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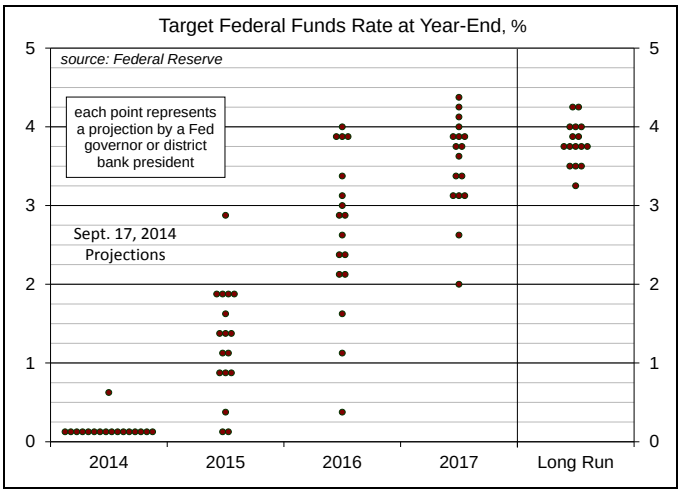
Weekly Market Monitor

The Dots

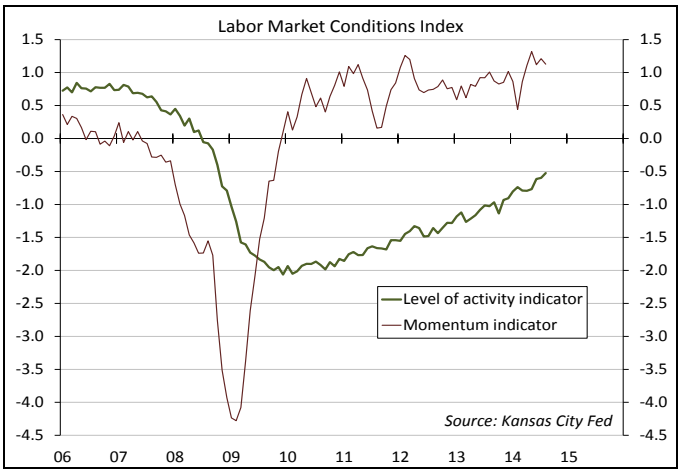
As was widely anticipated, Federal Reserve policymakers reduced the monthly pace of asset purchases by another $10 billion and kept the "considerable time" language. Fed policymakers revised slightly their forecasts of growth, unemployment, and inflation. However, the really interesting item in the Fed's Summary of Economic Projections was the dot plot, the projections of the appropriate year-end level of the federal funds rate for each of the next few years. There is a huge range of uncertainty among Fed officials.

In announcing its plans to normalize policy, the Federal Open Market Committee indicated that it will announce a range for the federal funds rate. The dot plots show the middle point of each Fed official's projection of the appropriate year-end range. The five Fed governors and 12 district bank presidents differ widely in their expectations for the federal funds rate at the end of 2015 (and implicitly, in their expectations of when the Fed will begin raising short-term rates). Projections of the federal funds rate at the end of 2016 are even more widely dispersed.



The 2015 projections suggest that there is not clear consensus among Fed officials regarding when the first rate hike will come. Implicitly, most appear to be almost evenly spread between March and September next year. In the Fed's next update of these projections (December 17), we should see the 2015 dots coalesce around a specific level, signifying a developing consensus for when the first rate hike will occur.

Why such a large range in the federal funds rate projections? Fed officials differ in their expectations for growth and inflation, but mostly in their perceptions of the amount of slack in the economy, especially in the job market. The unemployment rate has fallen significantly over the last few years, but the figure has been distorted by a drop in labor force participation. The baby-boomers began to reach retirement age just as the Great Recession got underway, making it difficult to isolate the demographic impact. Moreover, the unemployment rate does not reflect underemployment, the number of individuals who are involuntarily working part time but would prefer full-time employment, and those who are not searching for a job but would if the labor market were stronger.



