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Weekly Market Monitor

Should Be an Eventful Week

The economic calendar is packed with important items this week. Oddly, Wednesday afternoon's policy announcement from the Federal Open Market Committee may be the least interesting. One shouldn't put too much weight on the advance GDP estimate, as the figures will be revised, but the initial estimate, along with annual benchmark revisions, should have important implications for the outlook for growth in the second half of the year. Payroll figures from the employment report are subject to a fair amount of statistical noise, but the financial markets will have to take the reported figures at face value.

The Federal Reserve has well telegraphed its intention to taper the monthly pace of asset purchases by another $10 billion. However, Fed officials are not expected to provide any fresh clues on exactly when short-term interest rates will begin to rise. Fed officials are researching and debating the mechanics of policy normalization (the tools and the order of steps to be taken as the Fed begins to remove policy accommodation), but won't provide details in the near term. There may be some minor changes in the wording of the Fed's economic outlook.

There's nothing magical about the size of the Fed's balance sheet. By itself, a large balance sheet does not imply a higher inflation rate. It's a question of loan growth and whether that's leading to inflation pressure in resource markets. When appropriate, the Fed can drain bank reserves through reverse overnight repos, issuing time deposits to depository institutions, or by raising the interest rate that the Fed pays on excess reserves held at the Fed (IOER). There are a number of issues regarding the ability of the Fed to take these steps in sufficient size, but officials are working on the details and expect to let the public know their conclusions by the end of the year.

The advance estimate of GDP growth is always an adventure. The government does not have a complete picture for the quarter and has to make assumptions about foreign trade, inventories, and other components. The GDP figure will be revised in late August and again in late September. Compounding the uncertainty this time, the government will also release annual benchmark revisions to the GDP figures for the last few years. This will be a "garden-variety" benchmark, one based on revised source data rather than any major change in methodology (although figures will incorporate the recently improved international transactions data). Typically, this kind of revision will shift some GDP from one quarter to the next, but not raise or lower the level of activity by much. Nevertheless, it will be interesting to see how much of the reported plunge in 1Q14 GDP holds up in revision. The PCE Price Index, the Fed's chief inflation gauge, will be subject to revisions, but the recent history is unlikely to change by much.

Investors are likely to focus on the headline GDP figure, but the more important issue is what the data suggest about GDP growth in the second half of the year. Monthly figures on personal income and spending will be released on Friday, including benchmark revisions. Most likely, the recent figures will be consistent with many of the other major economic reports such as retail sales and industrial production. These reports showed a relatively strong rebound from the first quarter's weather-related weakness, but with some loss of momentum heading toward the third quarter. That apparent loss of momentum is worrisome, as it suggests that second half GDP growth may be softer than was hoped for earlier.

Income inequality has been a political issue this year and the debate has largely focused on taxes. However, the more important concern should have been the whittling away of the middle class. Inflation-adjusted average wage income has been essentially flat. Last week, the Bureau of Labor Statistics reported that median usual weekly earnings for 2Q14 were down 0.3% from 2Q13 (note: the median refers to the middle point in the distribution – half had higher earnings and half had lower earnings). Adjusting for inflation, median usual weekly earnings were down 1.2% from a year ago and are roughly at the same level as ten years ago. Aggregate wage income (and in turn, aggregate spending) can still increase as long as job growth is positive, but the weakness in inflation-adjusted average wages has been a limiting factor for consumer spending growth.

Last week, the report on durable goods orders and shipments included some disturbing details. Shipments of nondefense capital goods excluding aircraft fell 1.0% in June, the third consecutive quarterly decline. Shipments still rose moderately in 2Q14 (thanks to a 2.2% weather-related rebound in March), but the trend points toward a subpar pace in 3Q14.

