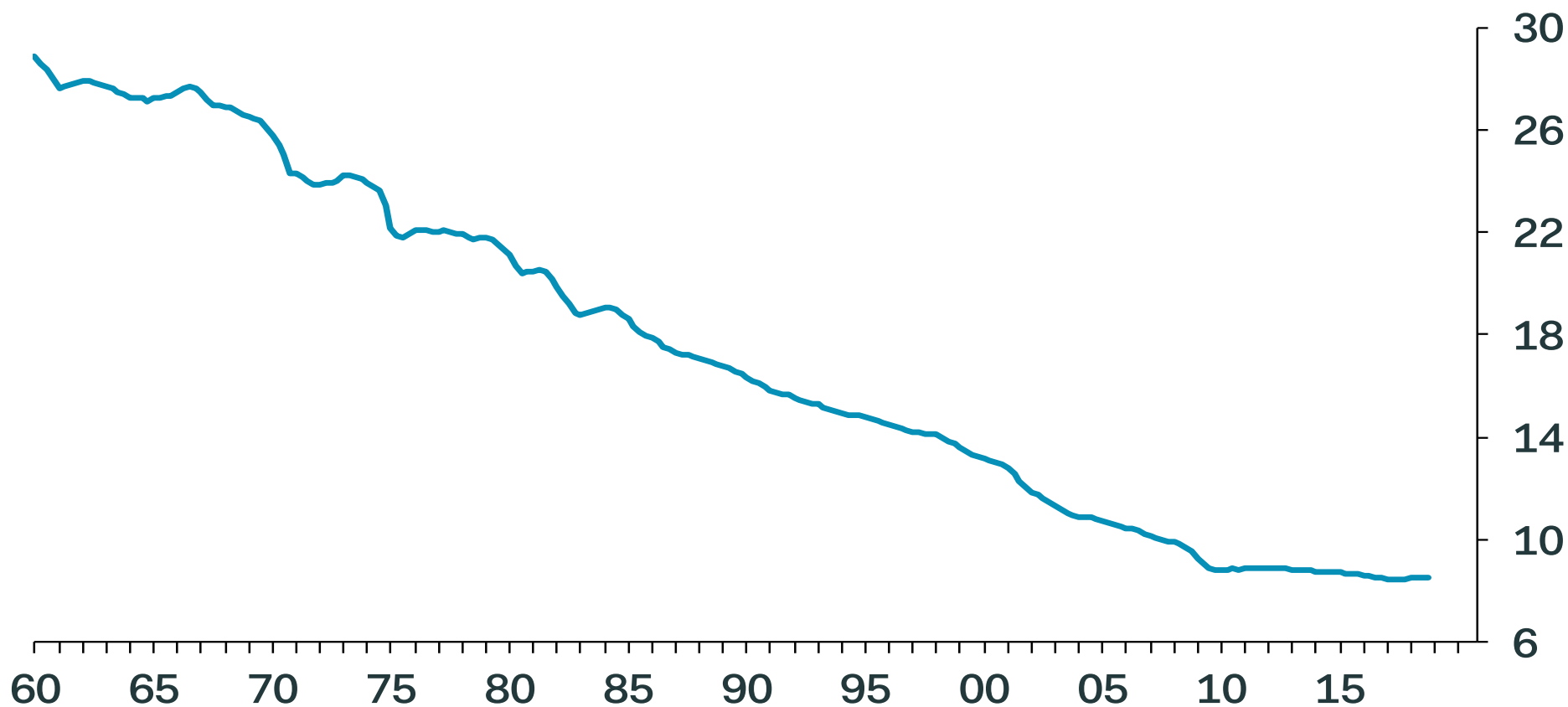
- NFIB capital spending intentions index, y/y change, points (Left)
- Real non-res capex less oil structures and equipment, y/y% (Right)





