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Weekly Market Monitor

Nearing Normalization / Shutdown Shuffle – Part 2

Fed Chair Janet Yellen downplayed concerns about the rest of the world and indicated that she was among the majority of Fed officials expected to raise short-term interest rates this year. Meanwhile, while John Boehner's resignation as House Speaker may signal an agreement on the budget, Congress has moved further away from future compromise.

In the revised dot plot, the graph of senior Fed officials' forecasts of the appropriate federal funds target rate for the next few years, there is no indication of which dot corresponds to which official. It was speculated that Chair Yellen may have been one of the four officials who didn't expect to raise short-term interest rates this year. In her post-FOMC press conference, Yellen was obligated to speak for all Fed policymakers. However, in her speech at UMass Amherst, Yellen placed herself among the group expecting a rate hike by year-end. The stock market has often reacted poorly to the possibility of a Fed rate hike. However, investors seemed to be encouraged by Yellen's expressed confidence in the U.S. economy. Why the Fed would raise rates matters. Yellen downplayed worries about the rest of the world and played up the prospects for the domestic economy.

Real GDP rose at a 3.9% annual rate in the government's 3rd estimate for 2Q15 (revised from 3.7% in the 2nd estimate). In July, the Bureau of Economic Analysis introduced a new measure: real final sales to private domestic purchasers. This figure is simply GDP less the change in inventories, net exports, and government – a less-volatile measure of underlying domestic demand. Private Domestic Final Sales rose at a 3.9% annual rate in 2Q15, up 3.5% from a year earlier. That's strong.

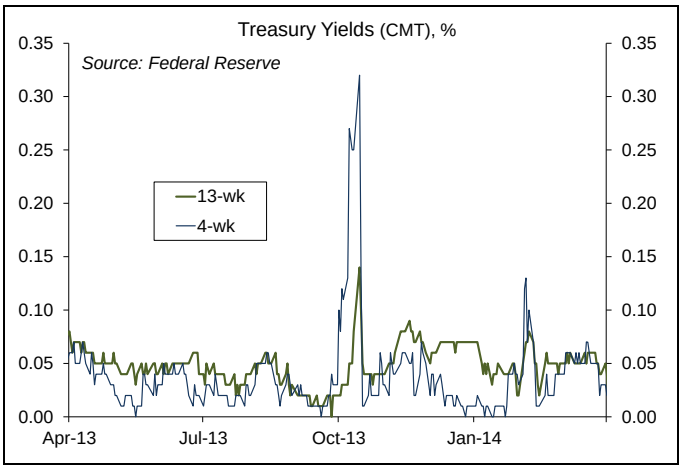
One of the key themes in the U.S. economic outlook is the split between the rest of the world and what's happening at home. Softer global growth and a strong dollar are likely to restrain exports and corporate earnings from abroad. However, falling prices of oil and other commodities should continue to provide support for U.S. consumers and investors. Inventories and foreign trade account for much of the quarter-to-quarter noise in GDP growth and at this point we only have figures for July. However, we should see net exports and slower inventory growth subtracting from GDP growth in 3Q15, perhaps a very large drag on headline growth (which is another good reason to focus on Private Domestic Final Sales).

On Friday, John Boehner announced his resignation as House Speaker effective at the end of October. The only surprise here is the timing. His decision was driven largely by disagreements with the Freedom caucus (a group of ultra-conservative House Republicans) and Tea Party members. Their dissatisfaction with Boehner was largely over his willingness to compromise.

Boehner was blamed for Congress' inability to overturn the Affordable Care Act. Two years ago, Boehner acquiesced to Tea Party demands to shut the government down. The government does not save money in a shutdown. The 16-day shutdown in 2013 added about $2 billion to the government's budget shortfall that year (government salaries are still paid, contracts have to be honored, and there are added costs to starting the government up again). It also shaved 0.1 to 0.2 percentage points from GDP growth (mostly activity is shifted from one month to the next). Some private-sector output is lost.

The 2013 shutdown led to a postponement of several economic data releases. It also interfered with the government's collection of economic data, distorting figures over the following few months.

Boehner's resignation should significantly reduce the odds of a government shutdown over the budget this week. That was the trade-off. Boehner would work with House Democrats on the budget, but that would cost him his job. **At the same time, Boehner's resignation substantially increases the odds that we'll see a shutdown over raising the debt ceiling in early December**. Boehner's replacement (the new House Speaker) will be less willing to compromise. The debt ceiling is a much bigger problem than the budget, as it raises the possibility that the Treasury could miss a payment on its debt.