There are many labor market indicators. Some suggest stronger conditions than others. As Fed Chair Yellen noted in her Jackson Hole speech, the Kansas City Fed's Labor Market Conditions Index, a composite of 24 job market gauges, provides a convenient summary. The trend in the LMCI through August is consistent with the view that the slack in the labor market is being taken up gradually, but that we still have a long way to go.

A weak trend in inflation-adjusted earnings is another sign of slack in the job market. Real average hourly earnings rose just 0.4% over the 12 months ending in August. That's not a lot of firepower for consumer spending growth. Thanks to job growth, you can still get growth in aggregate income, and in turn aggregate spending, but the lack of wage growth is a limiting factor for consumer spending growth (which accounts for 70% of Gross Domestic Product). Wage growth should pick up as the labor market tightens, but recent reports suggest little upward pressure on wages for the near term.

Fed Chair Yellen emphasized that rates could be raised *"sooner and more rapidly"* if the economy proves to be stronger than expected. Conversely, if economic performance disappoints, *"increases in the federal funds rate are likely to take place later and to be more gradual."* While there is a wide range in the projections of Fed officials, there is a high degree of uncertainty in the individual forecasts themselves. The decision to begin raising rates will be driven by the economic outlook, estimates of the amount of slack in the job markets, and assessments of how rapidly slack is being taken up. The recent economic data suggest that the Fed will be in no hurry to tighten.

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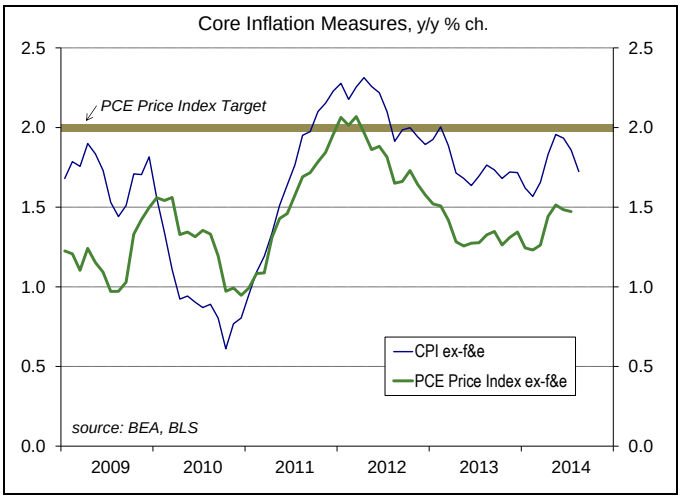
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
8/22/14	0.03	0.05	0.11	0.50	0.95	1.63	2.34	3.08	1.324	1.657	103.97	1.095	4538.55	1988.40	17001.22
9/12/14	0.02	0.05	0.11	0.58	1.07	1.83	2.62	3.35	1.296	1.624	107.24	1.108	4567.60	1985.54	16987.51
9/19/14	0.02	0.04	0.11	0.57	1.09	1.82	2.58	3.29	1.284	1.630	108.94	1.095	4579.79	2010.49	17280.51

Recent Economic Data and Outlook

The weak economic recovery has made it tough for a lot of kids to leave home, but enough about the Scottish Independence Referendum. Fed policymakers trimmed the monthly pace of asset purchases, on their way to ending QE at the end of October. More importantly, the Fed kept the "considerable time" phrase.



The **Federal Open Market Committee** reduced the monthly pace of asset purchases by another $10 billion. The FOMC repeated that conditions are likely to warrant an exceptionally low federal funds rate for a "considerable time" after the asset purchase program ends. The FOMC noted that *"economic activity is expanding at a moderate pace,"* while *"inflation has been running below the committee's longer-run objective."*

In the **Summary of Economic Projections**, Fed officials' expectations for the appropriate federal funds target rate for the next few years varied widely, suggesting no broad consensus of when short-term rates would begin to rise and how rapidly. Implicitly, the Fed expects GDP growth of 3.0% to 3.4% in the second half of 2014, and explicitly, 2.6% to 3.0% in 2015.