## 14. ...BUT MANUFACTURING IS ONLY SMALL PART OF THE ECONOMY

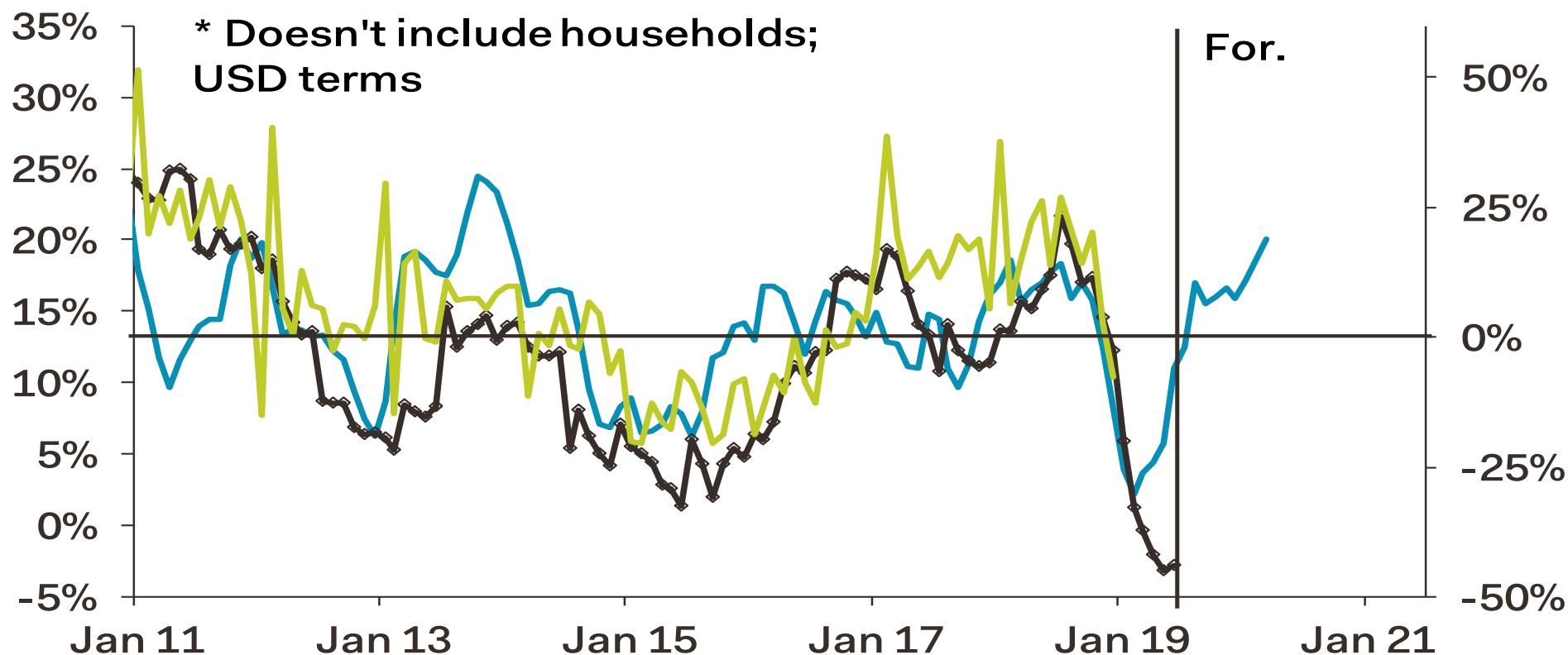
— Manufacturing as % total payrolls





## 15. CHINA IS EASING, AND A TRADE DEAL WILL BE DONE BY THE SPRING

- Official M1\* y/y forecast from sovereign yields, adv. 6m (Left)
- Official M1\* y/y, advanced 6m (Left)
- Imports y/y, USD terms

