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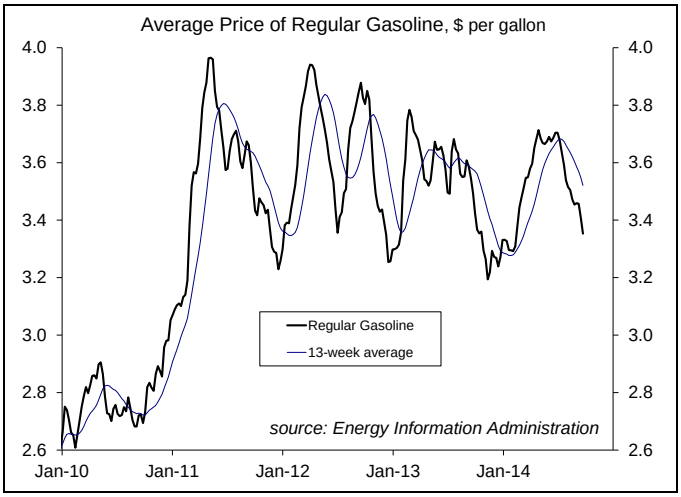
Weekly Market Monitor

Looking Back, Looking Ahead

Real GDP is now estimated to have risen at a 4.6% annual rate in 2Q14. However, the second quarter's strength must be balanced against the first quarter's weakness (a -2.1% pace). As the third quarter ends, we still don't have a complete picture. However, figures are likely to suggest a moderately strong pace of growth and a gradual taking up of economic slack.

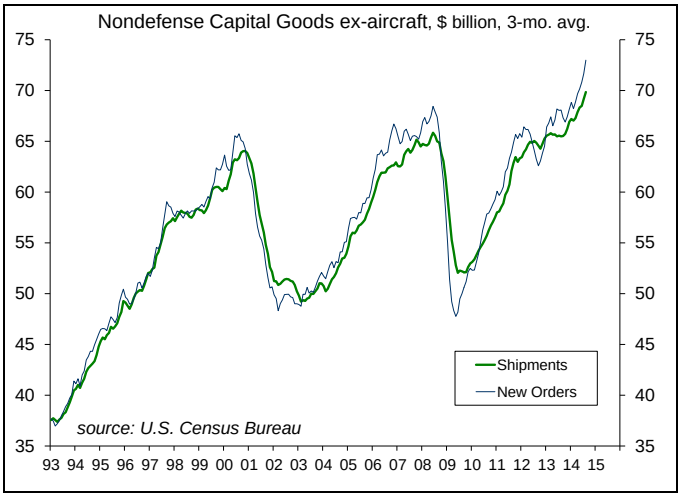
Consumer spending accounts for 70% of Gross Domestic Product. Inflation adjusted spending fell 0.2% in the initial estimate for July, following a 0.2% gain in June – suggesting very little positive momentum into the early part of 3Q14. Those figures will be subject to revision in this Monday's report on personal income and spending. The August spending figures and September auto sales data will help to fill in the consumer picture for 3Q14. Motor vehicle sales snapped higher in August, which should drive overall spending up.



Weak growth in real average wages has been a restraining factor for consumer spending in recent months. Labor compensation has been rising roughly 2% year-over-year, vs. a normal pace of 3.5% to 4.0%. The average worker is barely keeping up with inflation. Lower gasoline prices ought to help in the remainder of the year. Retail gasoline prices normally fall about 12% between May and December. They've already fallen 8.7% this year. Spending less to fill their gas tanks, consumers should be left with more to spend on other things over the next few months. The 13-week average is good for gauging the lagged impact on consumer spending.

Market participants tend to put a lot of weight on consumer attitude measures, but spending is driven largely by income, wealth, and the consumer's ability to borrow. Given these factors, consumer attitude measures don't add much explanatory power. However, they do tend to summarize the overall strength of consumer fundamentals.

