Weekly Market Summary

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When the US Federal Reserve Chair Speaks ... Markets Still Listen (Unfortunately !!)

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On Tuesday, Federal Reserve Chair Janet Yellen – in a speech to the Economic Club of New York – mentioned that it is appropriate for U.S. central bankers to raise interest rates very gradually because the global economy presents heightened risks. "*I consider it appropriate for the Committee to proceed cautiously in adjusting policy*," Yellen said. "*This caution is especially warranted because, with the Federal funds rate so low, the FOMC's ability to use conventional monetary policy to respond to economic disturbances is asymmetric*."

Prior to her speech, Fed officials had left the benchmark lending rate target unchanged at 0.25% -- 0.50% at their March meeting while revising down their median estimate for the number of rate increases that will be warranted this year to two hikes, from four projected in December (revised Fed dot plot). That, however, did not prevent some members of the Federal Open Market Committee to sound a lot more hawkish in their follow-up individual speeches than the group as a whole did in the policy statement that followed the March 16th FOMC gathering.

Take for example James Bullard: The St. Louis Fed president, a voter, said that if unemployment continues to fall much more, the Fed may have to raise rates faster later. His comments followed Chicago Fed's Charles Evans, San Francisco's John Williams and Atlanta's Dennis Lockhart who all indicated they supported at least two rate hikes this year, including one relatively soon. Still, Philadelphia Fed President Patrick Harker was probably the most hawkish, saying that the Fed should "*get on with*" more rate hikes, potentially in April. "*I am not a two-dot person,*" he said, meaning that he personally favors there should be more than two rate hikes this year. Those views led CNBC Fed watcher Steve Leisman to write an article mid-last week titled, "*Fed Chair Yellen Has a Mini Revolt on Her Hands*." Leisman noted that there was a dissenter in last week's FOMC vote as Kansas City Fed President Esther George called for a rate hike then, but also pointed out that most of the recent hawkish speeches came from non-voters on the FOMC.

So what exactly made Janet Yellen double down on the dovishness from the March statement and press conference ?

Was it solely to do with mounting risks associated with global economic and geopolitical developments or is the US Fed Chair anticipating a recession to hit soon at home ?? (mind you that a recent survey conducted by Bank of America Merrill Lynch found that 59% of U.S. fund managers believe the current stretch of economic growth is in its "final innings." That is the highest reading since the financial crisis in 2008 ! As if to support this outlook, the Commerce Department released economic data last Friday that showed fourth-quarter 2015 corporate profits fell at their fastest rate since—you guessed it—the same period in 2008!).

Janet Yellen mentioned two risks in her New York speech: Growth in China is slowing (The Fed Chair would have been better off waiting for today's release of the Chinese official factory gauges that showed solid improvements for both Manufacturing and Non-Manufacturing PMIs), she noted, and there is some uncertainty about how the nation will handle the transition from exports to domestic sources of growth. A second risk is the outlook for commodity prices, and oil in particular. Further declines in oil prices could have "*adverse*" effects on the global economy, she said. Since the March meeting, Fed officials have seen more evidence that the pace of domestic growth may be slowing. U.S. GDP decelerated to 1.4% pace in the fourth quarter (up from a preliminary reading of 1.0%), while the Atlanta Fed's GDP estimate for the first quarter of 2016 currently stands at 0.6%, partly due to slower rates of consumer spending growth. On the other hand, inflation measures have shown a trend of gradual firming. The Core Personal Consumption Expenditures price index (ex-food and energy) rose 1.7% for the year ended February, the fastest pace in three years. Yellen said she was confident that inflation would gradually return to the Fed's 2% goal over time, while noting that the course of prices was a two-sided risk.

Now that Janet Yellen has spoken, where does this leave us?

The Federal Reserve chair's speech to the New York Economics Club probably put the final touch to the Fed's developing strategy for reconciling the disparate parts of its mandate this year. Judged in isolation, both US unemployment and inflation data, which should matter most, justify further rate rises. Nonetheless, the international situation raises concerns and Mr. Yellen has now offered an elegant and very market-friendly rationale for the Fed not just to await the release of US data, but also to err on the side of leaving monetary policy too loose to support global markets (for the 100th time, central bankers have not learned much from the lessons of the 2007-2008 financial crisis, and the unfortunate crash that will most likely rock markets in late 2017/early 2018 would have to be blamed uniquely on their loose and desperate monetary measures, as well as Wall Street greed!).

Markets greeted Yellen's speech with welcome relief! It almost sounded like what the stock, bond and currency markets wanted to hear! Bond markets rallied with a vengeance with yields down noticeably (11-14 bps in past 3 sessions). The S&P 500 gained ground , trading to the its highest level for 2016 though still 4% short of breaking the record it set last May. Last, the US dollar was headed for its biggest weekly decline in almost two months on speculation the Federal Reserve will maintain a gradual pace for raising rates whatever upcoming US data show.
Still, important tests lie ahead: The unemployment data, along with ISM manufacturing surveys from around the world, will be released later today. Immediately following that will be the earnings season for the first quarter. Additionally, central bankers' assertions should never be taken too seriously: After all, didn't the same Janet Yellen - in her testimony to the Financial Crisis Inquiry Commission in 2010 - confirm the following:

"*For my own part, I did not see and did not appreciate what the risks were with securitization, the credit ratings agencies, the shadow banking system, the S.I.V.'s — I didn't see any of that coming until it happened. I guess I thought that similar to the collapse of the stock market around the tech bubble, that most likely the economy could withstand [the housing collapse] and the Fed could move to support the economy the way it had after the tech. bubble collapsed*" (Her startled interviewers noted that almost none of the officials who testified had offered a similar acknowledgment of an almost universal failure. *At least Yellen is honest in admitting her complete lack of vision and failure to not only stop but see what was coming… Let us give her credit where it is deserved!!)*

A final reminder with regards to this afternoon March US payroll data: The BLS announcement will be at 4:30 pm Bahrain local time. Bloomberg's consensus is for a 205,000 increase in jobs on the month (following a very solid 242,000 increase the previous month), an unchanged unemployment rate and average workweek (at 4.9% and 34.5 hours respectively), a 0.2% month-on month increase in average hour earnings (2.2% year-on-year) following a weak

-0.1% monthly showing for the month of February. The US dollar is last trading at 1.1410 and 112.25 against the Euro and JPY respectively. WTI Oil is at $ 37.80 a barrel and gold is at $ 1231 an ounce. Last, US 5-year and 10-year UST yields are hovering close to 1.23% and 1.79% respectively ! (And to think fair values for these 2 tenors would be north of 1.75% and 2.25% respectively, if it wasn't for central bankers' verbal manipulation and forward misguidance!).

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