

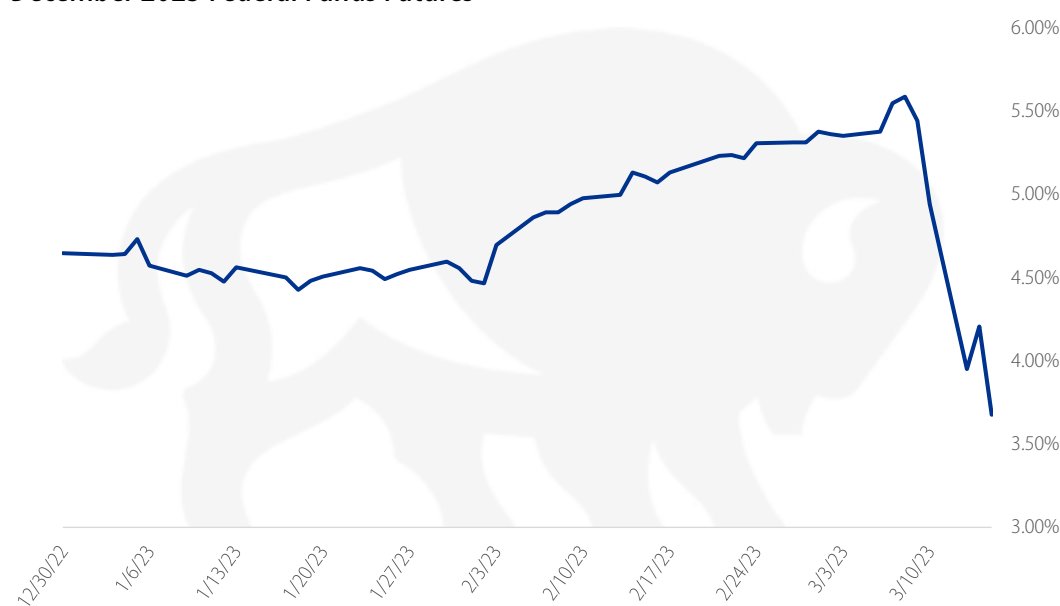
Yields Plunge Again on Bank Jitters, while PPI and Retail Sales Cool

Shares of Credit Suisse plunged more than -25% to a record low after it revealed “material weakness” in its reporting, and its largest shareholder adamantly refused to provide additional funding to the troubled Swiss bank. Market values of other major European financial institutions, already reeling from the abrupt collapse of Silicon Valley Bank last week, dropped further, with Societe Generale, BNP Paribas and Deutsche Bank all down between -8% and -11% on the day. The *Eurostoxx Banks Index* has shed over -8% of its value since Tuesday.

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December 2023 Federal Funds Futures



Source: Bloomberg

The European Central Bank (ECB) was widely-expected to hike its key deposit rate by 50 basis points tomorrow. *That move is suddenly in question.* The simple fact that the ECB's deposit rate was *negative* less than a year ago assures that the series of European rate hikes that began *last July* have had a significant negative impact on global bond portfolios. The pace of withdrawals has increased along with depositor concerns. If banks are forced to sell securities, losses are expected.

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U.S. bond yields are down sharply *once again*. On Monday, the two-year Treasury note yield experienced the largest single day plunge in 36 years. Today's drop could challenge that mark. In just five trading days, the two-year has shed more than 130 basis points and is now yielding just 3.75%.

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Contributing to the decline this morning was an unexpectedly soft inflation report. The headline Producer Price Index (PPI), a measure of wholesale prices, actually *fell* -0.1% in February, well below the median forecast for a +0.3% increase, while the previously reported +0.7% January increase was trimmed to +0.3%. On a year-over-

year basis, PPI retreated sharply from +5.7% to +4.6%. Just eight months ago, the annual pace of producer inflation was an alarming +11.3%.

Wholesale energy prices declined -0.2% in February after rising +5.2% in January, while food prices fell -2.2%, the third straight monthly decrease. When food and energy prices are excluded, core PPI, expected up +0.4%, was actually *unchanged* for the month. Given Tuesday's slightly warmer-than expected CPI report, February PPI shouldn't signal a major turning point, but in the midst of market turmoil, it's a convenient factor for Fed officials to lean on should the committee decide a pause is more appropriate next week.

In other news this morning, retail sales reversed the revised +3.2% January gain with a -0.4% February decline. In all fairness, the drop was fully expected, exactly matching the median forecast. Sales in 8 of 13 categories fell last month, with vehicle sales down -1.8% and sales at gas stations falling -0.6%. The sole service sector category, restaurant and bar sales, dropped -2.2%.

Similar to the PPI report, the headline weakness in retail sales may provide cover for Fed officials to pause next week, but it's probably too early to expect U.S. consumers have hit a wall. January spending numbers were elevated by favorable weather at the expense of February sales.

The futures market is now indicating no better than a 50/50 chance of a 25 bp rate hike next week. The market is also signaling the first quarter point rate *cut* will happen three months from now at the June FOMC meeting, with additional cuts announced at the July, September and December meetings. Obviously, Fed officials will consider incoming data and make whatever call is appropriate at each meeting, but the markets are spooked, and the objective for policy-makers next week is to restore confidence.

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Market Indications as of 10:51 A.M. Central Time

DOW	Down -550 to 31,221 (HIGH: 36,800)
NASDAQ	Down -81 to 11,347 (HIGH: 16,057)
S&P 500	Down -58 to 3,861 (HIGH: 4,797)
1-Yr T-bill	current yield 4.06%; opening yield 4.40%
2-Yr T-note	current yield 3.82%; opening yield 4.28%
3-Yr T-note	current yield 3.73%; opening yield 4.11%
5-Yr T-note	current yield 3.51%; opening yield 3.85%
10-Yr T-note	current yield 3.44%; opening yield 3.69%
30-Yr T-bond	current yield 3.64%; opening yield 3.81%

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