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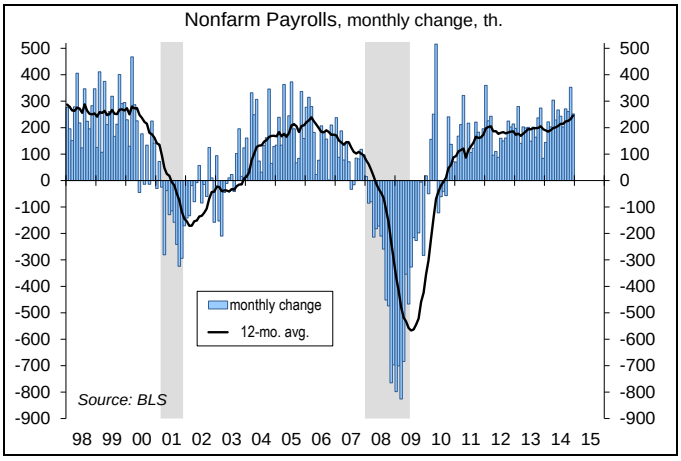
Weekly Economic Monitor

The Job Market and the Fed

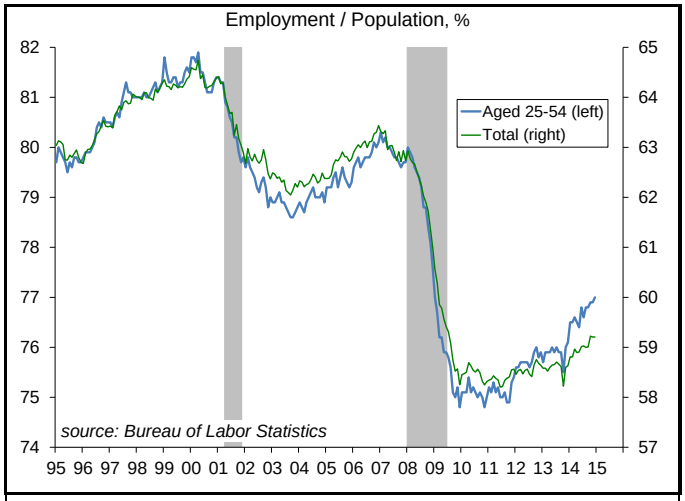
The December Employment Report presented a mixed job market picture. The establishment survey data reflected strong job growth, but with a lackluster trend in average hourly earnings. The household survey showed a larger-than-expected drop in the unemployment rate, but that was due to a decline in labor force participation. What should Fed policymakers make of this report? Patience, grasshopper, patience...

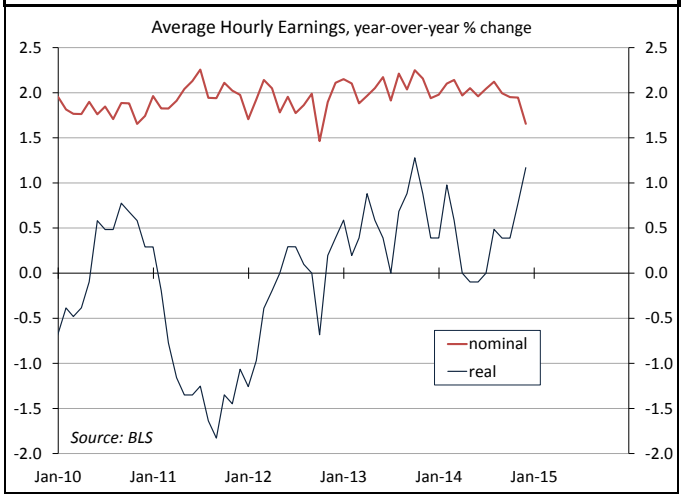
Next month, the Bureau of Labor Statistics will release annual benchmark revisions to the payroll survey data. That's unlikely to alter the recent picture. In September, the BLS indicated that it expects that (based on payroll tax receipts) the March 2014 estimate of payrolls will be lifted by a mere 7,000 (or less than 0.05%). The BLS will also add two lines to the payroll table, the three-month average monthly gains for total and private-sector payrolls. This isn't a hard calculation. Rather, the BLS will be emphasizing the trend in payroll growth over the monthly change. That's a good thing. Investors pay way too much attention to the monthly figure, which is noisy and subject to revision. Payrolls averaged a 246,000 monthly gain in 4Q14. The average for private-sector payrolls was +238.000. This is over twice the rate of growth of the working-age population.



