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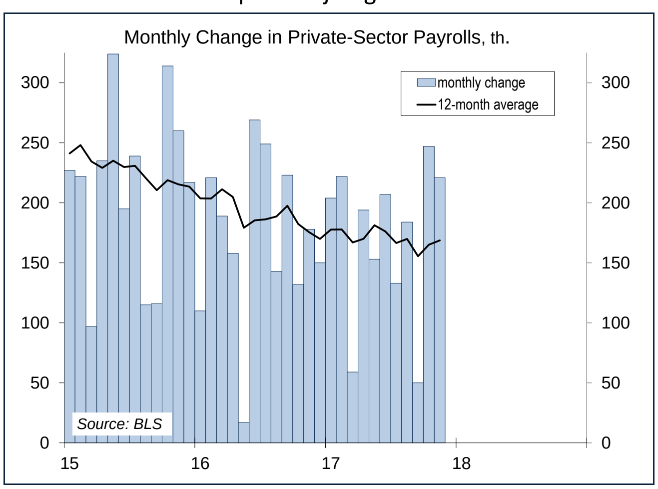
Weekly Economic Monitor

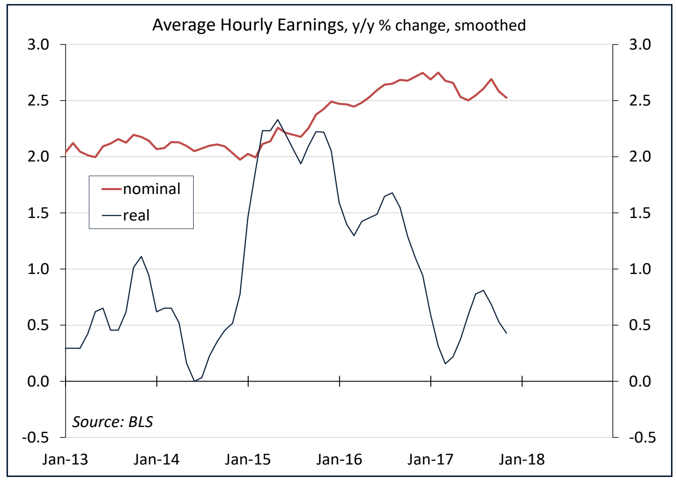
The Fed, the Job Market, and the Risks

The appointment of Jerome "Jay" Powell as Fed chair should result in a smooth transition for monetary policy into early 2017. However, other personnel changes mean greater policy uncertainty as one looks beyond the middle of next year. This comes at a time when the risks of a policy error are increasing.

Nonfarm payrolls rose by 228,000 in the initial estimate for November (median forecast: +200,000). Unadjusted payrolls rose by 532,000 (vs. 424,000 a year ago). Unadjusted "holiday" payrolls (retail + couriers) rose by 521,600 (vs. 438,100 a year ago) accounting for much of the strength in the adjusted number. Seasonally adjusted, private-sector payrolls averaged a 173,000 gain over the last three months, vs. +170,000 over the first eight months of 2017, the same pace as in 2016. These figures are subject to revision (and the Bureau of Labor Statistics has indicated that the March 2017 level of payrolls is expected to be revised about 95,000) higher, but the longer-term trend appears to be lower, as one would expect if the labor market is tightening. Still, the payroll data for 2017 suggest that there was more slack in the labor market than was commonly believed at the start of the year. Remember, the growth in the working-age population is consistent with monthly growth in payrolls of a little less than 100,000. Eventually, a tight labor market will restrain the pace of job growth

