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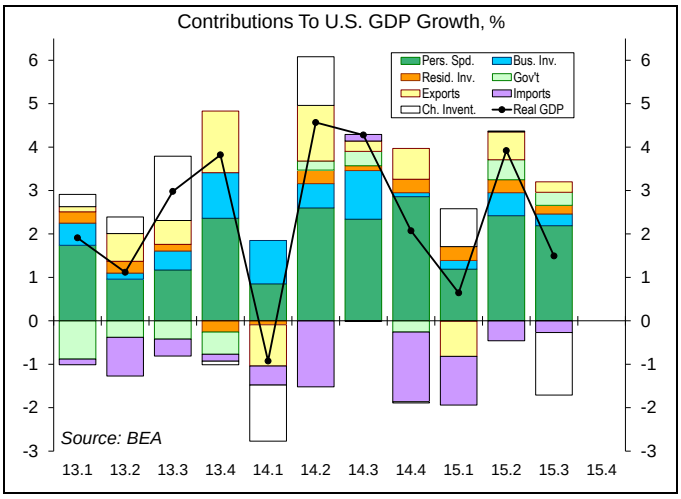
Weekly Market Monitor

Only the Data Can Stop a December Fed Rate Hike

As expected, the Federal Open Market Committee left short-term interest rates unchanged last week. However, the wording of the policy statement was decidedly hawkish, suggesting (contrary to market expectations) that officials are leaning toward a move on December 16. GDP growth wasn't especially brisk in the third quarter, but that was due largely to slower inventory growth. Domestic demand remained strong, but monthly figures suggest a loss of momentum heading toward 4Q15. Ultimately, the Fed's decision will remain data-dependent and there are many reports between now and then.

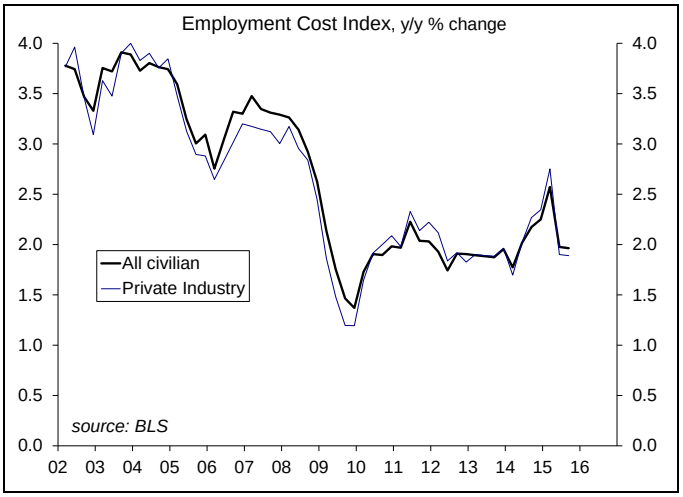
The advance estimate of GDP growth is always an adventure, as not all the pieces are known. However, the advance estimate for 3Q15 was largely in line with expectations, both in the headline number and in the details. In the monetary policy statement, the FOMC noted that *"household spending and business fixed investment have been increasing at solid rates in recent months."* Well, that's half right. Consumer spending led the way, rising at a 3.2% annual rate (down from 3.6% in 2Q15, which partly reflected a rebound from bad 1Q15 weather). Business fixed investment rose at a 2.1% pace (vs. +4.1% in 2Q15) – positive, but not quite *"solid."* Homebuilding continued to advance. Exports rose at a 1.9% annual rate (+1.5% y/y), while imports, which have a negative sign in the GDP calculation, rose 1.8% (+5.5% y/y) – leaving little change in net exports. Inventories slowed sharply. These figures will be revised.



The September figures on personal income and spending were a bit weaker than expected (and expectations were soft), suggesting that consumer spending lost momentum at the end of the quarter. However, this isn't horrible. We've had strong job gains over the last year and the drop in gasoline prices has added to consumer purchasing power (but a rise in rents has restrained those at the low end of the income scale).

The Fed appeared close to raising rates at the mid-September meeting, but refrained, noting that *"recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term."* That phrase received a lot of attention at the time, but it was removed in the October 28 statement. The FOMC did note, however, that it would be *"monitoring global economic and financial developments."*

Given the apparent "slow patch" in economic growth, and continued downside risks from abroad, why would the Fed even consider raising rates? It's still largely about the job market. Fed officials believe that a lot of slack has been taken up in the job market in the last few years. While some slack clearly remains, officials expect to see considerably less slack in 12 to 18 months, which is when monetary policy changes should have an impact on the economy. The Fed doesn't have to move to a neutral policy position right away, but it does have to start moving in that direction at some point.



