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Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com **September 18, 2017**

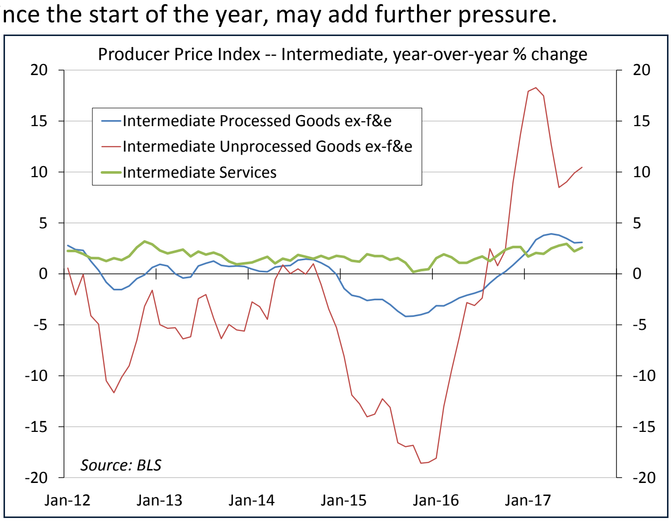
Weekly Economic Monitor

Transitory

In her post-FOMC press conference, Federal Reserve Chair Janet Yellen is expected to provide a concise evaluation of the current economic situation. That includes a discussion about the recent trend in low inflation and the economic impact of hurricanes Harvey and Irma. She is not expected to signal what the Fed will do with short-term interest rates in the months ahead. At this point, nobody knows – that's the point of monetary policy being *"data-dependent."* However, we can expect to hear a lot about the "temporary" or "transitory" nature of forces on the economy – and it will take some time for upcoming data reports to present a clear picture.

On the inflation front, Fed officials have signaled a belief that much of the recent trend in low inflation is transitory. Notably, March's sharp drop in the price index for wireless telecom services shaved about 0.2 percentage point from the year-over-year increase in headline CPI inflation (and about 0.25 percentage point in the core CPI). At the same time, officials are aware that structural changes in the labor market may be preventing wage growth from rising as much as in the past.

Drilling into the details of the August CPI report, we're still seeing a continued deflationary trend in consumer goods ex-food & energy. Despite a pickup in global economic growth, there appears to be plenty of excess capacity in the production of goods. The producer price data had shown moderate pressure in finished goods, but this failed to flow through much to the consumer level. More recently, prices of intermediate goods and materials have begun to reflect pressure. A softer dollar, now down around 10% against the major currencies since the start of the year, may add further pressure.



Last week, the key mid-month economic data (retail sales and industrial production) were disappointing. Retail sales were weaker than expected in August, with significant downward revisions to the figures for June and July. Industrial production fell far short of expectations, although partly reflecting unseasonably mild East Coast temperatures. Hurricane Harvey likely had an impact, with mixed, but mostly negative effects on retail sales (the Bureau of Census says it's impossible to tell how much of an impact Harvey had). Oil and gas well drilling, which has been recovering since last May, had a sharp setback, which was almost certainly related to Harvey.

We can expect to see a bounce back from Harvey's effects in the weeks ahead. Energy exploration should pick back up and retail sales will rebound as Houston gets back to normal. Speaking from personal observation, Irma had a widespread impact on Florida's economy, disrupting activity in the week before the hurricane's arrival and in the aftermath. At the end of the week, many homes and businesses were without power, but activity should get back to normal in the weeks ahead. Don't expect rebuilding to have a big impact on growth. It's never enough to offset the loss of activity. However, whatever impact we see on 3Q17 GDP growth (probably 0.2-0.4 percentage point) should come back in the fourth quarter.

Still, there's some question about what the economy's strength is beyond the impact of the hurricanes. Adjusted for inflation, hourly earnings were about flat year-over-year in the first quarter. We saw a pickup in May, June, and July, as gasoline prices began to stabilize. However, August brought a decline; and we're likely to see some softness in real earnings in September as well. Every month in 2017, motor vehicle sales have been reported lower than a year ago. Vehicle production was a source of strength in the economic recovery, but having likely topped out, we shouldn't expect much contribution to consumer spending or industrial production from here on. So, the moderate pace of GDP growth isn't likely to be temporary. Demographic constraints (slower labor force growth) will likely keep GDP growth in the 1.5-2.0% range over the next few years, whether or not we see much change coming out of Washington.