We've been through this before. Congress took the Treasury to the brink of default in August 2011. Treasury bill rates briefly spiked higher. Standard & Poor's downgraded the U.S. credit rating, but that did not have a lasting impact. In fact, Treasury bond yields fell rather than rose.

A government shutdown need not be unsettling for the U.S. economy, but it may add uncertainty for the financial markets. Looking ahead, Washington is expected to become even more dysfunctional that it is now.

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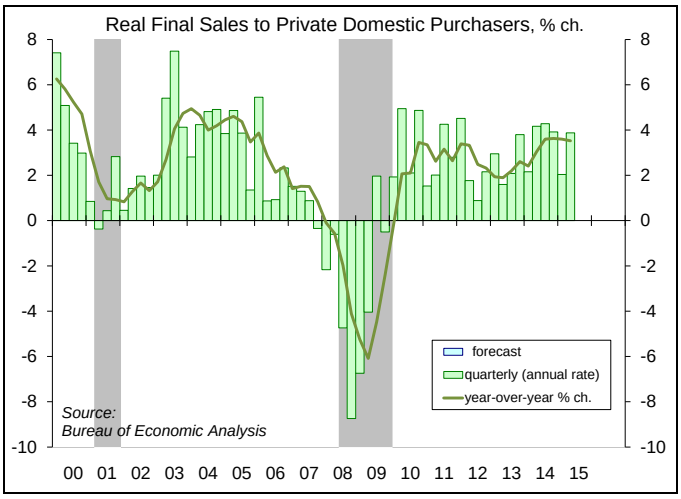
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
8/28/15	0.06	0.25	0.38	0.72	1.04	1.52	2.19	2.92	1.117	1.536	121.32	1.327	4828.33	1988.87	16643.01
9/18/15	0.00	0.10	0.35	0.69	0.97	1.45	2.13	2.93	1.136	1.557	119.85	1.315	4827.23	1958.03	16384.58
9/25/15	-0.02	0.07	0.33	0.70	1.00	1.48	2.17	2.96	1.120	1.519	120.57	1.332	4686.50	1931.37	16314.53

Recent Economic Data and Outlook

Through another choppy week in the markets, equity investors took some encouragement from Janet Yellen, who downplayed concerns about global economic growth.



Fed Chair Janet Yellen gave everyone a scare as she struggled to finish her speech at UMass Amherst on September 24. She seemed to repeatedly lose her place, paused for a long time, and her voice grew a bit soft. She looked unwell, but (like a champ) she stayed on her feet and left the stage on her own power. She received medical attention after the talk. It was a long speech (30 typed pages), which may have been a factor. A Fed spokesperson said that she was dehydrated; adding that she later felt fine (confirmed by witnesses) and had resumed her schedule (she had a dinner engagement).

In her speech, Fed Chair Yellen downplayed concerns about softer growth in the rest of the world. She firmly placed herself in the camp expecting to raise **Short-Term Interest Rates** by the end of the year (during her post-FOMC press conference, she was obligated to represent the views of all Fed policymakers). She did leave herself an out: *"if the economy surprises us, our judgments about appropriate monetary policy will change."* She continued to stress that the entire path of rates is more important than the timing of the first move.

House Speaker John Boehner resigned as House Speaker.

Real GDP rose at a 3.9% annual rate in the government's 3rd estimate of 2Q15 growth (vs. +3.7% in the second estimate and +2.3% in the advance estimate). Personal spending rose at a 3.6% pace (vs. +3.1% in the previous estimate). Business fixed investment rose 4.1% (vs. +3.2%). Private Domestic Final Sales (GDP less next exports, the change in inventories, and government) rose at a 3.9% annual rate, up 3.5% y/y.

Durable Goods Orders fell 2.0% in August, reflecting a further retreat in civilian aircraft orders (which had spiked higher in June) and the unwinding of a seasonal quirk in autos (which boosted July at the expense of August). Transportation orders dropped 5.8% (motor vehicles -1.6%, civilian aircraft -5.9%, defense aircraft +5.0%). Ex-transportation, orders were about as expected (median forecast: +0.1%), with mixed results across industries (primary metals +0.1%, fabricated metals -1.8%, machinery +1.0%, computers and electronics -0.2%, electrical equipment and appliances -0.6%). Orders for nondefense capital goods ex-aircraft slipped 0.2% (median forecast: -0.1%), down 5.2% from a year ago. Shipments fell 0.2%, with a slight downward revision to July – a +3.8% annual rate for the first two months of 3Q15 (vs. +0.3% in 2Q15 and -4.4% in 1Q15)

New Home Sales rose 5.7% (±16.2%) in August, to a 552,000 seasonally adjusted annual rate (+21.7% y/y). July was revised higher. Results were mixed across regions. These figures tend to be erratic (choppy and subject to large revisions). Sales for the last three months were up 22% from the same period in 2014, but remained far below "normal."

