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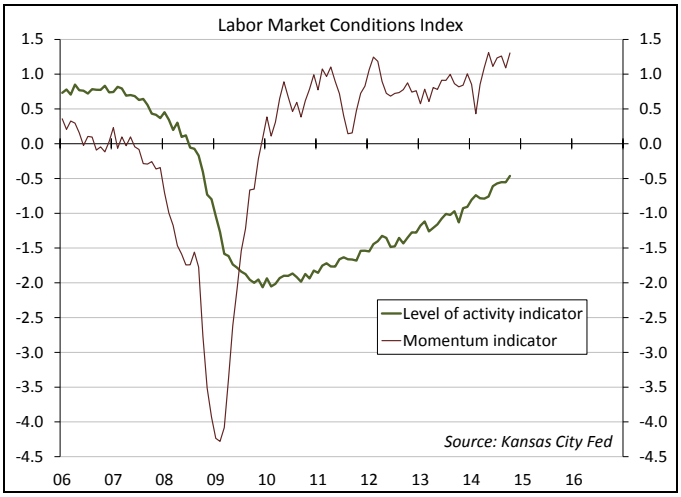
Weekly Market Monitor

Monetary Policy Outlook

The minutes of the October 28-29 Federal Open Market Committee meeting suggested that there is still no consensus opinion among senior officials regarding when the Fed will begin raising short-term interest rates. There is strong agreement that monetary policy moves will be data-dependent. However, policymakers differ in their views on the amount of slack in the job market. Only *"a few"* Fed officials expressed concerns that inflation might persist below the Fed 2% target. However, while survey-based measures of long-term inflation expectations had remained stable, *"market-based measures of inflation compensation had declined somewhat."* While this bears watching in the U.S., it's a much bigger worry for the euro area.

"Indicators of labor market conditions continued to improve over the intermeeting period, with a further reduction in the unemployment rate, declines in longer-duration unemployment, strong growth in payroll employment, and a low level of initial claims for unemployment insurance. Business contacts reported employment gains in several parts of the country, with relatively few pointing to emerging wage pressures, although one participant indicated that larger wage gains had been accruing to some individuals who switched jobs. Labor market conditions indexes constructed from a broad set of indicators suggested that the underutilization of labor had continued to diminish, although a number of participants noted that underutilization of labor market resources remained. A couple of participants judged that the large number of individuals working part time for economic reasons and the continued drift down in the labor force participation rate suggested that the unemployment rate was understating the degree of labor market underutilization."

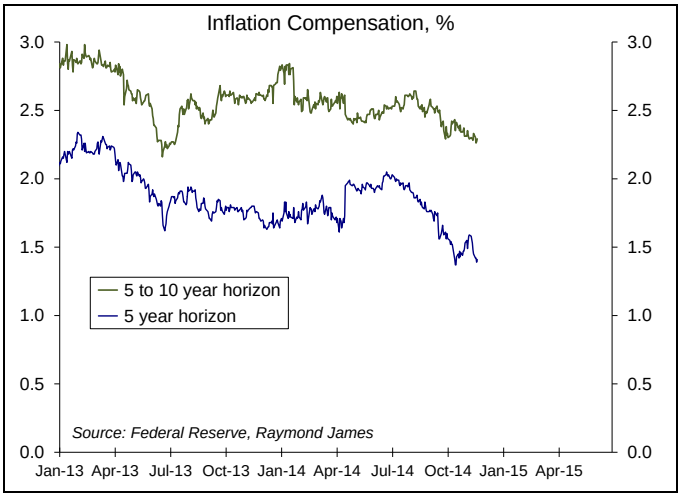
– FOMC Minutes (October 28-29)



