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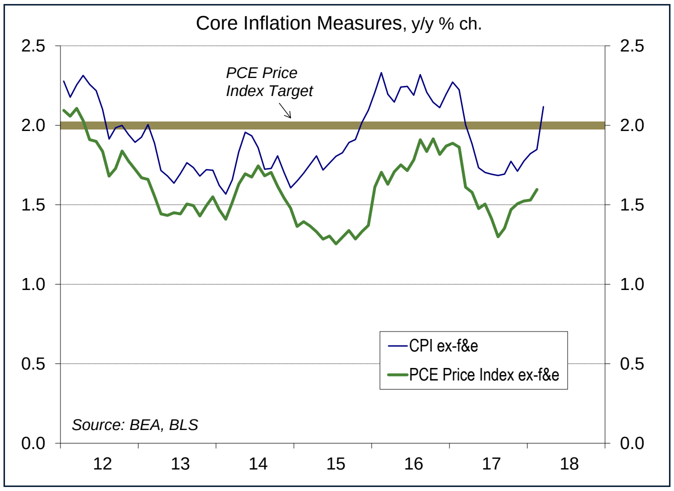
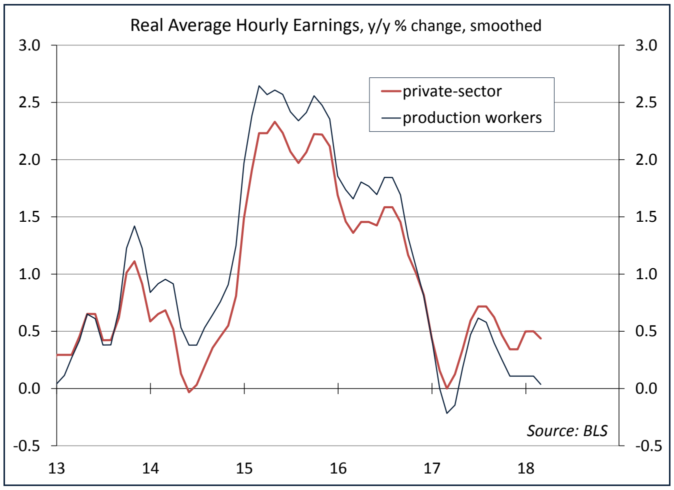
Weekly Economic Monitor

Like Sands Through the Hourglass…

The March reports remained consistent with the view that inflation will move toward the Fed's 2% goal, perhaps sooner than expected. The FOMC minutes were not expected to surprise, but several Fed officials felt that it might be appropriate to move the federal funds rate above a neutral level for a time. As expected, the Congressional Budget Office is projecting higher deficits for the foreseeable future. Stock market participants ignored all this, buffeted by shifting perceptions of the White House's trade policy.



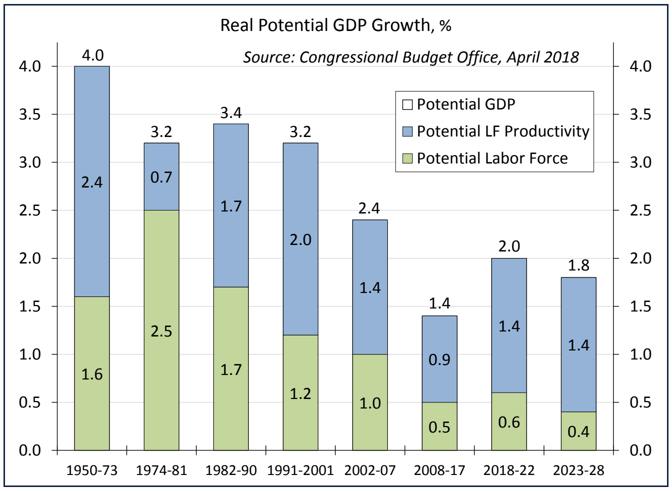
The y/y increase in the core Consumer Price Index rose to 2.1% in March (vs. +1.8% in February), as the March 2017 drop in wireless telecom services rolled off the 12-month calculation. Bear in mind that the Fed uses the PCE Price Index as its inflation gauge, which has been trending about 0.3 percentage point below the CPI. The reports on producer prices and import prices reflected a gradual buildup in pipeline pressures, consistent with the view that the Fed is nearing its inflation goal.