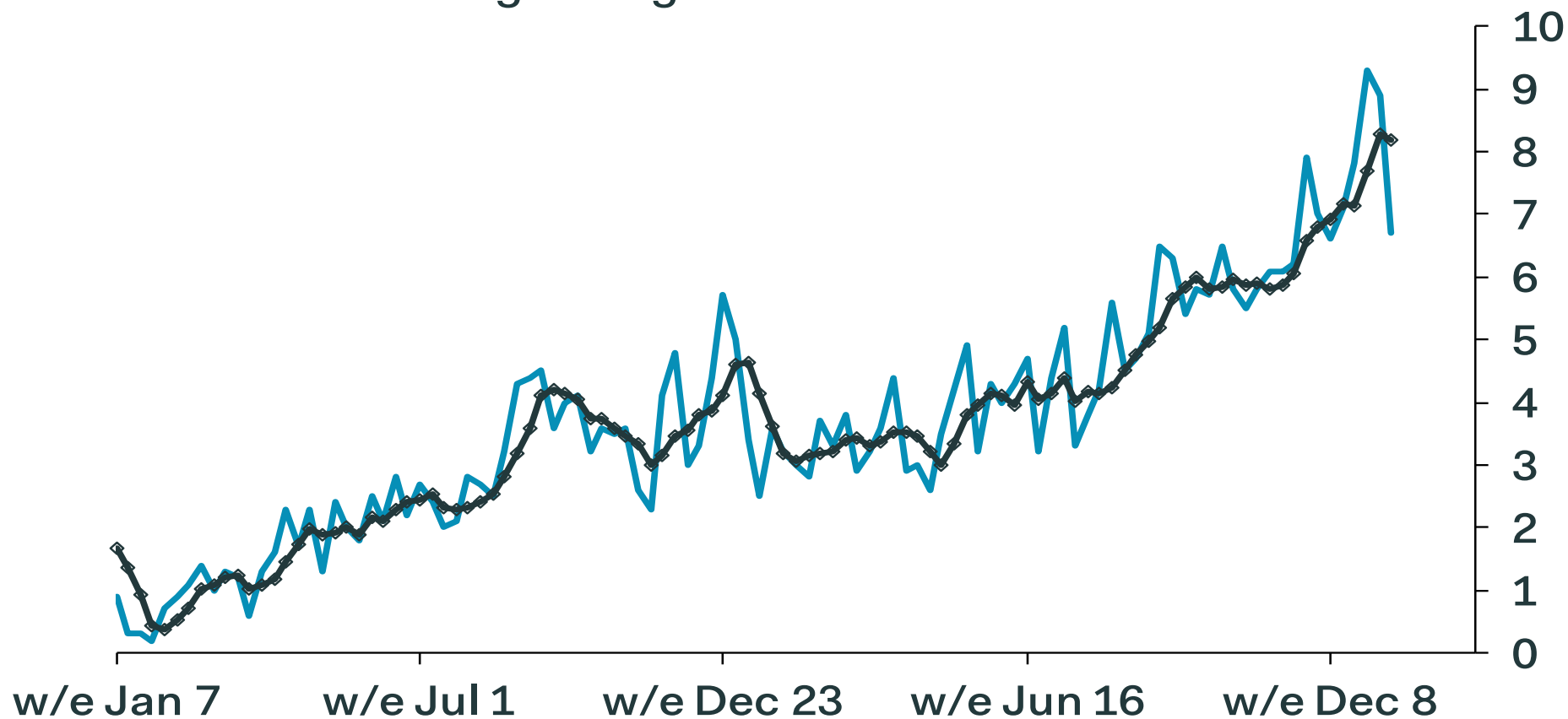






## 16. THE CONSUMER IS IN GOOD SHAPE; THANK TAX CUTS AND GAS PRICES

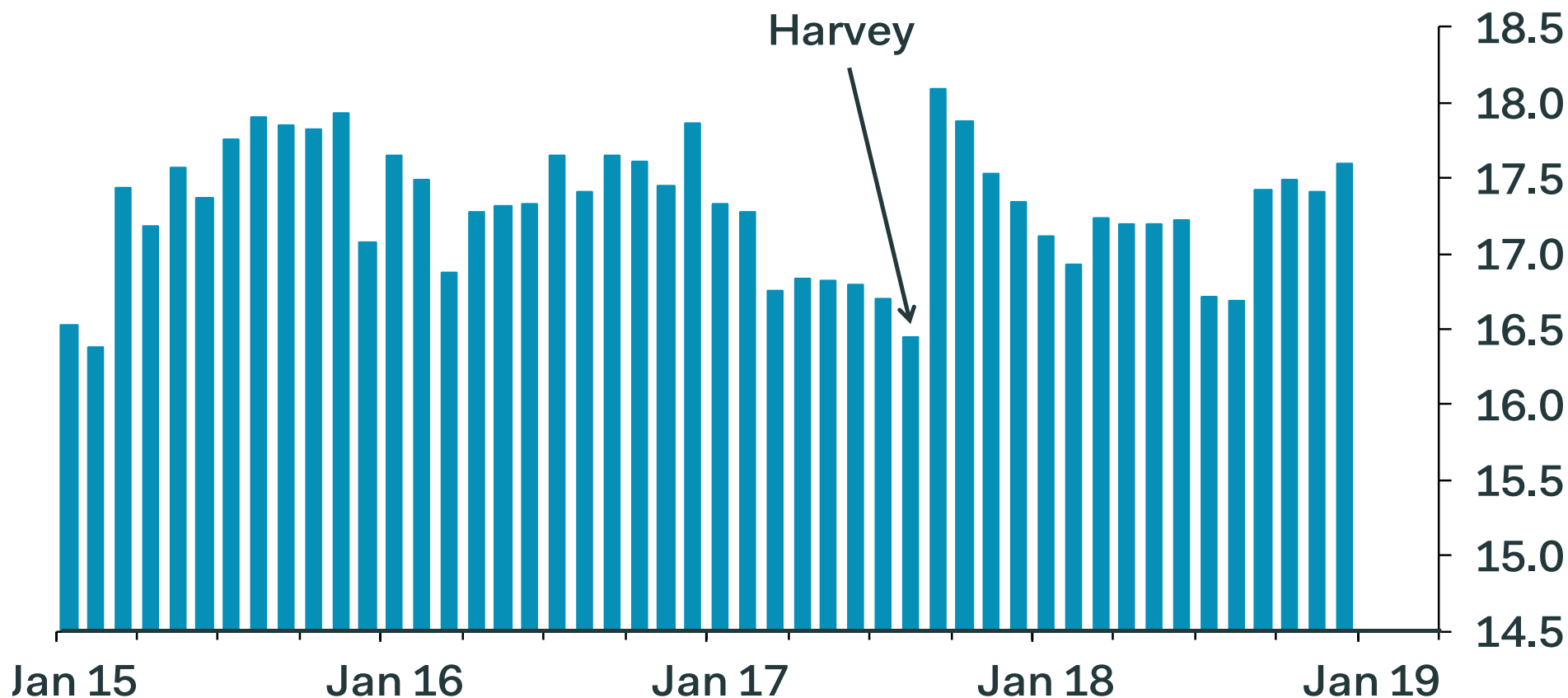
- Redbook chain store sales, year-over-year, %
- ◆ Four-week moving average