The FOMC issued a separate statement on its **Plans to Normalize Monetary Policy**. As previously indicated in the minutes of the July FOMC meeting, the Fed will announce a range for the federal funds rate (not a specific level) and will use the interest rate paid on excess reserves (IOER) as the main policy tool to keep the federal funds rate within its range. The size of the portfolio will be reduced by ending the reinvestment of principal payments sometime after the first rate increase.

In her press conference, **Fed Chair Yellen** noted that *"the labor market has yet to fully recover. There are still too many people who want jobs but cannot find them, too many who are working part time but would prefer full-time work, and too many who are not searching but would be if the labor market were stronger."*

The **Consumer Price Index** fell 0.2% in August (+1.7% y/y), reflecting a 2.6% decline in energy (+0.4% y/y). Ex-food & energy, the CPI was unchanged (+1.7% y/y) – a 1.8% annual rate in the first eight months of 2014 (vs. +1.7% for all of 2014).

Real Weekly Earnings rose 0.4% in August (also +0.4% y/y).

The **Producer Price Index** was flat in August (+1.8% y/y), up 0.1% ex-food & energy (+1.8% y/y).

Industrial Production fell 0.1% in August (+4.1% y/y). manufacturing output fell 0.4% (+4.0% y/y) reflecting a seasonal adjustment quirk in motor vehicles (down 7.6%, following a 9.1% rise in July). Ex-autos, factory output rose 0.1% (+3.3% y/y).

Building Permits fell 5.6% in August, to a 998,000 seasonally adjusted annual rate (+5.3% y/y). Single-family permits fell 0.8% (-0.8% y/y). **Housing Starts** sank 14.4%, to a 956,000 pace (+8.0% y/y), with single-family starts down 2.4% (+4.2% y/y).

Homebuilder Sentiment jumped to 59 in September, the highest level since November 2005.

Based on unemployment insurance tax receipts, the Bureau of Labor Statistics' estimate of the **Annual Benchmark Revision** to nonfarm payrolls (to be implemented in early February 2015) raises the March 2014 level of payrolls by a mere 7,000 (less than 0.05%) – that's really small.

The Index of **Leading Economic Indicators** rose 0.2% in August.

Scotland voted "no" on independence from the U.K.

Economic Outlook (3Q14): 2.5% to 3.0%

Employment: Job growth has been strong this year, reflecting a limited amount of job destruction and a pickup in hiring. However, a considerable amount of slack remains.

Consumers: Real average earnings are trending about flat, which will limit the pace of improvement in spending, but job growth is a key driver in the aggregate.

Manufacturing: Mixed results across industries, but mostly strengthening. Weakness in Europe and a stronger dollar should have a negative impact on export growth.

Housing/Construction: Affordability issues have been a constraint at the middle level and below. Supply constraints remain an issue for many builders, but should fade over time.

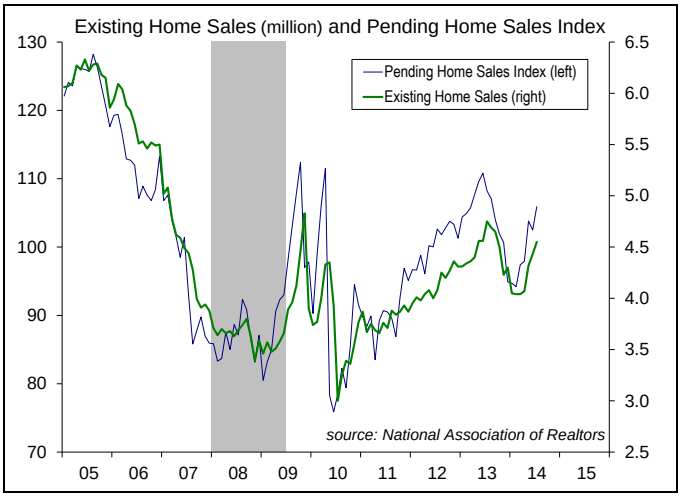
Prices: The PCE Price Index, the Fed's chief inflation gauge, remains well below the Fed's 2% target on a y/y basis. Pipeline pressures appear mild. Wage pressures are limited. Inflation expectations remain well-anchored.