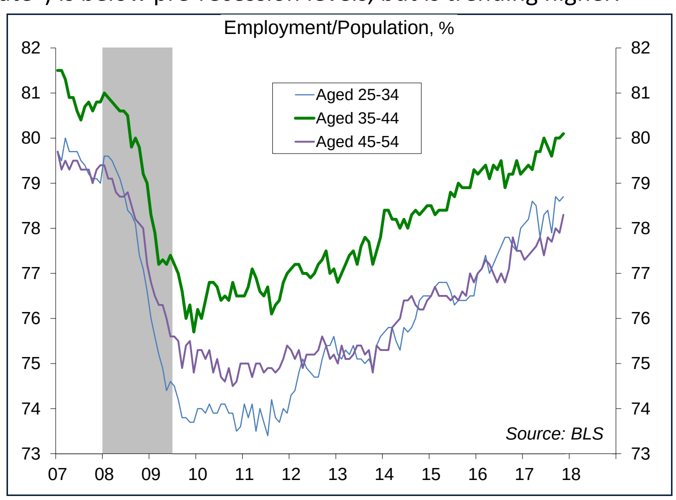


Average hourly earnings rose 0.2% in the initial estimate for November, as expected, but figures for September and October were revised a bit lower, leaving the year-over-year pace at 2.5% – not terrible, but not particularly strong either. Wage growth is thought to be restrained by a shift in bargaining power in recent decades (lower union membership, a greater concentration of large firms), but demographics could also be at play (older, higher-paid employees exit the labor force, while younger, lower-paid workers enter). Increases in minimum wages are expected to add to overall wage growth in early 2018.



While nominal (current dollar) wage growth has been moderate in recent months, real (constant dollar) wage growth has been relatively lackluster. Inflation may be low, but it's not trivial. Adjusted for inflation, aggregate wages and salaries were reported to have risen 2.1% over the 12 months ending in October. This is the main fuel for consumer spending growth, and consumer spending accounts for nearly 70% of GDP.

At 4.1%, the unemployment rate is low by historical standards. The employment/population ratio (the "employment rate") is below pre-recession levels, but is trending higher.

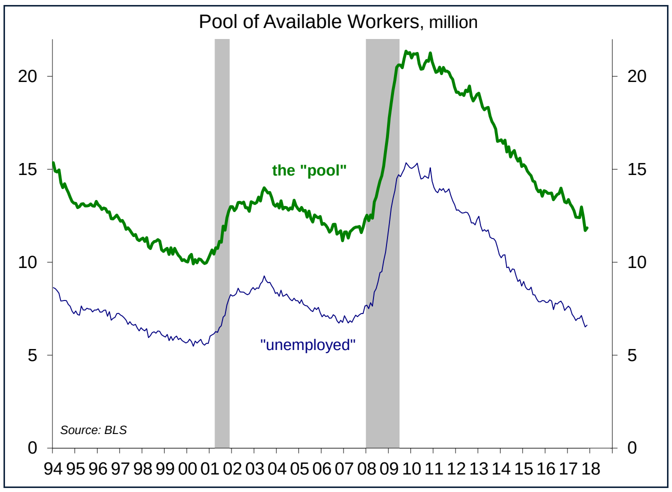


With slack remaining in the job market and wage growth relatively lackluster, why has the Fed been raising short-term interest rates? Rather than hitting the brakes, the Fed has been taking the foot of the gas pedal, moving monetary policy to a more neutral position. From here, raising rates too slowly risks overshooting, which would require even sharper rate increases later. Raising too quickly risks weakening the pace of the expansion and pushing inflation lower. The Fed has plenty of time, but will incoming Fed officials agree with that assessment?

	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
11/10/17	1.23	1.37	1.54	1.67	1.79	2.06	2.40	2.88	1.165	1.313	113.40	1.269	6750.94	2582.30	23422.21
12/01/17	1.27	1.45	1.62	1.78	1.90	2.13	2.37	2.76	1.191	1.351	111.88	1.271	6847.59	2642.22	24231.59
12/08/17	1.28	1.45	1.66	1.80	1.91	2.14	2.38	2.77	1.176	1.339	113.48	1.286	6840.08	2651.50	24329.16

Recent Economic Data and Outlook

The House and Senate continued to work to bring the two tax-cut bills together, and (as expected) lawmakers easily avoided a showdown over the current budget. The economic data reports remained consistent with moderate growth in the near term.



Congress passed a **Continuing Resolution** to authorize federal government spending through December 22. Expect lawmakers to kick the can down the road into 2018.

The **Employment Report** was a mixed bag. Nonfarm payrolls rose by 228,000 in the initial estimate for November, with a net revision of +3,000 to September and October. Private-sector payrolls rose by 221,000, bringing the three-month average to 173,000, essentially the same pace as in the first eight months of the year (and also 2016). Manufacturing and construction were stronger than expected, possibly reflecting mild weather. Retail employment improved, following a downtrend since the start of the year. The unemployment rate held steady at 4.1% (vs. 4.6% a year ago), with broad U-6 measure edging up to 8.0% (from 7.9% in November and 9.3% a year ago). The employment/population ratio edged down to 60.1% (vs. 60.2% in October and 60.4% in September), which may reflect a quirk in teenage participation). Average hourly earnings rose 0.2%, but figures for September and October were revised slightly lower, leaving the year-over-year pace at 2.5%.

