Financial Markets This Week

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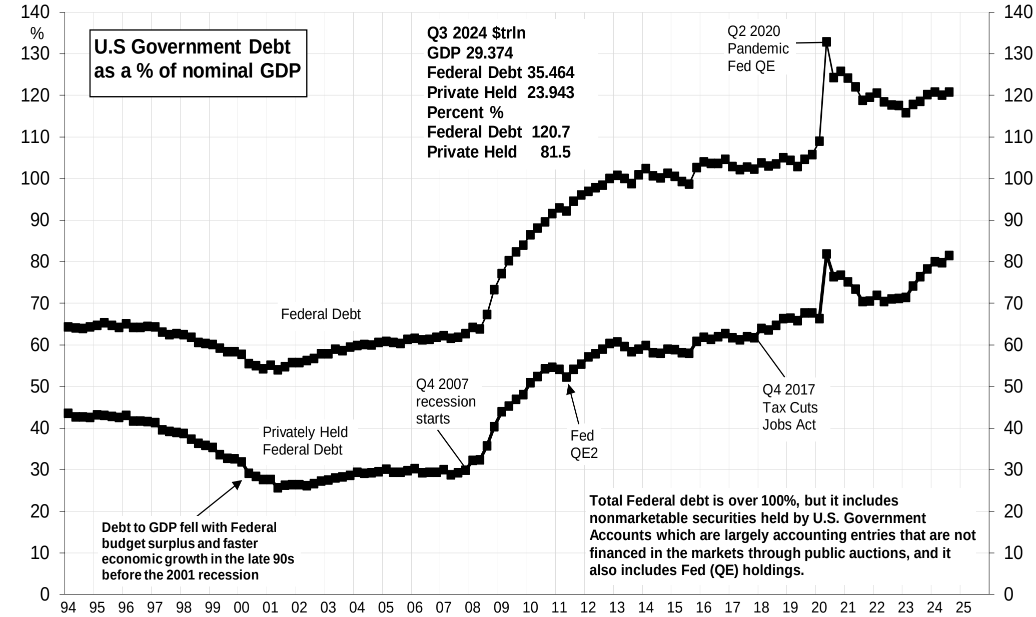
FEDERAL DEBT TIME BOMB

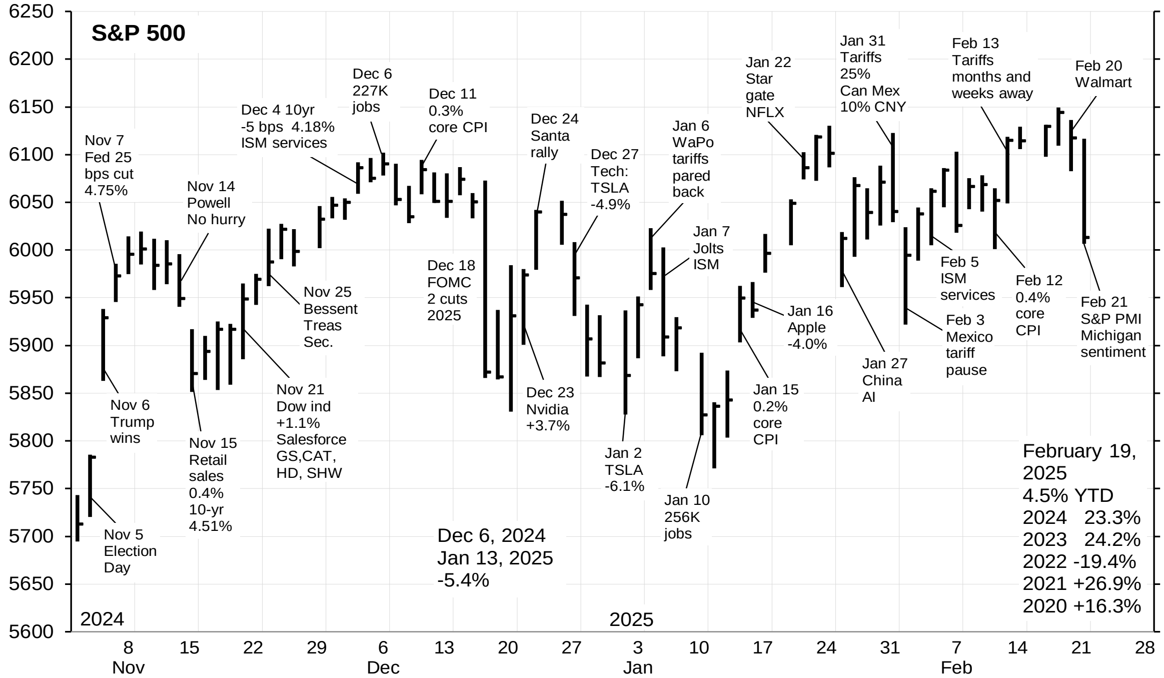
We read this week that the Federal debt was a ticking time bomb, so we checked out the latest data before the U.S. Treasury scrubs it from the website. Powell was asked about this in his session before the House on February 12. Norman (R-S.C.) said Yellen told us there was an imbalance back in 2011 and now Federal debt held by the public as a percentage of GDP is even higher, do you share her concern? Powell: “We’re on an unsustainable path. And the debt level isn’t unsustainable, but the path is unsustainable.”