While inflation is still low by historical standards, it's nearly matched gains in average hourly earnings, leaving inflation-adjusted earnings up modestly from a year ago. This suggests little firepower for consumer spending growth for the typical worker, which is consistent with the softer spending numbers we've seen in recent months.

The FOMC minutes from the March policy meeting showed that Fed officials generally saw the soft 1Q17 economic data as "transitory," and therefore unlikely to deter them from gradually raising short-term interest rates. More importantly, several Fed officials saw growth as likely exceeding its potential, requiring an above-neutral federal funds rate to get back to a long-term sustainable trajectory.

In its revised outlook, the non-partisan Congressional Budget Office is projecting 3.3% GDP growth (4Q18/4Q17), on the high side of the range of most economic forecasters, but short of the 4% or more put forth by administration officials. No surprise, the CBO is projecting higher federal budget deficits over the next several years, exceeding $1 trillion in FY20, and those forecasts are almost certainly too optimistic (as lawmakers have never been able to keep to proposed spending caps).



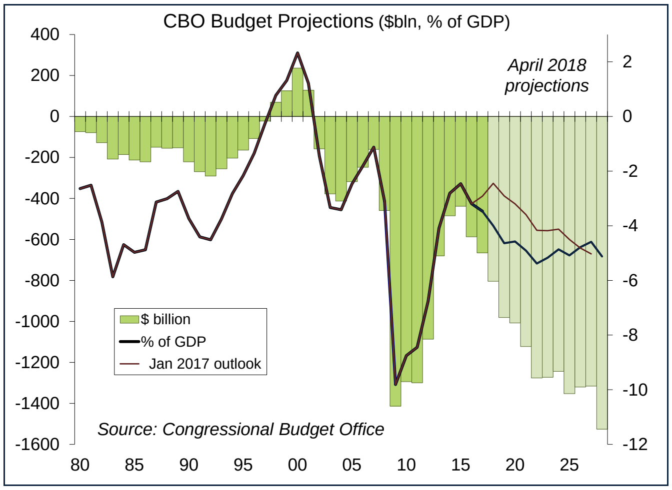
The CBO expects the TCJA to help fuel business fixed investment, which will boost productivity growth to some extent. However, growth is still seen as exceeding its potential in the near term, leading to a correction (below-trend growth) within a couple of years. The labor market is expected to be the binding constraint for GDP growth over the next ten years.

Meanwhile, China's President Xi gave a speech that was virtually the same as the one he gave in Davos a few months ago. Market participants took it as "conciliatory." Emboldened, President Trump indicated an even tougher stance, but he also suggested that he might be down with TPP (that is, negotiating a U.S. entrance to multi-lateral agreement). I can't even…

	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
3/16/18	1.78	1.96	2.08	2.31	2.44	2.65	2.85	3.08	1.228	1.392	106.10	1.310	7481.99	2752.01	24946.51
4/06/18	1.73	1.91	2.06	2.27	2.40	2.58	2.77	3.01	1.227	1.409	107.03	1.276	6915.11	2604.47	23932.76
4/13/18	1.76	1.96	2.10	2.36	2.50	2.67	2.82	3.03	1.234	1.425	107.36	1.260	7105.10	2656.30	24360.14

Recent Economic Data and Outlook

The economic data reports took second stage to shifting views on trade policy and the conflict with Syria.