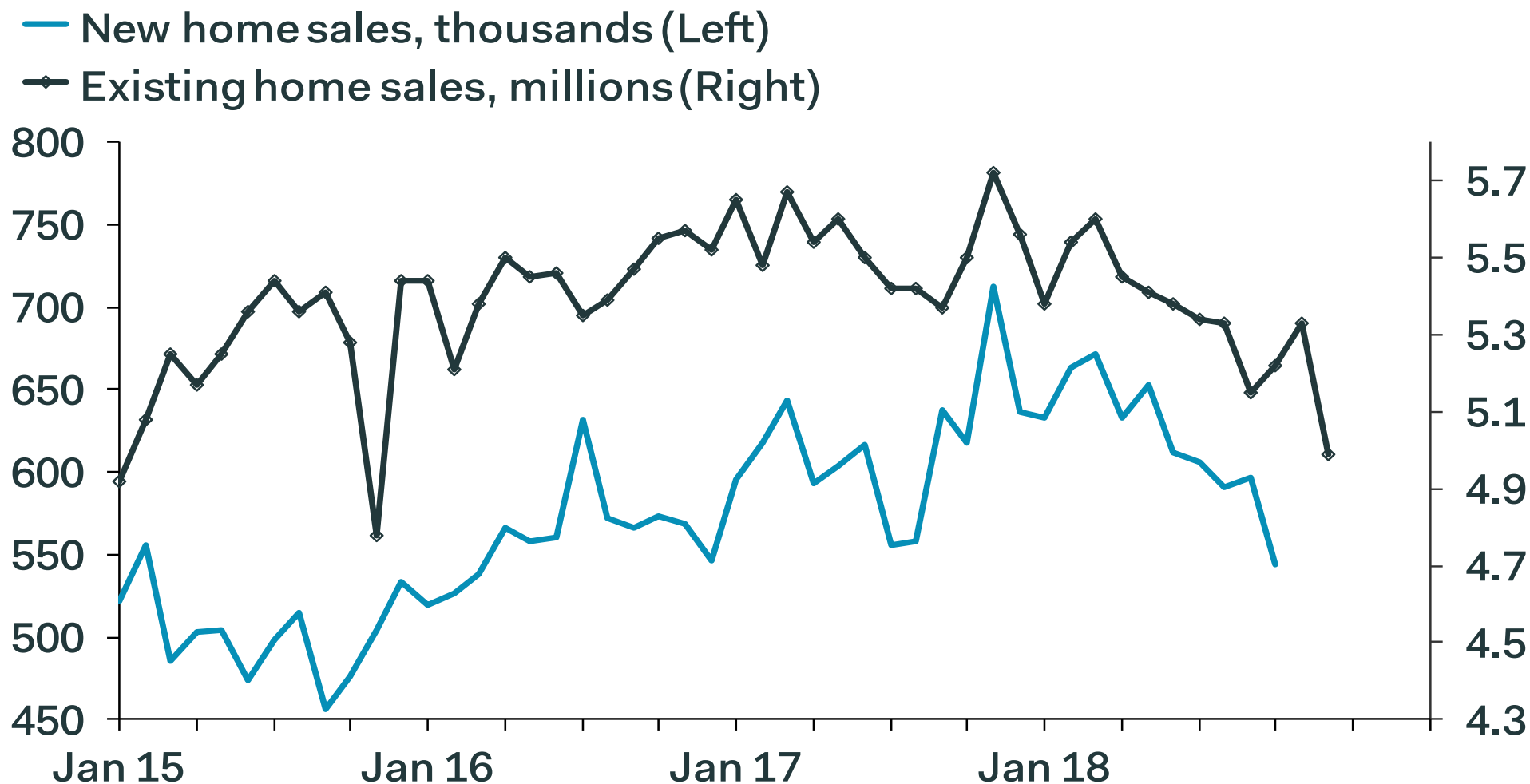
## 17. AUTO SALES ARE STRONG TOO

■ Total U.S. light vehicle sales, millions



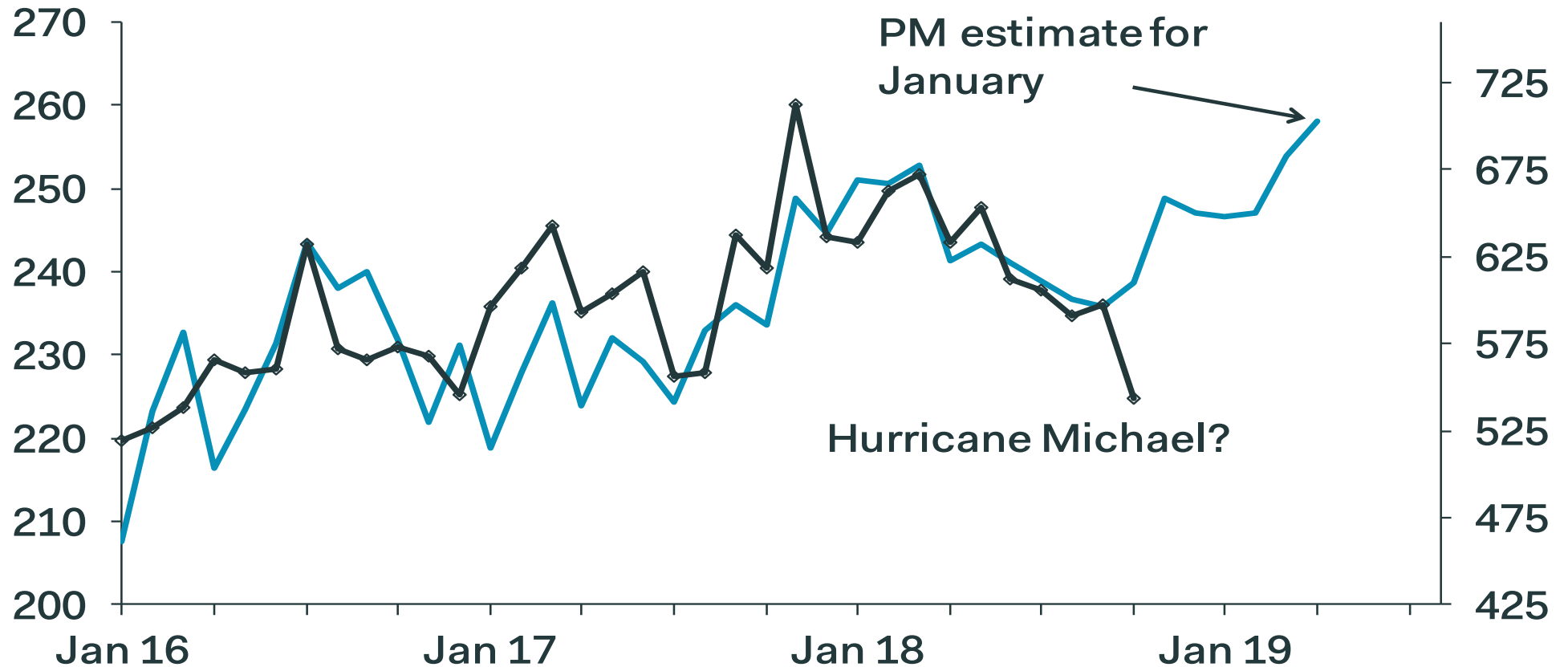


## 18. THE HOUSING MARKET LOOKS TERRIBLE...



## 19. ...BUT EXPECT A BIG REBOUND IN ACTIVITY IN Q1 AS SHOCKS FADE

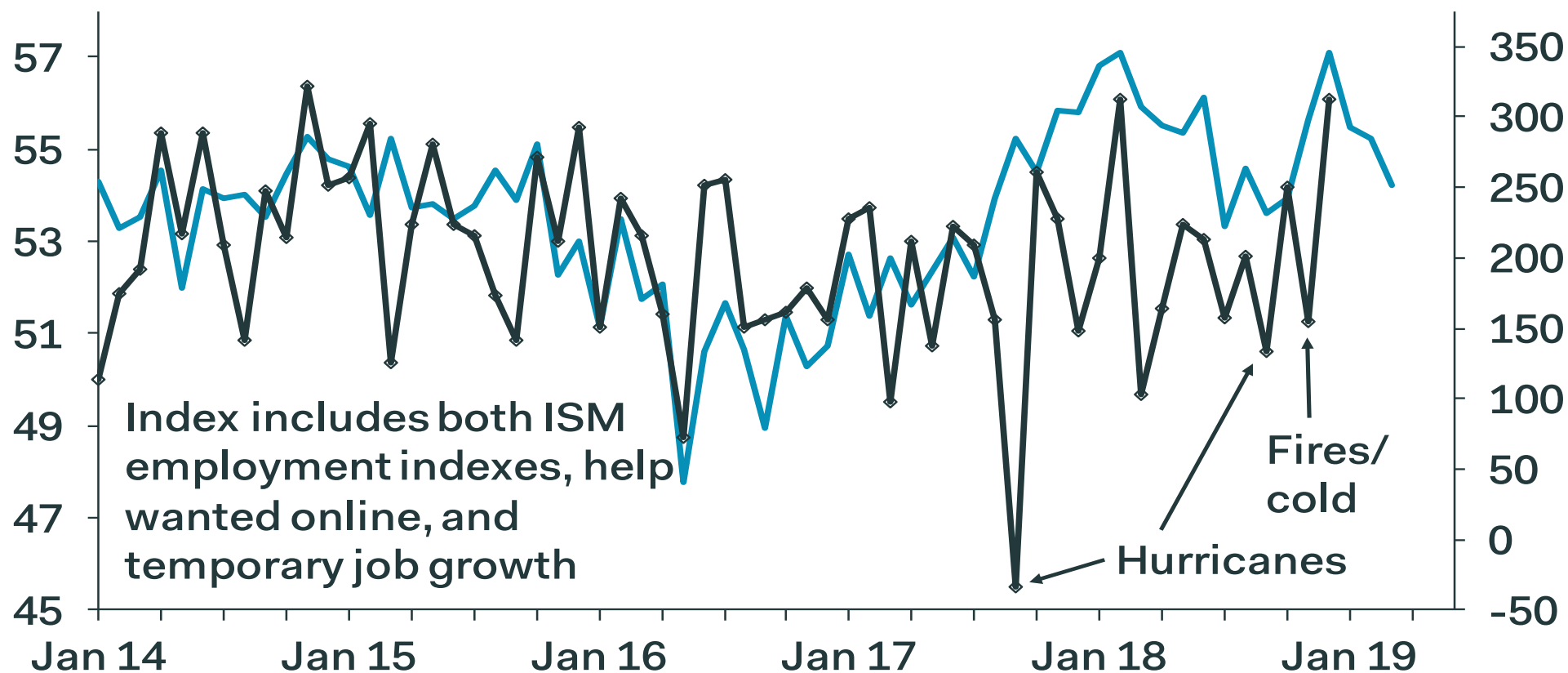
- MBA purchase index, re-adjusted and advanced three months (Left)
- ◆— New home sales (Right)