The labor market slack debate has grown in recent weeks. One issue is how to weigh the various measures. The Kansas City Fed's Labor Market Conditions Index provides a handy summary. The LMCI suggests that slack is being taken up, perhaps a bit more rapidly in recent months. However, it also indicates that a lot of slack remains. Other parts of the debate focus on which measures of slack matter more. Currently short-term unemployment (those out of work for six months or less) is trending low (at a level which we would normally associate with a job market that is running at full steam). Longer-term unemployment (more than 6 months) has been trending lower, but remains relatively high by historical standards. Some economists have argued that long-term unemployment is largely irrelevant to the inflation outlook. Last week, New York Fed economists argued that it does matter. There are enough people on the sidelines (not officially counted as "unemployed," but who would still take a decent job if one were offered) to keep wage pressures relatively muted.

The major surprise in the October 29 policy statement was the absence of concern about low inflation. In policy statements in the first half of this year, the FOMC noted that *"inflation persistently below the 2% objective could pose risks to economic performance."* This sentiment was missing from the October policy statement, but also from the FOMC minutes. Many economists had expected that the current low trend in inflation and downward inflationary pressure coming from the rest of the world would lead to a delay in the first Fed rate hike.

Inflation Compensation, the spread between fixed rate and inflation-adjusted Treasury securities, is not an exact measure of inflation expectations. However, recent values suggest a lower inflation outlook over the next five years and over the five years after that (the five-year rate five years forward).



As inflation expectations fall, real interest rates rise, which has a negative impact on growth. Nominal interest rates can't be lowered. This isn't a big concern for the U.S. economy just yet, but it is a critical problem for the euro area, where the economy is much weaker than in the U.S.

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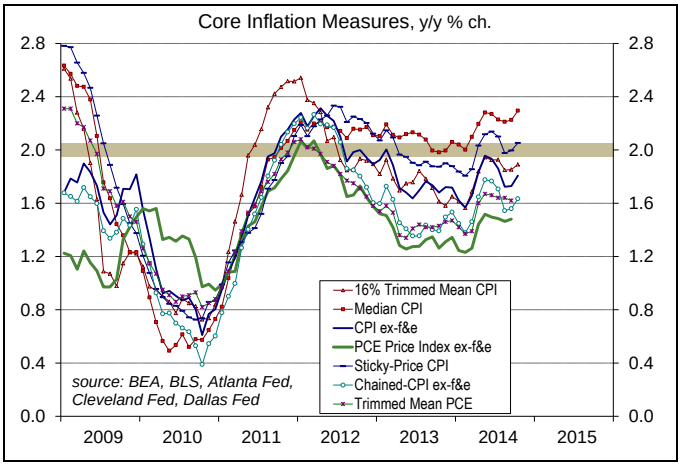
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
10/24/14	0.01	0.06	0.11	0.41	0.82	1.52	2.29	3.05	1.268	1.610	108.06	1.121	4483.72	1964.58	16805.41
11/14/14	0.02	0.07	0.15	0.54	0.96	1.62	2.32	3.04	1.249	1.566	116.52	1.129	4688.54	2039.82	17634.74
11/21/14	0.01	0.07	0.12	0.51	0.94	1.61	2.31	3.02	1.239	1.565	117.73	1.124	4712.97	2063.40	17807.81

Recent Economic Data and Outlook

The mid-month economic data reports were a mixed bag. While U.S. stock market participants reacted to poor overseas data, they remain encouraged by central bank efforts to spur growth.



The **FOMC Minutes** reflected a wide range of views regarding the amount of slack remaining in the job market and the inflation outlook, but little concern that overseas developments would have more than a limited impact on the domestic economy. There remained widespread agreement that monetary policy will be data-dependent. There was some anxiety about changing the language in the forward guidance (that is, how to lose the "considerable time" phrase).

The **Consumer Price Index** was unchanged in October (+1.7%), as lower gasoline prices offset what are expected to be one-time gains in other areas. Food rose 0.1% (+3.1% y/y). Gasoline prices fell 3.0% (-6.3% before seasonal adjustment, -5.0% y/y). Ex-food & energy, the CPI rose 0.2% (+1.8% y/y), reflecting gains in airfares (+2.4%), tobacco (+0.6%), and car insurance (+0.6%).