Nonfarm payrolls rose by 2.952 million in 2014, the strongest year since 1999. Private-sector payrolls rose by 2.861 million, the best since 1997. The ADP payroll estimate suggests that job gains are being led by small firms, with good strength in medium-size hiring as well. This is what one should naturally expect to see as the economy gathers steam.

The household survey data painted a somewhat different picture. The unemployment rate fell to 5.6% (a level which was once considered to reflect "full employment"). However, the decline was due to a drop in labor force participation. The employment/population ratio, the preferred measure of labor utilization, held steady – up just 0.4 percentage point from a year ago. That suggests that while labor market slack is being taken up, the improvement is very gradual. Progress is more apparent for the key age cohort (those aged 25 to 54), but the ratio remains well below the pre-recession level (which was well short of the peak in the late 1990s).





A month ago, average hourly earnings were reported to have risen 0.4% in November, which led some to declare that more rapid wage growth had finally arrived. Whoops. Average hourly earnings fell 0.2% in December, while the November figure was revised down to +0.2%. Luckily, a drop in the Consumer Price Index will boost real earnings for December. However, the lackluster growth in hourly earnings is one more sign of slack.

Minutes of the December 16-17 Fed policy meeting noted that officials could begin raising short-term interest rates even if inflation remains low (as long as it's expected to move to the Fed's 2% goal) and policy will remain very accommodative for a long time after the initial rate hike. At some point, the Fed will simply have to take its foot of the gas. Nevertheless, the risks surrounding the timing of tightening aren't symmetric.

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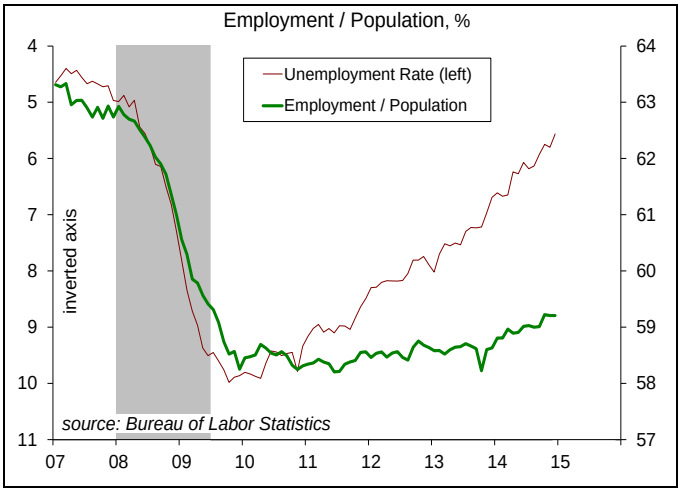
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
12/12/14	0.02	0.09	0.19	0.56	0.98	1.53	2.10	2.75	1.248	1.573	118.22	1.154	4653.60	2002.33	17280.83
1/02/15	0.02	0.11	0.25	0.66	1.07	1.61	2.12	2.69	1.202	1.536	120.20	1.173	4726.81	2058.20	17832.99
1/09/15	0.02	0.08	0.20	0.57	0.93	1.43	1.96	2.54	1.184	1.516	118.51	1.187	4704.07	2044.81	17737.37

Recent Economic Data and Outlook

Stock market volatility continued as investors attempted to gauge the U.S. economic outlook and the risks from abroad. Growth in nonfarm payrolls was strong, but wage growth remained weak.



The **FOMC Minutes** from the December 16-17 policy meeting showed that *"participants generally regarded the net effect of the recent decline in energy prices as likely to be positive for economic activity and employment."* However, *"many of them thought that a further deterioration in the foreign economic situation could result in slower domestic economic growth than they currently expected."* Most Fed officials saw *"no clear evidence of a broad-based acceleration in inflation."* It was noted that the Federal Open Market Committee *"might begin normalization at a time when core inflation was near current levels, although in that circumstance participants would want to be reasonably confident that inflation will move back toward 2% over time,"* and some officials stressed that *"policy will still be highly accommodative for a time after the first increase in the federal funds rate target."*

The **December Employment Report** was mixed. Nonfarm payrolls rose by 252,000, with a net revision to the two previous months of +50,000. It was the strongest year of job growth since 1999 (and the strongest year of private-sector job growth since 1997). The unemployment rate fell to 5.6%, but the decline was due entirely to a drop in labor force participation (don't read too much into that – seasonal adjustment is difficult in December). The employment/population ratio held steady at 59.2% up 0.4 percentage point from a year ago). Average hourly earnings fell 0.2%, following a 0.2% rise in November (revised from +0.4%). Average weekly hours held steady.