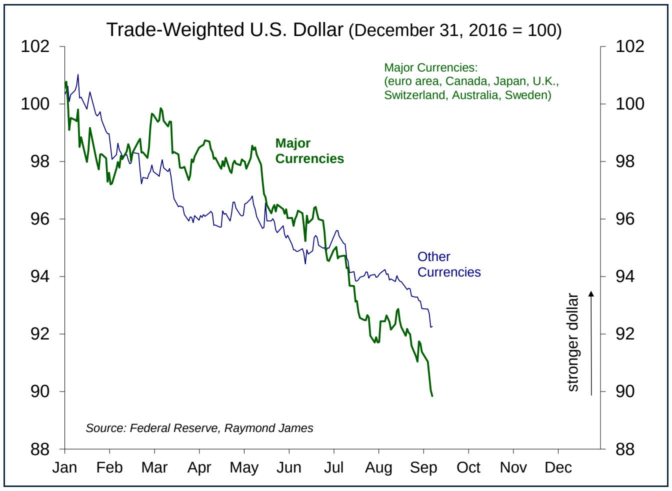
This restrained outlook for growth isn't necessarily bad for the stock market. While growth is expected to be slower than historical norms, it's still projected to be positive. Interest rates are expected to be lower than they would be otherwise, and lower interest rates imply the P/E ratios can be higher than usual. Of course, we could get some negative shock to the economy, or there may be some necessary adjustments if expectations prove to be too unrealistic, but a steady hand on the monetary policy tiller should help.

The greater uncertainty is who will be at the helm beyond February. The Wall Street types in the White House will likely have a significant hand in the president's decision on the next Fed chair, but at this point, who knows?

	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
8/18/17	1.02	1.13	1.24	1.33	1.47	1.77	2.19	2.78	1.175	1.285	109.32	1.259	6216.53	2425.55	21674.51
9/08/17	1.04	1.14	1.22	1.27	1.39	1.64	2.06	2.67	1.204	1.321	107.72	1.213	6360.19	2461.43	21797.79
9/15/17	1.04	1.17	1.30	1.38	1.53	1.80	2.20	2.77	1.195	1.359	110.82	1.218	6445.29	2500.21	22268.34

Recent Economic Data and Outlook

Worries about North Korea and Hurricane Irma did not have a lasting impact on the stock market psychology. A (small) upside surprise in the CPI, lifted the market odds of a mid-December Fed rate hike (now seen at about 50%).



Though not as bad as feared, **Hurricane Irma** was significantly disruptive to the Florida economy. Around 5.6 million people were ordered to evacuate. Utility workers struggled to restore electricity. Many businesses were closed. Still, while the loss of live and damage to homes and businesses were tragic, the state's economy is expected to bounce back in the weeks ahead.

Retail Sales fell 0.2% (+3.2% y/y), reflecting a 1.6% decline in motor vehicle sales (+1.5% y/y). Figures for June and July were revised significantly lower. Ex-autos sales rose 0.2% (+3.6% y/y), boosted by a 2.5% increase in gasoline sales (higher prices, +6.4% y/y). Ex-autos, building materials, and gasoline, sales slipped 0.1% (+2.8%) – a 1.3% annual rate in the first two months of 3Q17, vs. 3.2% in 2Q17 (revised down from +3.7%).

Business Inventories rose 0.2% in July (+3.0% y/y), while business sales rose 0.2% (+4.9% y/y).

Industrial Production fell 0.9% in August, reflecting a 5.5% drop in the output of utilities (unseasonably mild East Coast temperatures) and a hurricane-related decline of 4.8% in oil and gas well drilling. Manufacturing output fell 0.3% (a contrast to the strong gain in aggregate hours in the August Employment Report), despite a 2.2% partial rebound in auto production (down 4.6% since December, consistent with this year's slowdown in vehicle sales). Ex-autos, factory output fell 0.5%.

The **Consumer Price Index** rose 0.4% in August (+1.9% y/y), up 0.2% ex-food & energy (+1.7% y/y). Food rose 0.1% (+1.1% y/y). Gasoline (3.3% of the overall CPI) jumped 6.3% (+3.9% before seasonal adjustment, and +10.4% y/y). Shelter costs rose 0.5% (+3.3% y/y), reflecting a 4.4% rebound in lodging away from home (which had fallen in June and July). Ex-food, energy, and shelter, the CPI rose 0.1% in August (+0.5% y/y). Ex-food & energy, consumer goods fell 0.1% (-0.9% y/y), -0.1% (-0.5% y/y) if you also exclude used vehicles (-0.2% m/m, -3.8% y/y).

Real Hourly Earnings fell 0.3% in August (+0.6% y/y), following gains in May, June, and July.