Seems manageable for now, i.e. 10-yr Treasury yields are not going to 6% or anything. Don’t let the national debt turn into becoming an even greater problem; limit the increase each year to that of nominal GDP growth. How bad is it? Subtract away various obligations, and find the national debt is not really as bad as $35.464 trillion in Q3 2024 once you start subtracting away various accounts like the Government accounts with nonmarketable paper of $7.137 trillion. This is mostly social security obligations which will be “converted” gradually into marketable debt over the next decade as benefits are running above tax collections, but we don’t need to address this now. The Fed’s Treasury holdings, which are not just QE/QT driven: Treasuries held by the Fed were $1.7 trillion before the pandemic. And then there are Treasuries held by foreigners and if we don’t retreat into these America First policies, totally alienate our allies and trading partners, they are likely to keep holding $8.672 trillion of our debt that we issued to buy tanks, build highways, health care, education, Veterans. So make all these subtractions and the national debt is just $15.3 trillion which is a much better number than $35.464 trillion. Federal Debt Time Bomb gone. Poof. Just a number on a piece of paper.

$trillions September 2024	
<u>35.464</u>	<u>Total Public Debt</u>
7.137	Minus Government Accounts (Social security)
4.384	Minus Fed Treasury holdings (QE/QT-plus)
8.672	Minus Treasuries held by Foreigners
Equals only $15.3 trillion	

INTEREST RATES



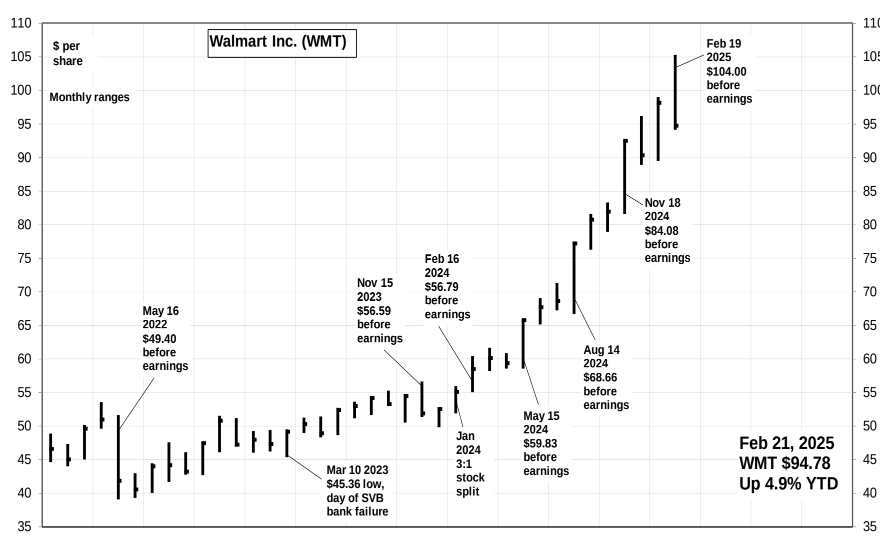
It was a relatively quiet week with stocks making small moves to record highs on Tuesday and Wednesday. Somehow the Walmart earnings at 7am ET Thursday got talked about as incredibly bearish for consumers and the economy, and stocks tumbled at the 930am ET Thursday stocks opening in cash markets. Not much for bonds until Friday at 945am ET with the release of the services purchasing managers index from S&P (49.7p Feb vs. 52.9 Jan) which brought yields down sharply. This was before the weak consumer sentiment data at 10am from the University of Michigan, existing home sales at the same time as well. Stocks did a copy-cat trade from Thursday, falling at the 930am cash opening, and proceeding down at the same speed regardless of the economic data. At Friday's close S&P 500 up 2.2% YTD, and 10-year yields at 4.43%.

Walmart Inc. (WMT) up 4.9% YTD

The stock dropped 6.5% to $97.21 on Thursday, February 20 after reporting earnings before the open. The stock had been up 15.1% YTD through Wednesday. The forecast for FY2026 ending next January seemed to be the problem where operating income was expected to be up 3.5 to 5.5 percent, after FY2025 operating income just completed was up 9.7%. Both measured on a constant currency basis.