Still, there are some good arguments for waiting. Labor compensation growth has remained lackluster (cited previously by Fed Chair Yellen as a sign of economic slack) and we should see some further downward pressure on inflation.

Global economic weakness is clearly having an impact on U.S. firms that do business abroad, but it doesn't appear to be large enough to threaten the current economic expansion (that is, expect somewhat slower growth, not a recession). Granted, global financial developments could still spin out of control, but that's not the base-case scenario.

Given everything we know now, the bottom line is that the Fed policy statement implies that policymakers are on track to begin tightening in December. It's up to the upcoming economic data reports to push the Fed off that path.

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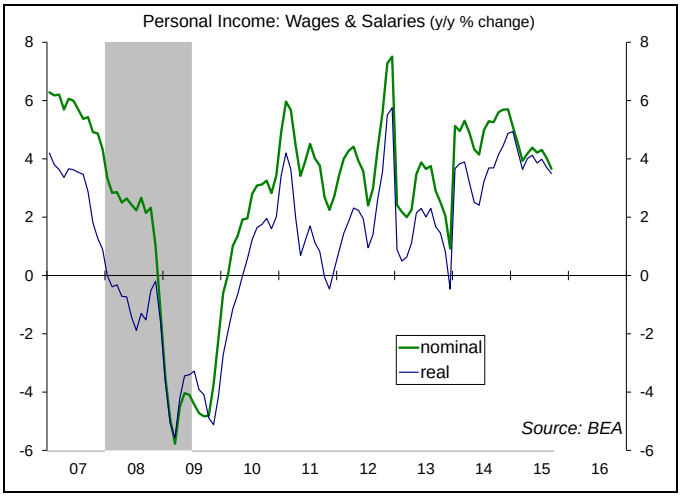
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
10/02/15	0.00	0.06	0.25	0.58	0.85	1.29	1.99	2.82	1.128	1.522	119.42	1.321	4707.78	1951.36	16472.37
10/23/15	0.01	0.13	0.24	0.66	0.94	1.43	2.09	2.90	1.102	1.534	121.20	1.317	5031.86	2075.15	17646.70
10/30/15	0.08	0.23	0.33	0.73	1.03	1.52	2.14	2.93	1.099	1.541	120.65	1.308	5053.75	2079.36	17663.60

Recent Economic Data and Outlook

The FOMC took a hawkish tone. GDP figures were in line with expectations. We have a deal on the debt ceiling and the budget.



Congress and the White House reached a tentative agreement on a two-year **Budget** deal, which would also suspend the **Federal Debt Ceiling** through March 2017.

The **Federal Open Market Committee** left short-term rates steady, as expected, but the policy statement had a more hawkish tilt. The FOMC removed the phrase about downside risks from the global economy (although the committee said it would continue *"monitoring global economic and financial developments"*). It also listed conditions for *"whether it will be appropriate to raise the federal funds target range at its next meeting"* (these were the same conditions as before, but the FOMC specifically referred to *"the next meeting"*). The FOMC noted *"solid"* rates of growth in consumer spending and business fixed investment, but recognized that job growth slowed and the unemployment rate held steady.

Real GDP rose at a 1.5% annual rate in the advance estimate for 3Q15. Consumer spending rose at a 3.2% pace (vs. 3.6% in 2Q15), while business fixed investment rose 2.1% (vs. 4.1%). Exports increased, offsetting higher imports (which have a negative sign in the GDP calculation). The pace of inventory growth was about half the 2Q15 pace, subtracting 1.44 percentage points from the headline GDP growth figure. Final sales to private domestic purchases rose 3.2% (vs. +3.9%).

The **Employment Cost Index** rose 0.6% over the three months ending in September, leaving the year-over-year gain at 2.0% (+1.9% for private industry).

Personal Income rose 0.1% in September (+4.1% y/y), restrained by a 0.1% decline in private-sector wages and salaries (+3.8% y/y). Manufacturing wages fell 0.6% (+0.9% y/y), which may reflect a combination of seasonal adjustment issues, slower global growth, and a stronger dollar. **Personal Spending** rose 0.1% (+3.4% y/y), up 0.2% adjusting for inflation (+3.2% y/y). Gasoline sales fell 9.1% (-25.4% y/y) – otherwise total spending would have risen 0.4% (+4.3% y/y). The **PCE Price Index** fell 0.1% (+0.2% y/y), up 0.1% ex-food & energy (+1.3% y/y).