Existing Home Sales sank 4.8% in August, to a 5.31 million seasonally adjusted annual rate (+6.2% y/y). Don't read too much into that. It appears that some sales were likely shifted from August into June and July. Results were weak across all four regions (although each was up significantly y/y).

Economic Outlook (3Q15): about a 2.0% to 2.5% annual rate, likely held back by an inventory correction.

Employment: The pace of job growth has remained strong. Job losses are limited. New hiring remains robust.

Consumers: Average wage growth has remained lackluster, but strong job growth and lower gasoline prices have been supportive for spending. Credit is still relatively tight, but should become gradually easier over time.

Manufacturing: Mixed across industries. Factory jobs fell in August, likely reflecting the impact of the stronger dollar and slower global growth. Domestic orders have improved.

Housing/Construction: Sales and construction activity are increasing. Mortgage credit is getting somewhat easier.

Prices: Overall consumer price inflation has been very low, but should pick up as energy prices stabilize. There is downward price pressure in commodities and imports. Wage pressures are generally mild. Inflation expectations remain well-anchored.

Interest Rates: Fed officials believe that conditions are likely to warrant an initial increase in short-term rates later this year, but the more important question is the pace of tightening after the initial hike (which is expected to be very gradual).

This Week:					*forecast*	last	last –1	comments
Monday	9/28	8:30	Personal Income	Aug	***+0.5%***	+0.4%	+0.4%	led by wage growth
			Personal Spending		***+0.3%***	+0.3%	+0.3%	restrained by lower gasoline prices
			PCE Price Index ex-f&e		***+0.1%***	+0.1%	+0.1%	the core CPI rose 0.074%
		10:00	Pending Home Sales Index	Aug	***+0.7%***	+0.5%	-1.7%	a bit choppy, but the trend is higher
Tuesday	9/29	8:30	Goods Trade Balance, $bln	Aug	***-61.8***	-61.4	-64.8	soft exports, lower oil prices
		10:00	**Consumer Confidence**	Sep	***95.5***	101.5	91.0	some impact from the stock market
Wednesday	9/30	8:15	**ADP Payroll Estimate, th.**	Sep	***+185***	+190	+177	moderately strong
		9:45	Chicago PM Index	Sep	***53.5***	54.4	54.7	seen moderating
Thursday	10/01	8:30	Jobless Claims, 0th.	9/26	***273***	267	264	about as low as it can go…
		9:45	Markit US Manf PMI (final)	Sep	***NF***	53.0	53.8	53.0 in the flash estimate
		10:00	**ISM Manf Index**	Sep	***50.9***	51.1	52.7	mixed, but likely lower
		tba	Motor Vehicle Sales, mln	Sep	***17.6***	17.7	17.5	still a strong trend
			domestically built		***13.8***	13.8	13.9	but may be flattening
Friday	10/02	8:30	**Nonfarm Payrolls, th.**	Sep	***+185***	+173	+245	moderately strong
			private sector		***+190***	+140	+224	watch for revisions
			Unemployment Rate		***5.1%***	5.1%	5.3%	seen flat, but trending lower
			employment/population		***59.4%***	59.4%	59.3%	up only gradually y/y
			Avg. Weekly Hours		***34.5***	34.6	34.5	little change (watch for revisions)
			Avg. Hourly Earnings		***+0.2%***	+0.3%	+0.2%	still lackluster
		10:00	Factory Orders	Aug	***-1.5%***	+0.3%	+2.2%	orders for durables reported at -2.0%
Next Week:								
Monday	10/05	10:00	**ISM Non-Manf Index**	Sep	***58.0***	59.0	60.3	moderate
Tuesday	10/06	8:30	**Trade Balance, $bln**	Aug	***-42.3***	-41.9	-45.2	seen a bit wider
			goods only		***-61.8***	-61.4	-64.8	lower oil prices, but some hit to exports
		1:00	Treasury Note Auction					3-year note
Wednesday	10/07	1:00	Treasury Note Auction					re-opened 10-year notes
Thursday	10/08	7:00	BOE Policy Decision					no change
		8:30	Jobless Claims, 0th.	10/03	***272***	***273***	267	a low trend
		1:00	Treasury Bond Auction					re-opened 30-year bonds
Friday	10/09	8:30	**Import Prices**	Sep	***NF***	-1.8	-0.9	trending sharply lower
			ex-food & fuels		***NF***	-0.4	-0.3	down, down, down