## 20. LABOR DEMAND REMAINS VERY STRONG

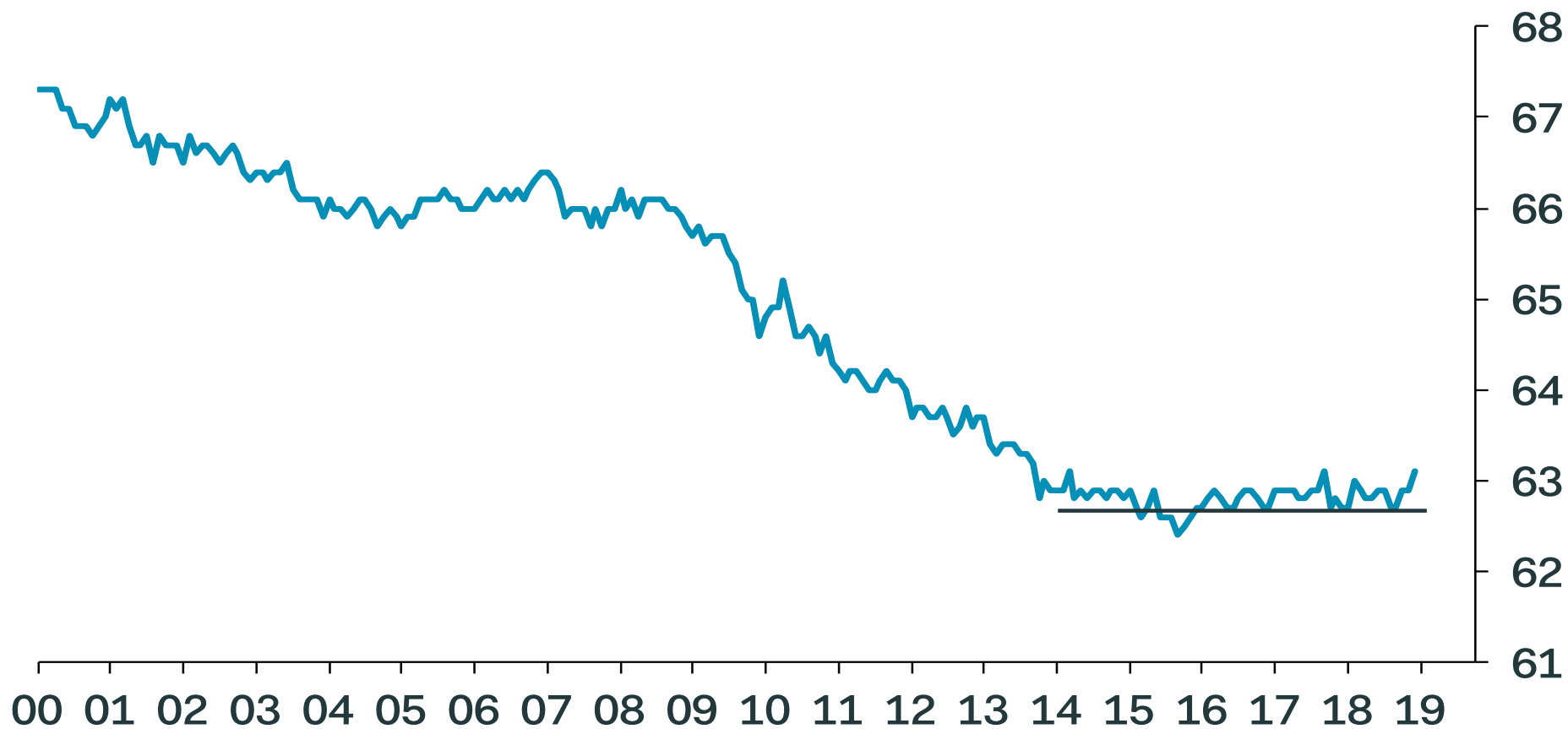
- PM narrow composite hiring index, advanced three months (Left)
- ◆— Payrolls ex-Verizon strike, thousands, initial est. (Right)





