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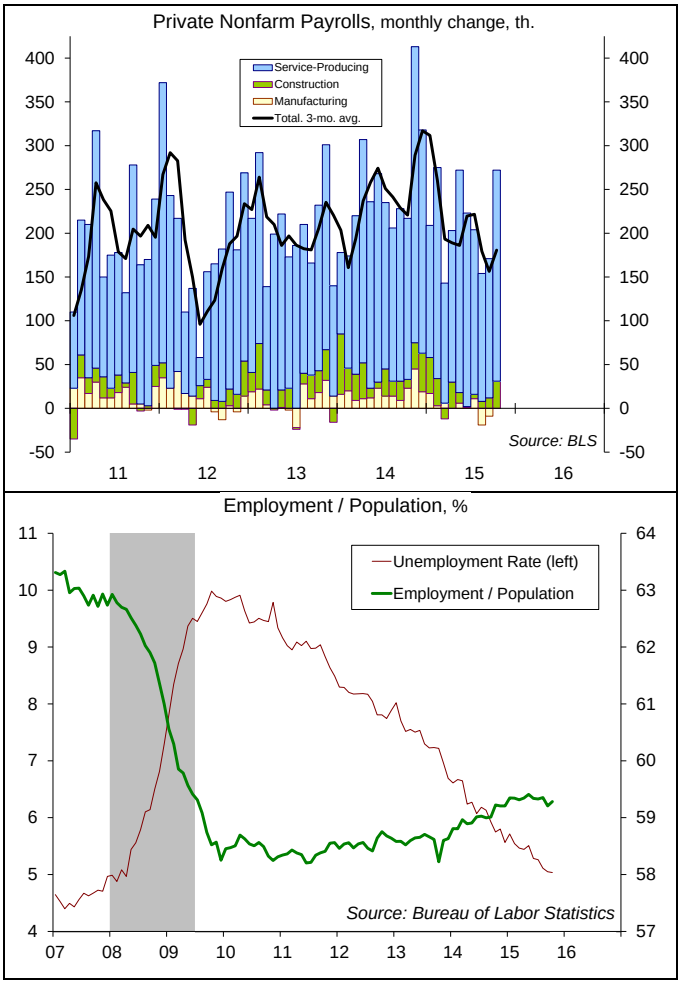
Weekly Market Monitor

The Job Market and the Fed

The October Employment Report was stronger than expected, but should be seen in its proper context. That is, while October's payroll gain far exceeded forecasts, it followed softer figures in August and September. The three-month average was moderate. Financial market participants believe that the report makes a December 16 rate hike a lot more likely. However, the Fed had already been signaling that such a move was likely.

Nonfarm payrolls rose by 271,000 in the initial estimate for October. Seasonal adjustment is often a bit tricky in the late summer and early autumn as the school year gets under way. We added 1.152 million jobs prior to the seasonal adjustment (vs. 1.082 million in October 2014 and 938,000 in October 2013), with about two-thirds of that gain in education. The three-month average for the adjusted payroll gain was +187,000 (a 2.2 million annual rate, vs. 3.0 million jobs added in 2014) – still well beyond the +120,000 monthly pace that would be consistent with population growth.



The unemployment rate was essentially unchanged (5.036%, vs. September's 5.051%), the lowest since April 2008. The employment/population ratio is trending about flat. Some Fed officials dismiss the e/p as distorted, largely reflecting a demographic change in labor force participation. Yet, it's also likely that the job market is a lot more flexible than the household survey data would suggest. That is, there are many individuals who could be lured back into the job market if there were a good enough job available. Two gauges that Fed Chair Yellen highlighted, long-term unemployment and the percentage of people involuntarily working part-time, continue to signal improvement, but they still have some way to go.

The Fed is not going to react to any one piece of economic data, including the October Employment Report. However, it should have been clear that officials were already leaning heavily toward a December move. Fed policymakers expect to see a lot less slack in the labor market a year from now. They anticipate that inflation will move back toward the 2% goal as the transitory impacts of low energy prices and lower import prices fade. Recall that the Fed came very close to raising rates in September, but delayed, citing possible restraints on the U.S. from global economic and financial developments. The downside risks from the rest of the world now appear to be a lot less worrisome than they did two months ago. Exports are down, but not terribly so, with most of the year-over-year decline being a reflection of lower prices for food and industrial commodities. A Fed rate hike would put some upward pressure on the dollar in the short term, but the exchange rate of the dollar is the Treasury's call and the Fed has to do what it has to do for the domestic economy. Still, the impact of a stronger dollar (restraint on exports, lower import prices) suggests that the Fed will likely be very gradual in raising rates over time.