Bln $	Revenue	Operating Income	Same-store Sales YOY *	13-weeks ending *
Q1 2022	141.6	5.3	4.0%	4/29/2022
Q2 2022	152.9	6.9	7.0%	7/29/2022
Q3 2022	152.8	2.7	8.5%	10/28/2022
Q4 2022	164.0	5.6	8.8%	1/27/2023
Q1 2023	152.3	6.2	7.3%	4/28/2023
Q2 2023	161.6	7.3	6.3%	7/28/2023
Q3 2023	160.8	6.2	4.7%	10/27/2023
Q4 2023	173.4	7.3	3.9%	1/26/2024
Q1 2024	161.5	6.8	3.9%	4/26/2024
Q2 2024	169.3	7.9	4.3%	7/26/2024
Q3 2024	169.6	6.7	5.5%	10/25/2024
Q4 2024	180.6	7.9	4.9%	1/31/2025

* US comparable sales, incl. Sam's Club, ex-fuel

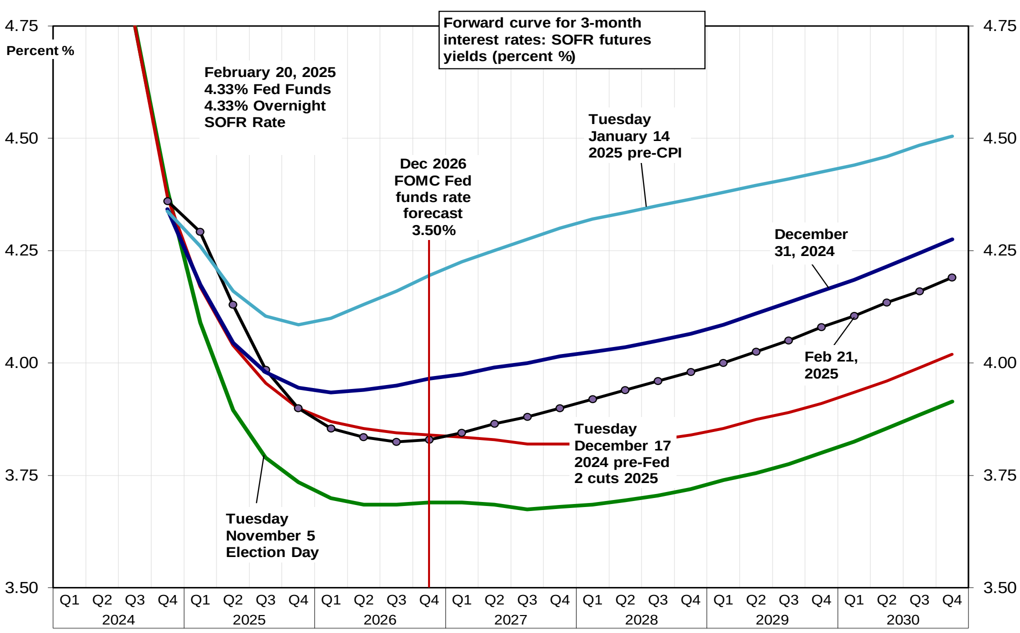


FEDERAL RESERVE POLICY

The Fed meets March 18-19, 2025 to consider its monetary policy. Lots of speakers and the FOMC meeting minutes from the January 28-29 meeting, but no clarity on whether the pro-growth Trump 2.0 agenda with tariffs means a hard pause for the two rate cuts expected this year. It is always possible Trump 2.0 uncertainty sends the economy down with job losses we suppose which means more than two rate cuts in 2025. Nothing to count on except Waller speaking down in Australia on Monday (last trip with Washington budget cuts coming) giving us the core PCE inflation forecast update for Friday, February 28 after last week's CPI/PPI data. Split the difference with a 0.25% increase in January core PCE inflation with a year-on-year rate of 2.6%. Better than 2.8% year-on-year where it has been stuck since October last year. Back to the Fed meeting minutes where they discussed slowing or pausing QT that adds to the amount of debt the US Treasury has to auction: QT currently $300 billion per year and was $720 billion before last May. Less supply, lower yields. But wait for the mountain of debt coming to fund the President's tax cuts. Stay tuned.

