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Economic Research

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Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com

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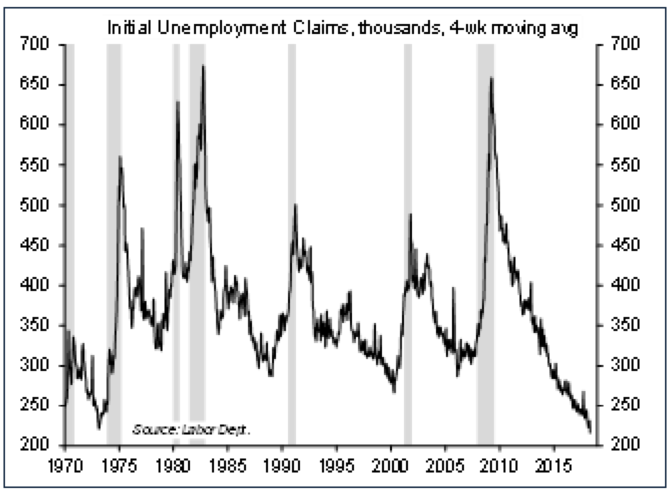
Weekly Economic Monitor

The Job Market, Inflation, and the Fed

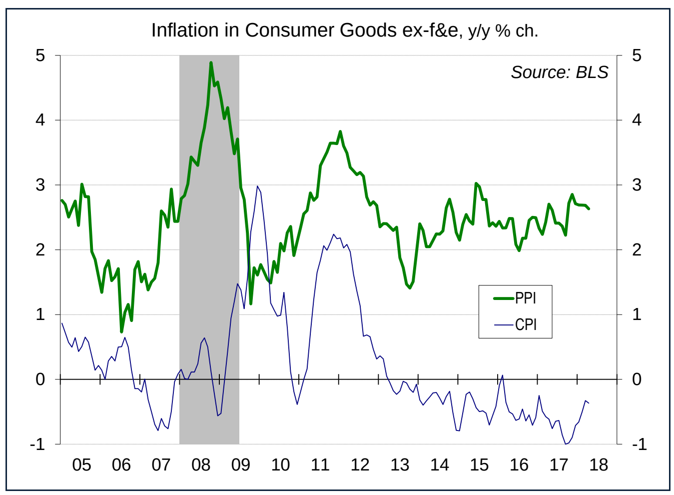
The April inflation reports were a bit on the soft side of expectations, reducing somewhat the fears that we're on the verge of an upside breakout in inflation. There's no sign that a strong economy is putting much upward pressure on consumer prices. However, the evidence suggests that the tight job market is getting even tighter. Importantly, higher oil prices are seen less as a catalyst for higher inflation and more as a restraint on consumer spending growth. This is all consistent with gradually tighter monetary policy in the months ahead.

Weekly claims for unemployment benefits are often noisy, which is why economists recommend following the four-week average. That average has dipped further, now at the lowest level since December 1969 (when the labor force was about half of its current size). There is always some friction in the job market, partly reflecting the seasonal nature of a lot of industries. However, in a very tight job market, someone laid off is more likely to find a new job right away – and therefore is less likely to file a claim for unemployment benefits.



The March Job Opening and Labor Turnover Survey (JOLTS) survey results showed job openings exceeding the number of unemployed persons for the first time (the survey originated in late 2000). In a tight job market, workers are more likely to quit to pursue other employment. However, quit rates have remained little changed, at a moderate level, over the last year. That likely reflects an aging population (older workers are less able to pull up stakes and job hop). Presumably, younger workers should be moving up more readily than in recent years. The National Federation of Independent Business' April Small Business Optimism survey showed that labor quality remained the #1 concern for the fourth consecutive month. Firms are responding to the tight job market by raising wages somewhat, but also by boosting job training, overtime, and automation.

Labor cost pressures have remained moderate overall, but they are creeping higher. Commodity price pressures have been more evident, but in general it takes a gigantic increase in the prices of raw materials to have much of an impact on prices at the consumer level. The PPI and CPI data have continued to reflect a wide gap between wholesale and retail price inflation in consumer goods. Retail prices reflect more than the basic cost of goods (labor, advertising, etc.)



Commodity price pressures generally have a hard time making it through to the consumer level, but oil prices are the exception. Higher gasoline prices will add to the impact of current constraints in transportation (a shortage of trucks and truckers) and dampen consumer spending growth (the idea is that if people are spending more money to fill their tanks, they will have less money to spend on other things).