The Advance report on **Trade in Goods** showed an unexpected narrowing in the deficit in September, to $58.6 billion, vs. $67.2 billion in August. Exports rebounded 3.1%, following a 3.2% drop in August (-5.8% y/y). Imports fell 2.5% (-5.1% y/y, reflecting lower petroleum prices).

The Conference Board's **Consumer Confidence Index** fell to 97.6 in the initial estimate for October (based on information collected to October 15), vs. 102.6 in September. Most of the decline was in evaluations of the present situation. Current job market perceptions were negative.

The University of Michigan's **Consumer Sentiment Index** rose to 90.0 in October, vs. 87.2 in September (the mid-October reading was 92.1). The improvement was concentrated in gains among lower income households, according to the report.

New Home Sales fell 11.5% (±11.2%) in September, to a 469,000 seasonally adjusted annual rate (+2.0%). The decrease was statistically different from 0%, but just barely.

The **Pending Home Sales Index** fell 2.3% in September, following a 1.4% decline in August (+6.1% y/y). The National Association of Realtors cited "a dearth of available listings in the lower end of the market for first-time buyers."

Durable Goods Orders fell 1.2% in the initial estimate for September, down 0.4% ex-autos. August figures were revised lower. Orders for nondefense capital goods ex-aircraft fell 0.3%, but that followed a 1.6% drop in August (revised from -0.8%).

The **Chicago Purchasing Managers Index** rose to 56.2 in October, vs. 48.7 in September and 54.4 in August. New orders and production were the highest since January. Production rose nearly 20 points. Employment fell back to neutral.

Economic Outlook (4Q15): about a 2.0% to 2.5% annual rate.

Employment: The pace of job growth has slowed somewhat, but job losses remain limited.

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

Manufacturing: Strength in autos, but flat 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 (or early 2016), but the more important question is the pace of tightening after the initial hike (expected to be very gradual).

This Week:					*forecast*	last	last –1	comments
Monday	11/02	9:45	Markit US Manf PMI (final)	Oct	***NF***	53.1	53.0	54.0 in the flash estimate
		10:00	Construction Spending	Sep	***+0.1***	+0.7%	+0.4%	assumed mixed in the advance GDP est.
		10:00	**ISM Manf Index**	Oct	***50.4***	50.2	51.1	seen a bit soft
Tuesday	11/03	10:00	Factory Orders	Sep	***-1.1%***	***-2.1%***	+0.2%	August to revised from -1.7%
		tbd	Motor Vehicle Sales, mln	Oct	***17.8***	18.1	17.7	expected to pull back
			domestically built		***14.0***	14.4	13.8	still a strong trend
Wednesday	11/04	8:15	**ADP Payroll Estimate, th.**	Oct	***+165***	+200	+186	seen slower (revisions?)
		8:30	Trade Balance, $bln	Sep	***-40.7***	-48.3	-41.8	likely a bit narrower
			goods only		***-60.2***	-67.9	-61.3	moderating
			ISM Non-Manf Index	Oct	***56.5***	56.9	59.0	moderately strong
		10:00	Yellen Testimony					on "Supervision and Regulation"
		1:00	Treasury Note Auction					$26 billion in 2-year notes (prev. delayed)
		7:30	Fed VC Fischer Speaks					on "Central Bank Independence"
Thursday	11/05	7:00	BOE Policy Decision					no change, but plenty of new information
		8:30	Jobless Claims, th.	10/31	***262***	260	259	a low trend
		8:30	Productivity (prelim.)	3Q15	***-1.2%***	+3.3%	-1.1%	NF business GDP at 1.2%, hours +2.7%
			Unit Labor Costs		***+3.5%***	-1.4%	+2.6%	choppy, but a higher trend
Friday	11/06	8:30	**Nonfarm Payroll, th.**	Oct	***+155***	+142	+136	a slower near-term trend
			private-sector		***+145***	+118	+100	but not "bad"
			Unemployment Rate		***5.1%***	5.1%	5.1%	flat or slightly lower
			employment/population		***59.3%***	59.2%	59.4%	little improvement y/y
			Avg. Weekly Hours		***34.5***	34.5	34.6	seen steady
			Avg. Hourly Earnings		***+0.2%***	-0.0%	+0.4%	modest wage pressures
Next Week:								
Monday	11/09	1:00	Treasury Note Auction					3-year notes
Tuesday	11/10	6:00	Small Business Optimism	Oct	***NF***	96.1	95.9	may improve slightly
		8:30	Import Prices	Oct	***NF***	-0.1%	-1.6%	may see a small bounce in petroleum
			ex-food & fuels		***NF***	-0.2%	-0.4%	trending down
		1:00	Treasury Note Auction					10-year notes
Wednesday	11/11		Veteran's Day					bond market closed
Thursday	11/12	8:30	Jobless Claims, th.	11/07	***260***	***262***	260	some seasonal noise, but a low trend
		1:00	Treasury Bond Auction					30-year bonds
Friday	11/13	8:30	**Producer Price Index**	Oct	***+0.2%***	-0.5%	0.0%	seasonal adjustment assumes gasoline ↓
			ex-food & energy		***+0.1%***	-0.3%	+0.3%	mild old core
			ex-f, e, trade services		***+0.0%***	-0.3%	+0.1%	flattish new core
		8:30	**Retail Sales**	Oct	***+0.2%***	+0.1%	0.0%	not especially strong
			ex-autos		***+0.3%***	-0.3%	-0.1%	small pickup in (seas. adj.) gasoline prices
			ex-autos, bld mat, gasoline		***+0.2%***	+0.1%	+0.2%	a soft trend heading into 4Q15
		10:00	Business Inventories	Sep	***-0.2%***	-0.0%	+0.0%	assumed lower in the adv. GDP est.
		10:00	Consumer Sentiment	m-Nov	***92.0***	90.0	87.2	likely to improve