Selected Fed assets and liabilities						Change
Fed H.4.1 statistical release						from
billions, Wednesday data	19-Feb	12-Feb	5-Feb	29-Jan	3/11/20*	3/11/20
Factors adding reserves						to Feb 19
U.S. Treasury securities	4251.251	4265.982	4265.944	4274.511	2523.031	1728.220
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2217.572	2217.559	2217.559	2217.559	1371.846	845.726
Repurchase agreements	0.000	0.100	0.000	0.003	242.375	-242.375
Primary credit (Discount Window)	3.234	3.033	3.095	3.200	0.011	3.223
Bank Term Funding Program	0.188	0.195	0.197	0.213		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	1.905	1.910	1.920	1.925		
Main Street Lending Program	7.324	7.402	7.394	7.648		
Term Asset-Backed Facility (TALF II)	0.000	0.000	0.000	0.000		
Gold stock	11.041	11.041	11.041	11.041	11.041	0.000
Central bank liquidity swaps	0.091	0.073	0.076	0.078	0.058	0.033
Federal Reserve Total Assets	6833.4	6864.8	6862.2	6868.7	4360.0	2473.382
~~3-month Libor %~~ SOFR %	4.35	4.32	4.33	4.35	1.15	3.200
Factors draining reserves						
Currency in circulation	2354.017	2350.536	2349.958	2349.125	1818.957	535.060
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	738.938	809.154	817.953	811.549	372.337	366.601
Treasury credit facilities contribution	3.461	3.461	3.461	3.461		
Reverse repurchases w/others	73.196	67.670	78.788	121.842	1.325	71.871
Federal Reserve Liabilities	3557.268	3609.347	3628.831	3668.047	2580.036	977.232
Reserve Balances (Net Liquidity)	3276.141	3255.407	3233.328	3200.654	1779.990	1496.151
Treasuries within 15 days	62.103	89.286	90.859	64.908	21.427	40.676
Treasuries 16 to 90 days	217.322	187.267	185.553	214.028	221.961	-4.639
Treasuries 91 days to 1 year	431.813	448.369	448.505	452.293	378.403	53.410
Treasuries over 1-yr to 5 years	1460.303	1450.277	1450.261	1456.789	915.101	545.202
Treasuries over 5-yrs to 10 years	531.257	549.210	549.206	545.659	327.906	203.351
Treasuries over 10-years	1548.452	1541.573	1541.561	1540.835	658.232	890.220
Note: QT starts June 1, 2022	Change	2/19/2025	6/1/2022			
U.S. Treasury securities	-1519.528	4251.251	5770.779			
Mortgage-backed securities (MBS)	-489.874	2217.572	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

Fed Policy-key variables					Long
	2024	2025	2026	2027	Term
Fed funds	4.4	3.9	3.4	3.1	3.0
PCE inflation	2.4	2.5	2.1	2.0	2.0
Core inflation	2.8	2.5	2.2	2.0	
Unemployed	4.2	4.3	4.3	4.3	4.2
GDP	2.5	2.1	2.0	1.9	1.8
December 2024 median Fed forecasts					



All but 5.5 bps of a 25 bps rate cut is discounted in June 2025.

Fed funds futures call Fed policy	
Current target: February 21 -- 4.50%	
Rate+0.17 Contract	Fed decision dates
4.490 Apr 2025	Mar 19
4.305 Jul 2025	Adds May 7, Jun 18*
Last trade, not settlement price	
* Not strictly true, Jul 2025 has Jul 30 Fed date, so 1 day could be a new interest rate	

Next up: January PCE inflation report Friday, February 28															
Monthly	2025	2024											2024	2023	2023
% Changes	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan	Dec	Nov
Core CPI inflation	0.4	0.2	0.3	0.3	0.3	0.3	0.2	0.1	0.1	0.3	0.4	0.4	0.4	0.3	0.3
Core PCE inflation	0.25e	0.2	0.1	0.3	0.3	0.2	0.2	0.2	0.1	0.3	0.3	0.2	0.5	0.2	0.1
Core PCE YOY	2.6e	2.8	2.8	2.8	2.7	2.7	2.7	2.6	2.7	2.9	3.0	2.9	3.1	3.0	3.2
Core CPI YOY	3.3	3.2	3.3	3.3	3.3	3.2	3.2	3.3	3.4	3.6	3.8	3.8	3.9	3.9	4.0

OTHER ECONOMIC NEWS

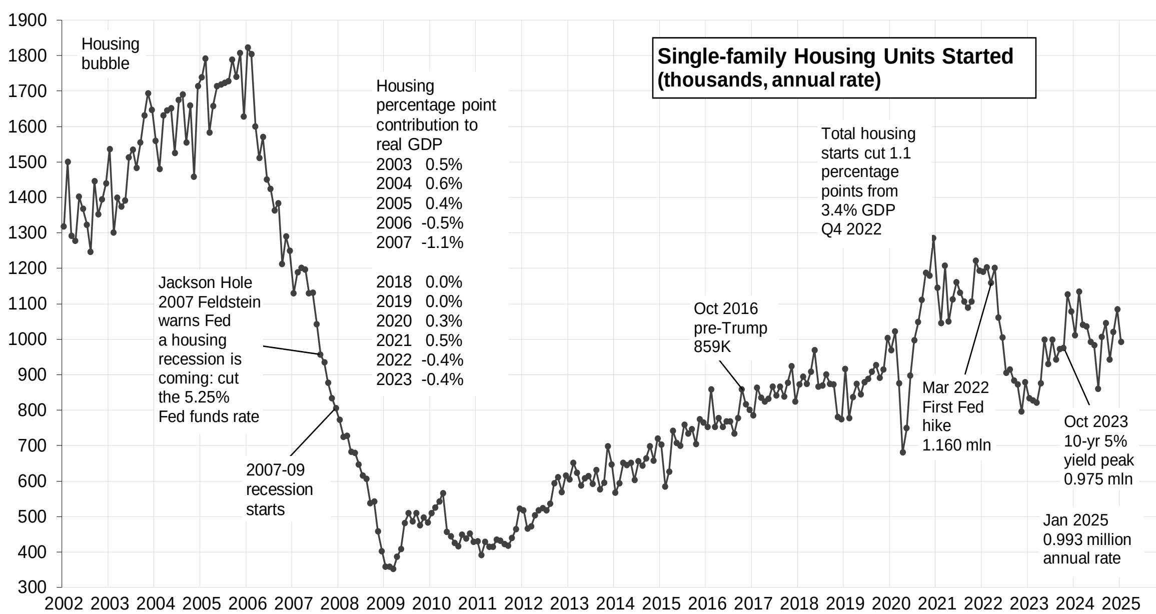
Housing crash (Wednesday)