The **ADP Estimate** of private-sector payrolls rose by 190,000, bringing the three-month average to 174,000.

The **ISM Non-Manufacturing Index** fell to 57.4 in November, vs. 60.1 in October and 59.8 in September. Growth in business activity, new orders, and employment remained strong, but the pace of improvement was slower than in October. Comments from supply managers were mixed.

Factory Orders edged down 0.1% in October, up 3.7% from a year ago. Durable goods orders fell 0.8% (vs. -1.2% reported earlier), reflecting an 18.5% drop in civilian aircraft orders. Inventories rose 0.2%, a slower pace than in 3Q17.

The **Trade Deficit** widened to $48.7 billion in October (more than was indicated in the advance estimate), vs. $44.9 billion in September. It's only one month, but it looks as if net exports will make a negative contribution to 4Q17 GDP growth (after adding 0.4 percentage point to 3Q17 GDP). For the first 10 months of 2017, exports rose 5.3%, while imports rose 6.5%.

The **Bank of Canada**'s Governing Council left its target for the overnight rate at 1%. The BOC had tightened in mid-July and early September, but has now paused in late October and early December. The BOC indicated that "higher interest rates will likely be required over time," but said it "will continue to be cautious, guided by incoming data in assessing the economy's sensitivity to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation ."

Economic Outlook (4Q17): around 2.5% GDP growth.

Employment: Job growth has remained strong, but the pace should decline as the job market tightens.

Consumers: Job and wage growth remain supportive, but excluding a temporary rise in vehicle sales in September, the pace of consumer spending growth appears moderate.

Manufacturing: Sentiment surveys remain strong and orders have been improving, but factory output fell in 3Q17. An improving global outlook has supported export growth.

Housing/Construction: Job growth has been supportive, with some weather-related shift into the earlier part of the year. Higher home prices and rising building costs are restraints.

Prices: Core inflation has continued to trend below the Fed's 2% target, partly reflecting a "one-off" plunge in wireless telecom services. Wage pressures are moderate.

Interest Rates: The Fed remains in tightening mode, and is expected to continue raising short-term rates gradually (most likely in December). Balance sheet reduction has begun, initially gradual, but picking up over the course of a year.

