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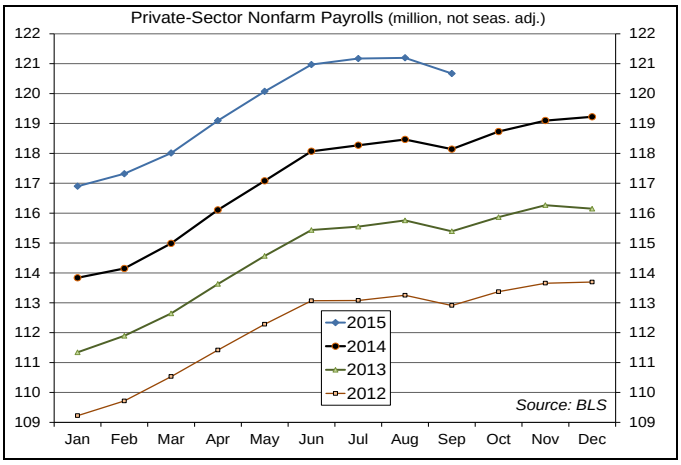
Weekly Market Monitor

Employment, GDP, and the Fed

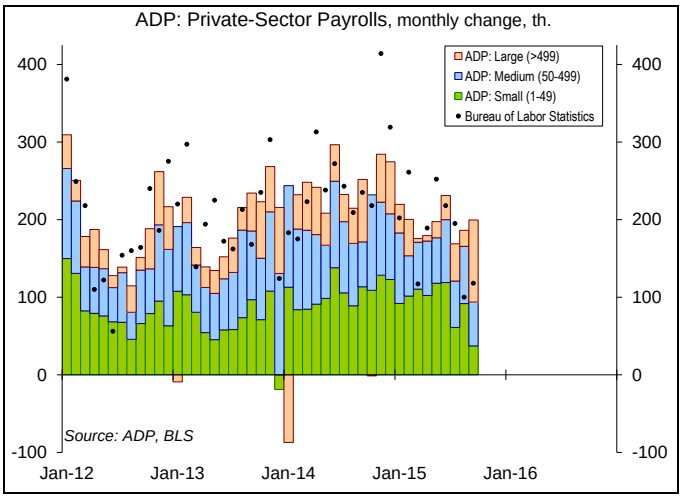
The September Employment Report was disappointing, but not horrible. Some of the recent softening in the pace of job growth may reflect seasonal issues. Stronger seasonal hiring in May and June should naturally lead to more seasonal layoffs in August and September. That is unlikely the only explanation. Concerns about global growth and financial market volatility may have made firms, especially smaller firms, reluctant to hire. Estimate of 3Q15 GDP have been declining, while underlying domestic demand have remained strong. All of this complicates the Fed's decision to begin normalizing monetary policy.

Nonfarm payrolls rose less than expected in September, while figures for July and August were revised lower. That is disappointing, to be sure, but not a disaster. One artifact of the financial crisis was a sharp drop in summer jobs. Labor force participation rates for teenagers and young adults fell sharply. The economy has been improving and the drop in gasoline prices was an enormous tailwind for tourism this summer. As teenagers and young adults head back to school, we should see more seasonal layoffs than usual.

Prior to seasonal adjustment, the economy added 1.5 million jobs in education (public and private), about the same as in September 2014. However, we shed 958,000 jobs outside of education, compared to 812,000 a year ago. Labor force participation fell 0.2 percentage points in September, but not for the key cohort (those aged 25-54).



There are issues beside the seasonal adjustment. Slower global growth has had an impact on U.S. manufacturing. The ISM Manufacturing Index was close to zero in September, reflecting mixed conditions. Recent volatility in global financial markets has likely reduced business confidence. The ADP estimate of private-sector payrolls showed slower gains at small and mid-sized firms in recent months. Job growth at smaller firms had been a key factor in job market strength.



With the third quarter now behind us, we still don't have a complete picture. However, we'll get a better focus as the economic data roll in. At this point, recent reports remain consistent with the general theme of domestic strength and global weakness. A wider trade deficit and slower inventory growth are expected to have subtracted significantly from 3Q15 GDP growth. How much is hard to say. We have foreign trade and inventory data for July. However, we have consumer spending figures for August and unit auto sales results through September. Inflation-adjusted consumer spending (70% of GDP) appears to be on track to have risen at a 3.5-4.0% annual rate.