The **FOMC Minutes** showed that Fed officials viewed signs of 1Q18 softness as "transitory." Trade policy was not expected to have a significant effect on the economy, but officials noted that it poses downside risks to the growth outlook. Despite strong job growth, wage gains are "moderate." Financial conditions are still "accommodative," despite recent stock market volatility. Further increases in short-term interest rates are "likely to be warranted." While the neutral federal funds rate is almost certainly lower than in the past, "several" Fed officials felt that it might become appropriate for the Fed to move above that for a period. That is, moving beyond neutral, pressing on the brakes a little harder over time.

The Congressional Budget Office released its **Budget Outlook**, which incorporates the impact of the Tax Cut and Jobs Act passed late last year and the recent agreement on spending. The deficit is expected to rise to $804 billion (4.0% of GDP) in FY18 and $980 billion (4.6% of GDP) in FY19.

The **Consumer Price Index** fell 0.1% in March, reflecting a 4.9% drop in gasoline prices (-0.2% before seasonal adjustment, and +11.1% y/y). Food edged up 0.1% (+1.3% y/y), with a continued split between food at home (+0.4% y/y) and food away from home (+2.5% y/y). Ex-food & energy, the CPI rose a bit more than expected (+0.2% m/m), with a 0.4% rise in shelter costs (+3.3% y/y). The CPI rose 2.4% year-over-year (vs. +2.2% y/y in February), as the 7.0% March 2017 drop in wireless telecom rolled off of the 12-month calculation. Ex-food & energy, the CPI rose 2.1% y/y (vs. +1.8% y/y in February). Note that the Fed uses the PCE Price Index, which has the core trending about 0.3 percentage point below the core CPI y/y in recent months.

Real Hourly Earnings rose 0.4% in March (+0.4% y/y), up 0.3% for production workers (+0.0% y/y). The year-over-year weakness in real earnings suggests limited firepower for consumer spending growth in the near term.

The **Producer Price Index** rose 0.3% in March (+3.0% y/y), up 0.4% ex-food, energy, and trade services (+2.9% y/y). Pipeline inflation indicators remained consistent with a further build-up of inflationary pressure at the earlier stages of production. Ex-food & energy, unprocessed intermediate goods rose 6.7% y/y, with processed intermediate goods up 3.5% y/y. Intermediate services rose 3.2% y/y. This isn't a major threat to the overall consumer inflation outlook, but it is something that Fed policymakers will notice (consistent with inflation in the PCE Price Index moving closer to the 2% goal).

Import Prices were flat on average in March (+3.6% y/y), up 0.1% excluding food and fuels (+1.8% y/y). The price index for industrial supplies and materials ex-fuels rose 1.0% (+8.0% y/y). Inflation in imported finished goods was mild, following increases in January and February (capital goods +1.4% y/y, autos +0.5% y/y, consumer goods +0.3% y/y).

The Index of **Small Business Optimism** slipped to 104.7 in March, vs. 107.6 (a 35-year high) in February – still strong. Hiring plans were moderate. Capital spending plans softened, not much different than the trend over the last few years.

The University of Michigan's Consumer Sentiment Index fell to 97.8 in the mid-April assessment, vs. 101.4 in March. The report noted that while confidence remains relatively high, there were growing concerns about the potential impact of the White House's trade policies on the domestic economy.

Economic Outlook (2Q18): 2.5-3.0% GDP growth, following about 2.0% in 1Q18 (advance estimate due April 27).

Employment: Job growth has remained strong, but the pace should slow (eventually) as the job market continues to tighten.

Consumers: Real wage growth has been lackluster, but reduced tax withholding boosted take-home pay in February. Credit remains easy, except at the low end.

Manufacturing: Sentiment remains strong. Figures are often choppy at the start of the year, but the underlying trends in orders and production appear to be moderate.

Housing/Construction: Job growth has been supportive. Monthly figures are often erratic and supply constraints remain, but the underlying year-over-year trends are relatively strong.