Unit **Auto Sales** edged down to a 16.8 million seasonally adjusted annual rate in December, vs. 17.1 million in November.

The **ADP Estimate** of private-sector payrolls rose by 241,000 in December, with strong gains continuing at small and medium-sized businesses.

The **ISM Non-Manufacturing Index** fell to 56.2 in December, vs. 59.3 in November and 57.1 in October. Business activity slowed (to a moderate pace). New orders remained brisk, although somewhat slower than in November. Employment growth remained moderate. Input price pressures eased. Comments from supply managers were mostly upbeat, with some citing delays at West Coast ports.

The U.S. **Trade Deficit** narrowed unexpectedly to $39.0 billion in November, while the October shortfall was revised to $42.2 billion (from $43.4 billion). Merchandise exports fell 1.3% (unchanged from a year ago). Merchandise imports fell 2.6% (petroleum down 11.9% and non-petroleum down 1.2%). Note that the drop in oil imports was due to lower prices (-6.2%) and lower quantities (-6.1%, to the lowest since February 1994). The figures suggest that net exports will not be much of a factor in fourth quarter GDP growth (advance estimate due January 30).

Factory Orders fell 0.7% in November (-1.0% y/y). Orders for nondefense capital goods ex-aircraft fell 0.5% (following -1.8% in October). Shipments fell 0.2% (following -0.9%) – a -1.9% annual rate in 4Q14 (vs. +12.7% in 3Q14).

Economic Outlook (1Q15): Real GDP growth of 2.5-3.0%, following around 3.0% in 4Q14.

Employment: Job growth was very strong in 2014. Labor market slack is being taken up, but considerable slack remains.

Consumers: The underlying trend in nominal average wages has been lackluster, but lower gasoline prices will add to consumer purchasing power in the near term and wage growth should pick up later on as the job market tightens.

Manufacturing: Mixed. A stronger dollar and weakness in the global economy are expected to restrain exports, but domestic demand should strengthen in the months ahead.

Housing/Construction: Supply constraints have eased and affordability has improved. Look for a better balance in 2015 (less speculative buying, better consumer fundamentals).

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, but could decline.

Interest Rates: With the Fed's large-scale asset purchases (QE3) completed, short-term interest rates are expected to remain exceptionally low through the middle of 2015. The Fed's policy moves in 2015 will be dictated largely by job market conditions, but the Fed will also react to financial market conditions.

