RAYMOND JAMES

Economic Research
Published by Raymond James & Associates

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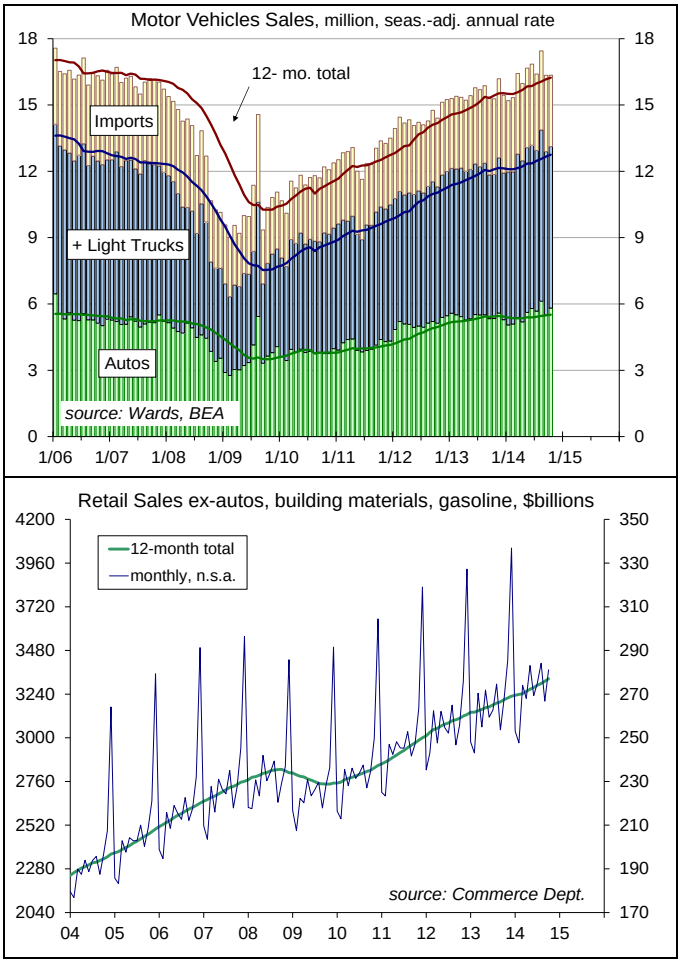
November 17 - 21, 2014

Weekly Market Monitor

A Mixed Bag, But Optimistic on the Consumer

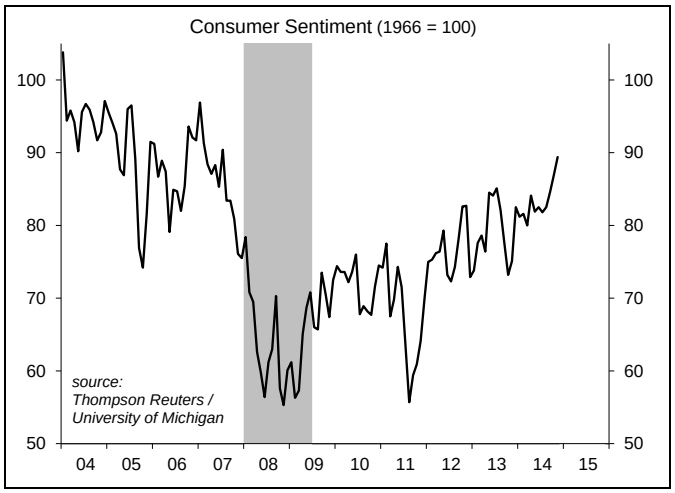
Inflation-adjusted consumer spending growth, 70% of Gross Domestic Product, rose at a lackluster 1.8% annual rate in the advance estimate for 3Q14. That figure is likely to be revised higher, but the pace is expected to remain disappointing relative to job growth (this year, we are on track to post the largest increase in jobs since 2005). The main restraint on spending appears to be the weak trend in average wages. Until the job market tightens a lot more, we're unlikely to see a significant pickup in wage growth. However, lower gasoline prices will add to consumer purchasing power in the near term.



