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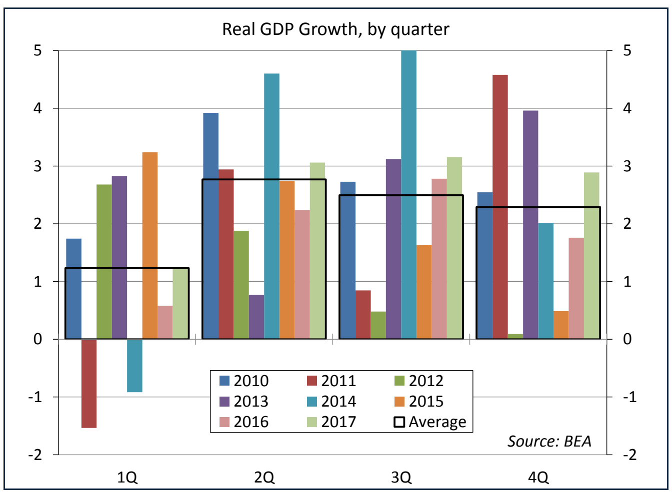
Weekly Economic Monitor

The Fed Policy Outlook

The Bureau of Economic Analysis will report the advance estimate of 1Q18 GDP growth on April 27. These figures will be revised, but the underlying story is not expected to change much. Growth was likely moderate, not horrible, but far short of the lofty expectations that some had put forth at the start of the quarter. Nobody appears too worried about that. Fed officials saw signs of first quarter softness as "transitory." Stock market volatility and tariffs are also viewed as no big deal. Policy decisions will remain data dependent and monetary policy is not on a preset path, but 25 basis points per quarter is the most likely scenario and it's up to the upcoming information to dissuade the Fed from acting.

Inflation-adjusted consumer spending rose at a 4.0 annual rate in 4Q17 – strong, but partly reflecting a rebound from the third quarter's hurricanes. Still, it's not unusual to see a more modest gain (seen at about a 1% annual rate) following such strength. Shipments of capital goods have continued to improve, but the pace slowed considerably from 4Q17 (where growth also reflected a rebound from hurricane effects). Weather was likely a factor in some areas in 1Q18. In addition, GDP figures have exhibited residual seasonality. Specifically, first quarter growth has generally been lower than the rest of the year. This could reflect permanent changes to seasonal patterns following the financial crisis, but that would disappear over time (as the seasonal adjustment pattern adapts). Note that the 1Q18 weakness is not observed in the key components of GDP (consumer spending, business fixed investment).



GDP growth figures are often uneven across quarters. Fed officials know this and continue to expect a pickup in growth in the near term, reflecting the impact of fiscal stimulus (the Tax Cut and Jobs Act and the recent government spending agreement) and a strong global economy.

Still, the impact of fiscal stimulus isn't clear. Cash on balance sheets and lower borrowing costs hadn't lit much of a fire under capital investment, so why would a reduction in corporate tax rates? At the same time, business sentiment has been strong, and that may help. However, the consumer is the driving force of the economy. There was some reduction in individual taxes, but not for everybody, and generally not enough for the typical worker to notice. While there have been announcements of one-time bonuses and salary increases, some critics have denounced that as mere PR (as some bonus intentions had been announced ahead of the TCJA passage). Moreover, wage increases have generally remained moderate in recent months.

Growth is likely to be limited by constraints in the job market. The Fed's recent Beige Book noted firms' "continued difficulty finding qualified candidates across a broad array of industries and skill levels." Labor shortages were most often cited in high-skill positions, including engineering, information technology, and health care, as well as in construction and transportation.

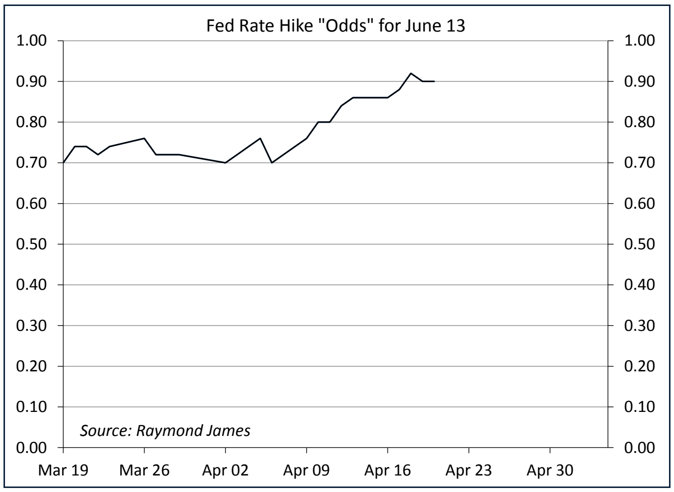
Fed officials recognize that there are risks of raising rates too rapidly or too slowly. Tightening too aggressively risks undermining the expansion. While wage pressures don't appear to be a problem, the Fed believes that left unchecked, the economy will soon exceed its potential (if it hasn't already), leading to a difficult correction later on. Hence, a policy of gradual rate hikes is seen as appropriate, balancing these risks.

