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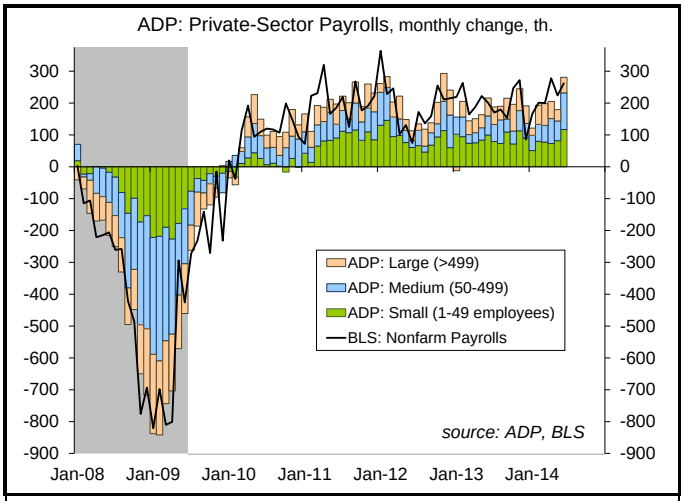
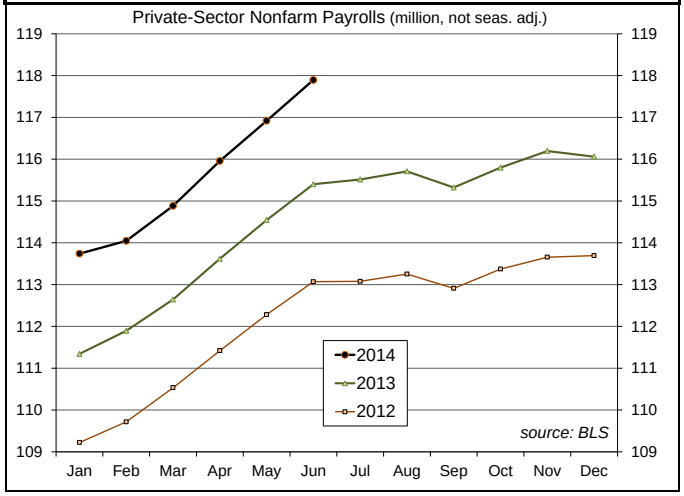
Weekly Market Monitor

Reaching Escape Velocity?

The strong pace of growth in nonfarm payrolls suggests much more than a rebound from bad weather. While recent economic figures have been generally mixed, the job market is clearly improving, led by increased hiring at small and medium-sized firms. The hope is that good news will feed on itself, lifting the pace of growth in the second half of the year. However, there are a few concerns in the outlook.

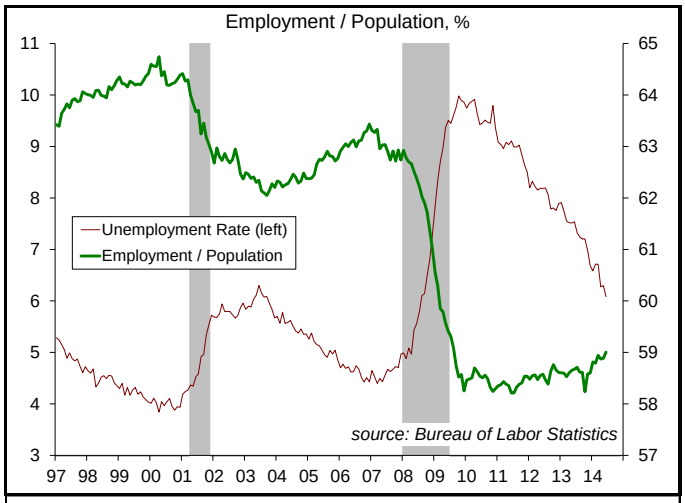
Small and medium-sized (essentially, newer) firms typically account for more than their fair share of job growth in an expansion. These firms have been restrained in the recovery, but demand appears to have improved to the point where many of them must hire new workers to keep up.