Interest Rates: The tapering of the Fed's monthly pace of asset purchases should be completed at the end of October. Short-term interest rates are expected to remain exceptionally low *"for a considerable time"* after the asset purchase program ends. The Fed's policy moves in 2015 will be dictated by the evolution of the economic outlook in the second half of 2014.

This Week:					*forecast*	last	last –1	comments
Monday	9/22	10:00	**Existing Home Sales, mln.**	Aug	***5.20***	5.15	5.03	seen slightly higher
			% change		***+1.0***	+2.4	+2.4	a moderately strong pace
Tuesday	9/23	9:45	Markit US Manf PMI (flash)	Sep	***NF***	57.9	55.8	not market-moving
		10:00	Philly Fed Non-Manf. Index	Sep	***NF***	NA	NA	new
		1:00	Treasury Note Auction					2-year notes
Wednesday	9/24	10:00	**New Home Sales, th.**	Aug	***425***	412	422	these data are very noisy
			% change		***+3.2***	-2.4	-7.0	watch for revisions
		1:00	Treasury Note Auction					5-year notes
Thursday	9/25	8:30	Jobless Claims, th.	9/20	***297***	280	316	a bit noisy, but a continued to trend
		8:30	**Durable Goods Orders**	Aug	***-19.4%***	+22.6%	+2.7%	aircraft orders come back to earth
			ex-transportation		***+0.5%***	-0.7%	+3.0%	seen somewhat higher
			nondef cap gds ex-aircraft		***+0.4%***	-0.7%	+5.4%	choppy
		1:00	Treasury Note Auction					7-year notes
Friday	9/26	8:30	**Real GDP (3rd estimate)**	2Q14	***+4.6%***	***-2.1%***	+3.5%	+4.2% in the 2nd estimate, seen higher
		9:55	UM Consumer Sentiment	Sep	***85.0***	82.5	81.2	84.6 at mid-month
Next Week:								
Monday	9/29	8:30	Personal Income	Aug	***+0.4%***	+0.2%	+0.5%	a rebound in wage growth
			Personal Spending		***+0.5%***	-0.1%	+0.4%	making up for soft July
			PCE Price Index		***+0.1%***	+0.1%	+0.1%	mild core inflation
		10:00	Pending Home Sales Index	Aug	***NF***	+3.3%	-1.3%	choppy
Tuesday	9/30	9:00	Case-Shiller Home Prices	Jul	***-0.1%***	-0.2%	-0.3%	seen a bit lower (seasonally adjusted)
			year-over-year		***+7.4%***	+8.1%	+9.4%	gap slowing
		9:45	Chicago PM Index	Sep	***62.0***	64.3	52.6	still relatively strong
		10:00	**Consumer Confidence**	Sep	***92.6***	92.4	90.3	a gradual trend higher
Wednesday	10/01	8:15	ADP Payroll Estimate, th.	Sep	***+190***	+204	+212	moderately strong
		9:45	Markit Us Manf PMI (final)		***NF***	57.9	55.8	not market-moving
		10:00	Construction Spending	Aug	***-0.6%***	+1.8%	-0.9%	seen lower
		10:00	**ISM Manf. Index**	Sep	***58.0***	59.0	57.1	moderate strength
		tba	Motor Vehicle Sales, mln	Sep	***16.9***	17.4	16.4	seen falling back somewhat
			domestically built		***13.4***	13.9	12.9	still a strong trend
Thursday	10/02	7:45	ECB Policy Decision					unlikely to move again, but more to come
		8:30	Jobless Claims, th.	9/20	***295***	***297***	280	still trending low
		10:00	Factory Orders	Aug	***NF***	+10.5%	+1.5%	lower aircraft orders
Friday	10/03	8:30	**Nonfarm Payrolls, th.**	Sep	***+190***	***+142***	+212	seen moderately strong
			private-sector		***+180***	***+134***	+213	rebounding from July's special factors
			Unemployment Rate		***6.0%***	***6.1%***	6.2%	trending lower
			employment/population		***59.1%***	***59.0%***	59.0%	trending gradually higher
			Avg. Weekly Hours		***34.5***	***34.5***	34.5	steady
			Avg. Hourly Earnings		***+0.2%***	***+0.2%***	+0.1%	mild wage pressures
		8:30	Trade Balance, $bln	Aug	***-40.0***	***-40.5***	-40.8	seen down a bit
			goods only		***-59.7***	***-60.2***	-60.4	lower oil prices, softer exports
		10:00	ISM Non-Manf. Index	Sep	***58.2***	59.6	58.7	moderately strong