Business cycles are characterized by swings in capital expenditures. Business fixed investment rises in economic expansions and crashes in recessions. The aftermath of the tech bubble was large, but the pullback in investment in the financial crisis was a lot steeper. The monthly data on shipments and new orders tend to be choppy, but the three-month averages have shown a strong trend in recent months. Business fixed investment rose at 1.2% annual rate in the first quarter, but accelerated to a 9.7% pace in the second. Data for July and August suggest continued strength in the third quarter.



Capital expenditures are driven largely by profits, although businesses are not going to expand if they don't think the demand will be there. Recent strength in capital spending suggests a renewed optimism regarding economic growth over the next several quarters. Note that firms have a tendency to hire new workers as they increase capital expenditures. Hence, good economic news could feed on itself.

Faster inventory growth added 1.4 percentage points to GDP growth in 2Q14 (vs. -1.2 ppt in 1Q14). While we have limited information at this point, inventory growth is likely to have slowed in 3Q14, subtracting from overall growth.

Global growth has been a lot weaker than expected this year. The dollar is a lot stronger. Hence, export growth ought to be restrained in the months ahead and imports (which have a negative sign in the GDP calculation) should be somewhat stronger. However, while foreign trade is likely to limit the overall pace of GDP growth in the next few quarters, domestic demand is likely to be significantly stronger.

Where does this put Federal Reserve policymakers? The key questions are how much slack remains in the economy and how rapidly that slack is being taken up. A low inflation environment allows the Fed more time to make these assessments.

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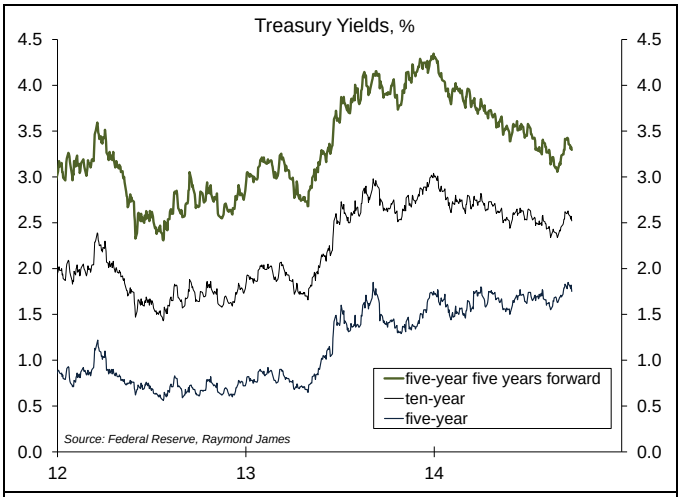
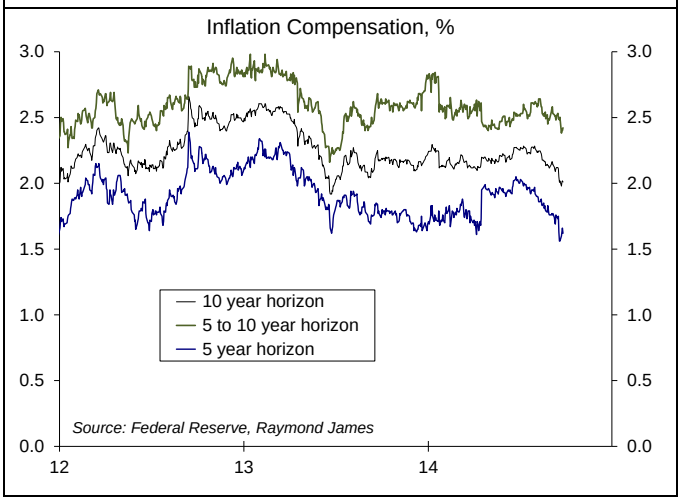
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
8/29/14	0.03	0.05	0.09	0.48	0.94	1.63	2.35	3.09	1.315	1.659	104.00	1.086	4580.27	2003.37	17098.45
9/19/14	0.02	0.04	0.11	0.59	1.09	1.83	2.59	3.29	1.284	1.631	108.96	1.097	4579.79	2010.40	17279.74
9/26/14	0.01	0.04	0.10	0.58	1.06	1.80	2.53	3.22	1.268	1.624	109.28	1.115	4512.19	1982.85	17113.15

Recent Economic Data and Outlook

The economic data were mixed, but did not have a big impact on the markets. Fed officials were generally dovish in their speeches. Equities fell sharply on Thursday.