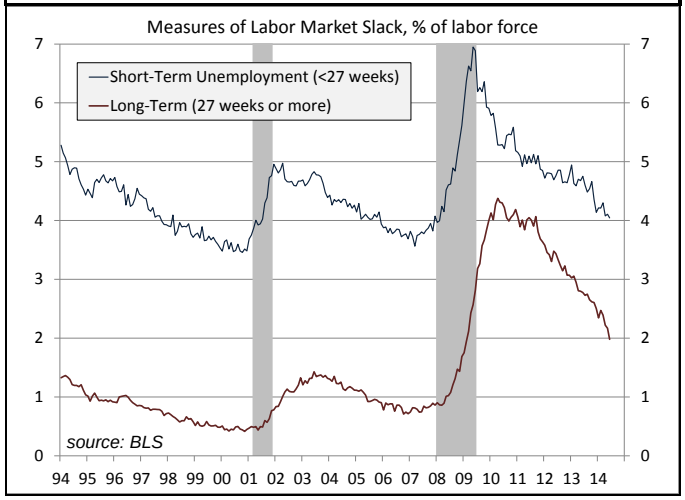




Prior to seasonal adjustment, nonfarm payrolls rose by 582,000 in June (education down 847,000, but up 1.429 million otherwise), up 3.8 million since February. That's a pretty good spring. Note that unadjusted private-sector payrolls usually trend only gradually higher in the second half of the year.

The unemployment rate fell to 6.1% in June, the lowest since July 2008. The employment/population ratio rose modestly and has been trending only gradually higher over the last year. The aging of the population suggests that we're unlikely to get back to the pre-recession level on employment/population, but we should be able to make up at least two-third of the ground lost. We still have a large amount of slack in the labor market.





Short-term unemployment has returned to normal levels, but long-term unemployment remains elevated.

There are three concerns in the economic outlook: 1) wage growth has remained low, limiting the potential upside for consumer spending growth; 2) geopolitical tensions could escalate, boosting gasoline prices and increasing the degree of caution in business hiring and capital spending; 3) there is little scope for expansionary fiscal or monetary policy should that be needed. However, strong job growth may be sufficient to boost consumer spending in the near term, which in turn, would lead to even more job growth in the second half of the year.

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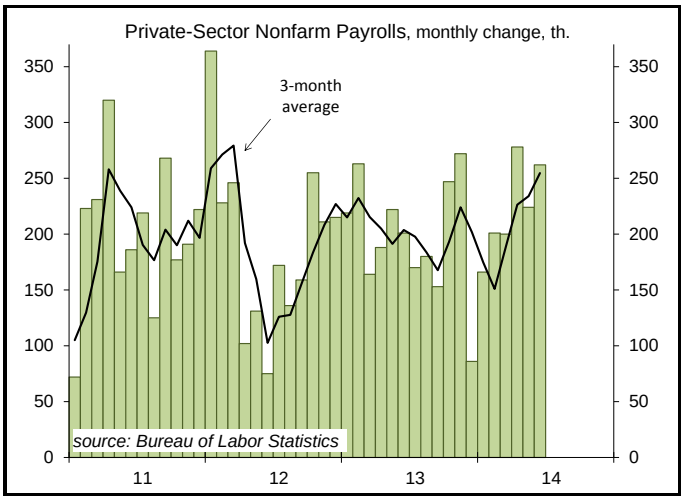
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
6/06/14	0.04	0.06	0.11	0.41	0.86	1.66	2.60	3.44	1.364	1.679	102.50	1.094	4321.40	1949.44	16924.28
6/27/14	0.03	0.06	0.10	0.45	0.88	1.64	2.54	3.36	1.363	1.702	101.39	1.068	4397.93	1960.96	16851.84
7/03/14	0.01	0.06	0.10	0.51	0.96	1.74	2.65	3.48	1.361	1.715	102.20	1.063	4485.93	1985.44	17068.26

Recent Economic Data and Outlook

Data reports were generally on the strong side of expectations, consistent with better economic growth in 2Q14. Janet Yellen said the Fed wouldn't use monetary policy to stop bubbles.