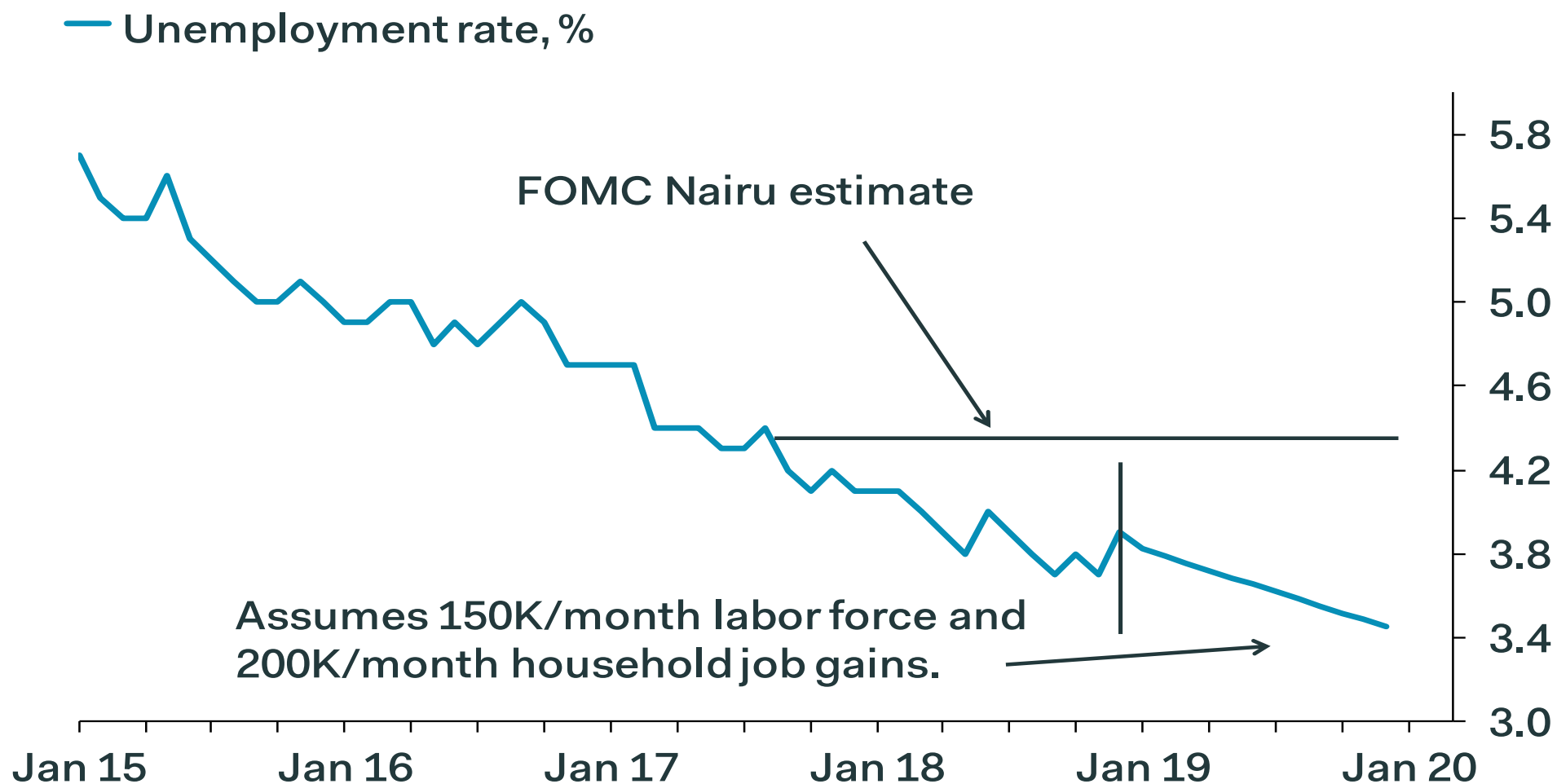
## 21. NO CERTAINTY THAT THE PICK-UP IN PARTICIPATION WILL LAST...