Prior to the recession, motor vehicle sales were fueled partly by the extraction of home equity (which dried up during the downturn). Motor vehicle sales have improved gradually since the recession ended, reflecting a simple story: 1) Cars get old and have to be replaced, and 2) banks are willing to make auto loans (it's a lot easier to repossess a car than a home). With the pace of vehicle sales now back to the pre-recession level, it's unclear whether we'll see that trend level out.

Core retail sales have risen at a moderate pace in recent months. The October retail sales report showed a modest upward revision to figures for August and September. Obviously, there's a significant seasonal pattern in unadjusted sales, with a sharp spike in December. As a rough rule of thumb, the back-to-school season is a good predictor of holiday sales. This year's back-to-school results were relatively lackluster.

Inflation-adjusted wage growth has been weak in recent months, but lower gasoline prices are adding to purchasing power. As noted previously, the impact on the consumer depends on how low gasoline prices go and how long they stay low, but it also arrives with a lag. While lower gasoline prices restrained the retail sales total for October, the added purchasing power should help to support inflation-adjusted spending in November and December. Yet, it's important to remember that gasoline prices normally fall about 12% from May to December. This year, they've fallen a little over 20% since late June. So, the decline in gasoline prices is not as impressive as one might think. Moreover, lower gasoline prices may simply offset the impact of sluggish wage growth, leading to only moderate spending growth in the near term.



One area where we may be seeing an impact of lower gasoline prices is in consumer sentiment. Consumers don't spend confidence. Spending is driven primarily by income, although wealth and the ability to borrow are also factors. Still, attitude measures are often a reflection of consumer fundamentals in general. Hence, this is still a positive story.

Gasoline futures are suggesting that there is more room for retail gasoline prices to fall and that they are likely to stay relatively low in the first half of 2015. That's helpful for the consumer spending outlook. We still need to see a greater pickup in wage growth, but we should get there in the months ahead as the labor market continues to improve.

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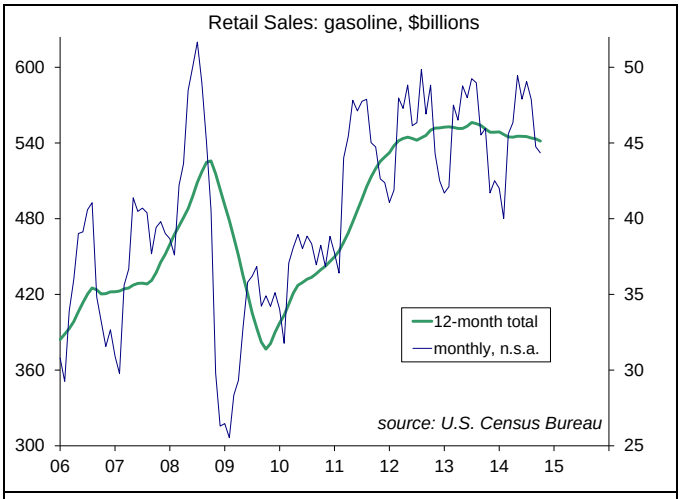
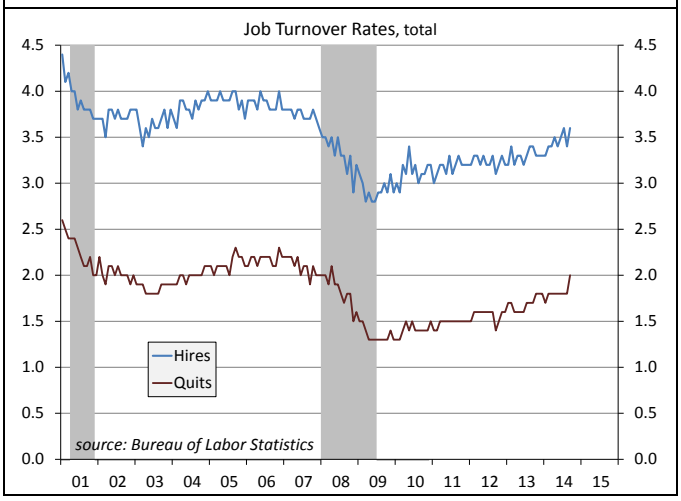
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
10/17/14	0.02	0.05	0.11	0.39	0.79	1.44	2.22	2.98	1.276	1.609	106.72	1.125	4258.44	1886.76	16380.41
11/07/14	0.03	0.06	0.12	0.51	0.95	1.60	2.32	3.04	1.242	1.584	114.73	1.136	4632.53	2031.92	17573.93
11/14/14	0.01	0.07	0.15	0.52	0.96	1.61	2.32	3.05	1.253	1.567	116.28	1.127	4688.54	2039.88	17635.96