In a speech to the IMF, **Fed Chair Yellen** said that the Fed would rely primarily on macroprudential policy (supervision and regulation of the broad financial system) rather than monetary policy to address financial excesses. She said that there were "pockets of increased risk-taking" across the financial system, but Fed officials do not see this as a systemic threat.

The June **Employment Report** was strong. Nonfarm payrolls rose by 288,000 (median forecast: +215,000) with widespread gains across industries (manufacturing: +16,000, construction: +6,000, retail: +40,000, professional and business services: +67,000). The unemployment rate fell to 6.1% (vs. 6.3% in May and 7.5% a year ago, but the employment/population ratio edged only slightly higher to 59.0% (vs. 58.9% in May and 58.7% a year ago). Average weekly hours held steady at 34.5. Average hourly earnings rose 0.2%, up 2.0% y/y (note that the Consumer Price Index rose 2.1% over the 12 months ending in May).

The **ADP Estimate** of private-sector payrolls rose by 281,000 in May, led by increased hiring at small and medium-sized firms.

Unit **Motor Vehicle Sales** rose to a 16.9 million seasonally adjusted annual rate in June, the strongest pace since July 2006 (up from 16.7 million in May and 15.8 million a year ago).

The **ISM Manufacturing Index** was little changed in June (55.3, vs. 55.4 in May). Growth in new orders picked up. Employment growth was moderate (positive, but not especially strong). Comments from purchasing managers were upbeat.

The **ISM Non-Manufacturing Index** edged down to 56.0 in June, vs. 56.3 in May. Business activity slowed to 57.5 (vs. 62.1). New orders picked up to 61.2 (vs. 60.5). Employment improved to 54.4 (vs. 52.4). Comments from supply managers on growth ranged from moderate to strong.

The **U.S. Trade Deficit** narrowed to $44.4 billion in May, vs. $47.0 billion in April (revised from $47.2 billion). Merchandise exports rose 1.2% (+4.9% y/y). Imports fell 0.4% (+3.3% y/y), with petroleum down 5.0% (-9.4% y/y) and non-petroleum up 0.5% (+5.7% y/y). Adjusting for inflation, the trade deficit appears to be on track to have widened further in 2Q14, subtracting from GDP growth (a full percentage point or more).

Factory Orders fell 0.5% in May, up 2.4% from a year ago. Durable goods orders fell 0.9% (revised from -1.0% reported a week earlier). Orders for nondefense capital goods ex-aircraft rose 0.7% (vs. -1.1% in April and +4.7% in March).

The **Pending Home Sales Index** rose 6.1% in May, following a 0.5% rise in April (still down 5.2% from a year ago).

Despite a continued low trend in inflation, the **European Central Bank** left monetary policy unchanged. ECB President Draghi said that officials were unanimous in their commitment to use unconventional instruments should that become necessary.

Economic Outlook (3Q14): 2.5% to 3.0% GDP growth, vs. 2.0% to 2.5% in 2Q14 (limited by a wider trade deficit).

Employment: Job destruction has continued to trend at a low level. New hiring appears to be picking up (concentrated in small and medium-sized firms).

Consumers: Lackluster growth in real average wages is a limiting factor for spending, but strong job growth helps fuel aggregate spending gains. Credit is still relatively tight (except for autos), but is expected to gradually improve.

Manufacturing: Lean inventories usually bode well for future production gains, but softer global growth is likely to limit export growth. Results vary across industries, but overall manufacturing strength has lagged the overall economy.

Housing/Construction: Builder supply constraints have been a factor, but should improve over time. Higher home prices have reduced affordability, but may be moderating. The spring housing season has been disappointing.

Prices: The PCE Price Index, the Fed's chief inflation gauge, is trending below the 2% goal, which will be a problem if that continues. Pipeline pressures have been modest. Wage gains are mild. Inflation expectations remain well-anchored.

Interest Rates: The tapering of asset purchases is *"not on a preset course,"* but Fed officials anticipate further reductions *"at a measured pace"* (-$10 billion per FOMC meeting) – and it would take a significant change in the economic outlook for the Fed to deviate from the path. If the economy evolves as the Fed anticipates, short-term interest rates are likely to be raised around the middle of 2015. Long-term interest rates should trend gradually higher, with some volatility along the way.