Real Weekly Earnings rose 0.4% in October (+0.9% y/y), reflecting a 0.3% increase in hours and a 0.1% rise in average hourly earnings. Real Hourly Earnings rose 0.1% (+0.4% y/y).

The **Producer Price Index** rose 0.2% in October (+1.5% y/y). Food rose 1.0% (+4.5% y/y). Energy fell 3.0% (-3.7% y/y), with gasoline down 5.8% (-9.6% before seasonal adjustment, -9.5% y/y). Ex-food & energy, the PPI rose 0.4% (+1.8% y/y), reflecting a 1.5% increase in margins for final demand trade services (which measure changes in margins received by wholesalers and retailers), which had been on a flattish trend in recent months. Ex-trade services, the core PPI rose 0.1% (+1.6% y/y).

Industrial Production fell 0.1% in October (+4.0% y/y), reflecting a 0.9% drop in mining (+9.9% y/y) and a 0.7% decline in the output of utilities (-1.3% y/y). Manufacturing output rose 0.2% (+3.7% y/y), with mixed results across industries.

The New York Fed's **Empire State Manufacturing Index** rose to 10.2 in November, vs. 6.2 in October and 27.5 in September. Orders and shipments picked up. Job growth was moderate.

The **Philadelphia Fed Index** surged to 40.8 in November, vs. 20.7 in October. While the headline figure is often erratic, the details were strong (sharper growth in new orders and production, a more rapid increase in employment).

Existing Home Sales rose 1.5% in October, to a 5.26 million seasonally adjusted annual rate (+2.5% y/y). Results were mixed across regions. Unadjusted sales for the last three months were down 0.7% from the same period in 2013.

Building Permits rose 4.8% in October, to a 1.080 million seasonally adjusted annual rate (+1.2% y/y). Single-family permits rose 1.4% (±1.2%). **Housing Starts** fell 2.8%, to a 1.009 million pace (+2.4% y/y). Single-family starts rose 4.2% (±8.8%).

Homebuilder Sentiment rebounded to 58 in November, vs. 54 in October and 59 in September.

The Index of **Leading Economic Indicators** rose 0.9% in October. The recent trend suggests little chance of entering a recession.

The **People's Bank of China** cut short-term interest rates.

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 moderate overall. Restraints (on exports) from European weakness should be offset by strength in domestic demand over the near term.

Housing/Construction: Affordability is still an issue, but has become somewhat less of a constraint for the middle of the market and below. Distressed sales and speculative buying has waned as consumer fundamentals have improved.

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 into the first half of 2015.