This Week…

The financial markets could react to any surprises in the economic data (if sufficiently far from expectations), but the reports are not going to alter the larger economic picture. The reports on new home sales and durable goods orders are notoriously choppy. The estimate of 2Q14 GDP growth is expected to be revised higher, but combined with the weak 1Q14 number, the first half of the year should still appear lackluster. The economic data for next week, including the September Employment Report, will be much more important.



Monday

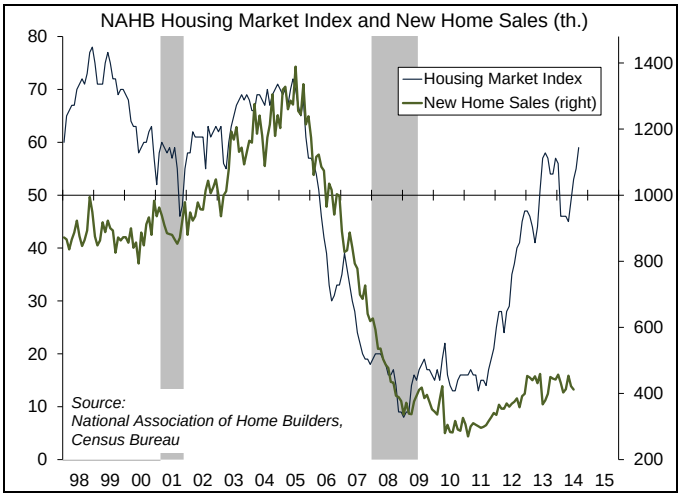
Existing Home Sales (August) – Existing home sales have exhibited an odd pattern over the last year, slumping as mortgage rates rose, but improving more recently. The figures tend to be led by the Pending Home Sales Index, which was reported to have risen 3.3% last month.

Tuesday

Philadelphia Fed Non-Manufacturing Index (September) – The Philly Fed's Manufacturing Index is the oldest regional manufacturing survey (conducted since 1968). This release will be the district's first survey results for the services sector, and will include sub-indices on business activity, new orders, sales or revenues, employment, prices, and capital expenditures.