Where does this leave the Fed? Since the FOMC meeting in mid-September, officials have been making the case for an initial rate increase by the end of the year. The September Employment Report would seem to put that in doubt. The federal funds futures contracts dipped after the report, with a 25-basis-point rate increase not fully factored in until March. Still, the Fed sees a further reduction in labor market slack over the next several months and it is appropriate to consider a very gradual path back to a normal policy position.

It's worth pointing out that the payroll figures are often revised. The "softening" in private-sector payroll growth may not hold up in revisions, or it could appear worse. While corporate layoff announcements continue to make headlines, when you add them all up, the monthly totals have remained relatively low. Moreover, weekly claims for unemployment benefits have continued to trend low (note that this is entirely consistent with large seasonal job losses for teenagers and young adults, who typically don't file claims when they go back to school). Job destruction is not an issue.

For the financial markets, the key takeaway is that the upcoming economic data will be important. Plenty of reports will arrive before the Fed policy meeting in mid-December.

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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
9/04/15	0.02	0.23	0.36	0.71	1.00	1.47	2.13	2.89	1.112	1.520	119.05	1.327	4683.92	1921.22	16102.38
9/25/15	0.00	0.07	0.35	0.70	1.00	1.48	2.17	2.96	1.119	1.517	120.74	1.332	4686.50	1931.34	16314.67
10/02/15	0.00	0.06	0.23	0.58	0.84	1.29	1.99	2.82	1.121	1.518	120.02	1.316	4707.78	1951.35	16472.64

Recent Economic Data and Outlook

The economic data reports were mixed, and investors continued to fret about global economic outlook. The employment report was disappointing (although hardly terrible) – a negative for stocks and the dollar, but a positive for bonds. Market participants were caught leaning the wrong way (looking for a better-than-consensus reading).

The September **Employment Report** was disappointing, but not a disaster. Nonfarm payrolls rose by 142,000 (median forecast: +205,000), while figures for July and August were revised a net 59,000 lower. Prior to seasonal adjustment, the economy added 1.5 million jobs in education (public and private) and lost 958,000 jobs outside of education (vs. 812,000 a year ago). Increased hiring in May and June likely led to more seasonal job losses than usual at the end of summer. Average weekly hours edged back down (after rising in August). Average hourly earnings were flat, up 2.2% y/y (in comparison the CPI rose 0.2% over the year ending in August). The unemployment rate held steady at 5.1%, but labor force participation fell from 62.6% to 62.4%, likely reflecting seasonal adjustment issues with teenagers and young adults (participation held steady for the key 25-54 aged cohort).

Personal Income rose 0.3% in August (+4.2% y/y), led by a 0.5% rise in private-sector wages and salaries (+4.4% y/y). **Personal Spending** rose 0.4% (+3.5% y/y), held down by lower gasoline prices. Ex-gasoline, spending rose 0.5% (+4.4% y/y). Inflation-adjusted spending (70% of GDP) rose 0.4% (+3.2% y/y) – and is on track for a 3.5-4.0% annual rate in 3Q15. The **PCE Price Index** was flat (+0.004% before rounding, +0.3% y/y), up 0.1% ex-food & energy (+1.3% y/y, vs. the Fed's goal of 2.0%).

Unit **Motor Vehicle Sales** rose to an 18.1 million seasonally adjusted annual rate in September, up from 17.7 million in August and 16.4 million a year ago. Sales of domestically built vehicles rose to a 14.4 million pace, from 13.8 million in August.

Consumer Confidence rose to 103.0 in the initial estimate for September, vs. 101.3 in August and 91.0 in July. September's improvement was concentrated in evaluations of the present situation. Current job market perceptions remained modestly optimistic. Expectations, which are thought to be a factor in big-ticket purchases, edged slightly lower (although strong sales of autos and furniture would seem to contradict that).

The **ISM Manufacturing Index** fell to 50.2 in September, vs. 51.1 in August and 52.7 in July. New orders were about flat. Production and employment continued to slow, but were still positive. Input prices fell more sharply. Comments from supply managers were mixed, but mostly cautious.