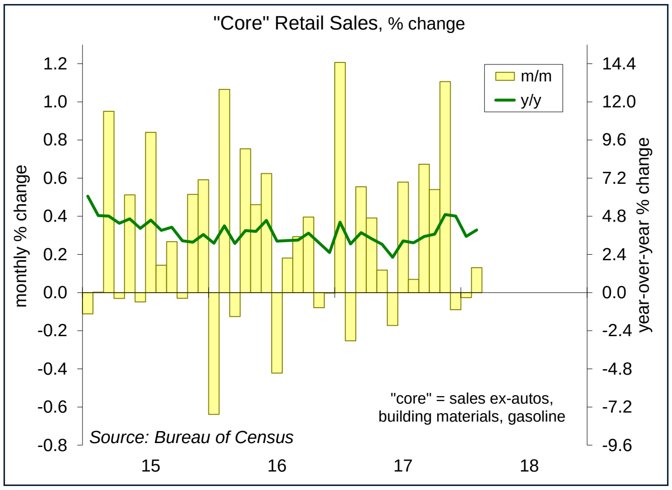
Prices: Core inflation has continued to trend below the Fed's 2% target, but recent figures, the tight job market, and pipeline pressures suggest inflation will move toward the 2% goal.

Interest Rates: The Fed remains in tightening mode, and is expected to continue gradually raising short-term rates. The increase in government borrowing is likely to add some upward pressure on yields. Balance sheet reduction is viewed as "background" and should not be disruptive for the markets.

This Week:					forecast	last	last –1	comments
Monday	4/16	8:30	**Retail Sales**	Mar	***+0.4%***	-0.1%	-0.1%	auto sales picked up
			ex-autos		***+0.3%***	+0.2%	+0.1%	gasoline prices lower
			ex-autos, bld mat, gasoline		***+0.4%***	+0.1%	0.0%	moderate (watch for revisions)
		10:00	Business Inventories	Feb	***+0.6%***	+0.7%	+0.6%	faster in 1Q18
		10:00	Homebuilder Sentiment	Feb	***70***	70	71	seen about steady
Tuesday	4/17	8:30	**Building Permits, mln.**	Mar	***1.330***	1.321	1.377	expecting a modest rebound
			% change		***+0.7***	-4.1	+5.9	single-family to remain strong
			Housing Starts		***1.295***	1.236	1.329	choppy
			% change		***+4.8***	-7.0	+10.1	watch for revisions
		9:00	**IMF World Econ Outlook**					updated from January's outlook
		9:15	**Industrial Production**	Mar	***+0.3%***	+0.9%	-0.2%	colder → utility output higher
			Manufacturing Output		***+0.1%***	+1.3%	-0.1%	aggregate hours fell 0.1%
			Capacity Utilization		***77.8%***	77.7%	77.0%	moderate
Wednesday	4/18	9:00	BOC Policy Decision					on track for a May 30 rate increase
		2:00	**Fed Beige Book**					monitoring cost pressures
Thursday	4/19	8:30	Jobless Claims, th.	4/14	***225***	233	242	a low trend
		10:00	Leading Econ Indicators	Mar	***+0.4%***	+0.6%	+0.8%	mixed components, but mostly positive
		1:00	TIPS Auction					$16 billion in 5-year TIPS
Friday	4/20		no significant data					Tito Puente (b. 1923)
Next Week:								
Monday	4/23	10:00	Existing Home Sales, mln	Mar	***5.59***	5.54	5.38	a moderate pace, with supply constraints
			% change		***+0.9***	+3.0	-3.2	perhaps with some weather effects
Tuesday	4/24	10:00	New Home Sales	Mar	***630***	618	622	these figures are choppy
			% change		***+1.9***	-0.6	-4.7	watch for revisions
		10:00	**CB Consumer Confidence**	Apr	***126.5***	127.7	130.0	seen a bit lower, but still strong
		1:00	Treasury Note Auction					2-year notes
Wednesday	4/25	11:30	FRN Auction					re-opened 2-year FRNs
		1:00	Treasury Note Auction					5-year notes
Thursday	4/26	7:45	ECB Policy Decision					focus is on the asset purchase program
		8:30	Jobless Claims, th.	4/21	***225***	***225***	233	a low trend
		8:30	**Durable Goods Orders**	Mar	***+2.0***	+3.0%	-3.6%	Boeing reported a surge in aircraft orders
			ex-transportation		***+0.6%***	+1.0%	-0.3%	uneven, but a moderate trend
			nondef cap gds ex-aircraft		***+0.5%***	+1.4%	-0.3%	stronger, but a slower pace than in 4Q17
		8:30	Advance Econ Indicators	Mar				filling in the 1Q18 GDP picture
			wholesale inventories		***NF***	+1.0%	+0.9%	faster in 1Q18 (+ to GDP)
			retail inventories		***NF***	+0.4%	+0.7%	faster in 1Q18 (+ to GDP)
			merch trade balance, $bln		***NF***	-75.9	-75.5	wider in 1Q18 (- from GDP)
		1:00	Treasury Note Auction					7-year notes
Friday	4/27	8:30	**Real GDP (advance)**	1Q18	***+2.0%***	+2.9%	+3.2%	trade and inventories add uncertainty
			Priv. Dom Final Purchases		***+2.1%***	+4.8%	+2.2%	a "soft" quarter for consumer spending
		8:30	**Employment Cost Index**	1Q18	***+0.8%***	+0.6%	+0.7%	AHE rose 0.7%
			year-over-year		***+2.6%***	+2.6%	+2.5%	moderate
		10:00	UM Consumer Sentiment	Apr	***97.5***	101.4	99.7	97.8 at mid-month