This Week:					*forecast*	last	last –1	comments
Monday	1/12	1:00	Treasury Note Auction					3-year notes
		20:30	**CFP National Championship**					Oregon vs. Ohio State
Tuesday	1/13	7:30	Small Business Optimism	Dec	***NF***	98.1	96.1	improving
		10:00	JOLTS: hiring rate	Nov	***NF***	3.6%	3.6%	a gradual trend of improvement
			JOLTS: quit rate		***NF***	1.9%	2.0%	still below normal
		1:00	Treasury Note Auction					10-year notes
		2:00	Treasury Budget, $bln	Dec	***+3.0***	+53.2	-1.2	higher outlays (a calendar quirk)
Wednesday	1/14	6:00	Eur. Court rules on OMT					a key hurdle for the ECB to undertake QE
		8:30	Import Prices	Dec	***-1.4%***	-1.5%	-1.2%	lower oil prices
			ex-food & fuels		***-0.2%***	-0.2%	-0.3%	mild disinflationary pressure for the U.S.
		8:30	**Retail Sales (advance)**	Dec	***+0.2%***	+0.7%	+0.5%	a relatively strong trend
			ex-autos		***+0.2%***	+0.5%	+0.4%	lower gasoline prices will subtract
			ex-autos, bld mat, gasoline		***+0.4%***	+0.6%	+0.7%	a moderately strong trend in core sales
		10:00	Business Inventories	Nov	***+0.3%***	+0.3%	+0.3%	a slower pace in 4Q14?
		1:00	Treasury Bond Auction					30-year bonds
		2:00	**Fed Beige Book**					likely to reflect an improving economy
Thursday	1/15	8:30	Jobless Claims, th.	1/10	***296***	294	298	still subject to seasonal noise
		8:30	**Producer Price Index**	Dec	***-1.0%***	-0.2%	+0.2%	lower gasoline prices
			ex-food & energy		***+0.1%***	0.0%	+0.4%	a low trend
			ex-f, e, & trade services		***+0.1%***	0.0%	+1.5%	mild core inflation
		8:30	Empire St. Manf. Index	Jan	***5.0***	-3.6	10.2	erratic in recent months
		10:00	Philadelphia Fed Index	Jan	***20.0***	24.3	40.2	figures can be volatile
Friday	1/16	8:30	**Consumer Price Index**	Dec	***-0.4%***	-0.3%	0.0%	lower gasoline prices
			year-over-year		***+0.5%***	+1.3%	+1.7%	dropping sharply
			ex-food & energy		***+0.1%***	+0.1%	+0.2%	mild core inflation
			year-over-year		***+1.7%***	+1.7%	+1.8%	a low trend
		8:30	Real Weekly Earnings	Dec	***+0.2%***	+0.9%	+0.1%	nominal earnings fell 0.2%
			Real Hourly Earnings		***+0.2%***	+0.6%	+0.1%	should support spending growth
		9:15	**Industrial Production**	Dec	***+0.2%***	+1.3%	+0.1%	more moderate weather
			manufacturing output		***+0.4%***	+1.1%	+0.4%	aggregate hours edged up 0.1%
			Capacity Utilization		***80.1%***	80.1%	79.3%	a mild increase
			manufacturing		***79.4%***	79.2%	78.4%	near the long-term average
		9:55	Consumer Sentiment	m-Jan	***94.2***	93.6	88.8	lower gasoline prices helping
Next Week:								
Monday	1/19		MLK, Jr. Holiday					markets closed
Tuesday	1/20	10:00	Homebuilder Sentiment	Jan	***59***	57	58	lower gasoline prices should help
		21:00	State of the Union Address					what's on the agenda?
Wednesday	1/21	8:30	**Building Permits, th.**	Dec	***1065***	1052	1092	seen a bit higher
			% change		***+1.2***	-3.7	+5.9	the bigger test comes in the spring
			Housing Starts		***1050***	1028	1045	likely to rebound
			% change		***+2.1***	-1.6	+1.7	watch for revisions
		10:00	BOC Policy Decision					no change
Thursday	1/22	7:45	**ECB Policy Decisions**					QE is widely anticipated, but how much?
		8:30	Jobless Claims, th.	1/17	***295***	***296***	294	a low trend
		1:00	TIPS Auction					10-year TIPS
Friday	1/23	9:45	Markit US Manf PMI (flash)	Jan	***NF***	53.9	54.8	trended lower in 4Q14
		10:00	**Existing Home Sales, mln**	Dec	***5.12***	4.93	5.25	likely to rebound somewhat
			% change		***+3.9***	-6.1	+1.4	low mortgage rates should help
		10:00	Leading Economic Indicators	Dec	***+0.6%***	+0.6%	+0.6%	will include annual benchmark revisions

This Week…

The calendar heats up early on Wednesday morning. The European Court of Justice's ruling on the ECB's Outright Monetary Transactions (OMT) is seen as a key hurdle for quantitative easing. An ECJ okay of the ECB's OMT would be a positive for the markets. December retail sales results arrive after that and should set the tone for the remainder of the week (but none of that will matter if the OMT is ruled illegal). Monthly inflation reports should show a large impact from lower gasoline prices. Core inflation is expected to remain mild.

Monday

College Football Playoff National Championship (Oregon vs. Ohio State) – Oregon is favored by a touchdown.

Tuesday

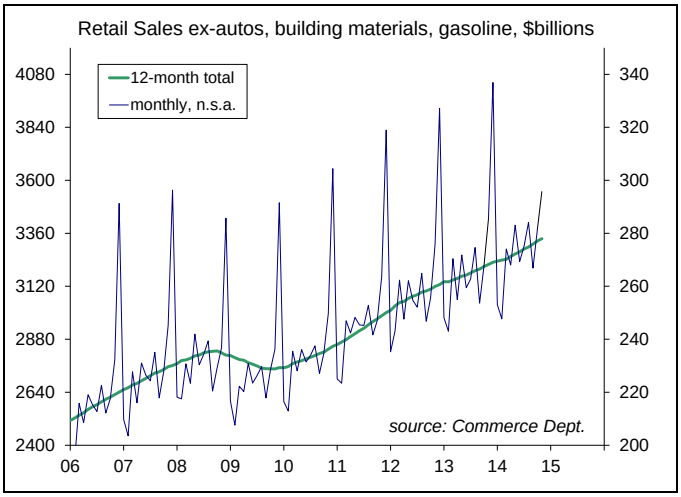
Small Business Optimism Index (December) – Clearly things are getting better for small businesses. The ADP Payroll Report showed that they are doing a lot of hiring (likely in response to signs of increased demand). Bank credit is still relatively tight, but is gradually getting easier.