Last week, the White House indicated that President Trump intends to nominate Richard Clarida (a professor at Columbia and an advisor to PIMCO) to be Fed Vice Chair, and Michelle Bowman (a Kansas Bank Regulator) to be a Fed governor. Neither nomination was a surprise. Clarida brings critical monetary policy expertise to the Fed's Board of Governors, while Bowman will fill a slot representing community bankers. Neither should face any difficulty in being approved in the Senate. Meanwhile, Marvin Goodfriend, who had a terrible hearing (he was wrong on monetary policy throughout the recovery and shows no signs of having learned anything by that), has seen his nomination stall. His Senate approval would be a close vote (Rand Paul doesn't like him and John McCain is sidelined), but he might pass if the three nominations are voted on together. Personnel changes (especially Randall Quarles appointment as Vice Chair of Supervision) have already had an impact on the Fed's regulatory outlook, but monetary policy isn't likely to be much different. The makeup of the Federal Open Market Committee is a little more hawkish this year, but the FOMC's basic approach to monetary policy is essentially the same as it was under Yellen, anchored by the central bank's excellent staff. Looking ahead, the Fed's decisions are expected to focus more on the balancing of risks of a policy error.

	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
3/23/18	1.77	1.93	2.10	2.26	2.39	2.58	2.78	3.03	1.236	1.415	104.83	1.287	6992.67	2588.26	23533.20
4/13/18	1.76	1.97	2.12	2.37	2.51	2.67	2.82	3.03	1.232	1.426	107.52	1.260	7106.65	2656.30	24360.14
4/20/18	1.81	2.01	2.20	2.46	2.62	2.80	2.96	3.15	1.228	1.401	107.64	1.275	7138.28	2670.14	24462.94

Recent Economic Data and Outlook

Earnings reports were supportive of stocks, but fears for higher interest rates appeared to dampen enthusiasm toward the end of the week. The economic data reports were consistent with moderate growth in the near term.



The White House indicated that President Trump will nominate **Richard Clarida** (a professor at Columbia and an advisor to PIMCO) to be Fed Vice Chair and **Michelle Bowman** (a Kansas Bank Regulator) to be a Fed governor. Neither nomination was a surprise. Clarida brings critical monetary policy expertise to the Fed's Board of Governors, while Bowman will fill a slot representing community bankers.

The Fed's **Beige Book** noted that *"economic activity continued to expand at a modest to moderate pace in March and early April."* Outlooks remained positive, but *"contacts in various sectors including manufacturing, agriculture, and transportation expressed concern about the newly imposed and/or proposed tariffs."* Labor markets across the country remained tight, *"restraining job gains in some regions."* Upward wage pressures persisted but *"generally did not escalate."* Most Fed districts reported wage growth as *"only modest."* Prices increased across all districts, *"generally at a moderate pace."* There were widespread reports that steel prices rose, sometimes dramatically, due to the new tariff.

Retail Sales rose 0.6% in March, vs. a 0.3% decline over the three previous months (+4.5% y/y). Auto sales rose 2.0% (+4.5% y/y), consistent with the rise in unit sales reported by the various automakers. Gasoline sales fell 0.3% (+14.4% before seasonal adjustment, +9.7% y/y). Ex-autos, building materials, and gasoline, sales rose 0.4% (+3.7% y/y).

Business Inventories rose 0.6% in February, on a faster track than in 4Q17 (hence, likely to add to 1Q18 GDP growth).

Industrial Production rose 0.5% in March, reflecting increases in mining and utilities (cold temperatures). Manufacturing output edged up 0.1% (+3.3% y/y), supported by a 2.7% increase in auto production (+8.2% y/y). Ex-autos, factory output edged down 0.1% (+2.6% y/y). Oil and gas well drilling rose 4.1% (+17.0% y/y). Energy extraction rose 0.8% (+12.8% y/y).

Building Permits rose 2.5% (±1.4%) in March, to a 1.354 million seasonally adjusted annual rate (+7.5% y/y). Single-family permits, the key figure in the report, fell 5.5% (+1.7% y/y), but unadjusted figures for the first quarter were up 5.5% y/y. **Housing Starts** rose 1.9% (±12.4%), to a 1.319 million pace, with single-family starts down 3.7% (±11.8%).

Homebuilder Sentiment edged down to 69 in April, vs. 70 in March and 71 in February. Builders generally report strong demand, boosted by gains in jobs and wages. However, builders also face supply constraints, "such as a lack of buildable lots and increasing construction material costs."