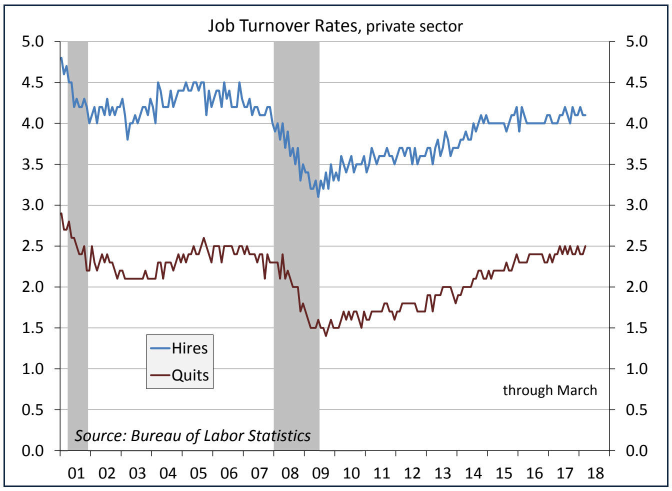
Weighing the impact of higher gasoline prices on inflation and growth will add to the Fed's challenge in the coming months – and the risks of a monetary policy error continue to rise.

International Headquarters: The Raymond James Financial Center | 880 Carillon Parkway | St. Petersburg, Florida 33716 | 800-248-8863

	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
4/13/18	1.76	1.97	2.12	2.37	2.51	2.67	2.82	3.03	107.520	1.426	107.52	1.260	7106.65	2656.30	24360.14
5/04/18	1.84	2.03	2.24	2.51	2.63	2.78	2.95	3.12	1.195	1.354	109.16	1.285	7209.62	2663.42	24262.51
5/11/18	1.91	2.05	2.26	2.54	2.69	2.84	2.97	3.10	1.194	1.354	109.30	1.279	7397.32	2727.72	24831.17

Recent Economic Data and Outlook

President Trump pulled out of the Iran nuclear agreement, sending crude oil prices higher. However, the stock market continued to advance (rallying on unwelcome news is practically the definition of a bull market). Lower-than-expected inflation data did not alter expectations for a June 13 Fed rate hike.



Fed Chair Powell, seemed to partly dismiss concerns that Fed policy can be disruptive to the emerging market economies. Powell noted that *"research at both the Fed and the IMF suggests that actions by major central banks account for only a relatively small fraction of global financial volatility and capital flow movements."* However, *"some investors and institutions may not be well positioned for a rise in interest rates, even one that markets broadly anticipate."*

The **Consumer Price Index** rose 0.2% in April (+2.5% y/y). Food prices rose 0.3% (+1.4% y/y), while energy prices rose 1.4% (+7.9% y/y). Gasoline (4.0% of the overall CPI) fell 4.9% (+6.2% before seasonal adjustment, and +13.4% y/y). Ex-food & energy, the CPI rose 0.1% (+0.098% before rounding, and up 2.1% y/y). New motor vehicle prices fell 0.5% (-1.6% y/y). Used motor vehicle prices fell 1.6% (-0.9% y/y). Ex-food, energy, and shelter, the CPI fell 0.1% in April (+1.2% y/y).

Real Hourly Earnings were unchanged in April (+0.2% y/y). For production workers, real earnings slipped 0.1% (flat y/y). These results suggest little fuel for consumer spending growth for the typical worker. Higher gasoline prices are expected to further limit consumer purchasing power in May.

The **Producer Price Index** edged up 0.1% in April (+2.6% y/y). Food fell 1.1% (partly reversing a 2.2% rise in March, -0.3% y/y), while energy edged up 0.1% (+9.0% y/y). Wholesale gasoline prices fell 0.4% (+6.1% before seasonal adjustment, and +14.6% y/y). Ex-food & energy, the PPI rose 0.1% (median forecast: +0.2%). Consumer goods ex-f&e rose 0.4% (+2.6% y/y, a contrast to the mild y/y deflation seen in CPI goods). Rail transportation (freight) rose 0.2% (+5.1% y/y), while truck transportation rose 0.2% (+6.0% y/y). Iron and steel scrap rose 5.2% (+27.8% y/y). Pipeline inflation indicators remained consistent with a moderate build-up of inflationary pressure at the earlier stages of production. Ex-food & energy, unprocessed intermediate goods rose 8.1% y/y, with processed intermediate goods up 3.4% y/y. Intermediate services rose 3.1% y/y

Import Prices rose 0.3% in April (+3.3% y/y), reflecting a 1.6% rise in petroleum (+20.6% y/y). Ex-food & fuels, import prices rose 0.2% (+1.8% y/y). Ex-fuels, prices of imported industrial supplies and materials rose 0.7% (+7.8% y/y). The price index for imported capital equipment was flat (+1.1% y/y). Autos edged up 0.1% (+0.3% y/y). Consumer goods rose 0.1% (+0.3% y/y). Export prices rose 0.6% (+3.8% y/y). The price index for agricultural exports fell 1.2% (+1.4% y/y).