This Week…

There are a number of important economic data releases. However, we may not get the employment report on Friday if the government shuts down (moreover, a lengthy shutdown would limit data collection, distorting a wide range of economic series). The new federal fiscal year begins on October 1. With no progress on any of the 12 appropriations bills, Congress will need to come up with a Continuing Resolution to fund the government into FY16. A short shutdown need not be too disruptive to economic growth, mostly shifting growth from one month to the next. However, the added uncertainty of shutdown and a potential of further conflict over raising the federal debt ceiling, may add to market volatility.

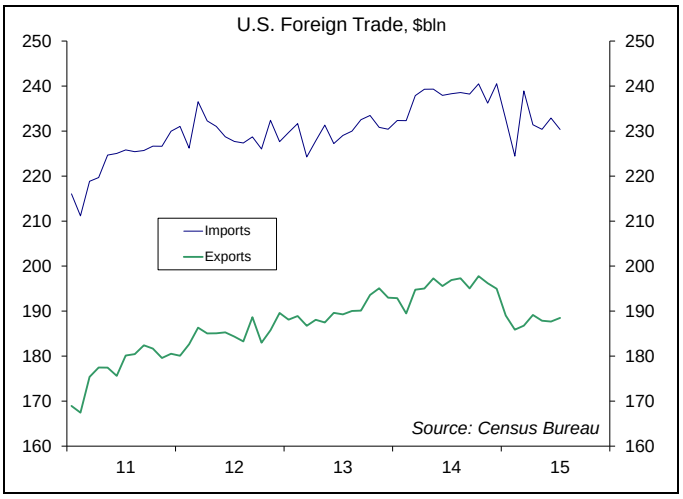
Monday

Personal Income and Spending (August) – Income is expected to have been supported by robust gains in wages and salaries, which will get an added boost in real terms by the drop in gasoline prices. That drop in gasoline ought to limit overall consumer spending growth (probably more so in September), but we should see moderately strong gains otherwise. The PCE Price Index should continue to reflect low inflation, but the Fed believes that the impact of lower oil and import prices is going to be transitory (and therefore, inflation should move higher, as long as inflation expectations remain well-anchored).

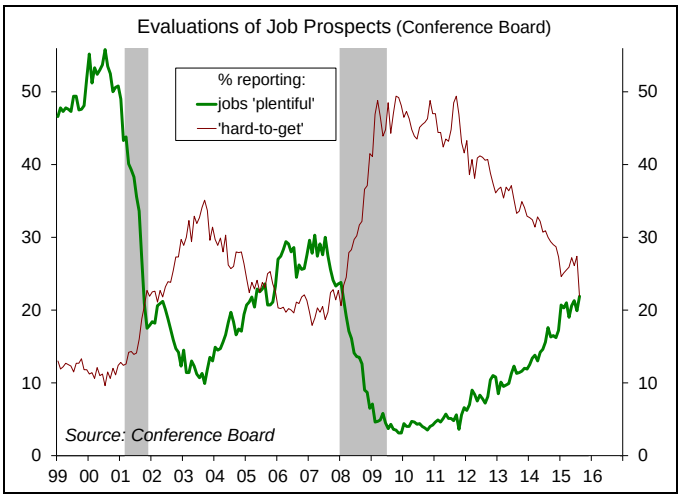
New Home Sales (August) – These data are reported with a huge amount of statistical uncertainty. Figures are erratic and subject to large revisions. However, the trend is moderately higher.

Tuesday

International Trade in Goods (August) – The Bureau of Census now releases an estimate of the goods deficit about a week before the more comprehensive trade report (due October 6). The report is unlikely to be market-moving, but the data will help fill in the picture for 3Q15 GDP growth.



Conference Board Consumer Confidence Index (September) – The headline figures are unlikely to be as sensitive as the UM Consumer Sentiment figures are to the stock market. However, the advance estimate is based on a partial sample. So we could see revisions to the figures for August. A month ago, the data showed the best rating on job availability since January 2008.