Recent Economic Data and Outlook

The economic calendar was thin. Retail sales figures for October were not far from expectations.





Retail Sales rose 0.3% in October (+4.1% y/y), with very little revision to August and September. Ex-autos, sales rose 0.3% (+3.3% y/y), vs. unchanged in September (revised from -0.2%). Auto sales rose 0.5% (+7.6% y/y) – note that the Bureau of Economic Analysis uses the unit sales figures (reported by the automakers) in calculating GDP. Sales of building materials and garden supplies rose 0.4% (+6.4% y/y). Sales of gasoline fell 1.5% (-0.9% before seasonal adjustment, -4.0% y/y). Ex-autos, building materials, and gasoline, sales rose 0.6% (+4.1% y/y), with small upward revisions to August and September.

Business Inventories rose 0.3% in September (+5.3% y/y), somewhat more than was assumed in the advance GDP report. Retail inventories, the only new information in the report, rose 0.3% (autos +0.4%, ex-autos +0.2%). Manufacturing inventories rose 0.2% and wholesale inventories rose 0.3%. Business sales (factory shipments plus wholesale and retail sales) were flat in September, up 4.1% y/y. These figures are not adjusted for price changes (for example, lower petroleum prices).

Import Prices fell 1.3% in October (-1.8% y/y), reflecting a 6.9% drop in petroleum (-11.1% y/y). Ex-food & fuels, import prices slipped 0.2% (+0.1% y/y). Ex-food & fuels, prices of imported industrial supplies and materials fell 0.7% (-0.1% y/y). There was no pressure in imported capital equipment (-0.1% y/y), autos (-0.7% y/y), or other consumer goods (+0.7% y/y).

The **Job Opening and Labor Turnover Survey** data through September suggested a trend of gradual reduction in labor market slack (still far from normal). The hiring rate rebounded to 3.6%, vs. 3.4% in August and 3.4% a year earlier. The quit rate rose to 2.0%, vs. 1.8% in August and 1.7% a year ago.

The Index of **Small Business Optimism** rose to 96.1 in October, vs. 95.3 in September and 96.1 in August – little changed over the last six months and still relatively low by historical standards. Details were mixed. The earnings trend remained weak. Sales expectations were moderate. The general business outlook was a bit pessimistic. Hiring plans were moderate.

Real GDP for the **euro area** rose 0.2% (q/q) in 3Q14 (vs. +0.1% in 2Q14, up 0.8% y/y). Germany rose 0.1% (vs. -0.1%, up 1.2% y/y). France rose 0.3% (vs. -0.1%, up 0.4% y/y). Italy fell 0.1% (vs. -0.2%, -0.4% y/y). In comparison, U.S. GDP rose 0.9% (q/q) in the advance estimate for 3Q14, up 2.3% y/y.

Economic Outlook (4Q14): GDP growth of 2.5% to 3.0%

Employment: Job destruction is very low. New hiring does not appear to have been restrained much by global worries.