Factory Orders fell 1.7% in August (-6.5% y/y). Durable goods orders fell 2.3% (revised lower from the advance report), following a 1.9% rise in July (reflecting some seasonal adjustment noise in autos). Orders for nondefense capital goods ex-aircraft fell 0.8% (vs. +1.5% in June and +1.9% in July). Unfilled orders continued to edge lower.

The advance **Trade Deficit in Goods** widened to $67.2 billion in August, vs. $59.1 billion in July. The increase was about evenly split between higher imports (despite lower gasoline prices) and lower exports (reflecting economic softness abroad).

Economic Outlook (4Q15): about a 2.0% to 2.5% annual rate, following growth of around 2% in 3Q15 (held back by wider trade deficit and an inventory correction).

Employment: The pace of job growth has slowed somewhat, but job losses remain limited and new hiring remains good.

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

Manufacturing: Strength in autos, but soft otherwise -- likely reflecting the impact of the stronger dollar and slower global growth. Domestic orders have improved relative to 2Q15.

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

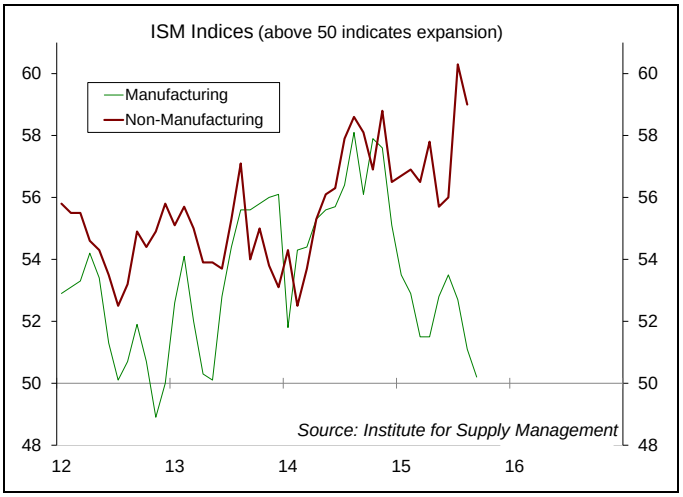
Prices: Overall consumer price inflation has been very low, but should pick up after energy prices stabilize. There is downward price pressure in commodities and imports. Wage pressures are generally mild. Inflation expectations remain well-anchored.

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	10/05	10:00	**ISM Non-Manf Index**	Sep	***58.0***	59.0	60.3	seen moderating, but still strong
Tuesday	10/06	8:30	**Trade Balance, $bln**	Aug	***-45.3***	-41.9	-45.2	should have widened
			goods only		***-64.9***	-61.4	-64.8	imports up, exports down
		9:00	**IMF: World Econ Outlook**					how bad?
		1:00	Treasury Note Auction					$24 billion in 3-year notes
Wednesday	10/07	1:00	Treasury Note Auction					$21 billion in re-opened 10-year notes
Thursday	10/08	7:00	BOE Policy Decision					no change
		8:30	Jobless Claims, 0th.	10/03	***274***	277	267	a low trend
		1:00	Treasury Bond Auction					$13 billion in 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
Next Week:								
Monday	10/12		Columbus Day					bond market closed
Tuesday	10/13	9:00	Small Business Optimism	Sep	***NF***	95.9	95.4	still recovering
		2:00	Treasury Budget, $bln		***+100.0***	+105.8	+75.1	release date tentative
			full fiscal year		***-430.0***	-483.4	-680.2	less than 3.5% of GDP
Wednesday	10/14	8:30	**Producer Price Index**	Sep	***-0.4%***	0.0%	+0.2%	lower oil prices
			ex-food & energy		***+0.2%***	+0.3%	+0.3%	mild old core
			ex-f, e, trade services		***+0.1%***	+0.1%	+0.2%	mild new core
		8:30	**Retail Sales**	Sep	***+0.5%***	+0.2%	+0.7%	unit auto sales rose
			ex-autos		***+0.2%***	+0.1%	+0.6%	lower gasoline prices
			ex-autos, bld mat, gasoline		***+0.5%***	+0.5%	+0.6%	moderate core sales
		10:00	Business Inventories	Aug	***-0.2%***	+0.1%	+0.7%	lower petroleum prices
		2:00	**Fed Beige Book**					still "modest to moderate"
Thursday	10/15	8:30	Jobless Claims, 0th.	10/10	***273***	***277***	267	a low trend
		8:30	**Consumer Price Index**	Sep	***-0.2%***	-0.1%	+0.1%	lower gasoline prices
			year-over-year		***+0.1%***	+0.2%	+0.2%	still very low
			ex-food & energy		***+0.1%***	+0.1%	+0.1%	mild core inflation
			year-over-year		***+1.9%***	+1.8%	+1.8%	seen about steady
		8:30	Real Hourly Earnings	Sep	***-0.2%***	+0.5%	+0.1%	nominal hourly earnings were flat
			Real Weekly Earnings		***-0.5%***	+0.7%	+0.1%	nominal weekly earnings fell 0.3%
		8:30	Empire St. Manf. Index	Oct	***-8.0***	-14.7	-14.9	very week in August and September
		10:00	Philadelphia Fed Index	Oct	***-1.0***	-6.0	+8.3	erratic, but seen soft
Friday	10/16	9:15	**Industrial Production**	Sep	***-0.4%***	-0.4%	+0.9%	looking for another decline
			Manufacturing Output		***-0.4%***	-0.5%	+0.9%	aggregate hours fell 0.5%
			Capacity Utilization		***77.2%***	77.6%	78.0%	lower
		10:00	UM Consumer Sentiment	m-Oct	***86.8***	87.2	91.9	low gasoline price vs. weak stock market