Real GDP rose at a 4.6% annual rate in the 3rd estimate (vs. 4.2% in the 2nd estimate and 4.0% in the advance estimate). Consumer spending rose at a 2.5% annual rate (vs. 2.5% in the 2nd estimate), while business fixed investment rose 9.7% (revised from 8.4%). Domestic Final Sales (GDP less net exports and the change in inventories rose 3.4%, vs. +0.7% in 1Q14, which averages out to 2.1% (not great, but not horrible either). Faster inventory accumulation added 1.4 percentage points to 2Q14 GDP growth, but the pace is expected to have slowed (subtracting from GDP growth) in 3Q14.

Durable Goods Orders fell 18.1% in August, reflecting an unwinding of July's spike in civilian aircraft orders and a seasonal quirk in autos. Transportation orders fell 42.0% (motor vehicles -6.4%, civilian aircraft -74.3%, defense aircraft -0.6%). Ex-transportation, orders rose 0.7%, with mostly moderate gains across sectors (primary metals -0.7%, fabricated metals +0.3%, machinery +0.7%, computers and electronics +1.7%, electrical equipment and appliances +3.1%). For nondefense capital goods ex-aircraft, orders rose 0.6% (following -0.2% in July and +5.4% in June), while shipments edged up 0.1% (following +1.9% in July and +1.0% in June – an 11.1% annual rate for the first two months of 3Q14 vs. 2Q14).

New Home Sales surged 18.0% in August (±16.3%), to a 504,000 seasonally adjusted annual rate (+33.0% y/y, ±21.7%). Two-thirds of the gains were in the West (+50.0% y/y).

Existing Home Sales fell 1.8% in August, to a 5.05 million seasonally adjusted annual rate (-5.3% y/y). According to the National Association of Realtors, there was "a marked declined" in all-cash sales from investors.

The **Chicago Fed National Activity Index** fell to -0.21 in August, from a revised +0.26% in July (that largely reflects the seasonal adjustment quirk in autos). The three-month average was +0.07, consistent with the economy growing slightly above its long-term trend (but not by a lot).

The **UM Consumer Sentiment Index** rose to 84.6 in September, unchanged from the mid-month level and the second highest reading in the last seven years. The report noted that "improved income expectations have the potential to reinvigorate personal financial optimism (the key driving force behind large discretionary expenditures," but cautioned that "it will take repeated and cumulative gains to reverse the impact of stagnant incomes on spending."

Economic Outlook (3Q14): GDP growth of around 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	9/29	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%	core CPI rose 0.014%
		10:00	Pending Home Sales Index	Aug	***-0.5%***	+3.3%	-1.3%	choppy, likely a bit lower
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	***61.8***	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	57.9 in flash estimate
		10:00	Construction Spending	Aug	***-0.6%***	+1.8%	-0.9%	seen lower
		10:00	**ISM Manf. Index**	Sep	***58.2***	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 now, but QE to come
		8:30	Jobless Claims, th.	9/27	***296***	293	281	a low trend
		10:00	Factory Orders	Aug	***-10.1%***	+10.5%	+1.5%	durables reported down 18.2%
Friday	10/03	8:30	**Nonfarm Payrolls, th.**	Sep	***+195***	***+142***	+212	seen moderately strong
			private-sector		***+185***	***+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	***58.4***	59.6	58.7	moderately strong
Next Week:								
Monday	10/06		no significant data					Karol Szymanowski born 1882
Tuesday	10/07	10:00	JOLTS: hiring rate	Aug	***NF***	3.5	3.5	still suggesting slack
			JOLTS: quit rate		***NF***	1.8	1.8	still suggesting slack
		1:00	Treasury Note Auction					3-year notes
Wednesday	10/08	11:00	Labor Mkt Conditions Index	Sep	***NF***	-0.524	-0.597	slack being taken up, but gradually
		1:00	Treasury Note Auction					re-opened 10-year notes
		2:00	**FOMC Minutes**	9/17				some new details in the Fed discussion
Thursday	10/09	7:45	BOE Policy Decision					no change
		8:30	Jobless Claims, th.	10/04	***294***	***296***	293	still low
		1:00	Treasury Bond Auction					re-opened 30-year bonds
Friday	10/10	8:30	Import Prices	Sep	***NF***	***-0.9***	-0.3	falling
			ex-food & fuels		***NF***	***0.0***	-0.1	no inflation pressure from abroad
		2:00	Treasury Budget, $bln	Sep	***+84.0***	***+75.1***	+75.2	release date and time tentative
			cumulative	FY14	***-505***	-680	-1089	less than 3% of GDP