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This Week:					*forecast*	last	last –1	comments
Monday	7/07		no significant data					World Cup: rest day
Tuesday	7/08	7:30	Small Business Optimism	May	***NF***	96.6	95.2	trending higher
		10:00	JOLTS: hiring rate	May	***NF***	3.4%	3.4%	still below normal
			JOLTS: quit rate		***NF***	1.8%	1.8%	trending about flat
		1:00	Treasury Note Auction					$27 billion in 3-year notes
		4:00	WCup: Semifinal					(BRA/COL) vs. (FRA/GER)
Wednesday	7/09	1:00	Treasury Note Auction					$21 billion in re-opened 10-year notes
		2:00	**FOMC Minutes**	6/18				some discussion of exit plans
		4:00	WCup: Semifinal					(NED/CRC) vs. (ARG/BEL)
Thursday	7/10	7:00	BOE Policy Decision					no change
		8:30	Jobless Claims, th.	7/05	***310***	315	313	subject to seasonal noise
		1:00	Treasury Bond Auction					$13 billion in re-opened 30-year bonds
Friday	7/11	2:00	Treasury Budget, $bln		***NF***	+116.5	-59.7	not market-moving (but trending lower)
Sunday	7/13	3:00	WCup: Final					
Next Week:								
Monday	7/14		no significant data					
Tuesday	7/15	8:30	Import Prices	Jun	***NF***	+0.1%	-0.5%	a low trend
			ex-food & fuels		***NF***	+0.1%	+0.1%	no inflation pressure from import prices
		8:30	**Retail Sales**	Jun	***+1.1%***	+0.3%	+0.5%	led by strength in auto sales
			ex-autos		***+0.6%***	+0.1%	+0.4%	some pickup (watch for revisions)
			ex-autos, bld mat, gasoline		***+0.5%***	-0.1%	+0.2%	a moderate trend
		8:30	Empire St. Manf. Index	Jul	***13.2***	19.3	19.0	some moderation seen (still strong)
		10:00	Business Inventories	May	***NF***	+0.7%	+0.4%	faster in 2Q14 (adding to GDP growth)
		20:00	MLB 85th All-Star Game					in Minnesota dontcha know
Wednesday	7/16	8:30	**Producer Price Index**	Jun	***+0.3%***	-0.2%	+0.6%	some pressure in food and energy
			ex-food & energy		***+0.1%***	-0.1%	+0.5%	mild otherwise
		9:15	**Industrial Production**	Jun	***+0.5%***	+0.6%	-0.3%	moderate
			Manufacturing Index		***+0.5%***	+0.7%	-0.1%	aggregate hours rose 0.1%
			Capacity Utilization		***79.4%***	79.1%	78.9%	trending higher, but no inflation threat
		10:00	BOC Policy Decision					no change
		10:00	Homebuilder Sentiment	Jul	***50***	49	45	likely to improve
		2:00	**Fed Beige Book**					should be a bit brighter
Thursday	7/17	8:30	Jobless Claims, th.	7/12	***320***	***310***	315	subject to seasonal noise
		8:30	**Building Permits, th.**	Jun	***1045***	1005	1059	single-family strength
			% change		***+4.0***	-5.1	+5.9	multi=family noise
			Housing Starts		***1025***	1001	1071	seen higher
			% change		***+2.4***	-6.5	+12.7	watch for revisions
		10:00	Philadelphia Fed Index	Jul	***12.5***	17.8	15.4	moderate
Friday	7/18	9:55	Consumer Sentiment	m-Jul	***84.0***	82.5	81.9	likely to improve
		10:00	Leading Econ Indicators	Jun	***+0.5%***	+0.5%	+0.3%	mixed components, mostly higher