Breaking economy news. January housing starts tumbled 9.8% to 1.366 million at an annual rate, and single-family fell 8.4% to 993 thousand (December single-family revised up to 1.084 million from 1.050 million). Multifamily units have been volatile but also ended lower. It appears the colder winter weather played a part as it likely did for retail sales and certainly was a factor for industrial production.

Housing Starts Total, Single-Family, Multi-Family

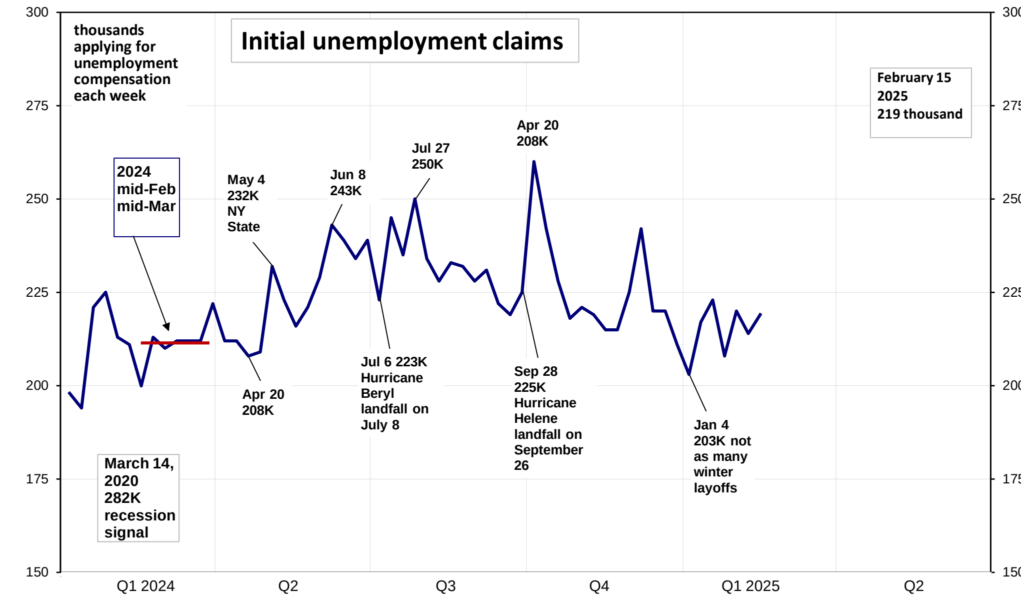
	United States			Northeast		Midwest		South		West	
000s	Total	1 unit	Multi	Total	1 unit	Total	1 unit	Total	1 unit	Total	1 unit
Jan 2025	1366	993	355	105	53	181	138	680	521	400	281
Dec 2024	1515	1084	399	145	62	202	152	887	645	281	225
Jan 2024	1376	1011	347	133	69	139	112	754	579	350	251
% Chgs											
Jan/Dec	-9.8	-8.4	…	-27.6	-14.5	-10.4	-9.2	-23.3	-19.2	42.3	24.9
Jan/Jan	-0.7	-1.8	…	-21.1	-23.2	30.2	23.2	-9.8	-10.0	14.3	12.0

Net, net, the party is over for the rally in new residential housing construction as starts come tumbling down at the start of the new year as the economic outlook becomes increasingly uncertain after the blizzard of changes announced down in Washington. The data are surprisingly uneven across the country with big declines seen in the Northeast, Midwest, and South where colder than seasonal temperatures undoubtedly played a big part. Housing starts in the West soared an astounding 42.3% in January, the same month as the LA fires which likely had no impact. Permits nationwide for future construction are holding up which could be a sign the outlook is not completely lights out, but then again permits activity has not changed the last few months. Stay tuned. The colder winter weather appeared to bring down the number of new housing projects started in much of the country, but the weather effects aside, there still is a shortage of housing in much of the country and this means there will be continued upward pressure on prices. The outlook for more homebuilding is cloudy and gray as import tariffs are likely to push up building costs in the months to come, and homebuyers report the higher cost of borrowing is holding them back from being able to afford and purchase a new home. The housing market is not out of the woods and the costs of home ownership are likely to climb.