The **Producer Price Index** rose 0.2% in August (+2.4% y/y), as a 1.3% drop in food (+1.7% y/y) offset a 3.3% rise in energy (+8.6% y/y). Ex-food, energy, and trade services, the PPI rose 0.2% (+1.9% y/y). Pipeline pressures picked up in August. Ex-food & energy, the index for processed intermediate goods rose 0.4% (+3.1% y/y), while the index for unprocessed intermediate goods rose 0.9% (+10.5% y/y).

The University of Michigan's **Consumer Sentiment** Index dipped to 95.3 in mid-September, vs. 96.8 in August. Evaluations of current conditions improved (to the highest level since November 2000). Expectations fell, reflecting concerns about a more lasting impact of Hurricanes Harvey and Irma.

The Index of **Small Business Optimism** edged up to 105.3 in August ("basically unchanged"). Businesses remained generally optimistic. Hiring expectations were moderate. Capital spending plans improved somewhat.

The **Bank of England**'s Monetary Policy Committee voted 7-2 to leave short-term interest rates unchanged. The MPC did not alter the asset purchase program, but "if the economy follows a path broadly consistent with the August Inflation Report central projection, then monetary policy could need to be tightened by a somewhat greater extent over the forecast period than current market expectations."

Economic Outlook (3Q17): 2.0-2.5% GDP growth.

Employment: The trend in private-sector job growth has remained similar to that of 2016, but is expected to slow as the job market continues to tighten.

Consumers: Recent figures suggest some loss of momentum into 3Q17. Job gains have been supportive. Inflation-adjusted wage growth has begun to weaken again.

Manufacturing: Orders and production have remained mixed across sectors, but moderate overall. Better global growth and the rebound in energy exploration have helped, but motor vehicle sales appear to have passed their peak.

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. Balance sheet reduction is expected to start in October, initially gradual, but picking up over the course of a year.

This Week:					*forecast*	last	last –1	comments
Monday	9/18	10:00	Homebuilder Sentiment	Sep	***66***	68	64	still elevated, but likely a bit softer
Tuesday	9/19	8:30	**Building Permits, mln**	Aug	***1.245***	1.230	1.275	moderate strength in single-family
			% change		***+1.2***	-3.5	+9.2	multi-fam is noisy
			Housing Starts		***1.190***	1.155	1.213	seen rebounding from soft July
			% change		***+3.0***	-4.8	+7.4	but watch for possible revisions
		8:30	Import Prices	Aug	***NF***	+0.1	-0.2	higher petroleum prices
			ex-food & fuels		***NF***	0.0	0.0	no inflation pressure in imports
Wednesday	9/20	10:00	Existing Home Sales, mln	Aug	***5.48***	5.44	5.51	a strong trend
			% change		***+0.7***	-1.3	-2.0	limited by supply constraints
		2:00	**FOMC Policy Decision**		***1-1.25%***	1-1.25%	1-1.25%	balance sheet unwind to start in Oct
		2:00	**Summary of Econ Proj.**					a new dot plot
		2:30	**Yellen Press Conference**					monetary policy still data-dependent
Thursday	9/21	8:30	Jobless Claims, th.	9/16	***280***	284	298	Harvey/Irma Impact
		8:30	Philadelphia Fed Index	Sep	***NF***	18.9	19.5	erratic, but a moderately strong trend
		10:00	Leading Econ Indicators	Aug	***+0.3***	+0.3	+0.6	most components will add
		1:00	TIPS Auction					re-opened 10-year TIPS
Friday	9/22		no significant data					
Next Week:								
Monday	9/25		no significant data					Happy Bday, Bob McAdoo, Scottie Pippen
Tuesday	9/26	10:00	New Home Sales, mln	Aug	***600***	571	630	likely to have partially rebounded
			% change		***+5.1***	-9.4	+1.9	but watch for revisions
		10:00	**CB Consumer Confidence**	Sep	***117.5***	122.9	120.0	likely lower
		11:50	**Yellen Speech**					to NABE conference
		1:00	Treasury Note Auction					2-year notes
Wednesday	9/27	8:30	**Durable Goods Orders**	Aug	***+0.6%***	-6.8%	+6.4%	a modest rebound in aircraft
			ex-transportation		***+0.3%***	+0.6%	-0.0%	moderately higher
			nondef cap gds ex-aircraft		***+0.2%***	+1.0%	-0.1%	a soft-to-moderate trend
		10:00	Pending Home Sales Index	Aug	***-0.5%***	-0.8%	+1.3%	seen a bit softer
		11:30	FRN Auction					2-year FRNs
		1:00	Treasury Note Auction					5-year notes
Thursday	9/28	8:30	Jobless Claims, th.	9/23	***320***	***280***	284	Irma Impact
		8:30	Real GDP (3rd estimate)	2Q17	***+2.9%***	+1.2%	+1.8%	+3.0% in 2nd estimate
			Priv. Dom. Final Purchases		***+3.2%***	+3.1%	+2.7%	+3.4% in the 2nd estimate
		8:30	Advance Econ Indicators	Aug				inventory and merchandise trade figures
		1:00	Treasury Note Auction					7-year notes
Friday	9/29	8:30	Personal Income	Aug	***+0.2%***	+0.4%	0.0%	a modest gain
			Personal Spending		***-0.2%***	+0.3%	+0.2%	weak / autos sales fell
			PCE Price Index ex-f&e		***+0.2%***	+0.1%	+0.1%	core CPI reported up 0.x%
		9:45	Chicago Business Barometer	Sep	***56.8***	58.9	58.9	likely softer
		10:00	UM Consumer Sentiment	Sep	***95.0***	96.8	93.4	95.3 at mid-month