This Week…

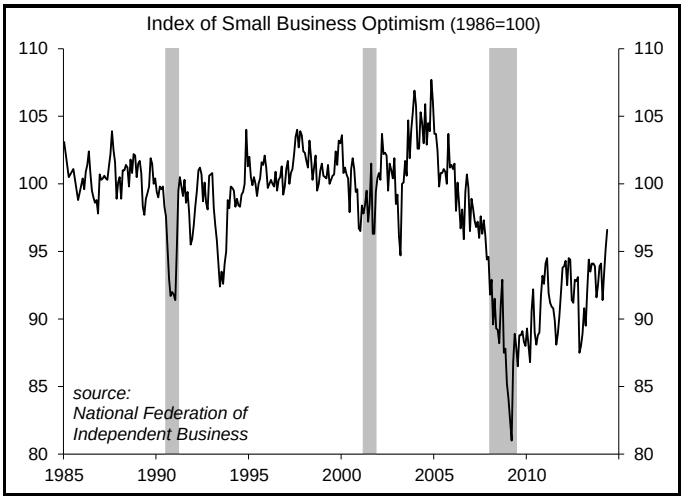
The economic calendar is thin. Fed policy meeting minutes should show that officials discussed exit plans (not that tighter policy is going to happen anytime soon – this is simply "prudent planning"). There's always a chance that the financial markets will take some quote out of its proper context. Jobless claims will be subject to seasonal distortions over the next few weeks.

Monday

No significant data.

Tuesday

Small Business Optimism Index (June) – Small firms play on oversized role in an economic recovery, typically accounting for more than their fair share of job growth. Until recently, small firms have been relatively constrained. However, the outlook has begun to improve more significantly as many of these firms are forced to hire new workers to keep up with demand.



JOLTS Data (May) – Part of Janet Yellen's dashboard of labor market indicators, hiring and quit rates are likely to trend

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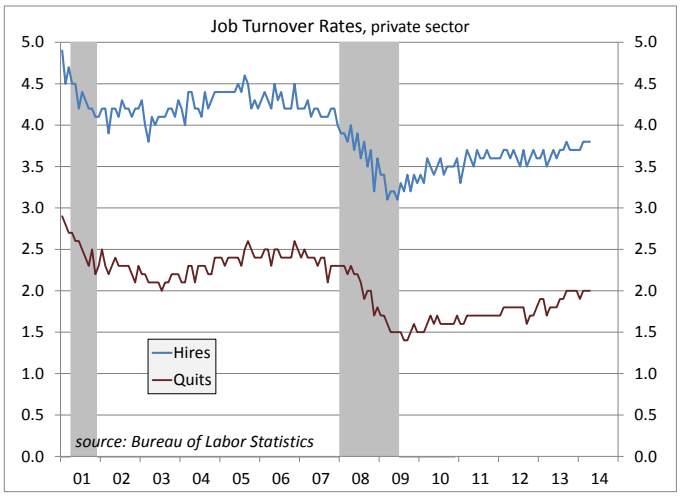
gradually higher over time. However, levels have remained well below normal, consistent with labor market slack.