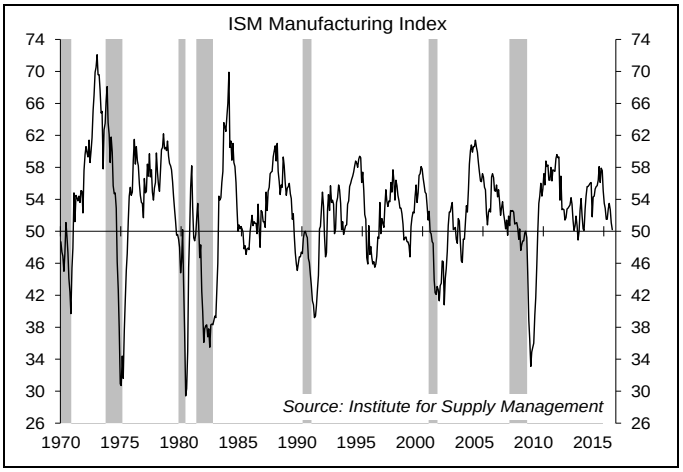
This Week…

The Fed's October 28 policy statement clearly put a December 16 rate hike back into play and most officials appears to be leaning toward a move at that time. However, the decision will remain data-dependent and there are a lot of figures between now and then. The Employment Report will likely be viewed as a key driver of policy. Seasonal adjustment (the start of the school year and end of the summer travel season) will still be a factor in October. Note that a step-up in hiring at small and medium-sized firms helped boost job growth last year and in the first half of this year, but the pace appeared to slow in the third quarter. Hence, the ADP payroll estimate (which includes a size-of-firm breakout) should be examined closely. Fed Chair Yellen and Vice Chair Fischer will speak, but not on monetary policy.

Monday

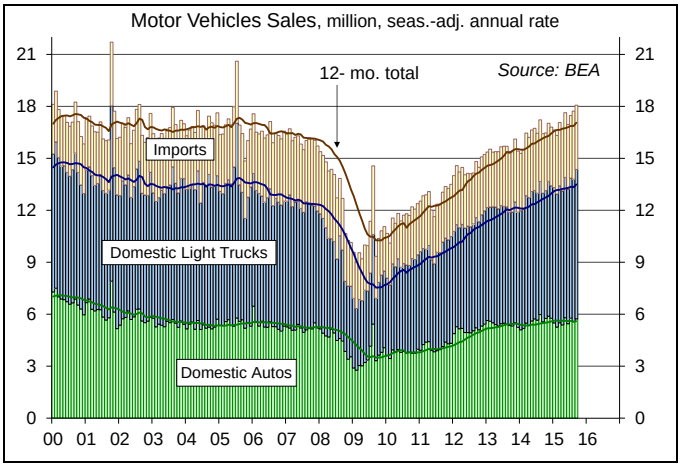
Construction Spending (September) – Construction activity was assumed to be mixed in the advance GDP estimate.

ISM Manufacturing Index (October) – A soft patch in manufacturing is not necessarily a sign of a recession. We may see some degree of improvement (still mixed) in October.