Consumers: Lack of real wage growth restrained the pace of consumer spending growth in the summer, but lower gasoline prices should provide some support in the near term.

Manufacturing: Mixed, but moderately strong overall. Restraints (on exports) from European weakness should be offset by strength in domestic demand.

Housing/Construction: Affordability issues have remained a constraint for the middle of the market and below. Supply constraints have been an issue for builders, but are fading.

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: With the Fed's large-scale asset purchases (QE3) completed, short-term interest rates are expected to remain exceptionally low *"for a considerable time."* 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	11/17	8:30	Empire St. Manf. Index	Nov	***8.5***	6.2	27.5	likely moderate (but a bit erratic)
		9:15	**Industrial Production**	Oct	***+0.2%***	+1.0%	-0.2%	mixed (watch for revisions)
			Manufacturing Output		***+0.3%***	+0.5%	-0.5%	aggregate hours edged up 0.1%
			Capacity Utilization		***79.2%***	79.3%	78.7%	little changed
			Manufacturing		***78.2%***	78.1%	77.9%	no pressure for inflation
Tuesday	11/18	8:30	**Producer Price Index**	Oct	***-0.2%***	-0.1%	0.0%	lower energy prices
			ex-food & energy		***+0.1%***	0.0%	+0.1%	mild core inflation
		10:00	Homebuilder Sentiment		***56***	54	59	should rebound somewhat
Wednesday	11/19	8:30	**Building Permits, th.**	Oct	***1045***	1031	1003	seen somewhat higher
			% change		***+1.4***	+2.8	-5.1	single-fam strength, multi-fam volatility
			Housing Starts		***1025***	1017	957	moderately strong
			% change		***+0.8***	+6.3	-12.8	but watch for revisions
		2:00	**FOMC Minutes**	10/29				how much worry about low inflation?
Thursday	11/20	8:30	Jobless Claims, th.	11/15	***282***	***290***	278	Veterans Day adjustment may add noise
		8:30	**Consumer Price Index**	Oct	***-0.1%***	+0.1%	-0.2%	lower gasoline prices
			year-over-year		***+1.6%***	+1.7%	+1.7%	little changed
			ex-food & energy		***+0.1%***	+0.1%	0.0%	mild core inflation
			year-over-year		***+1.7%***	+1.7%	+1.7%	low and steady
		8:30	Real Earnings	Oct	***+0.5%***	+0.2%	+0.5%	nominal earnings +0.4%
		10:00	Philadelphia Fed Index	Nov	***15.0***	20.7	22.5	moderate (but uneven month to month)
		10:00	**Existing Home Sales, mln**	Oct	***5.25***	5.17	5.05	seen a bit higher
			% change		***+1.5***	+2.4	-1.8	some moderation in speculative buying
		10:00	Leading Econ Indicators	Oct	***+0.7%***	+0.8%	+0.0%	stocks down, other components will add
		1:00	TIPS Auction					re-opened 10-year TIPS
Friday	11/21		no significant data					note: 4 weeks between T-day & Xmas
Next Week:								
Monday	12/24	1:00	Treasury Note Auction					2-year notes
Tuesday	11/25	8:30	**Real GDP (2nd estimate)**	3Q14	***+3.3%***	+4.6%	-2.1%	+3.5% in the advance estimate
		9:00	Case-Shiller (national)	Sep	***+0.3%***	+0.4%	+0.1%	broad-based improvement, but gradual
			year-over-year		***+4.4%***	+5.1%	+5.6%	moderate
			Case-Shiller (20-city)		***0.0%***	-0.1%	-0.5%	less speculative buying in key cities
			year-over-year		***+4.5%***	+5.6%	+6.7%	narrowing
		10:00	**Consumer Confidence**	Nov	***95.8***	94.5	89.0	watch for revisions to October
		11:30	Treasury FRN Auction					re-opened 2-yr Floating Rate Notes
		1:00	Treasury Note Auction					5-year notes
Wednesday	11/26	8:30	Jobless Claims, th.	11/15	***280***	***282***	278	choppy, but a low trend
		8:30	Personal Income	Oct	***+0.5%***	+0.2%	+0.3%	a pickup in wage income
			Personal Spending		***+0.3%***	-0.2%	+0.5%	restrained a bit by lower gasoline prices
			PCE Price Index ex-f&e		***+0.1%***	+0.1%	+0.1%	mild core inflation
		8:30	**Durable Goods Orders**	Oct	***+0.7%***	-1.1%	-18.3%	seen rebounding
			ex-transportation		***+0.6%***	-0.1%	+0.7%	mixed, but a moderate pace
			nondef cap gds ex-aircraft		***+0.6%***	-1.6%	+0.4%	seen higher
		9:45	Chicago PMI	Nov	***62.0***	66.2	60.5	moderately strong
		9:55	Consumer Sentiment	Nov	***90.0***	86.9	84.6	89.4 at mid-month
		10:00	**New Home Sales, th.**	Oct	***460***	467	466	a moderate pace
			% change		***-1.5***	+0.2	+15.3	watch for revisions
		10:00	Pending Home Sales Index	Oct	***+0.5%***	+0.3%	-1.0%	seen somewhat higher
		1:00	Treasury Note Auction					7-year notes
Thursday	11/27		Thanksgiving					mmmm, tryptophan…
Friday	11/28		no significant data					markets close early