This Week:					*forecast*	last	last –1	comments
Monday	11/24	8:30	Chicago Fed Nat Act Index	Oct	***NF***	0.47	-0.25	no sign of a recession
		1:00	Treasury Note Auction					$28 billion in 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					$13 billion in re-opened 2-yr FRNs
		1:00	Treasury Note Auction					$35 billion in 5-year notes
Wednesday	11/26	8:30	Jobless Claims, th.	11/22	***288***	291	293	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		***+0.2%***	+0.1%	+0.1%	the core CPI rose 0.203%
		8:30	**Durable Goods Orders**	Oct	***+0.5%***	-1.1%	-18.3%	seen rebounding
			ex-transportation		***+0.5%***	-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	***62.2***	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	***465***	467	466	a moderate pace
			% change		***-0.4***	+0.2	+15.3	watch for revisions
		10:00	Pending Home Sales Index	Oct	***+1.2%***	+0.3%	-1.0%	seen somewhat higher
		11:30	Treasury Note Auction					$29 billion in 7-year notes
Thursday	11/27		Thanksgiving					mmmm, tryptophan…
Friday	11/28		no significant data					markets close early
Next Week:								
Monday	12/01	9:45	Markit US Manf PMI (final)	Nov	***NF***	55.9	57.5	54.7 in the flash estimate
		10:00	**ISM Manf. Index**	Nov	***57.9***	59.0	56.6	still strong
Tuesday	12/02	10:00	Construction Spending	Oct	***NF***	-0.4%	-0.5%	choppy, subject to large revisions
		tba	Motor Vehicle Sales, mln	Nov	***16.5***	16.3	16.3	a moderately strong pace
			domestically built		***13.3***	13.1	12.9	likely to pick up
Wednesday	12/03	8:15	**ADP Payroll Estimate, th.**	Nov	***+235***	+230	+225	a moderate gain
		10:00	**ISM Non-Manf. Index**	Nov	***57.8***	57.1	58.6	moderately strong
		10:00	BOC policy Decision					no change
		2:00	**Fed Beige Book**					no longer "modest to moderate"?
Thursday	12/04	7:00	BOE Policy Decision					no change
		7:45	ECB Policy Decision					QE or not QE? If not, then in January
		8:30	Jobless Claims, th.	11/29	***290***	***288***	291	a low trend
Friday	12/05	8:30	**Nonfarm Payrolls, th.**	Nov	***+245***	+214	+256	relatively strong
			private-sector		***+240***	+209	+244	seasonal adjustment adds uncertainty
			Unemployment Rate		***5.8%***	5.8%	5.9%	trending lower
			employment/population		***80.9%***	80.8%	80.7%	trending higher
			Avg. Weekly Hours		***34.6***	34.6	34.5	steady (but watch for revisions)
			Avg. Hourly Earnings		***+0.2%***	+0.1%	0.0%	modest wage pressures
		8:30	Trade Balance, $bln	Oct	***-42.0***	-43.0	-40.0	likely to have narrowed
			goods only		***-61.7***	-62.7	-60.2	reflecting lower petroleum prices
		10:00	Factory Orders	Oct	***+0.2%***	-0.6%	-10.0%	depressed by lower petroleum prices

This Week…

The economic data bunch up on Tuesday and Wednesday, but the figures aren't seen as critical for the overall outlook. Real GDP growth is expected to have risen a bit slower in the government's 2nd estimate of third quarter growth, as component revisions were mixed. Yet, there's enough uncertainty to make it interesting for the financial markets. Consumer confidence is expected to improve further – keep an eye on labor market perceptions. On Wednesday, the reports on durable goods and new home sales are often volatile, and reactions to any surprises could be exaggerated by thin volumes. Financial markets close early on Friday.

Monday

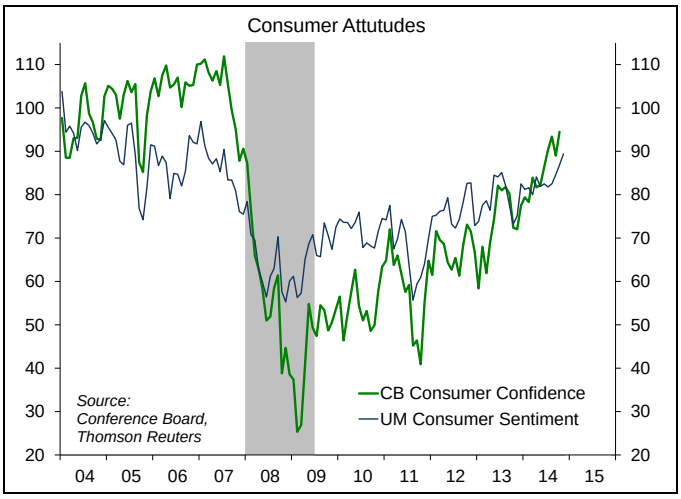
Chicago Fed National Activity Index (October) – Not followed widely by the financial markets, the CFNAI is a useful gauge for overall economic activity. Recent figures have signaled that growth is somewhat above its long-term trend.