This Week…

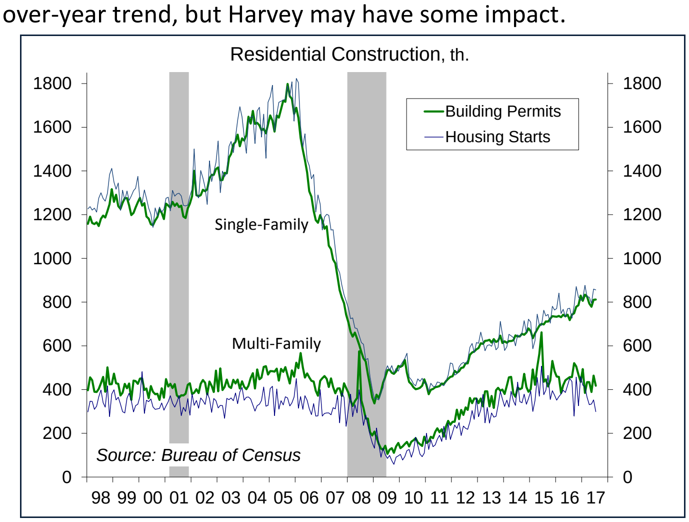
The focus is clearly going to be on the Fed policy meeting. There's little suspense about what the Federal Open Market Committee will do. The federal funds target rate range is widely expected to remain at 1.00-1.25%. Officials are also expected to announce the start of the balance sheet unwinding. The FOMC has already indicated how this will proceed (it just hasn't given a start date yet – although, back in June, market expectations had quickly solidified on October). Market participants will be more interested in the signals that the Fed sends on future policy moves – hence focus on the dot plot.

Monday

Homebuilder Sentiment (September) – Likely to have softened.

Tuesday

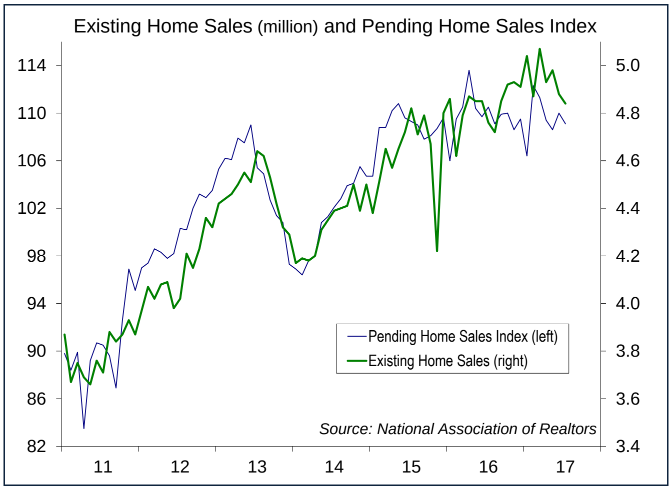
Building Permits, Housing Starts (August) – Starts are volatile and reported with a huge amount of statistical uncertainty. Single-family permits are likely to remain on a relatively strong year-over-year trend, but Harvey may have some impact.



Import Prices (August) – There is generally plenty of excess capacity in the production of raw materials and finished goods, but the softer dollar ought to be having some impact.