This Week:					*forecast*	last	last –1	comments
Monday	12/11	10:00	JOLTS data	Oct				quit rate and hiring rate trending flat
		11:30	Treasury Note Auction					$24 billion in 3-year notes
		1:00	Treasury Note Auction					$20 billion in re-opened 10-year notes
Tuesday	12/12	6:00	Small Business Optimism	Nov	***NF***	103.8	103.0	still elevated
		8:30	**Producer Price Index**	Nov	***+0.6%***	+0.4%	+0.4%	seasonal adjustment adds to energy rise
			ex-food & energy		***+0.3%***	+0.4%	+0.4%	moderate
			ex-f, e, trade services		***+0.2%***	+0.2%	+0.2%	moderate
		1:00	Treasury Bond Auction					$12 billion in re-opened 30-year notes
Wednesday	12/13	8:30	**Consumer Price Index**	Nov	***+0.4%***	+0.1%	+0.5%	seasonal adjustment adds to gasoline
			year-over-year		***+2.2%***	+2.0%	+2.2%	a bit higher
			ex-food & energy		***+0.2%***	+0.2%	+0.1%	moderate core inflation
			year-over-year		***+1.8%***	+1.8%	+1.7%	seen steady
		8:30	Real Hourly Earnings	Nov	***NF***	-0.1%	-0.1%	softer in recent months
		2:00	**FOMC Policy Decision**		***1.25-1.5%***	1-1.25%	1-1.25%	expected to hike
		2:00	**Fed Summary of Econ Proj**					new econ forecasts and dot plot
		2:30	**Yellen Press Conference**					Yellen's final press conference
Thursday	12/14	7:00	BOE Policy Decision					pausing after hike in early November
		7:45	ECB Policy Decision					any hints of phasing out of bond buying?
		8:30	Jobless Claims, th.	12/09	***240***	236	238	a low trend
		8:30	**Retail Sales**	Nov	***+0.2%***	+0.2%	+1.9%	some retreat in autos
			ex-autos		***+0.5%***	+0.1%	+1.2%	some boost from gasoline prices
			ex-autos, bld mat, gasoline		***+0.4%***	+0.4%	+0.4%	moderate core sales
		8:30	Import Prices	Nov	***NF***	+0.2%	+0.8%	limited pressure in finished goods
			ex-food & fuels		***NF***	+0.2%	+0.2%	some pickup in prices of raw materials
		10:00	Business Inventories		***-0.2%***	-0.0%	+0.6%	likely to subtract from 4Q17 GDP growth
Friday	12/15	8:30	Empire St. Manf. Index	Dec	***NF***	19.4	30.2	choppy, but likely to remain strong
		9:15	**Industrial Production**	Nov	***+0.5%***	+0.9%	+0.4%	limited by mild weather
			Manufacturing Output		***+0.6%***	+1.3%	+0.4%	aggregate hours rose 0.4%
			Capacity Utilization		***77.4%***	77.0%	76.4%	no significant bottleneck constraints
Next Week:								
Monday	12/18	10:00	Homebuilder Sentiment	Dec	***70***	70	68	still strong
Tuesday	12/19	8:30	Building Permits, th.	Nov	***1275***	1316	1225	choppy, likely lower
			% change		***-3.1***	+7.4	-3.7	single-family trend remains strong
			Housing Starts		***1240***	1290	1135	noisy
			% change		***-3.9***	+13.7	-3.2	watch for possible revisions
Wednesday	12/20	10:00	Existing Home Sales, mln	Nov	***5.52***	5.48	5.37	a strong trend
			% change		***+0.7***	+2.0	+0.4	but limited by supply constraints
Thursday	12/21	8:30	Jobless Claims, th.	12/16	***240***	***240***	236	a low trend
		8:30	Real GDP (3rd estimate)	3Q17	***+3.3%***	+3.1%	+1.2%	+3.3% in the 2nd estimate
			Priv. Dom. Final Purchases		***+2.3%***	+3.3%	+3.1%	+2.3% in the 2nd estimate
		8:30	Philadelphia Fed Index	Dec	***NF***	22.7	27.9	erratic, but likely to remain strong
		10:00	Leading Econ Indicators	Nov	***+0.4%***	+1.2%	+0.1%	mostly positive components
		1:00	TIPS Auction					5-year TIPS
Friday	12/22	8:30	**Durable Goods Orders**	Nov	***+1.5%***	-0.8%	+2.4%	aircraft orders higher
			ex-transportation		***+0.5%***	+0.9%	+1.3%	moderate
			nondef cap gds ex-aircraft		***+0.6%***	+0.3%	+2.3%	a strong trend
		8:30	Personal Income	Nov	***+0.4%***	+0.4%	+0.4%	moderate growth in aggregate wages
			Personal Spending		***+0.3%***	+0.3%	+0.9%	autos down, gasoline up, moderate ow
			PCE Price Index ex-f&e		***+0.2%***	+0.2%	+0.2%	moderate core inflation
		10:00	New Home Sales, th.	Nov	***640***	685	645	choppy, likely lower
			% change		***-6.7***	+6.2	+14.2	a moderately strong trend
		10:00	UM Consumer Sentiment	Dec	***97.0***	98.5	100.7	96.8 at mid-month

This Week…

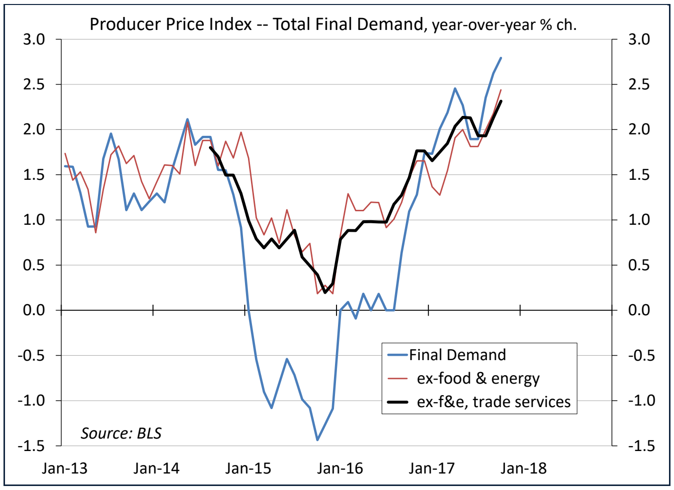
The Fed is widely expected to raise short-term interest rates on Wednesday. Investors may look to the revised dot plot to gauge the likely pace of tightening in 2018, but many of the individuals behind those dots will change (and there's a lot of uncertainty around each dot). Chair Yellen will appear in her last policy press conference. Investors will also have the mid-month economic data, including reports on retail sales, industrial production, and consumer price inflation, to mull over.