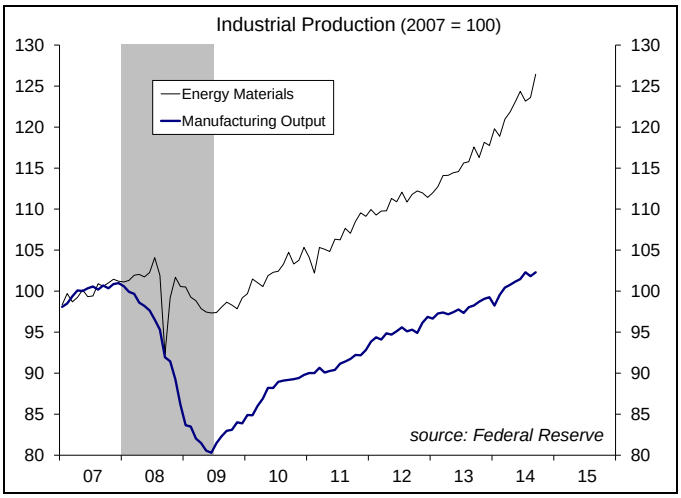
This Week…

The economic calendar picks back up, with plenty of potentially market-moving data releases. However, the Fed policy meeting minutes may garner the most attention. In the October policy statement, the FOMC (other than the lone dissenter, Minneapolis Fed President Kotcherlakota) did not express concerns about the low trend in inflation. The minutes should show a broader debate on the inflation outlook and how that might influence the monetary policy outlook.

Monday

Empire State Manufacturing Index (November) – The New York Fed's factory sector survey tends to be erratic. The headline figure moderated in October, following a strong summer.

Industrial Production (October) – Aggregate hours (from the employment report) edged up 0.1% in manufacturing. Energy has been especially strong in the last couple of years, but is likely to slow (and decline) following the drop in crude oil prices.