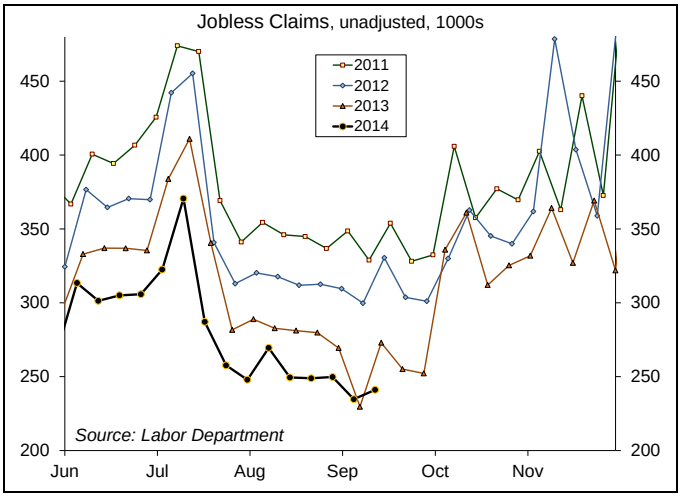
Wednesday

New Home Sales (August) – Homebuilder sentiment has improved, but there's little relationship between that and the pace of new home sales. Supply constraints are still an issue, but the soft trend largely reflects affordability issues. Job growth is a positive factor for home sales, but the lack of real wage growth for the typical worker is restraining the pace of improvement. Note that these figures are reported with a large degree of uncertainty. The numbers tend to be choppy from month to month and are subject to relatively large revisions.

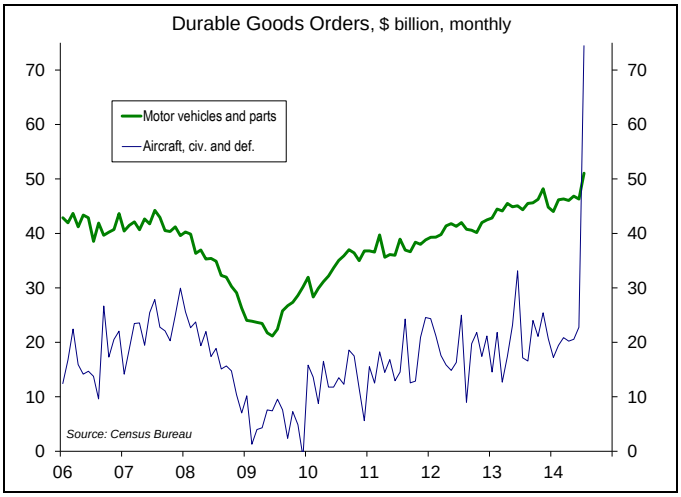


Thursday

Jobless Claims (week ending September 20) – Figures for the last few weeks have been distorted due to the difficulties in adjusting for the Labor Day holiday. However, the underlying trend has remained low, consistent with improving labor market conditions. Note that the figures are subject to increased distortions in the last few months of the year.



Durable Goods Orders (August) – In July, aircraft orders at Boeing spiked sharply higher and orders for motor vehicles were exaggerated by the seasonal adjustment. These effects should reverse in the August data, dominating the headline figure (but watch for revisions). Ex-transportation, orders are likely to be mixed, but moderately higher overall. The details of the recent factory sector data suggest that we're not firing on all cylinders. Some industries are doing better than others. Soft global growth is expected to be a restraining factor for exports, but domestic demand should continue to improve. Keep an eye on the nondefense capital goods ex-aircraft data, which have been suggesting relatively good strength in business fixed investment.



Friday

Real GDP (2Q14, 3rd estimate) – The 3rd estimate of GDP used to be a nonevent. However, with more detailed service sector data now being published, the 3rd estimate (second revision) to the GDP growth figure is more interesting. Those data, along with revisions to the other components data, point to an upward revision to the second quarter growth figure.

Next Week …

September economic data begin to arrive. The focus is expected to be on the employment figures, which should reflect a rebound from temporary factors in August.

Coming Events and Data Releases

October 8	FOMC Minutes (September 16-17)
October 13	Columbus Day (bond market closed)
October 29	FOMC Policy Decision (no press conference)
November 4	Election Day
October 29	Employment Report (October)
December 17	FOMC Policy Decision, Yellen press conference
January 28	FOMC Policy Decision (no press conference)
March 18	FOMC Policy Decision, Yellen press conference
April 29	FOMC Policy Decision (no press conference)
June 17	FOMC Policy Decision, Yellen press conference