Tuesday

Real GDP (3Q14, 2nd estimate) – Component revisions were mixed, but on balance they point to a downward revision to the third quarter growth estimate (a 3.5% annual rate in the advance estimate, released last month). The financial markets have a tendency to focus too much on the headline figure.

Recall that the advance estimate indicated lackluster consumer spending growth, a small drag from slower inventory growth, and strong contributions from foreign trade and defense spending. That story is unlikely to change much.

Conference Board Consumer Confidence Index (November) – The headline figure is expected to improve in November, but watch for possible revisions to the October figures. Labor market perceptions are gradually improving, but have remained relatively low by historical standards.



Wednesday

Jobless Claims (week ending November 22) – Seasonal adjustment is tricky in the final months of the year, often resulting in an increase in the week-to-week noise. However, the underlying trend has remained low in recent weeks.

Personal Income and Spending (October) – The Employment Report indicated a pickup in aggregate wage growth last month, but that followed relatively weak results in August and September. The retail sales report suggested a lackluster gain in consumer spending, but that partly reflects lower gasoline prices. Initially, lower gasoline prices reduce nominal spending, but consumers soon begin to use the money they're not putting in their gasoline tanks and begin to spend on other things. The PCE Price Index is likely to be about flat, up modestly ex-food & energy (the core CPI was reported to have risen 0.2%).

Durable Goods Orders (October) – Monthly changes in the headline figures are often choppy, which makes it hard to determine whether the trend is changing. Most likely, we'll see a mixed bag across industries.

Chicago Purchasing Managers Index (November) – The survey (which covers firms in Illinois and Northern Indiana) is likely to remain relatively strong.

New Home Sales (October) – Supply problems are less of a constraint. Consumer fundamentals are improving. Average wage growth is relatively slow, but strong job growth is a bigger plus for the housing market. Low mortgage rates have helped.

Pending Home Sales Index (October) – While these figures can be somewhat choppy, the underlying trend is likely to reflect gradual improvement.

Thursday

Thanksgiving Holiday – Markets closed.

Friday

No significant data. Markets close early.

Next Week …

December gets off to a roaring start, with fresh economic figures and the European Central Bank's policy meeting.

Nonfarm payrolls are likely to post a strong gain for November. Seasonal adjustment adds some uncertainty. Prior to seasonal adjustment, we normally shed some jobs in construction and leisure, but continue to add in education. Retail employment picks up significantly during the holiday shopping season. This year, retailers have recognized the shorter period (four weeks) between Thanksgiving and Christmas and have stepped up their discounting and sales promotions. That should correspond to a somewhat greater than usual pickup in retail jobs, which ought to boost the headline payroll figure (note that seasonal jobs added in November and December will disappear in January). The unemployment rate is a bit tougher to gauge. Most likely we should start to see some of those on the sidelines (not officially "unemployed," but people who would likely take a job if one were available) come back into the labor force. The unemployment rate should decline more gradually or perhaps flatten out as labor force participation picks up. The employment/population ratio is a better measure of labor utilization, and that is trending gradually higher.

Will this be the month that the ECB pulls the trigger on QE? Mario Draghi, who may have the toughest job on the planet, has continued to express concerns about the low trend in inflation, and, more importantly, the decline in inflation expectations. In his press conference following the ECB policy meeting on November 6, Draghi indicated that "should it become necessary to further address risks of too prolonged a period of low inflation, the Governing Council is unanimous in its commitment to using additional unconventional instruments within its mandate." Moreover, "the Governing Council has tasked ECB staff and the relevant Eurosystem committees with ensuring the timely preparation of further measures to be implemented, if needed." On November 21, he noted that "we will do what we must to raise inflation and inflation expectations as fast as possible, as our price stability mandate requires of us."

Coming Events and Data Releases

December 11	Retail Sales (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