This Week…

The economic calendar thins out considerably. The ISM Non-Manufacturing Index has some market-moving potential. The IMF's World Economic Outlook should show a downward revision to global growth projections (and it usually does a good job in exploring the key issues). The markets usually don't pay much attention to the WEO, but it could serve to heighten concerns about the global economy. The FOMC policy meeting minutes are unlikely to shed much new light on the Fed outlook, but there's always a chance that something will be taken out of context and a lot has happened in the last couple of weeks (in their public comments, officials have made a strong case for raising short-term interest rates by the end of the year – but recent economic data have been mixed).



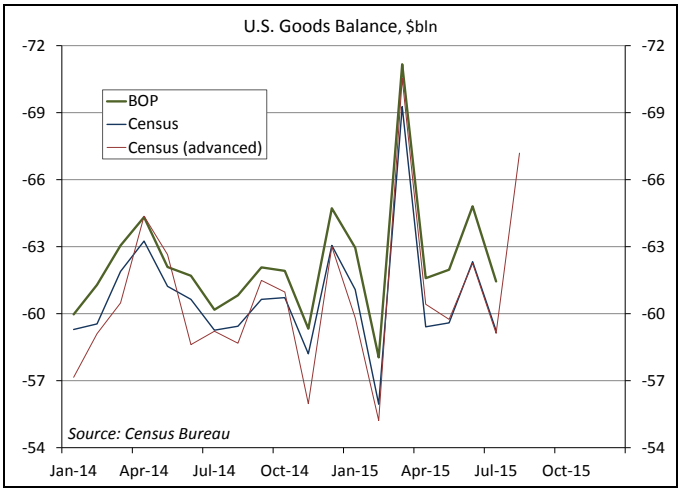
Monday

ISM Non-Manufacturing Index (September) – The IMF's factor survey showed mixed, but soft conditions in September. The IMF's other survey was strong in July and August, but is likely to reflect some moderation (still strong) in September.

Tuesday

Trade Balance (August) – The trade deficit in goods widened by about $8 billion in the advance estimate for August, with that move split about evenly between higher imports and lower

exports. These numbers can bounce around from month to month, but the average for July and August suggest that next exports will make a significant subtraction from 3Q15 GDP growth. Note that the full report will have estimates of price-adjusted imports and exports. Note that there are two deficit measures: the Bureau of Census gauge and the Balance of Payment gauge. The BOP measure, which is used in GDP calculations, makes adjustment to avoid double counting.