This Week…

There are a lot of important economic data releases. While surprises in any of these could generate reactions in the financial markets, most of the weight will be on the employment report. Seasonal adjustment of payrolls can be tricky in September (due to the start of the school year) and the total should be biased higher due to an unwinding of special factors that subtracted from August.

Monday

Personal Income and Spending (August) – The markets usually don't pay much attention to these figures (we get a good idea of wage income from the employment report and retail sales set the outlook for overall consumer spending). However, the consumer spending figures are a direct input into GDP (accounting for 70%). In addition, the PCE Price Index is the Fed's official measure of inflation (expected to continue trending below the 2% target for some time).

Pending Home Sales Index (August) – The PHSI tends to lead existing home sales, but can be choppy from month to month.

Tuesday

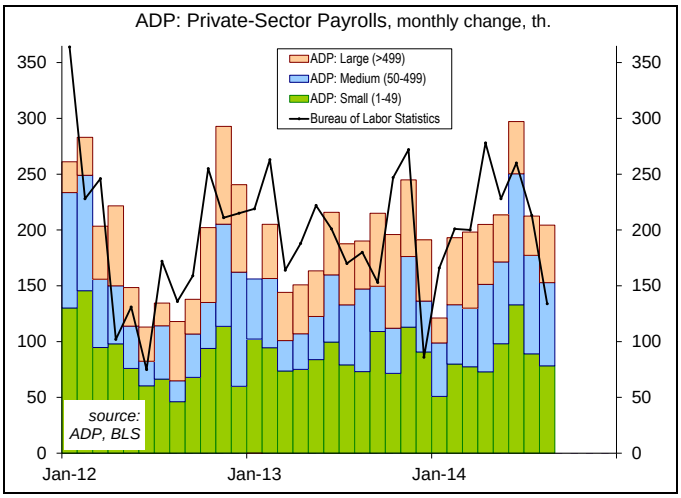
Case-Shiller Home Price Index (July) – Seasonally adjusted home prices have pulled back in recent months, likely reflecting less speculation from real estate investors (following a sharp rise last year), affordability issues, and relatively tight credit.

Chicago PM Index (September) – Strong for most of this year, the headline figure dipped in July, but rebounded in August.

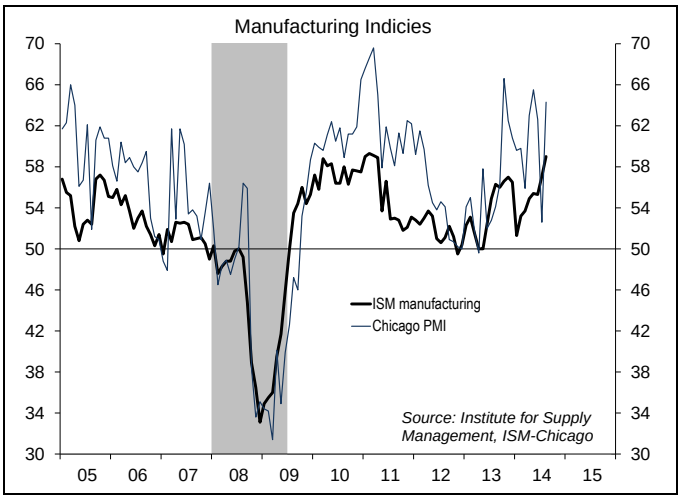
Consumer Confidence (September) – Spending is dependent on income, wealth, and the ability to borrow. Consumer attitudes don't add much to the equation, but are reflective of the overall health of the household sector. Evaluations of current labor market conditions have improved over the last several months, but are still poor by historical standards. Household income expectations, less optimistic in August, should rebound.