— Participation rate, people aged 16+





## 22. UNEMPLOYMENT WILL LIKELY KEEP FALLING





## 23. WAGE GAINS ARE PICKING UP, AS EMPLOYERS BECOME MORE DESPERATE

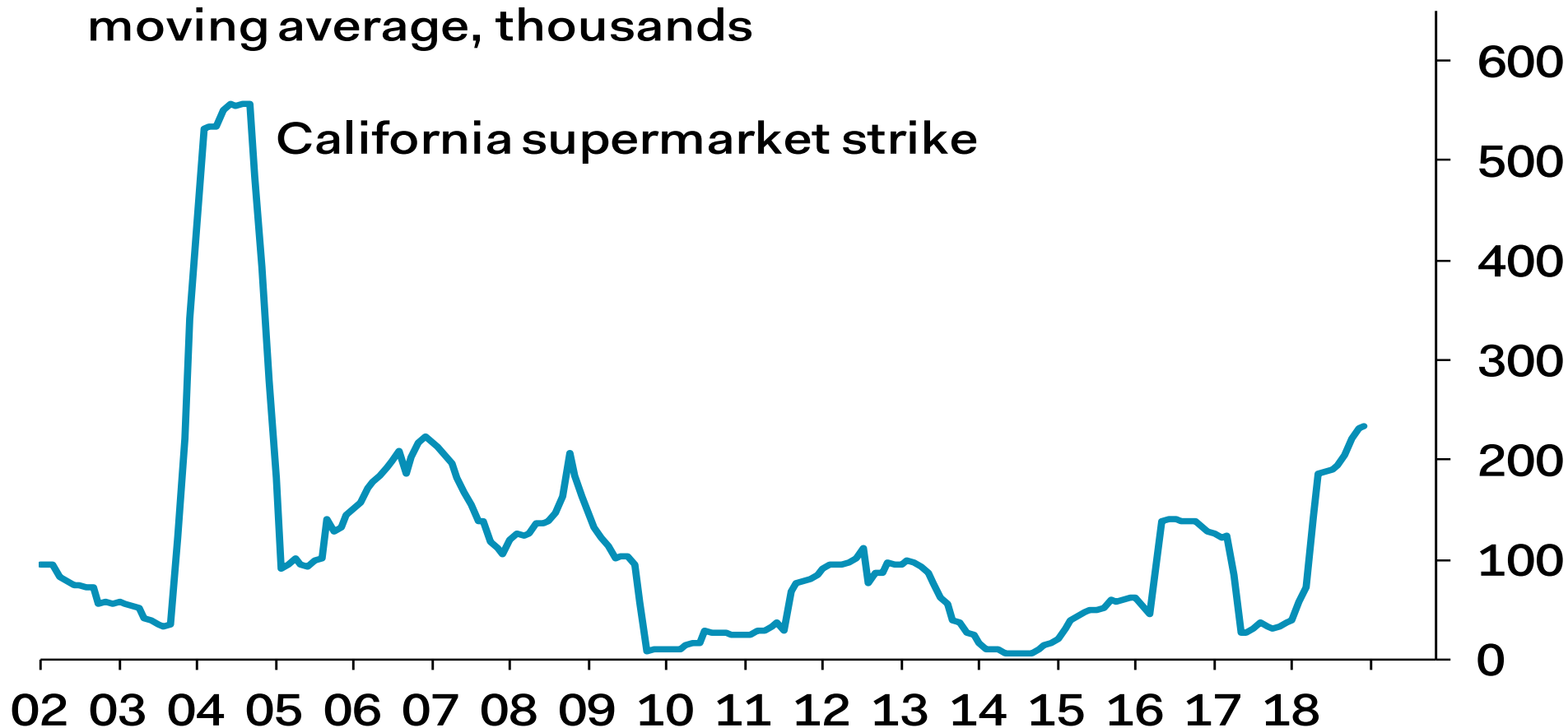






## 24. EMPLOYEES FINALLY BELIEVE THEY HAVE SOME POWER

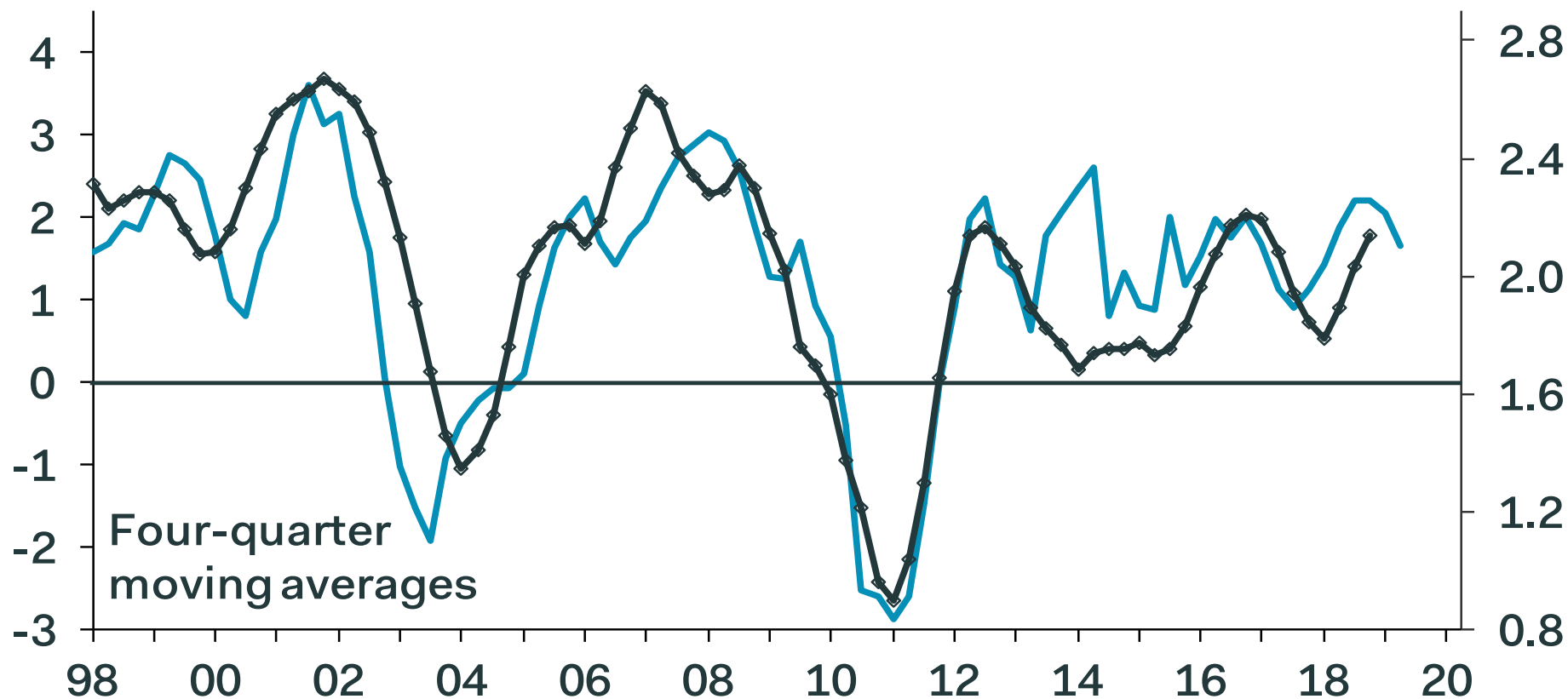
— Working days lost due to stoppages, 12-month moving average, thousands





## 25. CORE INFLATION REMAINS CONTAINED BY SLOW GROWTH IN LABOR COSTS

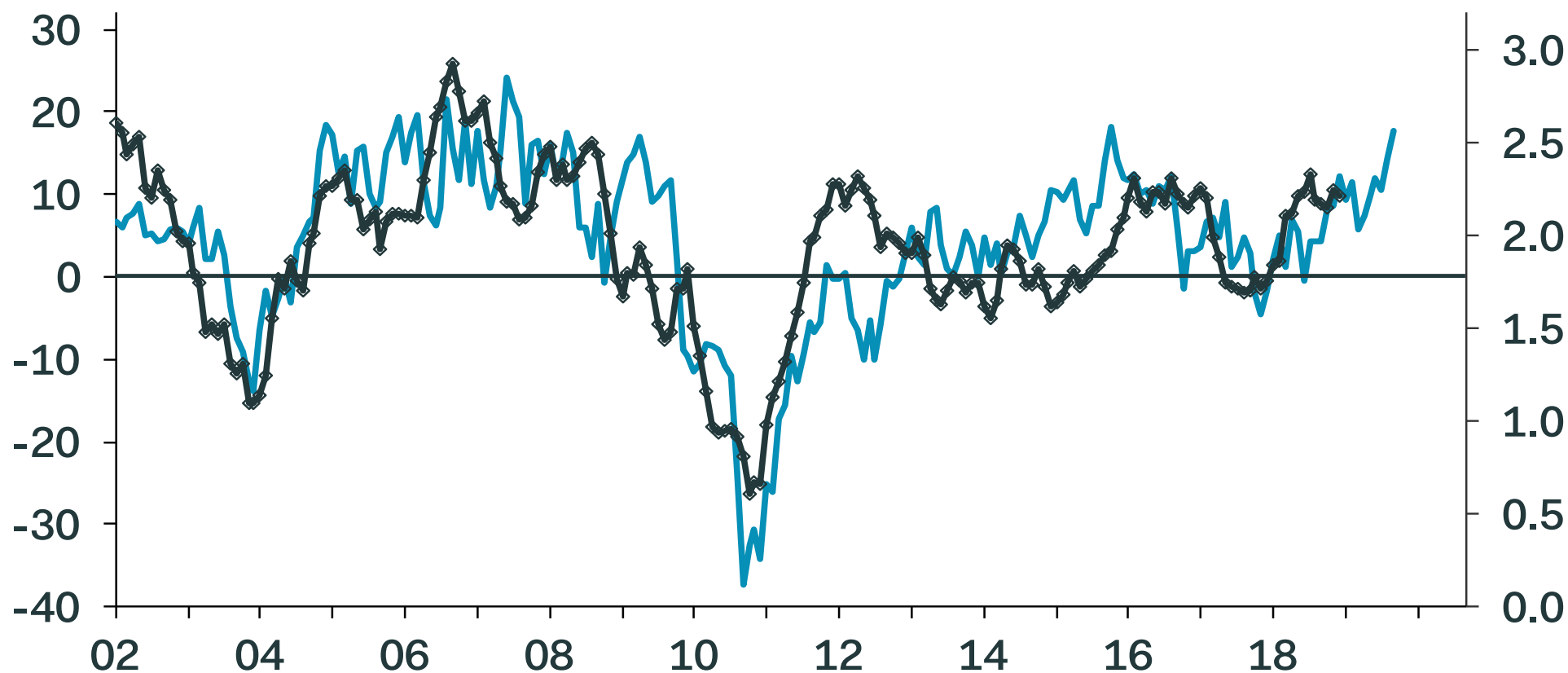
- Unit labor costs, y/y% advanced three quarters (Left)
- ◆— Core CPI y/y% (Right)