Labor productivity figures bounce around a lot from quarter to quarter, but the trend over the last few years has been disturbingly low (about a 0.5% annual rate). It's unclear exactly why productivity has slowed, but it does add to concerns about secular stagnation. All else equal, a slower trend in productivity growth implies that the Fed should be quicker in raising rates (as the job market will tighten more rapidly at any given growth rate for GDP), but at the end of the cycle, the central bank should end up raising rates a lot less. That fits in with the idea of a December hike and a gradual pace thereafter.

Stock market participants need not fear a Fed tightening cycle. The initial move will reflect an optimistic economic outlook. Monetary policy will still be very accommodative even after the first couple of rate hikes. Still, we may see some volatility as the markets try to figure it all out. Fed officials can help by simplifying the message.

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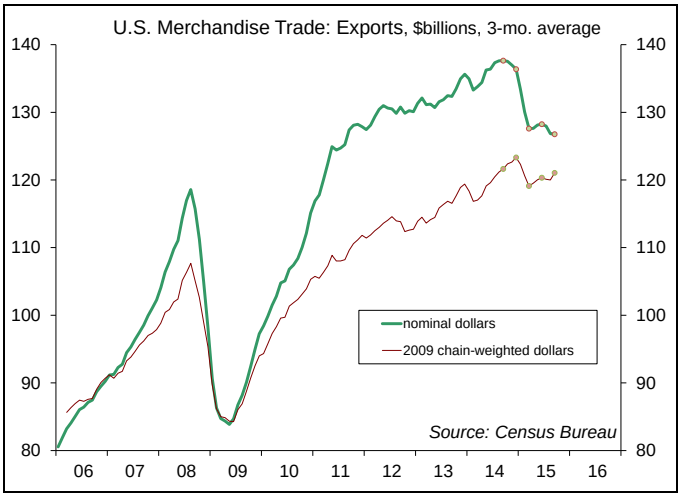
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
10/09/15	0.01	0.07	0.28	0.65	0.96	1.41	2.12	2.94	1.136	1.532	120.30	1.295	4830.47	2014.89	17084.49
10/30/15	0.08	0.23	0.34	0.75	1.05	1.52	2.16	2.93	1.104	1.545	120.70	1.308	5053.75	2079.36	17663.54
11/06/15	0.08	0.31	0.44	0.89	1.22	1.74	2.33	3.09	1.074	1.505	123.21	1.330	5147.12	2099.20	17910.33

Recent Economic Data and Outlook

The October employment figures were much stronger than anticipated, but should be considered in the broader context following softer job growth in August and September. Fed Chair Yellen pointed out that a December hike is on the table.



During the Q&A of her testimony on bank regulation, Fed Chair **Janet Yellen** said that while no decision has been made, a December rate hike is a possibility. She said that the economy is performing well and that inflation should move higher as the transitory effects of low energy prices and lower import prices fade. She stressed that the pace of tightening after the first move is more important than the timing, and it would be prudent for the Fed to move *"at a gradual, measured pace."*

The October **Employment Report** was much stronger than anticipated. Nonfarm payroll rose by 271,000 (median forecast: +180,000), with a net revision to the two previous months of +12,000 (the three-month average was +187,000). Unadjusted payrolls rose by 1.152 million (reflecting the start of the school year), vs. +1.081 million in October 2014. The unemployment rate edged down to 5.0%, but the employment/population ratio was only slightly higher than a year earlier. Average hourly earnings rose 0.4% (median forecast: +0.2%), but that followed no change in September (+2.5% y/y).

The **ADP Estimate** of private-sector payroll growth rose by 182,000 in the initial estimate for October. Hiring at small and medium-sized firms was strong last year and in the first half of this year, slowed in 3Q15, but picked back up in October.

Unit **Motor Vehicle Sales** held steady at a brisk 18.1 million seasonally adjusted annual rate in October, vs. 16.5 million in October 2014. The mix shifted a bit toward imports.

The **ISM Manufacturing Index** was little changed at 50.1 in October, vs. 50.2 in September and 51.1 in August. New orders and production picked up (still relatively slow). Employment declined (the lowest level since August 2009). Order backlogs continued to decline. Input prices continued to retreat. Comments from supply managers were mixed.

The **ISM Non-Manufacturing Index** rose to 59.1 in October, vs. 56.9 in September and 59.0 in August. Business activity, new orders, and employment each grew more rapidly. Comments from supply managers were mixed, but mostly upbeat.

The **U.S. Trade Deficit** narrowed to $40.8 billion in September, vs. $48.0 billion in August, no surprise given the advance report on trade in goods (released a week earlier) and about as expected in the advance GDP estimate. Exports were down 3.7% from a year earlier, not a sharp decline.