The **Job Opening and Labor Turnover Survey** (JOLTS) showed job openings exceeding the number of unemployed persons for the first time ever (these data began in late 2000). For the private sector, hiring and quit rates have trended flat over the last year, consistent with tighter job market conditions.

The **Index of Small Business Optimism** was essentially unchanged in April (104.8, vs. March's 104.7). Labor quality remained the #1 problem for the fourth straight month. Reports of improved earnings trends were the highest in survey history. Reports of compensation increases held at the highest level since 2000. Reported job creation posted another solid gain.

The **Bank of England** left short-term interest rates unchanged and did not alter the asset purchase program. In its policy statement, the BOE judged that "the UK economy has a very limited degree of slack." Hence, "the prospect of excess demand over the forecast period has reduced the degree to which it is appropriate to accommodate an extended period of inflation above the target." While tighter policy is expected in the months ahead, "any future increases in Bank Rate are likely to be at a gradual pace and to a limited extent."

Economic Outlook (2Q18): 2.5-3.0% GDP growth.

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

Consumers: Real wage growth remains soft on a year-over-year basis. Credit remains easy, except at the low end.

Manufacturing: Sentiment remains strong, but the pace of improvement is likely to moderate in the near term.

Housing/Construction: Job growth has been supportive, but supply constraints and affordability remain key issues.

Prices: Core inflation is trending closer to the Fed's 2% goal. Pipeline pressures remain somewhat elevated, but are not a major threat to the consumer inflation outlook. Wage pressures are moderate, but trending gradually higher.

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 bond yields. Balance sheet reduction is viewed as "background" and should not be disruptive for the markets.

This Week:					*forecast*	last	last –1	comments
Monday	5/14		no significant data					Sidney Bechet (b. 1897)
Tuesday	5/15	8:30	**Retail Sales**	Apr	***+0.4%***	+0.6%	-0.1%	unit auto sales fell
			ex-autos		***+0.6%***	+0.2%	+0.2%	gasoline prices rose
			ex-autos, bld mat, gasoline		***+0.4%***	+0.4%	+0.1%	moderately strong
		10:00	Business Inventories	Mar	***+0.1%***	+0.6%	+0.6%	somewhat faster in 1Q18
		10:00	Homebuilder Sentiment	Apr	***68***	69	70	still strong
		10:00	**Fed Nomination Hearing**					Richard Clarida, Michelle Bowman
Wednesday	5/16	8:30	**Building Permits, mln**	Apr	***1.355***	1.379	1.321	single-fam strength, multi-fam volatility
			% change		***-1.7***	+4.4	-4.1	moderate strength y/y
			Housing Starts		***1.320***	1.319	1.295	choppy, but a strong y/y trend
			% change		***+0.1***	+1.9	-3.3	watch for revisions
		9:15	**Industrial Production**	Apr	***+0.6%***	+0.5%	+1.0%	moderately strong
			Manufacturing Output		***+0.9%***	+0.1%	+1.5%	aggregate hours rose 1.0%
			Capacity Utilization		***78.5%***	78.0%	77.7%	creeping higher
		1:00	TIPS Auction					$11 billion in re-opened 10-year TIPS
Thursday	5/17	8:30	Jobless Claims, th.	5/12	***220***	211	211	a tight job market
		10:00	Leading Econ Indicators	Apr	***+0.5%***	+0.3%	+0.7%	mixed components, but mostly higher
Friday	5/18	10:00	Advance Services Report	1Q18				some implications for GDP revisions
Next Week:								
Monday	5/21		no significant data					Fats Waller (b. 1904)
Tuesday	5/22		no significant data					Sun Ra (b. 1914)
Wednesday	5/23	10:00	New Home Sales, th.	Apr	***680***	694	667	reported with a lot of uncertainty
			% change		***-2.0***	+4.0	+3.6	watch for revisions
		2:00	**FOMC Minutes**	5/01				seen locking in a June 13 rate hike
Thursday	5/24	8:30	Jobless Claims, th.	5/19	***220***	***220***	211	a low trend
		10:00	Existing Home Sales, mln.	Apr	***5.65***	5.60	5.54	seen a bit higher
			% change		***+0.9***	+1.1	+3.0	strong demand vs. supply constraints
Friday	5/25	8:30	**Durable Goods Orders**	Apr	***-1.4%***	+2.6%	+3.6%	Boeing reported a large drop in orders
			ex-transportation		***+0.5%***	+0.1%	+1.0%	moderate
			nondef cap gds ex-aircraft		***+0.5%***	-0.4%	+1.0%	choppy, but likely to improve
		10:00	UM Consumer Sentiment	May	***98.6***	98.8	101.4	98.8 at mid-month