The Index of **Leading Economic Indicators** rose 0.3% in March, up 4.3% in the last six months. A shorter factory workweek and a rise in jobless claims made the only subtractions in March. The yield curve, ISM new orders, and consumer expectations made the largest positive contributions.

The **Bank of Canada** left its target for the overnight rate at 1.25%. The Governing Council continues to believe that "higher interest rates will be warranted over time, although some monetary policy accommodation will still be needed to keep inflation on target." The next meeting is May 30.

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	4/23	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					$32 billion in 2-year notes
Wednesday	4/25	11:30	FRN Auction					$17 billion in 2-year FRNs
		1:00	Treasury Note Auction					$35 billion in 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***	233	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					$29 billion in 7-year notes
Friday	4/27	8:30	**Real GDP (advance)**	1Q18	***+2.1%***	+2.9%	+3.2%	trade and inventories add uncertainty
			Priv. Dom Final Purchases		***+2.2%***	+4.8%	+2.2%	a softer 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
Next Week:								
Monday	4/30	8:30	Personal Income	Mar	***+0.4%***	+0.4%	+0.4%	moderate strength in wages and salaries
			Personal Spending		***+0.4%***	+0.2%	+0.2%	picking up somewhat
			PCE Price Index f&e		***+0.2%***	+0.2%	+0.3%	the core CPI rose 0.176%
			year-over-year		***+1.8%***	+1.6%	+1.5%	March 2017 wireless drop fades
		9:45	Chicago Bus. Barometer	Apr	***57.6***	57.4	61.9	moderately strong
		10:00	Pending Home Sales Index	Mar	***+0.5%***	+3.1%	-5.0%	uneven, but a moderate trend
Tuesday	5/01	10:00	Construction Spending	Mar	***NF***	+0.1%	0.0%	mixed
		10:00	**ISM Manf. Index**	Apr	***58.6***	59.3	60.8	moderately strong
		tbd	Motor Vehicle Sales, mln	Apr	***NF***	17.4	17.0	GM to report quarterly
			domestically built		***NF***	13.4	12.9	trend likely to moderate in 2018
Wednesday	5/02	8:15	ADP Payroll Estimate, th.	Apr	***+190***	+241	+246	strong in recent months
		2:00	**FOMC Policy Decision**					no change
Thursday	5/03	8:30	Jobless Claims, th.	4/28	***225***	***225***	233	a low trend
		8:30	NF Productivity (prelim.)	1Q18	***NF***	0.0%	+2.6%	likely lackluster
			Unit Labor Costs		***NF***	+2.5%	+1.0%	some further pressure
		8:30	Trade Balance, $bln	Mar	***NF***	-57.6	-56.7	wider in 1Q18
			goods only		***NF***	-77.0	-76.7	higher imports are a sign of strength
		10:00	Factory Orders	Mar	***NF***	+1.2%	-1.3%	should be higher
		10:00	**ISM Non-Manf. Index**	Apr	***58.4***	58.8	59.5	moderately strong
Friday	5/04	8:30	Nonfarm Payrolls, th.	Apr	***+185***	+103	+326	moderately strong
			private-sector		***+185***	+102	+320	watch for revisions
			Unemployment Rate		***4.0%***	4.1%	4.1%	expected to trend somewhat lower
			employment/population		***60.4%***	60.4%	60.4%	flat trend signals strength (demographics)
			Avg. Weekly Hours		***34.5***	34.5	34.4	steady
			Avg. Hourly Earnings		***+0.3%***	+0.3%	+0.1%	uneven, but likely to trend a bit higher
			year-over-year		***+2.7%***	+2.7%	+2.6%	moderate

This Week…

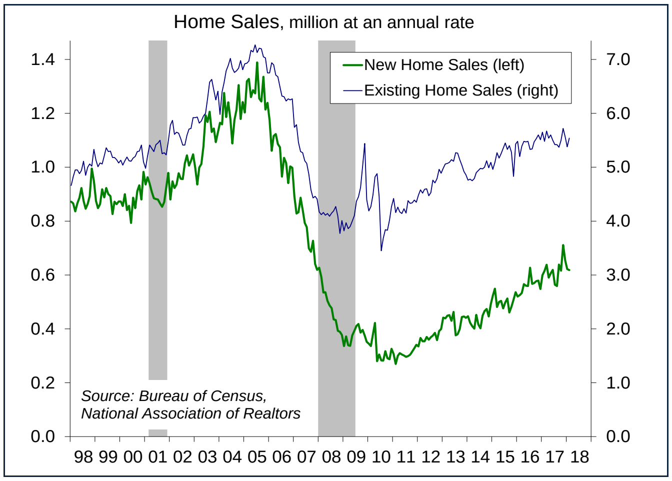
Earning reports are expected to be the focus of the stock market. The economic data calendar is dominated by the advance GDP report. The headline growth figure should be moderate, but much slower than many had expected at the start of the quarter. The report on durable goods orders and shipments, along with March merchandise trade and inventory data, may help to refine estimates heading into the GDP report. The ECI, due at the same time, is an important indicator.