Factory Orders fell 1.0% in September, following a 2.1% decline in August, reflecting a decrease in civilian aircraft orders and lower petroleum prices. Orders for nondefense capital goods ex-aircraft slipped 0.1%, following a 1.4% decline in August (down 7.0% from a year ago). Unfilled orders continued to trend lower. Inventories declined (but along with shipments, were close to what was assumed in the advance GDP report).

Nonfarm Productivity rose at a greater-than-expected 1.6% annual rate in the preliminary estimate for 3Q15, up 0.4% y/y (and a +0.5% annual rate over the last 12 quarters). Unit Labor Costs rose 1.4%, up 2.0% from a year ago.

The **Bank of England** left policy unchanged, as expected, but Governor Carney was less hawkish, implying no pressing need to raise the benchmark interest rates anytime soon.

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

Employment: The pace of job growth has moderated, but the trend remains relatively strong by historical standards.

Consumers: Job growth has been supportive. Wage growth is still lackluster, but may be picking up. The drop in gasoline prices has boosted consumer purchasing power, but the impact varies across the income scale.

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, 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	11/09	1:00	Treasury Note Auction					$24 billion in 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					$24 billion in 10-year notes
Wednesday	11/11		Veteran's Day					bond market closed
Thursday	11/12	8:30	Jobless Claims, th.	11/07	***272***	276	260	some seasonal noise, but a low trend
		1:00	Treasury Bond Auction					$16 billion in 30-year bonds
		6:00	Fed VC Fischer Speaks					*"Financial Stability and Monetary Policy"*
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	***+0.5%***	+0.1%	0.0%	moderately strong
			ex-autos		***+0.4%***	-0.3%	-0.1%	small pickup in (seas. adj.) gasoline prices
			ex-autos, bld mat, gasoline		***+0.4%***	+0.1%	+0.2%	seen strong enough…
		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
Next Week:								
Monday	11/16		Empire St. Manf. Index	Nov	***NF***	-11.4	-14.7	weak in recent months
Tuesday	11/17	8:30	**Consumer Price Index**	Oct	***+0.2%***	-0.2%	-0.1%	moderate
			year-over-year		***+0.1%***	-0.0%	+0.2%	still roughly flat y/y
			ex-food & energy		***+0.1%***	+0.2%	+0.1%	mild core inflation
			year-over-year		***+1.8%***	+1.9%	+1.8%	half of the y/y gain is shelter
		8:30	Real Hourly Earnings	Oct	***+0.1%***	+0.1%	+0.5%	nominal hourly earnings rose 0.36%
			Real Weekly Earnings		***+0.1%***	-0.2%	+0.4%	nominal weekly earnings rose 0.36%
		9:15	**Industrial Production**	Oct	***+0.3%***	-0.2%	-0.1%	a moderate gain, but a soft trend
			Manufacturing Output		***+0.3%***	-0.1%	-0.3%	aggregate hours rose 0.2%
			Capacity Utilization		***77.6%***	77.5%	77.8%	no bottleneck pressures for inflation
		10:00	Homebuilder Sentiment		***64***	64	61	trending higher
Wednesday	11/18	8:30	**Building Permits, mln**	Oct	***1140***	1105	1161	single-family strength
			% change		***+3.2***	-4.8	+2.7	multi-family noise
			Housing Starts		***1180***	1206	1132	choppy
			% change		***-2.2***	+6.5	-1.7	watch for revisions
		2:00	**FOMC Minutes**	10/28				leaning toward a December hike
Thursday	11/19	8:30	Jobless Claims, th.	11/14	***273***	***272***	276	a low trend
		10:00	Philadelphia Fed Index	Nov	***NF***	-4.5	-6.0	weak in recent months
		10:00	Leading Econ Indicators	Oct	***+0.5%***	-0.2%	0.0%	most components added
		1:00	TIPS Auction					re-opened 10-year TIPS
Friday	11/20		no significant data					note to self: order turkey

This Week…

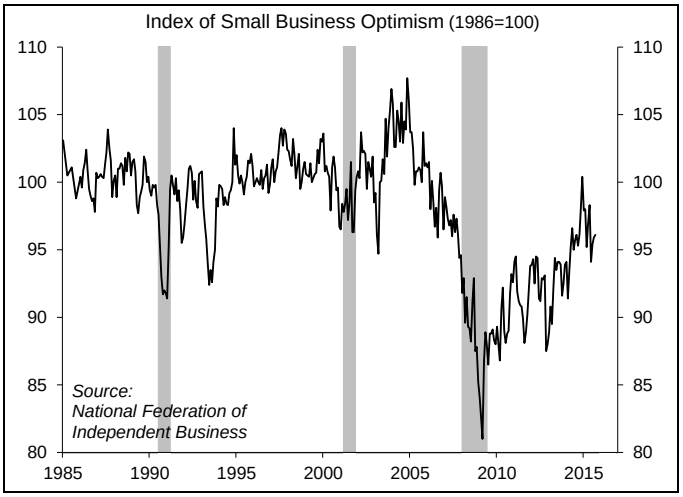
The economic calendar thins out considerably, with the important releases (retail sales, PPI) arriving on Friday. Unit motor vehicle sales remained strong last month and we ought to see some pickup in the pace of core retail sales. The seasonal adjustment anticipates a large drop in wholesale gasoline prices in October. Core inflation and pipeline gauges are likely to remain relatively mild. Fed Vice Chair Stanley Fischer will speak on Thursday after the market close and he may have some comments relating to the mid-December policy decision.