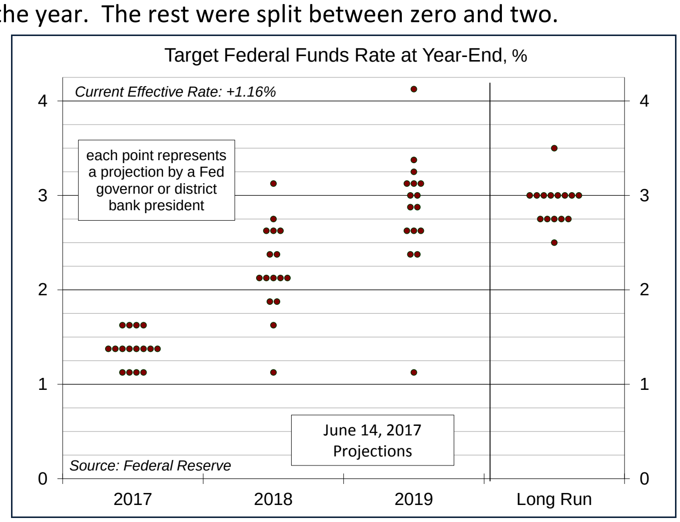
Wednesday

Existing Home Sales (August) – Single-family sales (pictured below) are likely to have picked up, but the trend appears to have flattened somewhat in recent months. Sales of condos ought to have rebounded after slipping in June and July.



Federal Open Market Committee Decision – It's widely expected that the FOMC will refrain from raising the federal funds rate target and announce the start of the balance sheet unwinding (October). At the mid-June policy meeting, the FOMC announced how it plans to reduce its security holdings.

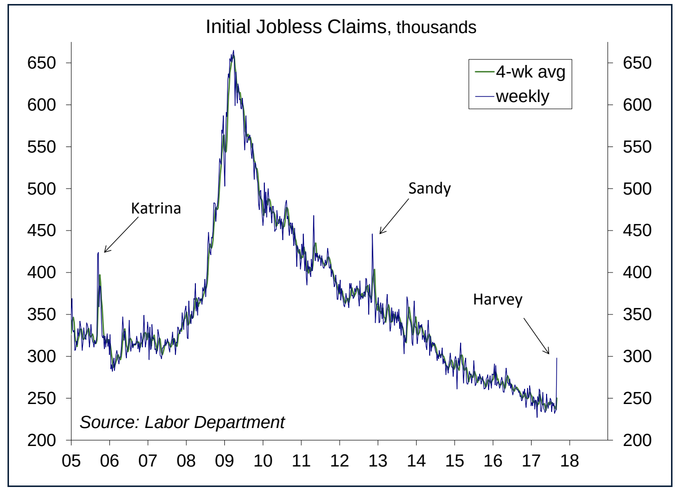
Fed Summary of Economic Projections – The SEP will include senior Fed officials' updated projections of growth, unemployment, and inflation (note: not all of these officials vote on the FOMC). We'll also get a new dot plot, and investors will zero in on the yearend set of dots for 2017 (which should help to gauge the likelihood of a mid-December move). In June, half of senior Fed officials expected one rate increase by the end of the year. The rest were split between zero and two.



Yellen Press Conference – The Fed chair is expected to cover a range of topics in her post-meeting press conference. She will summarize the decision to begin unwinding the balance sheet and present the general economic outlook. Expect some discussion of the impact of hurricanes ("temporary") and the low trend in inflation ("transitory").

Thursday

Jobless Claims (week ending September 16) – Figures for the most recent week suggest that the impact of Hurricane Harvey on claims may be less than anticipated, or perhaps unwinding sooner than anticipated. For Hurricane Irma, the impact shows up first as a decrease in claims (as individuals are unable to file), then as a sharp rise (reflecting delayed filings and hurricane-related job losses). It will take a few weeks before the figures settle down, most likely at around the low-pre-hurricanes trend.



Leading Economic Indicators (August) – The only clear negative component is the hurricane-related increase in jobless claims.

Friday

No significant data.

Next Week …

The third estimate of 2Q17 GDP ought to be somewhat lower than in the previous estimate, but the market shouldn't care. August durable goods shipments and personal spending data will help to fill in the picture of 3Q17 growth.

Coming Events and Data Releases

October 2	ISM Manufacturing Index (September)
October 4	ADP Payroll Estimate (September) ISM Non-Manufacturing Index (September)
October 6	Employment Report (September)
October 9	Columbus Day (bond market closed)
October 11	FOMC Minutes (September 19-20)
October 27	Real GDP (3Q17, advance estimate)
November 1	FOMC Policy Decision (no press conf.)
December 13	FOMC Policy Decision, Yellen press conf.
January 31	FOMC Policy Decision (no press conf.)
March 21	FOMC Policy Decision, press conf.