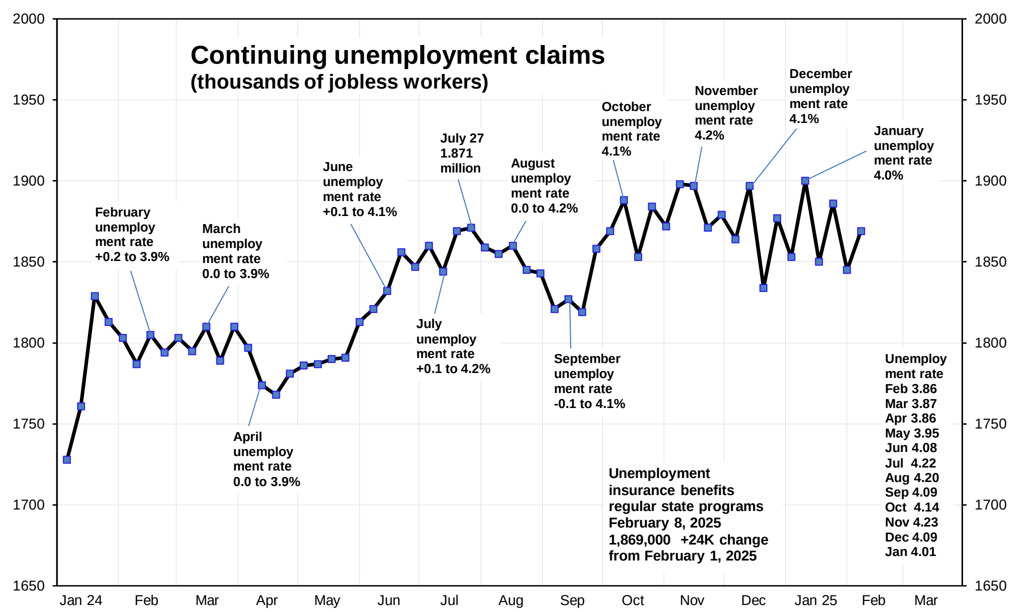


Weekly layoffs steady (Thursday)

Breaking economy news. Initial unemployment claims rose 5K to 219K in the February 15 week, where unadjusted filings dropped 10,118. It may be splitting hairs, but not seasonally adjusted filings would have fallen further, as is seasonal, except for the winter storms perhaps that pushed up claims 3,033 in Kentucky and 2,753 in Tennessee. Plenty of uncertainty about Trump 2.0's plans, but no company is laying off workers, which is traditionally done when there are declining revenues and sales.

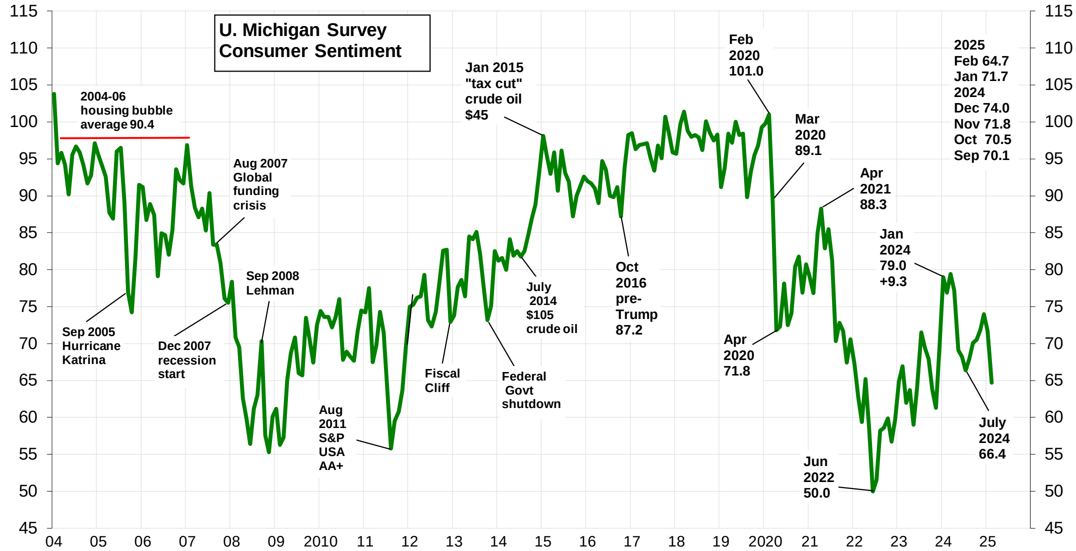


Net, net, joblessness has not yet hit the Beltway let alone the rest of the country with only 613 Federal employees filing for unemployment benefits versus 219 thousand for the regular state program filings in the February 15 week. There is plenty of uncertainty down in Washington about where policy veers next, but at the moment, employers are holding on tight to the workers they have and layoffs are minimal. There were 7,110 Federal employees receiving jobless benefits in the February 1 week which is barely changed from the 6,893 getting unemployment checks a year ago. The current round of unprecedented belt-tightening and budget cuts and layoffs in Washington have not become a reality yet in terms of showing up in the national statistics. But actions taken in the early days of the new Administration may yet bring about a broader economic slowdown and is frankly a risk factor that economists did not see at the start of the year. Stay tuned. All is calm in the labor market for now, but for how long is the million dollar question.