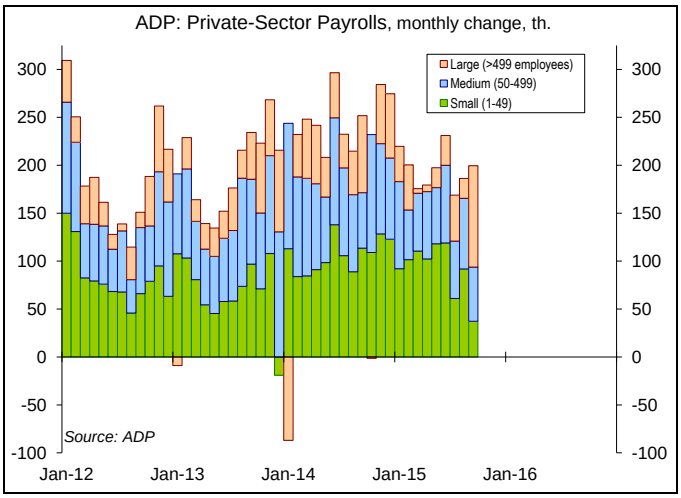
Tuesday

Motor Vehicle Sales (October) – Vehicle sales strengthened in the third quarter, adding to GDP growth. In the last few years, sales growth was driven by replacement needs and relatively easing credit in auto loans. At some point, sales should level out at a sustainable pace, but where that will be is an open question.



Wednesday

ADP Payroll Estimate (October) – We all know that the ADP is not a good predictor of the official BLS data, but a large enough surprise (relative to expectations) can move the financial markets. More importantly, the breakout by size of firm tells an important story. The slowdown in 3Q15, could reflect an impact from the negative news headlines (China, the stock market). Note that hiring at large firms jumped sharply in September – so watch for possible revisions to the previous data.



Trade Balance (September) – The advance report on trade in goods showed an unexpected narrowing in September and there tend to be few surprises in trade in services.

Thursday

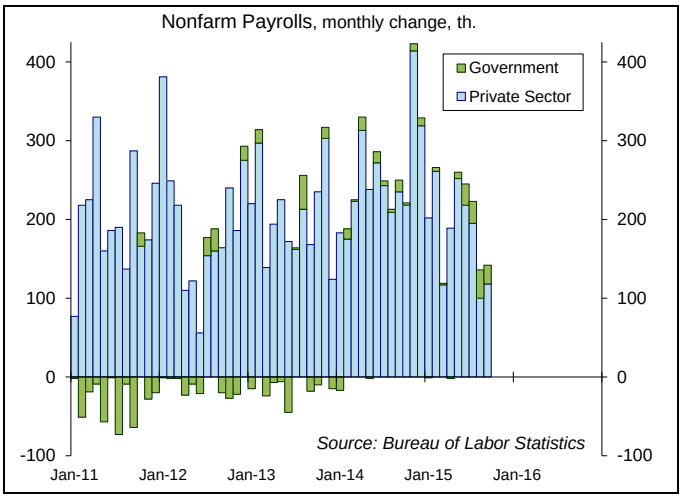
Bank of England Policy Decision – In the past, the BOE did not provide much information when policy did not change. Now, we get a lot more information, including a summary of the policy decision and an inflation report. The key question is when the BOE will start raising rates.

Jobless Claims (week ending October 30) – The trend in October has been very low, consistent with labor market strength.

Productivity (3Q15, preliminary) – Not good. The nonfarm business portion of GDP rose at a 1.2% annual rate. Aggregate private-sector hours rose at a 2.7% pace. Hence, we should see a decline in productivity and an increase in unit labor costs.

Friday

Employment Report (October) – The pace of growth in nonfarm payrolls slowed in July and August, but not terribly. Seasonal adjustment may have been a factor, in which case we should see a rebound in October or a revision to the previous figure. The market will zero in on the headline payroll change, but the three-month average will cut down the noise. The unemployment rate is likely to hold steady or perhaps edge a little lower. The employment/population ratio has risen only modestly over the last year. Average hourly earnings are likely to have risen modestly. Note that government (mostly state and local) is no longer a drag on overall job growth.



Next Week …

The important economic data (PPI and retail sales) arrive at the end of the week. The bond market has Veteran's Day off (why doesn't the stock market?).

Coming Events and Data Releases

November 17	Consumer Price Index (October) Industrial Production (October)
November 18	FOMC Minutes (10/28)
November 24	Real GDP (3Q15, 2nd estimate)
November 26	Thanksgiving (markets closed)
December 3	ECB Policy Decision Yellen JEC Testimony
December 4	Employment Report (November)
December 16	FOMC Policy Decision, Yellen press conference
January 27	FOMC Policy Decision (no press conference)
March 16	FOMC Policy Decision, Yellen press conference