Monday

Job Opening and Labor Market Turnover Survey (October) – The JOLTS data aren't market-moving. The trends in hiring and quit rates have been relatively flat over the last several months.

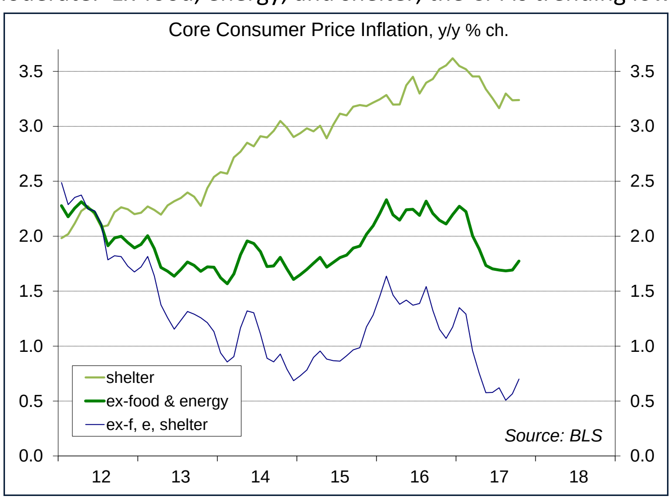
Tuesday

Producer Price Index (November) – Wholesale gasoline prices rose (while they normally fall) in November, which will boost the headline figure. Pipeline pressures in raw materials appear to be working through the system.



Wednesday

Consumer Price Index (November) – Retail gasoline prices about 1.6%, while the seasonal adjustment anticipates a 4.4% decline. That works out to about a 0.2 percentage point addition to the headline increase in the CPI. Core inflation is expected to be moderate. Ex-food, energy, and shelter, the CPI is trending low.



FOMC Policy Decision – The Federal Open Market Committee is widely expected to raise the federal funds target range by another 25 basis points, the third increase in 2017.

Summary of Economic Projections – The median of senior Fed officials' forecasts of growth, unemployment, and inflation can be seen as a consensus view for 2018 and beyond. The dot plot will be revised, but may not tell us much. There is a lot of uncertainty around each dot, not all of the dots are voting members of the FOMC, and many of the dots will be replaced in 2018 (reflecting personnel changes at the Board of Governors and among the district bank presidents.

Yellen Press Conference – This will be Yellen's last post-FOMC appearance. She has brought clear communication to these press conferences. Jay Powell should continue that when he assumes the position, but Yellen's expertise will be missed.

Thursday

Jobless Claims (week ending December 9) – The underlying trend has remained relatively low, but December figures are noisy.

Retail Sales (November) – Unit motor vehicle sales fell last month. Higher gasoline prices will add a little. Retail payrolls were reported higher in the employment report, which usually bodes well for sales, but seasonal adjustment can be tricky.

Import Prices (November) – Prices of imported supplies and raw materials have been rising, but there's been no appreciable pressure in finished goods.

Friday

Industrial Production (November) – Production rebounded sharply in October, following hurricane-related weakness in September and October. Aggregate hours in manufacturing were reported to have risen 0.4% in the employment report.

Next Week …

Investors will be waiting for the final outcome on a tax cut bill (if it hasn't yet been settled). The economic data are not expected to be market-moving, but will help to fill in the 4Q17 picture.

Coming Events and Data Releases

December 25	Christmas Holiday (markets closed)
December 27	CB Consumer Confidence (November)
January 1	New Year's Day (markets closed)
January 5	Employment Report (December)
January 15	MLK, Jr. Holiday (markets closed)
January 30	State of the Union Address
January 31	FOMC Policy Decision (no press conf.)
March 21	FOMC Policy Decision, press conf.
May 1-2	FOMC Policy Decision (no press conf.)
June 12-13	FOMC Policy Decision, press conf.