Wednesday

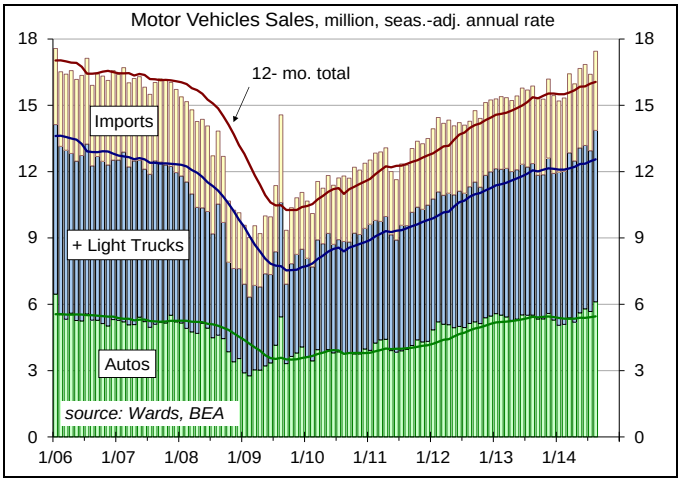
ADP Payroll Estimate (September) – The trend has been strong this year, with solid gains for small and medium-sized firms.



ISM Manufacturing Index (September) – The ISM survey have indicated strength recently, but other data (new orders and production) have been mixed across sectors.



Motor Vehicle Sales (September) – Incentives helped sales to rebound in August, but we're likely to see some moderation in September. Replacement needs and relatively easy credit should continue to provide support in the near term.



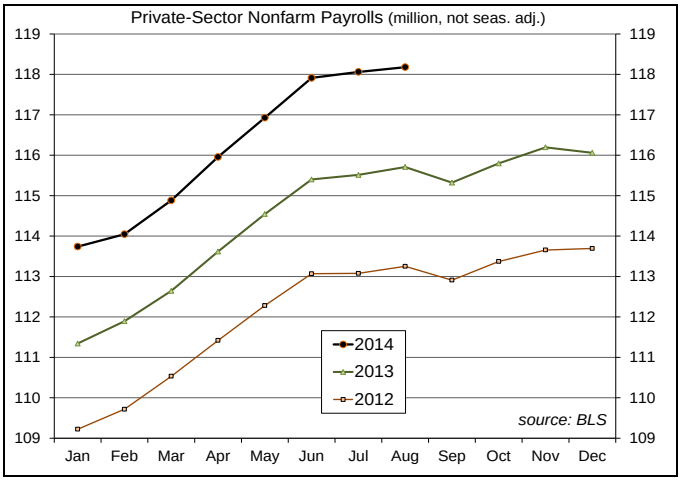
Thursday

Jobless Claims (week ending September 27) – The underlying trend has remained low, consistent with an economy fully hitting its stride, but other measures continue to show slack.

Factory Orders (August) – Durable goods orders (subject to revision in this release) were reported at -18.2%. Lower petroleum prices should push down orders for nondurables. Orders and shipments of nondefense capital goods ex-aircraft point to a strong quarter for business investment.

Friday

Employment Report (September) – August payroll figures were biased lower by a seasonal quirk in autos and by labor disruptions at a New England grocery chain. We should see a bounce-back of 25,000 to 30,000 in September as these effects unwind. Due to the start of the school year and the end of the summer, seasonal adjustment is a major issue in September. We can expect to gain over 1.4 million education jobs (public and private) and to lose over 800,000 non-education jobs. Remember also that the payroll figure is reported accurate to ±90,000. The unemployment rate is likely to edge lower, but seasonal adjustment may add some noise.



Next Week …

It should be a very quiet week. The Fed policy meeting minutes could be a catalyst for market action, provided something is taken out of context and blown up disproportionately.

Coming Events and Data Releases

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