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The Interest Rate People

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Last Week This Morning

- The 10T started the week at 2.96% and ended at 2.97%, but it did touch 3.00% again
    - German bund inched up to 0.56%
- 2 year Treasury continued setting decade highs, closing the week out at 2.54%
- The yield curve has flattened to just 0.43%, the flattest since 2007
- LIBOR actually ticked down 1bp to 1.92%
- SOFR ticked down to 1.73%
- Core CPI came in a little under expected, 2.1% actual vs 2.2% forecasted
- Oil broke $70/barrel for the first time since late 2014
    - Bank of America released a report that Iranian sanctions could push oil to $100/barrel
- Iranian sanctions should restrict oil exports to the tune of about 350k barrels a day
    - A decade ago, 1/3rd of US domestic demand was met by domestic production
    - Today, 2/3rds is met by domestic production
    - European nations lack similar domestic production capabilities
    - China and Russia are the most likely candidates to ramp up investment in Iran

Rates

The market has a 100% probability of a hike at the June 13th meeting, which would imply LIBOR around 2.15%.   There's even a 26% probability the Fed hikes 0.50% instead of 0.25%. We view that as a huge overstatement, but perhaps the take away is that the market is buying what the Fed is selling when it comes to rate hikes.

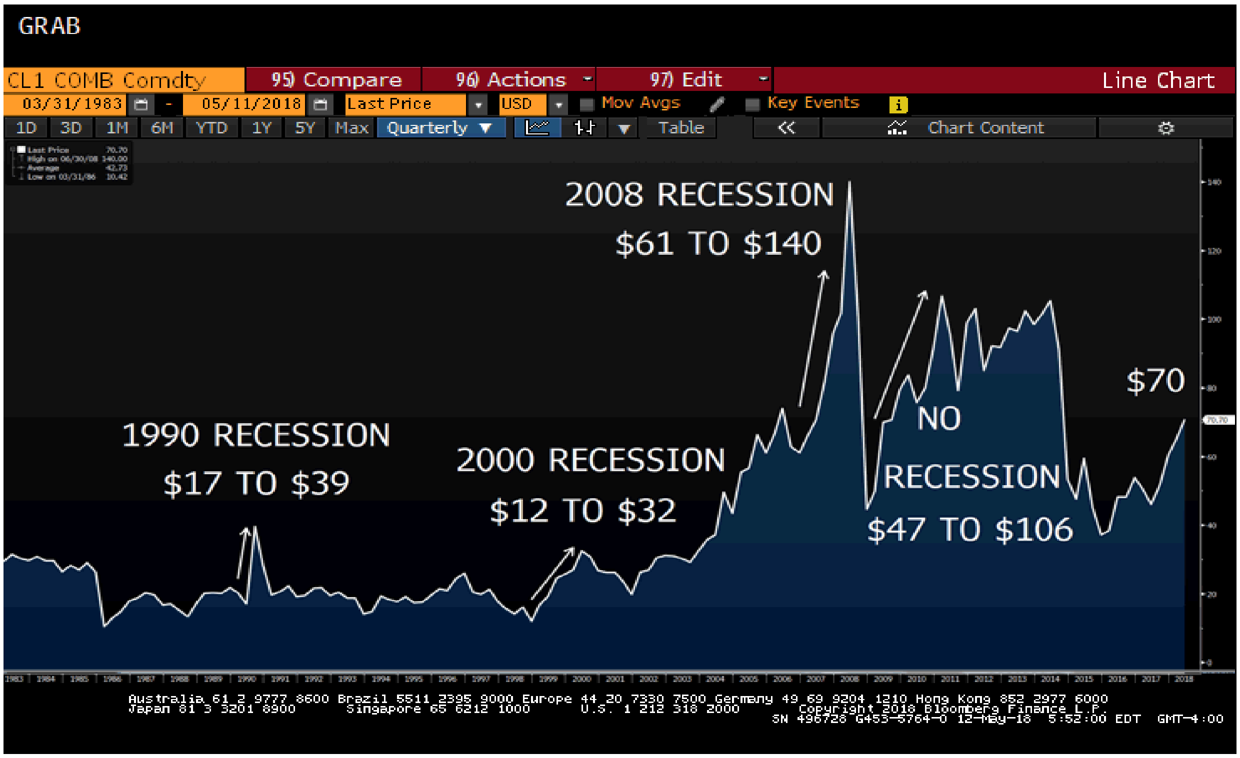
Expect LIBOR to resume it's climb this week as we get within the 30 day window of the next FOMC meeting. Over the next month, LIBOR will likely climb to 2.15%-ish barring a sudden change to rate hike probabilities.

The 10 Year Treasury is still flirting with 3.00%, but that's really a psychological level. The key technical level (like 2.62% before it) is 3.05%-ish.

Oil and Recessions

In four out of the last five recessions, oil prices doubled ahead of the economic slowdown.

Here's a graph illustrating the recessions since the 1980's. There appears to be a correlation between oil prices doubling in less than 18 months and recessions.



Source: Bloomberg Finance, LP

The notable exception was the post-crisis period when oil climbed from $47 to $106 and no recession ensued. What gives?

There is a LOT going on in the following graph, but let me try to highlight the takeaway. Focus on the red ovals.

- in 1994, Fed Funds increased but oil stayed flat – *no recession*
- in 2012, oil increased but Fed Funds stayed flat – *no recession*

In my state school vernacular – when one increased but not the other, no recession.

When both increased, recession.

Source: Bloomberg Finance, LP

Bottom Line – when the cost of money *and* the cost of energy increase, a recession follows.

Both are climbing right now.

Bonus Bottom Line – in previous recessions, oil doubled (or more) and Fed Funds increased by 2.00% (or more). Thus far,

- oil is up 52% from 18 month low (with $92/barrel as the implied threshold)
- Fed Funds is up 1.50% (with 2.25% as the implied threshold)

This suggests current levels are flashing warning signs, but we aren't in Recession Lead Pipe Lock territory…yet.

But with an FOMC suggesting it will hike Fed Funds to 3.00%, Iranian sanctions pushing up oil prices, and a flattening yield curve, the stage is being set.

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This Week

Relatively quiet week on the data and Fed-speaker front. Perhaps the consumer spending data will be the headline given the impact oil prices can have on disposable income.