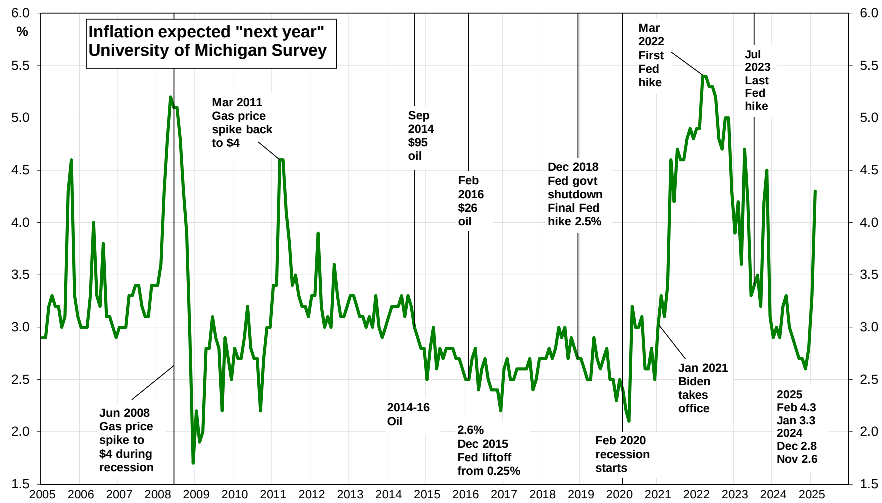


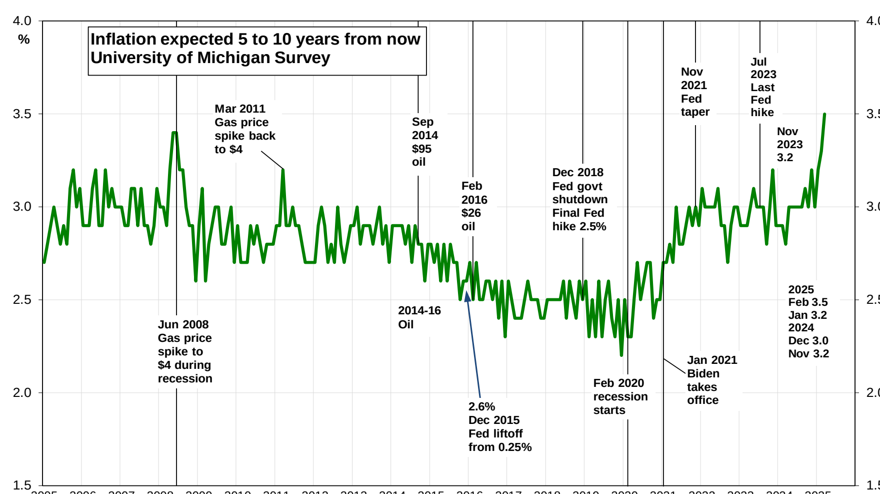
Consumer fears inflation, existing home sales cold in January (Friday)

Breaking economy news. Consumer survey from the University of Michigan with final results for February after the preliminary report two weeks ago. After the dust settles, February sentiment 64.7 versus 71.7 in January. One year inflation expectations were 3.3% in January and now 4.3%. Long-run inflation new high at 3.5 in February from 3.2 in January. Existing home sales fell in February. See graphs on next page.