This Week…

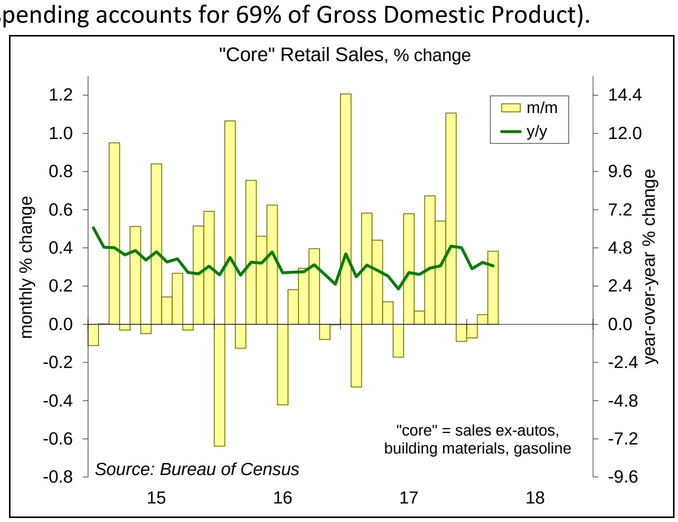
Consumer spending growth was soft in the first quarter, but is widely expected to pick up in 2Q18. The April retail sales results may reinforce that view, although unit motor vehicle sales fell last month. Higher gasoline prices should inflate the ex-auto figure. Note that the retail sales figures are reported with a lot of uncertainty (March sales were reported as "+0.6% ± 0.5%"). Thursday is the deadline for NAFTA negotiations. Recall that President Trump can, by himself, withdraw the U.S. from trade agreements (letters would be sent to leaders of Canada and Mexico and the official withdrawal would occur six months later). A new agreement would require congressional approval, which would take about six months. Hence, this week's deadline is a prerequisite to get it done before November's mid-term elections. We could see a watered-down agreement this week or a complete failure, in which case it's unclear how President Trump would respond. Financial market participants continue to hope that everything will work out (minor adjustments to current agreements), but there is a clear risk of more serious trade disruptions (a broader trade war, retaliatory tariffs against U.S. exports, higher input costs, supply chain disruptions and greater uncertainty for global investment.

Monday

No significant data.

Tuesday

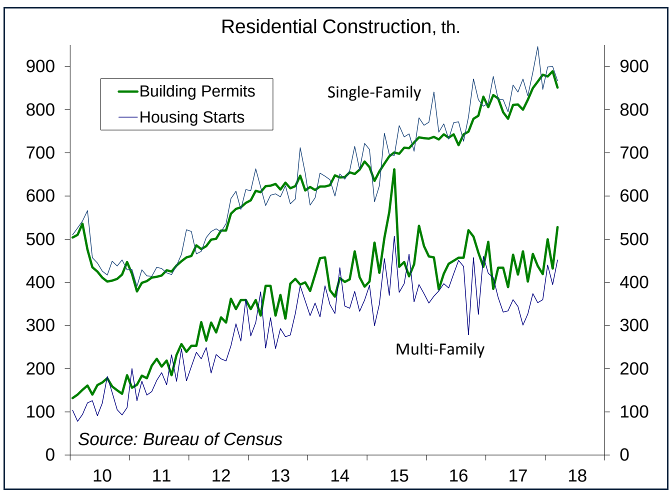
Retail Sales (April) – Unit vehicle sales slipped last month (and prices fell). Gasoline prices rose, which should boost the ex-auto figure. Core sales, which exclude vehicles, building materials, and gasoline, are likely to have risen moderately. There is a good chance of a surprise. Watch for possible revisions to February and March, which could significantly alter expectations for consumer spending growth in 2Q18 (consumer spending accounts for 69% of Gross Domestic Product).