Monday

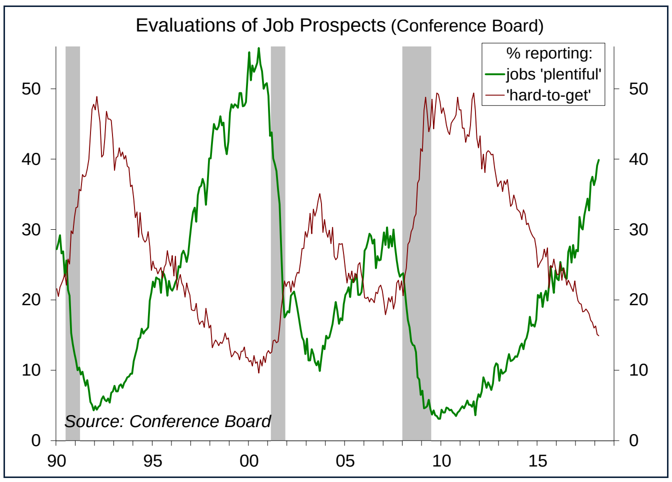
Existing Home Sales (March) – Sales have remained constrained by affordability issues and lean inventories of homes for sale. Job growth is supportive. Mortgage rates aren't a problem yet.

Tuesday

New Home Sales (March) – The monthly figures are erratic, reported with a huge amount of statistical uncertainty, but the underlying trend is expected to remain moderately strong.



Conference Board Consumer Confidence Index (April) – The headline figure is likely to remain high by historical standards.



Wednesday

No significant economic data.

Thursday

ECB Policy Decision – No change in rates is expected, but investors will continue to look for clues regarding on asset purchases (although Draghi may not drop any hints).

Jobless Claims (week ending April 21 – Claims have continued to trend at a low level in recent weeks, consistent with a further tightening in overall labor market conditions.

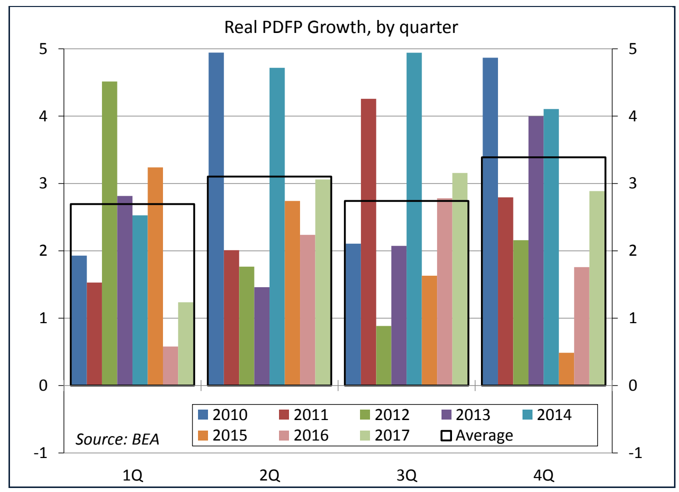
Durable Goods Orders (March) – Boeing reported a surge in orders, which should help lift the headline figure. Ex-transportation, orders are likely to be mixed, but moderate.

Advance Economic Indicators (March) – While not market-moving, this release (which includes figures on merchandise trade and wholesale/retail inventories) will help to fill in the picture ahead of the advance GDP report.

Friday

Employment Cost Index (1Q18) – The ECI (which includes benefit costs) is the preferred measure of labor cost pressures (although one still has to adjust for productivity growth to gauge the inflationary impact. Expect a moderately higher trend.

Real GDP (1Q18, advance estimate) – Consumer spending and business fixed investment appeared to be on a much slower track in the first quarter, following strong results in 4Q18.



Next Week ...

The focus is expected to be on the April Employment Report. February's mild weather appeared to pull forward seasonal job gains from March, but the average of the two months was strong. The unemployment rate, essentially flat over the previous six months, should be heading lower.

Coming Events and Data Releases

May 9	Producer Price Index (April)
May 10	Consumer Price Index (April)
May 15	Retail Sales (April)
May 16	Building Permits, Housing Starts (April) Industrial Production (April)
May 28	Memorial Day (markets closed)
June 1	Employment Report (May)
June 13	FOMC Policy Decision, press conf.
November 6	Election Day