This Week…

Of the mid-month economic releases, the retail sales report has some potential to move the financial markets. After that, it's relatively clear sailing until the advance GDP estimate (April 27). Trade policy and Syria will remain near-term wildcards. The stock market is expected to focus on earnings results. This follows an unusual pre-earnings season. Normally, earnings expectations are talked down and then actual earnings generally surprise to the upside. This time, earnings expectations have not come down. Hence, the bar is set high, leaving the market with some potential downside risks (if earnings disappoint, or if the market fails to rally on positive news). The weaker dollar ought to provide some support (lifting foreign earnings of U.S. firms relative to a year ago), but trade policy uncertainty and Fed tightening are concerns going forward.



Monday

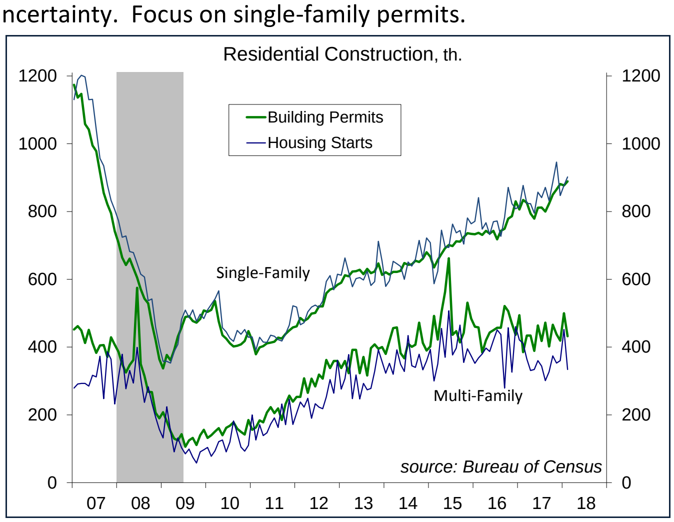
Retail Sales (March) – Unit auto sales (reported by the various automakers) improved (although that doesn't always translate into higher retail auto dealership sales). Gasoline prices fell (on a seasonally adjusted basis), which should trim the ex-auto figure somewhat in March. Core sales (which exclude autos, building materials, and gasoline) were soft in the three previous months. Thant's not unusual following earlier strength, but it is consistent with the weak year-over-year gains in inflation-adjusted average hourly earnings. Figures are adjusted for Easter, but it's difficult to get that right and weather may have been a factor in some areas of the country. Retail sales account for about a quarter of consumer spending, and consumer spending accounts for about 69% of GDP. One soft quarter need not be too worrisome (following a very strong 4Q17), but we need to see a pickup in the monthly numbers relatively soon, to have much hope for stronger GDP growth in 2018.