Job growth has been one of the most positive stories in the first half of 2014. Prior to seasonal adjustment, the economy added 3.85 million private-sector jobs between February and June. However, part of that reflects weather-related weakness in the early part of the year. Job destruction has remained low (it hasn't been an issue in the last few years) and new hiring appears to have picked up. However, there is a fair amount of statistical noise in the payroll figures (the monthly change in payrolls is reported accurate to ±90,000). It's not unusual to get a string of monthly figures above or below the underlying trend. Hence, the recent trend in payroll growth is encouraging, but hardly conclusive. Unfortunately, financial market participants essentially have to take the payroll numbers at face value.

By week's end, economists will have a clearer (but still distorted) picture of the near-term trends, which may lead to downward revisions to GDP growth expectations for the second half of the year (a bit below 3%, rather than a bit above).

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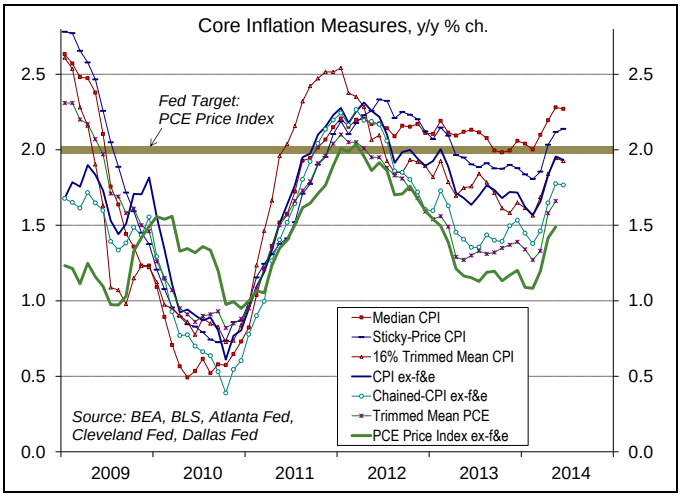
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
6/27/14	0.03	0.06	0.10	0.45	0.88	1.64	2.54	3.36	1.363	1.702	101.39	1.068	4397.93	1960.96	16851.84
7/18/14	0.02	0.05	0.10	0.51	0.97	1.69	2.50	3.29	1.352	1.707	101.37	1.074	4432.15	1978.22	17100.18
7/25/14	0.03	0.06	0.11	0.49	0.97	1.68	2.47	3.24	1.343	1.697	101.82	1.081	4449.56	1978.34	16960.57

Recent Economic Data and Outlook

U.S. financial markets appeared to be skittish and searching for direction, showing relatively little reaction to the economic data and geopolitical developments.



The **Consumer Price Index** rose 0.3% in June (+2.1% y/y), with two-thirds of that coming from gasoline (which was boosted by the seasonal adjustment). Food rose 0.1% (+2.3% y/y), following drought-related gains in the three previous months. Energy rose 1.6% (+3.2% y/y), with gasoline up 3.3% (+0.3% before seasonal adjustment, +2.0% y/y). Ex-food & energy, the CPI edged up 0.1% (+0.129% before rounding, +1.9% y/y). Ex-food & energy, prices of consumer goods rose 0.1% (-0.2% y/y), while non-energy services rose 0.1% (+2.7% y/y).

Real Weekly Earnings were unchanged in June (-0.1% y/y). Nominal weekly earnings rose 0.2% (+2.0% y/y). The weak trend in real average earnings is expected to limit the upside potential for consumer spending growth in the second half of 2014.

Durable Goods Orders rose 0.7% in June, following a 1.0% drop in May. Transportation orders rose 0.6% (motor vehicles -2.1%, civilian aircraft +8.2%, defense aircraft +15.3%). Ex-transportation, orders rose 0.8%, with mixed results across industries (primary metals +0.9%, fabricated metals -0.2%, machinery +2.4%, computers and electronics +0.8%, electrical equipment and appliances -0.2%). Orders of nondefense capital goods ex-aircraft rose 1.4%, but May was revised to -1.2% (from +0.7% in the previous estimate). Shipments for this category, a crude proxy for business fixed investment, fell 1.0% (vs. +2.2% in March, -0.3% in April, and -0.1% in May) – a 4.1% annual rate in 2Q14 (vs. +2.2% in 1Q14 and +8.8% in 4Q13). Inventories rose 0.8% (+6.6% y/y) and should make a positive contribution to overall GDP growth in 2Q14.

