Friday, May 18, 2018

The Week the Markets Woke Up

The bond market woke up with a vengeance this week to everything that has been talked about for months – trade tariffs, geopolitical issues, and the fate of higher interest rates. After struggling for weeks to stay over three percent, the 10-year Treasury note surged past the long-held resistance level to 3.11 percent – the highest yield in almost eight years. Not to be left out, the 30-year Treasury bond reached 3.25 percent, its highest level since 2015. The sudden rise in long-term yields was a head-scratcher. Nothing changed materially, but lots of little things came together. Fed spokespeople continue to reiterate their plan to raise rates, the amount of debt the Treasury needs to sell is growing, and inflation is headed higher rather than lower. Central banks remain confident the global economies can handle higher interest rates. Federal Reserve Bank of Cleveland President Loretta Mester believes the shifting economic condition may mean more interest rate hikes than she previously expected. The impact of Trump's plan to leave the Iran nuclear deal and impose tighter sanctions on Iran also began to take hold this week, pushing the price of oil to $80 a barrel, the highest price in over three years. The markets are becoming concerned that Washington will not issue sanction waivers to companies involved with bringing Iranian oil to buyers, thus effectively cutting off crucial oil supplies. In an effort to calm investors, several economists argued the rising price of oil will not hamper economic growth. Rather, they say, it could be a non-event, as capital expenditure will make up for any slowdown on the consumer side.

Other Key Indicators this Week:

Housing – Home building activity took a step back in April after a busy March, but in a good way. The 3.7 percent decline in housing starts came from a reversal in multi-family housing, which declined 11.3 percent. However, single-family construction increased 0.1 percent. The shift from multi-family to single-family is a necessary step in fulfilling the demand for single family homes. The housing industry has been suffering from a lack of supply which, in turn, is forcing prices higher. Homebuilder sentiment remains strong, increasing for the first time in five months. Despite rising lumber costs and higher mortgage rates, builders cite continued activity in buyer traffic and improved current sales as reasons for the growing optimism.

Retail Sales – For a second month in a row, retail sales increased. Total retail sales rose 0.3 percent in April and were revised higher for March. Nine of the 13 categories in the index posted gains, giving a good start for the second quarter. Sectors improving the most included apparel sales, increasing 1.4 percent, and furniture store sales, up 0.8 percent. The control index, which feeds into the quarterly GDP calculation, rose 0.4 percent.

Strategically for Credit Unions:

It is important to keep in mind that while bond yields are inching up, we are a long way from what used to be considered high rates. Anyone else remember when a 12 percent 30-mortgage rate was considered good? Rates may be going up, but they are still historically low. The shift in yields this week should be viewed as the market's way of rebalancing the yield curve, letting the long end finally catch up to the rise in short-term yields.
Note: Due to the Memorial Day holiday weekend, there will be no *Behind the Numbers* next week. *Behind the Numbers* will resume on June 1.

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