Wednesday

European Court of Justice Ruling (ECB's OMT) – In August 2012, European Central Bank's Governing Council decided (not unanimously) that it would undertake Outright Monetary Transactions in sovereign bonds. The mere announcement of OMT led to a narrowing in government bond spreads. However, the OMT was challenged in the German Federal Constitution Court, which expressed serious concerns but punted the case to the ECJ, which heard the case in October. So here we are. This will be a "preliminary" ruling, which means it's non-binding for the ECB – but if deemed illegal, it would make it much harder for the central bank to initiate QE (ECB policymakers meet January 22). If the ECJ's initial ruling is unfavorable, you can write off QE being announced next week. That would be bad.

Import Prices (December) – Falling petroleum prices should push the headline figure down. Yet, we're also seeing disinflationary trends in imported non-oil commodities and finished goods.

Retail Sales (December) – Unit autos sales edged lower on a seasonally adjusted basis. Lower gasoline prices will depress the headline figure. Core sales are likely to be moderately strong. Note that seasonal adjustment is very large in December.



Business Inventories (November) – The only missing piece here is retail inventories. Manufacturing inventories were reported to have edged up 0.1% (durables +0.4%), while wholesale inventories jumped 0.8% (despite lower petroleum prices).

Fed Beige Book – Fed officials love to receive anecdotal information on the economy. Pay attention to what is said about wage and price pressures. If they stay benign, policymakers are more likely to delay the initial rate hike.

Thursday

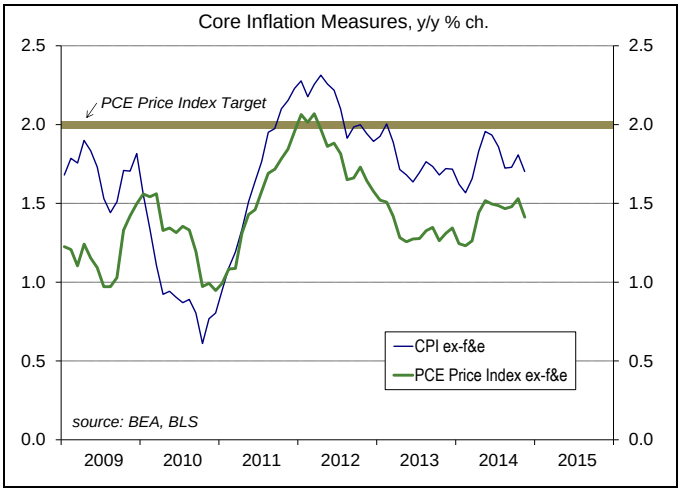
Jobless Claims (week ending January 10) – Seasonal adjustment is difficult in January, which could add volatility to the weekly figures, but the underlying trend should remain low. The seasonal spike in unadjusted claims has been a lot more muted than a year ago, consistent with a strengthening labor market.

Producer Price Index (December) – The seasonal adjustment will be looking for a 0.2% decrease in wholesale gasoline prices. Hence, we should see a sharp drop in the headline number.

Empire State Manufacturing Index, Philadelphia Fed Index (January) – The Fed's two main regional manufacturing surveys are often erratic. Hence, we could see a surprise.

Friday

Consumer Price Index (December) – Retail gasoline prices fell about 13% last month, while the seasonal adjustment anticipates a decline of 1.8%. Doing the math, gasoline should shave 0.5 or 0.6 percentage points from the CPI. Core inflation is expected to remain relatively low. Note that large moves in energy prices often lead to some flow-through to core inflation.



Real Earnings (December) – Nominal wages fell 0.2%, but the drop in the CPI should push real wages up a bit.

Industrial Production (December) – Weather was a bit milder (hence, lower output of utilities). Manufacturing output is expected to be mixed across industries.

UM Consumer Sentiment Index (mid-January) – Back to pre-recession levels in December. Lower gasoline prices help.

Next Week …

Monday's a holiday. It's a relatively light week for economic data. Residential construction data arrive on Wednesday, but it's hard to get excited about December figures (the bigger test will come in the spring). The focus will likely be on the ECB policy meeting. One of the key themes in recent months is that the U.S. stock market has reacted negatively to bad economic data abroad, but positively to efforts from foreign central banks.

Coming Events and Data Releases

January 27	Durable Goods Orders (December) Consumer Confidence (January)
January 28	FOMC Policy Decision (no press conference)
January 30	Real GDP (4Q14, advance estimate)
February 1	Super Bowl XLIX
February 6	Employment Report (January)
March 18	FOMC Policy Decision, Yellen press conference
April 29	FOMC Policy Decision (no press conference)
June 17	FOMC Policy Decision, Yellen press conference