New Home Sales sank 8.1% in June, to a 406,000 seasonally adjusted annual rate (vs. a median forecast of 480,000), down 11.5% y/y. Figures for March, April, and especially May were revised lower. Results were weak across the four regions (Northeast -20.0%, Midwest -8.2%, South -9.5%, West -1.9%). Note that these figures are reported with an enormous amount of uncertainty (reported declines were not statistically different from 0%), but the numbers do raise concerns regarding the strength of the housing market. Unadjusted sales for the last three months were down 6.4% from the same period in 2013.

Existing Home Sales rose 2.6% in June, to a 5.04 million seasonally adjusted annual rate (-2.3% y/y). Results were higher in all four regions (Northeast +3.2%, Midwest +6.2%, South +0.5%, West +2.7%).

The **Chicago Fed National Activity Index**, a composite of 85 economic indicators, edged down to +0.12 in June, vs. +0.16 in May. The three-month average was +0.13, consistent with overall economic activity slightly above its historical trend.

In its revised World Economic Outlook, the **International Monetary Fund** lowered its projections for global growth in 2014 (to 3.4% from +3.7%), largely reflecting the first quarter's sharp drop in U.S. GDP.

Economic Outlook (3Q14): 2.5% to 3.0% GDP growth, vs. 2.5% to 3.0% 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.