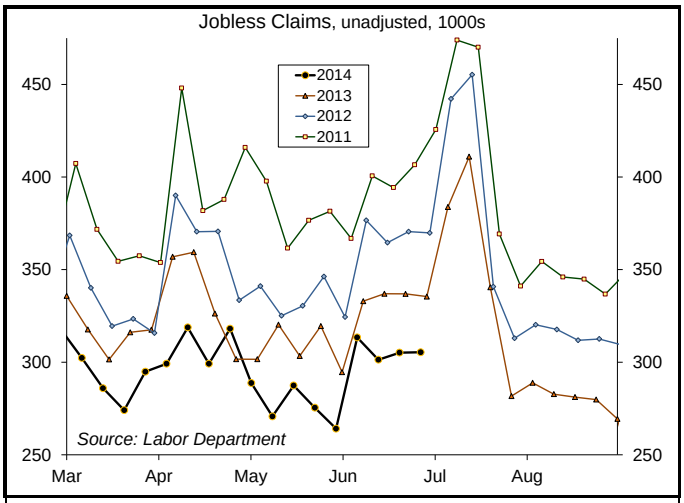


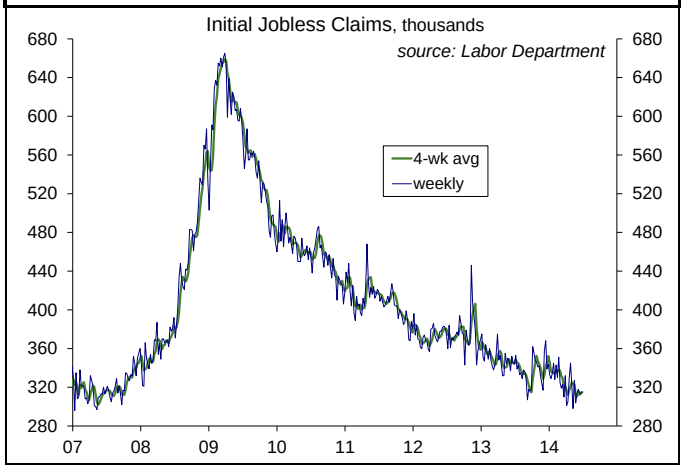
Wednesday

FOMC Minutes (June 17-18) – Fed officials discussed exit plans (prudent planning, not a sign that tighter policy is imminent).

Thursday

Jobless Claims (week ending July 5) – Auto plants shut down every summer for retooling, which leads to a spike in unadjusted jobless claims and often a lot of noise in the adjusted figures. Take any large swings with a grain of salt.



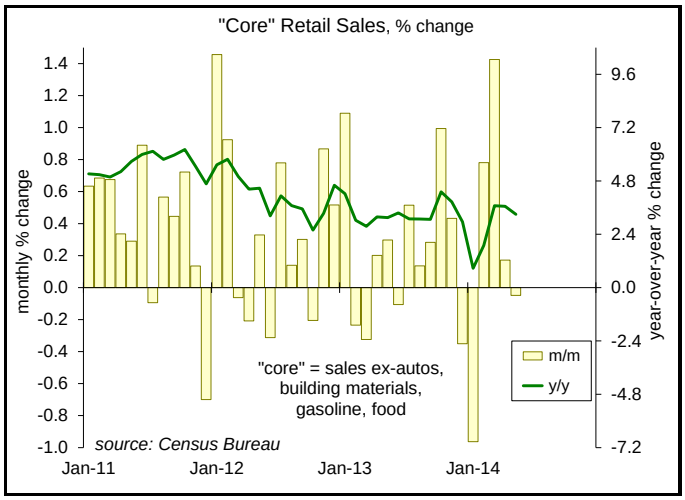


Friday

Treasury Budget (June) – With three months left in the fiscal year, the budget is likely to be on track for a deficit of less than 3% of GDP. We can live with that for the time being, but the problem with the budget is longer-term (mostly Medicare).

Next Week …

Retail sales figures are often choppy. That was especially so in recent months. Poor weather depressed sales in December and January. Sales rebounded in February and March. Figures for April and May were disappointing. Motor vehicle sales strengthened, but spending elsewhere was soft. Investors are likely to look for better retail sales results in June (although we may see an upward revision to previous months). The figures should help to refine forecasts of 2Q14 GDP growth, although as we've seen, the quirky GDP arithmetic can be a bit odd and misleading (better to pay attention to the wide range of economic indicators, not just GDP). Stronger job growth should lead to increased spending in the aggregate in the second half of the year, but lackluster wage growth is likely to limit spending per capita. None of this suggests that the Fed will have to reach for the brake anytime soon. In fact, Chair Yellen has suggested that the Fed would be willing to tolerate some pickup in wages.



Coming Events and Data Releases

July 22	Consumer Price Index (June) Existing Home Sales (June)
July 24	New Home Sales (June)
mid-July (tbd)	Yellen Monetary Policy Testimony
July 30	Real GDP (2Q14 advance, benchmark revisions) FOMC Policy Decision (no press conference)
August 1	Employment Report (July)
September 1	Labor Day (markets closed)
September 17	FOMC Policy Decision, Yellen press conference
October 29	FOMC Policy Decision (no press conference)
December 17	FOMC Policy Decision, Yellen press conference

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