## 26. ...BUT FIRMS WANT TO RAISE PRICES MORE QUICKLY

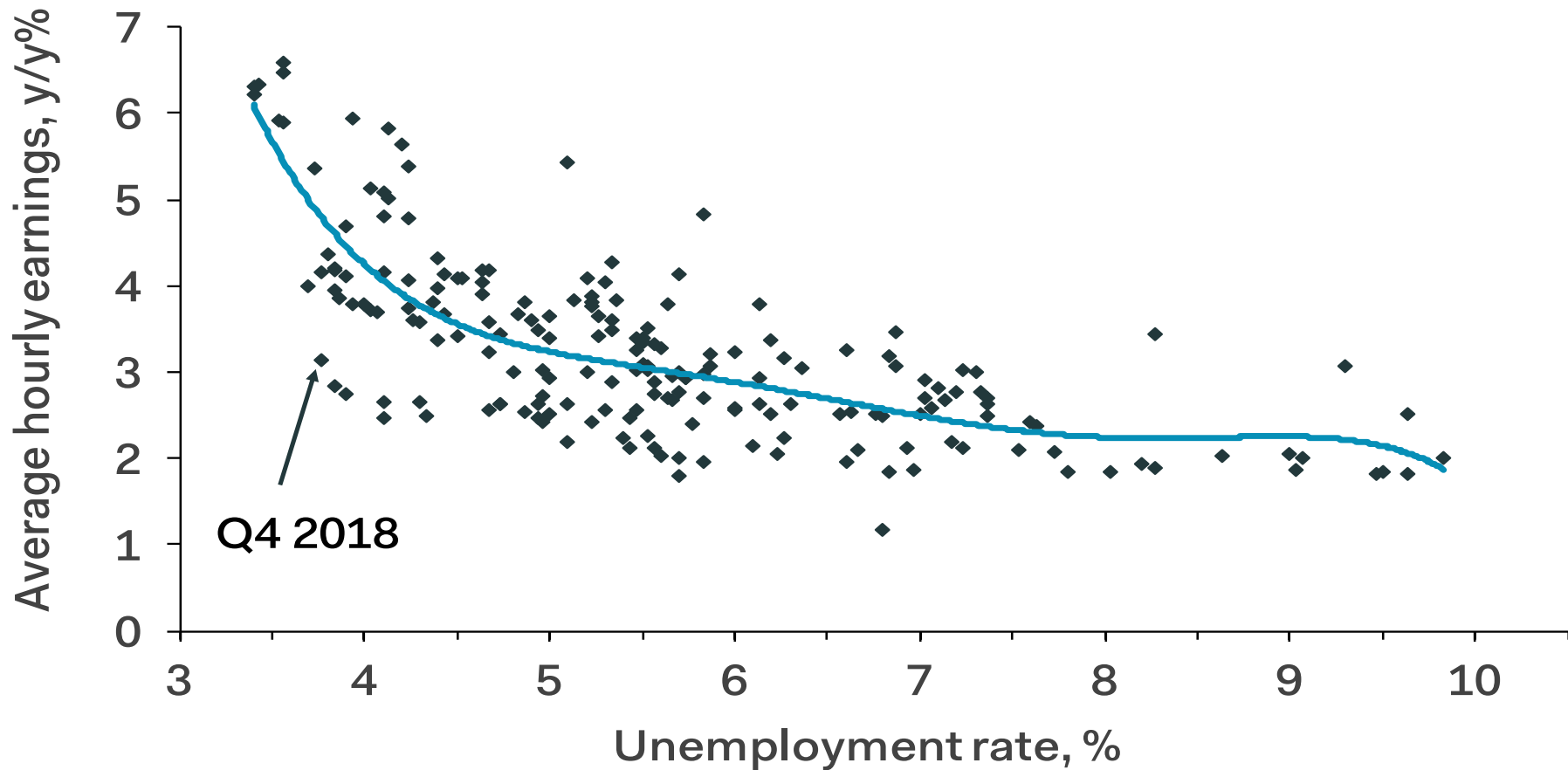
- NFIB selling prices, adjusted for gas prices, advanced 11 months (Left)
- ◆ Core CPI, y/y% (Right)





## 27. WHEN THE DUST SETTLES, THE FED LIKELY WILL WANT A SLOWDOWN

U.S. Phillips Curve, using data from 1955-to-69, and 1985 to date





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## 28. SUMMARY

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- \* **Growth is slowing, but it isn't rolling over, and a manufacturing recession won't kill the broader economy.**
- \* **When China and the U.S. reach a trade deal, and China's stimulus starts to work, expect attention to swing back to the domestic fundamentals.**
- \* **The Fed will be "patient" in H1, but they are sensitive to the short-term data, and faster wage growth will push them to hike at least twice, starting mid-year.**