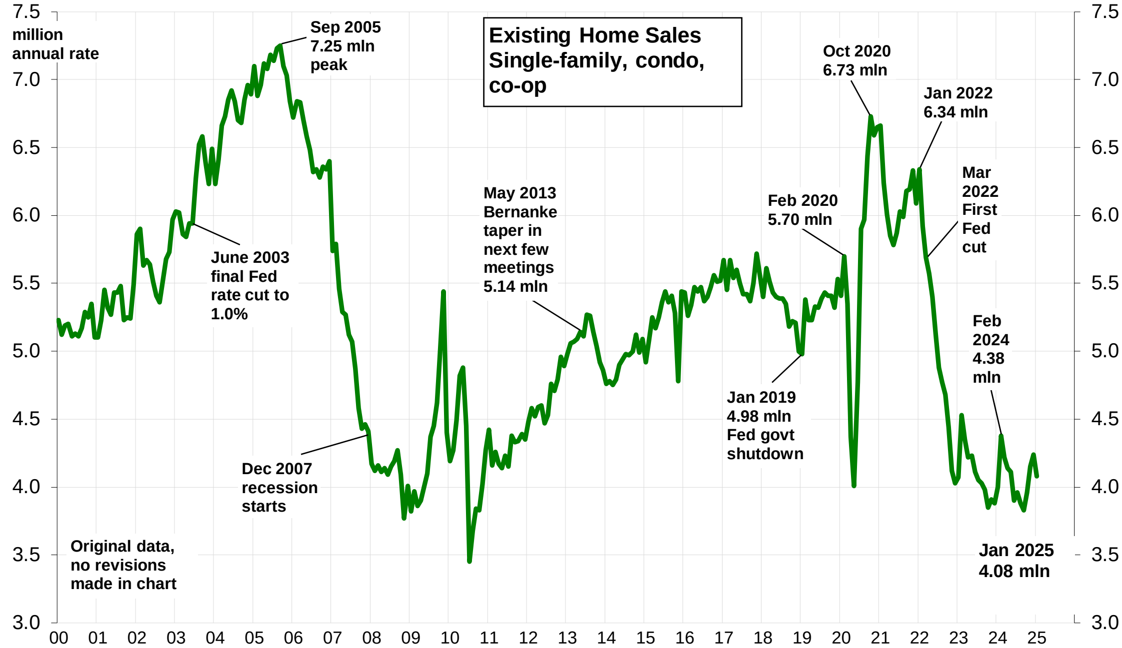


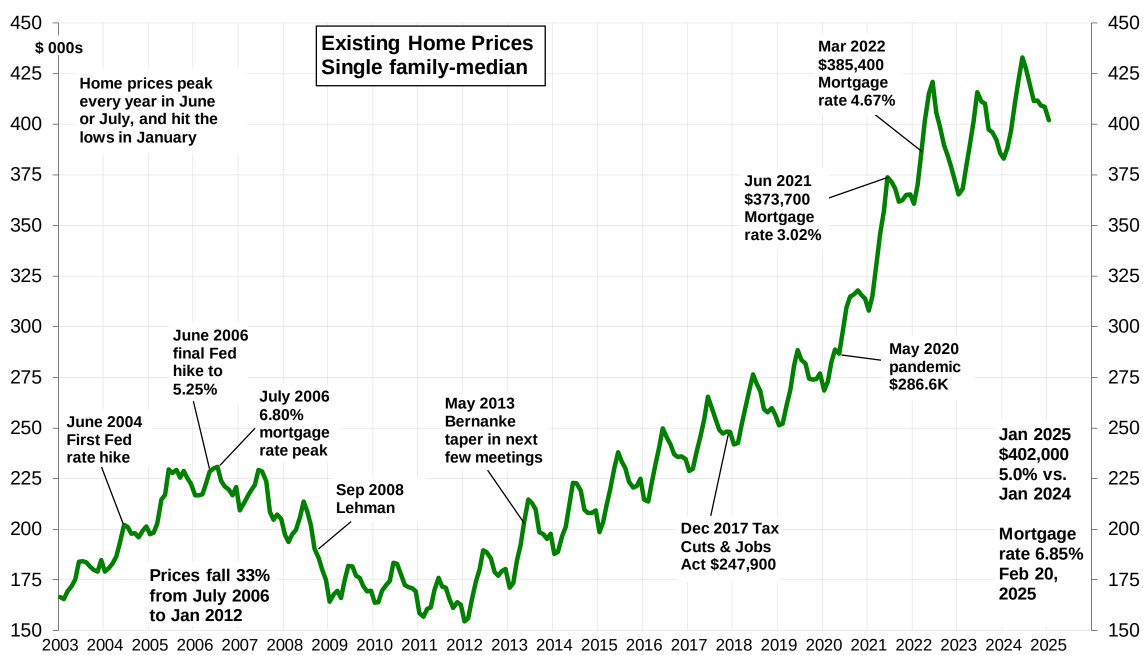
Net, net, Trump 2.0 fiscal policies to date are apparently an unmitigated disaster for consumer confidence with expectations of Washington-grown inflation soaring according to the latest survey from the University of Michigan. The public's fears have soared in just the last two weeks showing the blizzard of changes coming from the President's desk have spilled over the line between pro-growth into the realm of pro-inflation. Once inflation expectations start moving higher it is only a matter of time before actual inflation takes off. It is no wonder that consumer sentiment is tumbling from 71.7 in January to a preliminary reading this month of 67.8 released two weeks ago, and now the final 64.7 reading for February. Stay tuned. Washington policies have pushed long-run inflation expectations even higher now than it was nearly twenty years ago during the housing bubble that preceded the Great Recession. If the consumer balks at the higher prices coming their way the economy could collapse in a hurry. Bet on it.





Existing home sales dropped 4.9% to 4.08 million in January. No cold weather effect perhaps as existing home sales are recorded at the time of closing where the sales contract was signed perhaps 30-45 days earlier. Single-family existing home prices have fallen since the $432,900 peak last summer in keeping with seasonal trends. The bubble is still inflating though with prices up 5.0% from last year.





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