This Week:					*forecast*	last	last –1	comments
Monday	7/28	10:00	Pending Home Sales Index	Jun	***+1.0%***	+6.1%	+0.5%	likely to have risen further
		1:00	Treasury Note Auction					$29 billion in 2-year notes
Tuesday	7/29	9:00	Case-Shiller Home Prices	May	***+0.3%***	+0.2%	+1.2%	pace should be slowing
			year-over-year		***+10.1%***	+10.8%	+12.6%	y/y gap still high, but edging lower
		10:00	**Consumer Confidence**	Jul	***85.6***	85.2	82.2	watch for revisions to May
		1:00	Treasury Note Auction					$35 billion in 5-year notes
Wednesday	7/30	8:15	**ADP Payroll Estimate, th.**	Jul	***+220***	+281	+179	moderate
		8:30	**Real GDP (advance)**	2Q14	***+2.8%***	-2.9%	+2.6%	annual benchmark revisions due
			Domestic Final Sales		***+3.0%***	+0.3%	+1.6%	rebounding from bad weather
		11:30	FRN Auction					$15 billion in 2-year Floating-Rate Notes
		1:00	Treasury Auction					$29 billion in 7-year notes
		2:00	**FOMC Policy Decision**		***0-0.25%***	0-0.25%	0-0.25%	no change
			LSAP: Treasuries, $bln/mo		***15***	20	25	another taper
			LSAP: MBS, $bln/mo		***10***	15	20	no surprise
Thursday	7/31	8:30	Jobless Claims, th.	7/26	***310***	284	303	some distortions, but a low trend
		8:30	Employment Cost Index	2Q14	***+0.4%***	+0.3%	+0.5%	trending below +2% y/y
		9:45	Chicago PMI	Jul	***61.5***	62.6	65.5	some moderation seen (still strong)
Friday	8/01	8:30	**Nonfarm Payrolls, th.**	Jul	***+200***	+288	+224	moderately strong
			private-sector		***+210***	+262	+224	watch for revisions
			Unemployment Rate		***6.1%***	6.1%	6.3%	trending lower
			employment/population		***59.0%***	59.0%	58.9	trending gradually higher
			Avg. Weekly Hours		***34.5***	34.5	34.5	steady
			Avg. Hourly Earnings		***+0.2%***	+0.2%	+0.2%	moderate wage pressures
		8:30	Personal Income	Jun	***+0.5%***	+0.4%	+0.3%	some pickup in jobs and wages
			Personal Spending		***+0.4%***	+0.2%	+0.0%	mixed, but moderate (revisions?)
			PCE Price Index ex-f&e		***+0.2%***	+0.2%	+0.2%	mild core inflation
		9:45	Markit US Manf PMI (final)	Jul	***NF***	57.3	56.4	56.3 in flash estimate, not market-moving
		9:55	Consumer Sentiment	Jul	***82.0***	82.5	81.9	81.3 at mid-month
		10:00	Construction Spending	Jun	***NF***	+0.1%	+0.8%	watch for revisions to May
		10:00	**ISM Manf. Index**	Jul	***55.2***	55.3	55.4	moderate
		tba	Motor Vehicle Sales, mln	Jul	***17.0***	16.9	16.7	still strong
			domestically built		**13.3**	13.3	13.1	seen flat or slightly higher
Next Week:								
Monday	8/04		no significant data					1892: Lizzie Borden took an axe…
Tuesday	8/05	10:00	Factory Orders	Jun	***+0.5%***	-0.7%	+0.8%	durable goods orders report at +0.7%
		10:00	ISM Non-Manf. Index	Jul	***55.8***	56.0	56.3	moderate
		1:00	Treasury Note Auction					3-year notes
Wednesday	8/06	8:30	Trade Balance, $bln	Jun	***NF***	-44.4	-47.0	seen a bit wider
			goods only		***NF***	-63.3	-65.7	some implications for GDP revisions
		9:00	Quarterly Refunding Annc.					is a 50-year bond on the way?
		1:00	Treasury Note Auction					10-year notes
Thursday	8/07	7:00	BOE Policy Decision					raising short-term rates?
		7:45	ECB Policy Decision					no move, but leaning toward easing
		8:30	Jobless Claims, th.	8/02	***314***	***310***	284	stabilizing at a low level
		1:00	Treasury Bond Auction					30-year bonds
Friday	8/08	8:30	NF Productivity (prelim.)	2Q14	***NF***	-3.2%	+2.3%	2Q revised to be revised lower
			Unit Labor Costs		***NF***	+5.7%	-0.6%	choppy

This Week…

Busy, busy, busy. Oddly, the Fed's policy decision is expected to be one of the least interesting items on the economic calendar. Another $10 billion taper in the pace of asset purchases is baked in and officials are unlikely to provide any additional clues on when short-term interest rates will begin to head higher. There's always a lot of uncertainty in the advance GDP estimate, and annual benchmark revisions are likely to shift recent figures around somewhat, but growth for the first half of the year can only be described as "disappointing." The July Employment Report is expected to be moderately strong, but the payroll estimate is subject to noise from seasonal adjustment.

Monday

Pending Home Sales Index (June) – The PHSI (which measures signed contracts) tends to lead the existing home sales figures (which measure closings), but there's a fair amount of variation in the data from month to month. While there are more important data releases this week, this could help set the tone.

Tuesday

Case-Shiller Home Price Index (May) – With an increased number of home on the market and many buyers struggling with affordability issues, home price increases are expected to slow down significantly in near term.

Conference Board Consumer Confidence (July) – In June, the headline figure was reported to have risen to its highest level since January 2008. Job market perceptions have gradually improved, but are still at depressed level.

Wednesday

ADP Payroll Estimate (July) – Market participants are well aware that the ADP estimate is a poor predictor of the official BLS number, but that doesn't mean that the markets won't react to a large surprise. The end of the school year is less of a factor for the ADP estimate, which is private-sector (although there are plenty of private-sector jobs in education).