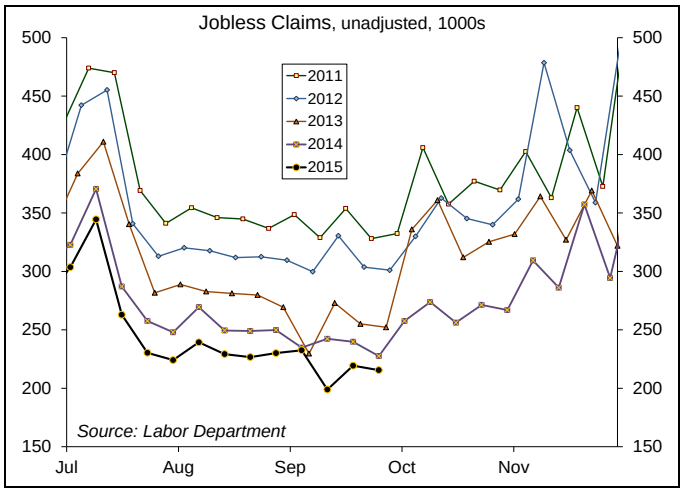
IMF World Economic Outlook – The World Bank and International Monetary Fund's annual conference will be held in Lima, Peru. The IMF is expected to revise down its forecast of global growth. We've already heard serious concerns expressed by Christine Lagarde, the IMF's managing director.

Wednesday

Bank of Japan Policy Decision – BOJ meetings rarely show up on the radar for U.S. investors, but following recent signs of weakness, many observers expect the BOJ to do more (and global financial markets may be disappointed if they don't).

Thursday

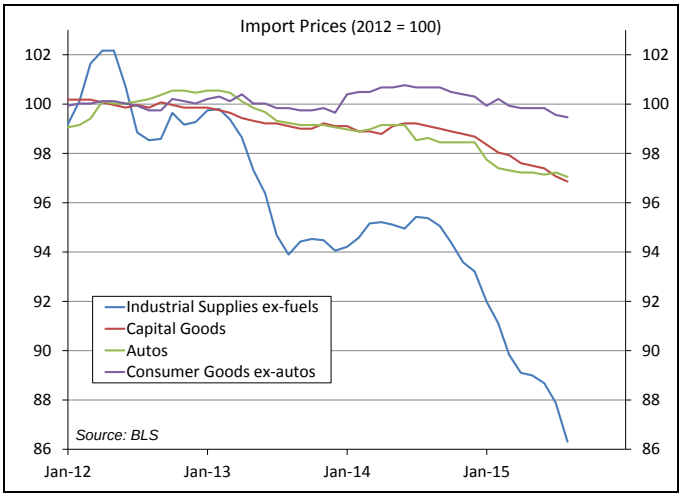
Jobless Claims (week ending October 3) – Unadjusted claims, which have been trending lower than a year ago, often spike at the start of the quarter (reflecting a "catch up" in state reporting. Hence, we could see some volatility in the adjusted figures in the next couple of weeks.



FOMC Minutes (September 16-17) – Investors will be looking for new insights into the Feds decision-making process, but we're unlikely to learn much that is new. The Fed indicated that it delayed the start of policy normalization due to concerns about the possible impact of "recent global economic and financial developments" on the U.S. economy (specifically, potential restraint on economic activity and further downward pressure on inflation in the near term). Since, that meeting, Fed officials have made compelling arguments that economic conditions are likely to warrant an initial rate hike by the end of the year. Janet Yellen, presented a thorough analysis of the inflation outlook. However, she did leave herself an out. That is, the Fed could alter the expected policy path "if the economy surprises." So what matters is the economy data since the policy meeting.

Friday

Import Prices (September) – Petroleum prices have been the dominant factor pushing import prices lower over the last year. However, we've also seen a sharp drop in prices of raw materials in general. Prices of imported finished goods have been trending lower as well.



Next Week …

Monday is a holiday for the bond market. The mid-month economic data begin to roll in, continuing the theme of domestic strength and global softness. The retail sales report is likely to receive most of the attention from the financial markets and should remain consistent with strong growth in spending.

Coming Events and Data Releases

October 20	Building Permits, Housing Starts (September)
October 28	FOMC Policy Decision (no press conference)
October 29	Real GDP (3Q15, advance estimate)
October 30	Employment Cost Index (3Q15)
November 6	Employment Report (October)
December 16	FOMC Policy Decision, Yellen press conference
January 27	FOMC Policy Decision (no press conference)
March 16	FOMC Policy Decision, Yellen press conference