Business Inventories (March) – The only missing piece here is retail inventories (up 0.4% in the advance estimate). Wholesale and factory inventories rose at a faster pace in January and February (than in 4Q17) and should add to 1Q18 GDP growth.

Homebuilder Sentiment (April) – Tariffs are expected to add to building costs, which may dampen builder sentiment in April. Otherwise, the housing story continues: strong demand, but with supply constraints and affordability issues.

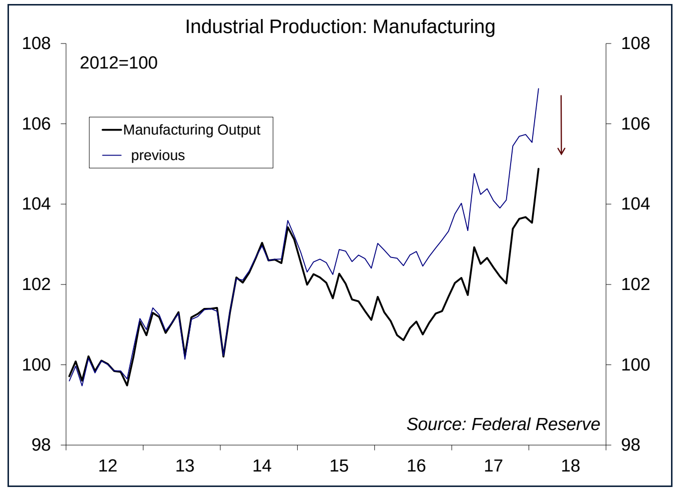
Tuesday

Building Permits, Housing Starts (March) – Weather may be a factor in some areas, but residential homebuilding is likely to improve further in the near term. The multi-family data are erratic and starts are reported with a huge amount of uncertainty. Focus on single-family permits.



ISM World Economic Outlook (update) – Forecasts are always going to be wrong, but the IMF does a good job of hitting the highlights and key issues in the global economy.

Industrial Production (March) – Annual benchmark revisions (released March 23) showed more significant weakness in factory output into mid-2016 (partly related to the contraction in energy exploration). Aggregate manufacturing hours (from the employment report) fell 0.1% last month.



Wednesday

Bank of Canada Policy Decision – The BOC is in tightening mode. The question is the timing. In the March 7 statement, the BOC noted that "trade policy developments are an important and growing source of uncertainty for the global and Canadian outlooks," adding that "while the economic outlook is expected to warrant higher interest rates over time, some continued monetary policy accommodation will likely be needed to keep the economy operating close to potential and inflation on target." Progress on NAFTA talks could add confidence, but the BOC is more likely to wait until the May 30 announcement.

Fed Beige Book – Growth is likely to stay "modest to moderate." Watch the assessment of the job market, wages, and prices.

Thursday

Jobless Claims (week ending April 14) – Trending low.

Leading Economic Indicators (March) – Mixed components in March, but mostly positive contributions.

Friday

No significant data.

Next Week …

There are a number of uncertainties heading into the advance estimate of 1Q18 GDP growth, but the initial figure is likely to be moderate, reflecting a slow pace of consumer spending growth.

Coming Events and Data Releases

April 30	Personal Income and Spending (March)
May 1	ISM Manufacturing Index (April)
May 2	ADP Payroll Estimate (April) FOMC Policy Decision (no press conf.)
May 3	Trade Balance (March) ISM Non-Manufacturing Index (April)
May 4	Employment Report (April)
June 13	FOMC Policy Decision, press conf.
November 6	Election Day