Real GDP (2Q14 advance estimate, benchmark revisions) – The government is missing June figures on foreign trade, inventories, and a number of other components. Data for April and May suggested that real consumer spending (70% of GDP) was tracking at about a 1.4% annual rate in 2Q14. Data on durable goods shipments point to a moderate pace of business fixed investment. Inventories slowed sharply in 1Q14, subtracting from overall GDP growth, but the pace appears likely to have picked up in 2Q14, adding to overall growth. Trade figures for April and May suggest another drop in net exports, subtracting from GDP. Putting it all together, growth is likely to be moderate, but disappointing relative to the weak 1Q14 GDP figure. This release will include annual benchmark revisions (based on revised source data, no major changes in methodology), which typically shift some growth from one quarter to another, but don't change the level of GDP by much. While the markets are expected to react to the headline growth figure, one should really pay more attention to the key components (consumer spending, business fixed investment) and keep an eye out for revisions to the 1Q14 GDP figure. Remember, the 2Q14 figures will be revised and revised.

FOMC Policy Decision – The Federal Open Market Committee is widely expected to taper the monthly pace of asset purchases by another $10 billion (to $25 billion). However, policymakers are expected to provide no new clues about when short-term interest rates are likely to be raised.

Thursday

Jobless Claims (week ending July 25) – The summer spike in unadjusted claims has been more moderate this July, resulting in a drop in the adjusted figure in the first two weeks of the months. In turn, the adjusted figures are likely to be a bit above trend in the second half of the month. Note that the underlying trend appeared lower heading into July.

Employment Cost Index (2Q14) – The ECI includes benefits and is usually of interest to the financial markets only when there is a perceived threat of higher inflation (not the case currently). To gauge the inflationary impact from the labor market, one needs to account for what one is getting for the added labor expense, and that means adjusting for productivity.

Chicago Purchasing Managers Index (July) – The Chicago PMI, which is more concentrated in durables, is likely to remain relatively strong in July (but perhaps a bit more moderate).

Friday

Employment Report (July) – Seasonal adjustment is a bigger factor in July than in most other months. The end of the school year has a big effect on unadjusted jobs and unemployment. In July 2013, we lost 1.37 million education jobs and gained 226,000 otherwise. July layoffs appear to have been more moderate this year (a more moderate spike in unadjusted jobless claims), which creates some upside potential in the adjusted data. However, there is a fair amount of statistical noise in these figures, which can create some lumpiness in the monthly changes. It's not unusual to see a string of stronger or weaker payroll numbers. To the untrained eye, this appears as a strengthening or softening of overall job market conditions, but it's almost always reflective of statistical noise. Regardless, financial market participants are going to take the figures at face value (bond market BINGO). By most measures, job destruction is trending low and new hiring has picked up. Short-term unemployment is about normal, but long-term unemployment and underemployment remain elevated.

Personal Income and Spending (June) – Aggregate wage income picked up somewhat in June (according to the Employment Report). Spending appears to have been relatively lackluster. This release will include annual benchmark revisions.

ISM Manufacturing Index (July) – This release is almost certain to be overshadowed by the employment report. The headline figure is likely to reflect moderate strength in manufacturing activity, but results may be a bit mixed across industries.

Motor Vehicle Sales (July) – Replacement needs and easy credit should continue to drive vehicle sales in the near term.

Next Week …

The ISM Non-Manufacturing Index has market-moving potential, but isn't going to alter the big picture. Productivity figures, released Friday, never get much attention from the markets, but the data could add to the growing debate about whether the U.S. is facing a significant slowdown in productivity growth and what the consequences of that would be.

Coming Events and Data Releases

August 13	Retail Sales (July)
August 15	Industrial Production (July)
August 19	Building Permits, Housing Starts (July)
August 20	FOMC Minutes (July 29-30)
August 21	KC Fed Mon Policy Sym (focus: Labor Market)
September 1	Labor Day (markets closed)
September 5	Employment Report (August)
September 17	FOMC Policy Decision, Yellen press conference
October 29	FOMC Policy Decision (no press conference)
December 17	FOMC Policy Decision, Yellen press conference