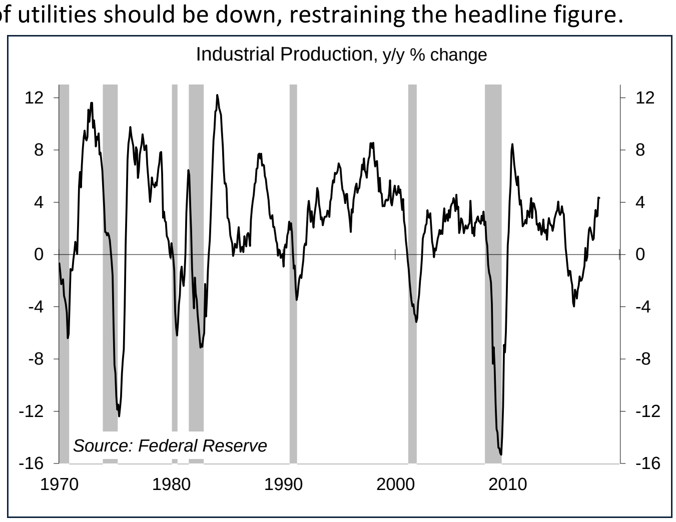
Fed Nomination Hearing (Senate Banking Committee) – This hearing will be important. Richard Clarida, a professor at Columbia, advisor to PIMCO, and wannabe popstar, is nominated for Fed Vice Chair. Chair Powell is not an economist, so it is critical that the Fed's Board of Governors has a greater level of monetary policy expertise. This hearing should delve into Clarida's approach to monetary policy, particularly in regard to how the central bank will proceed in a late-cycle economy. Michelle Bowman, currently serving as Bank Commissioner of Kansas, is nominated to fill a slot on the BOG representing community banking. Market participants with an interest in the banking sector should pay attention to her views on regulation.

Wednesday

Building Permits, Housing Starts (April) – The spring is a more important time for the housing sector, but reported residential construction figures are still subject to a high level of statistical uncertainty. Single-family permits, the key figure in the report is reported with a lot more accuracy than starts (although, for some reason, the markets continue to focus on the headline starts number – go figure). Supply constraints remain an issue for builders, but there is potential for an upside surprise (reflecting a rebound from March's poor weather).



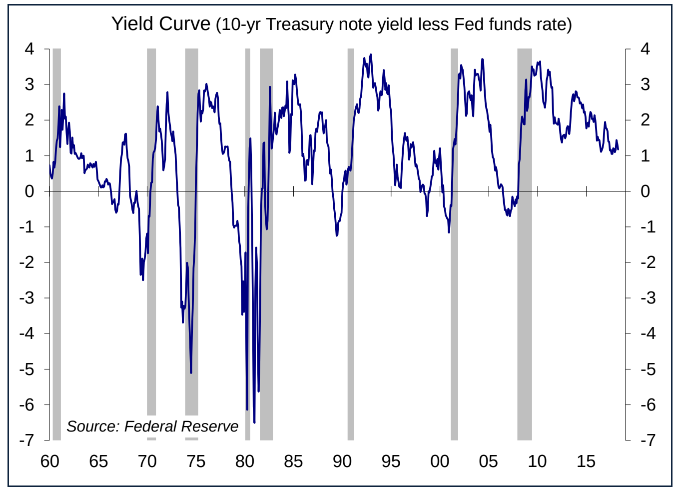
Industrial Production (April) – Aggregate hours picked up, which should translate to a stronger gain in factory output. The output of utilities should be down, restraining the headline figure.



Thursday

Jobless Claims (week ending May 12) – There's always some noise in the weekly data, which is why you want to focus on the four-week average. However, the trend has dipped a bit further recently (the lowest since 1969), suggesting that labor market conditions have grown even tighter.

Leading Economic Indicators (April) – The factory workweek, jobless claims, ISM new orders, the yield curve, and consumer expectations will make positive contributions in April. The stock market will make a negative contribution. The yield curve (10-year Treasury to the federal funds rate) is the best single indicator of recession. While flatter, it's still far from inverted.



Friday

Advance Quarterly Services Report (1Q18) – Not market-moving, but these figures could have some implications for GDP revision.

Next Week …

Home sales figures are more important in April, but the results are not expected to be market-moving. Durable goods orders will be dominated by a decline in aircraft orders, but the focus ought to be on orders for nondefense capital goods ex-aircraft, which were unexpectedly soft in the first quarter.

Coming Events and Data Releases

May 28	Memorial Day (markets closed)
May 29	CB Consumer Confidence (May)
May 30	ADP Payroll Estimate (May) Real GDP (1Q18, 2nd estimate) Fed Beige Book
May 31	Personal Income and Spending (April)
June 1	Employment Report (May) ISM Manufacturing Index (May)
June 13	FOMC Policy Decision, press conf.
August 1	FOMC Policy Decision (no press conf.)
September 26	FOMC Policy Decision, press conf.
November 6	Election Day