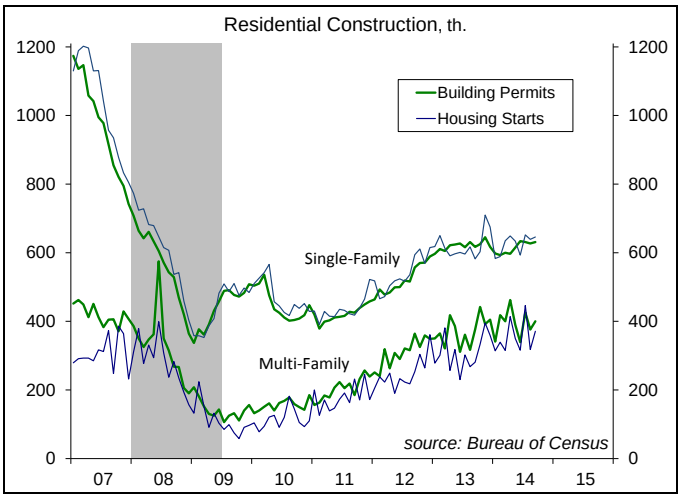
Tuesday

Producer Price Index (October) – Lower energy prices should push the headline figure down in October. Core inflation is expected to remain relatively mild, while falling commodity prices should help reduce pipeline inflation pressure.

Homebuilder Sentiment (November) – Following a sharp gain in September, the National Association of Home Builders' Housing Market Index fell back in October. Expect a partial rebound.

Wednesday

Building Permits, Housing Starts (October) – Over the last couple of years, two facts are clear. One is that improvement in single-family homebuilding has generally stalled. The other is that the multi-family sector is very volatile (but around a positive trend). It's hard to get excited about November construction data, as activity winds down. However, seasonal adjustment could easily exaggerate minor weather effects.

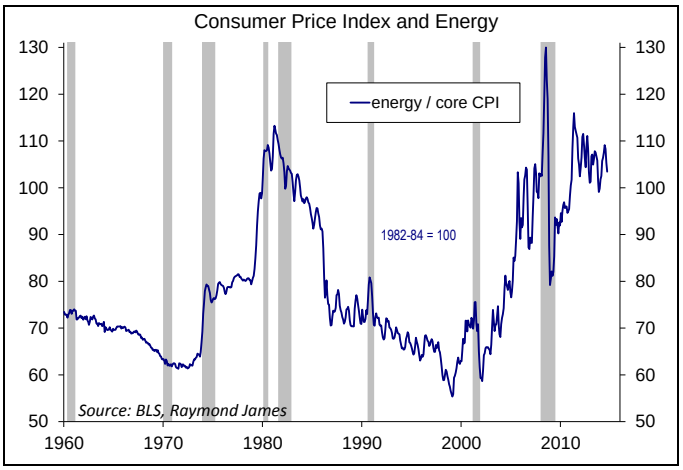


FOMC Minutes (October 28-29) – In the first half of the year, the Federal Open Market Committee cautioned that "inflation persistently below its 2 percent objective could pose risks to economic performance." This phrase was not included in the statements in July, September, and surprisingly, October. Many observers believe that the current low trend in inflation should lead the Fed to delay its initial increase in short-term interest rates. Most likely, the minutes will capture the Fed's internal debate on the inflation outlook and how it will influence policy.

Thursday

Jobless Claims (week ending November 15) – The data are subject to an increasing amount of noise in the final months of the year. Adjustments for the Veterans Day holiday add uncertainty. However, the underlying trend is expected to remain very low.

Consumer Price Index (October) – Lower energy prices should reduce the headline figure in October. Core inflation is expected to be mild. Moreover, there are no signs of upward pressure on inflation (low commodity prices, no production constraints, still no significant increase in average wages).



Real Earnings (October) – Nominal earnings were reported to have risen 0.5%. Real earnings are finally picking up.

Existing Home Sales (October) – We've seen a decrease in speculative purchases, but underlying demand should improve.

Leading Economic Indicators (October) – Another strong gain.

Friday

No significant data.

Next Week …

A feast of data on Tuesday and Wednesday. Quiet otherwise.

Coming Events and Data Releases

December 1	ISM Manufacturing Index (November)
December 2	Unit Motor Vehicle Sales (November)
December 3	ISM Non-Manufacturing Index (November) Fed Beige Book
December 5	Employment Report (November)
December 17	FOMC Policy Decision, Yellen press conference
December 25	Christmas Holiday (markets closed)
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