Wednesday

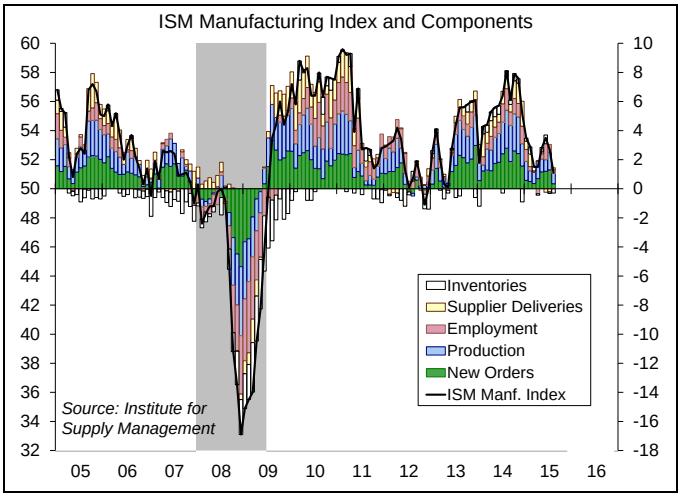
ADP Payroll Estimate (September) – The ADP is not considered to be a good predictor of the monthly changes in the official BLS figures (due Friday), but a large enough surprise (relative to the median forecast) can move the financial markets.

Chicago Purchasing Managers Index (September) – The Survey by ISM-Chicago covers firms in Illinois and Northern Indiana. The mix is believed to be more concentrated in durables. Figures this year have been unusually erratic.

Thursday

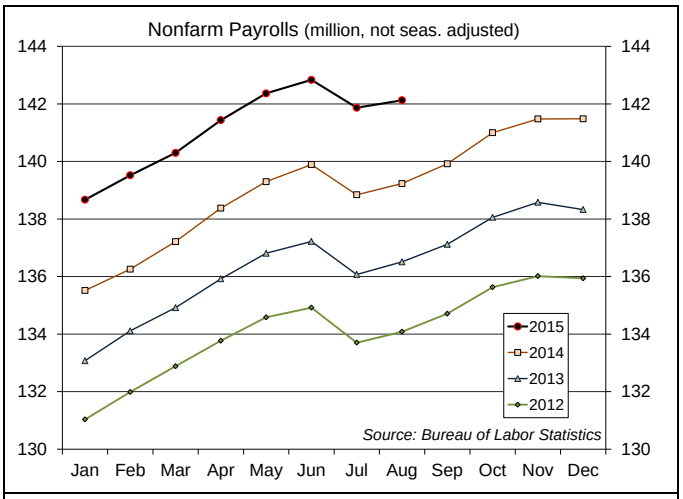
Jobless Claims (week ending September 26) – The trend has remained low in September.

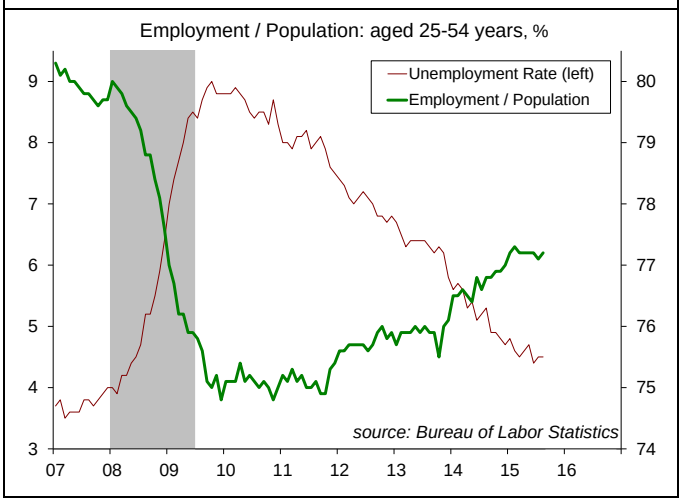
ISM Manufacturing Index (September) – The headline figures are likely to remain consistent with mixed, but generally lackluster, activity in the manufacturing sector. That reflects a mixture of overseas softness and domestic strength. Watch the components on new orders and employment.



Friday

Employment Report (September) – Once again, seasonal adjustment is a huge factor. We can expect to add about 1.5 million jobs in education (public and private) and lose over 800,000 non-education jobs (half of that in leisure and hospitality). The three-month average helps to smooth out much of the seasonal adjustment noise.





Next Week …

The economic calendar thins out.

Coming Events and Data Releases

October 12	Columbus Day (bond market closed)
October 14	Producer Price Index (September) Retail Sales (September) Fed Beige Book
October 28	FOMC Policy Decision (no press conference)
October 29	Real GDP (3Q15, advance estimate)
October 30	Employment Cost Index (3Q15)
December 16	FOMC Policy Decision, Yellen press conference
January 27	FOMC Policy Decision (no press conference)
March 16	FOMC Policy Decision, Yellen press conference