Monday

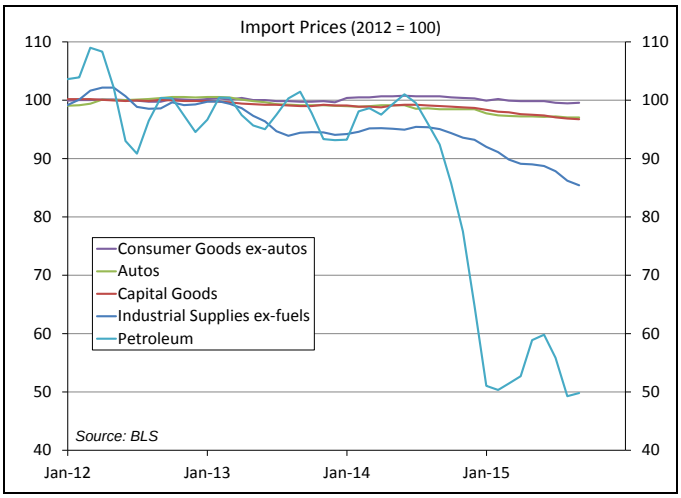
No significant data.

Tuesday

Small Business Optimism Index (October) – Following last year's improvement, the headline index slipped back a bit this year, but seems poised to trend higher (as the downside risks from the rest of the world appear to be less worrisome.



Import Prices (October) – We may see further downward pressure on commodity prices in the near term, but these are expected to stabilize (or begin to reverse) in the months ahead.

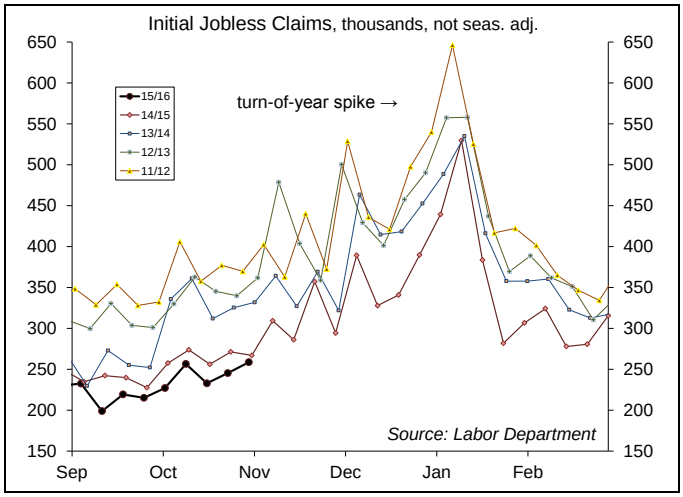


Wednesday

Veterans Day Holiday – Bond market closed.

Thursday

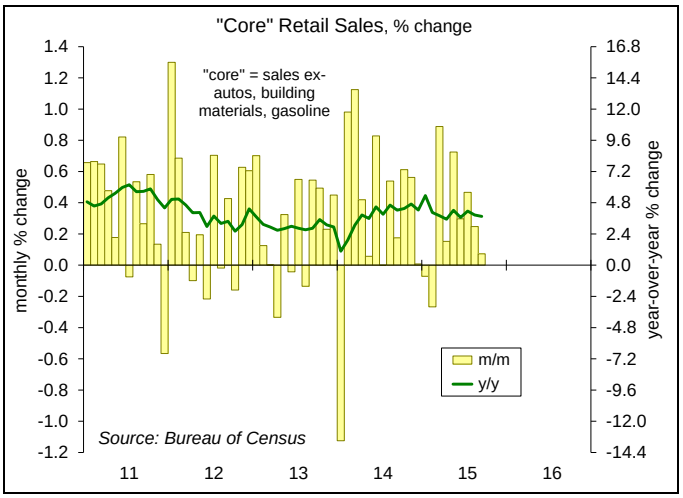
Jobless Claims (week ending October 30) – Seasonal adjustment becomes increasingly challenging in the final months of the year. The trend in claims was very low in October. We may see the numbers bounce around in the coming weeks, but the four-week average is likely to remain low, consistent with strengthening labor market conditions.



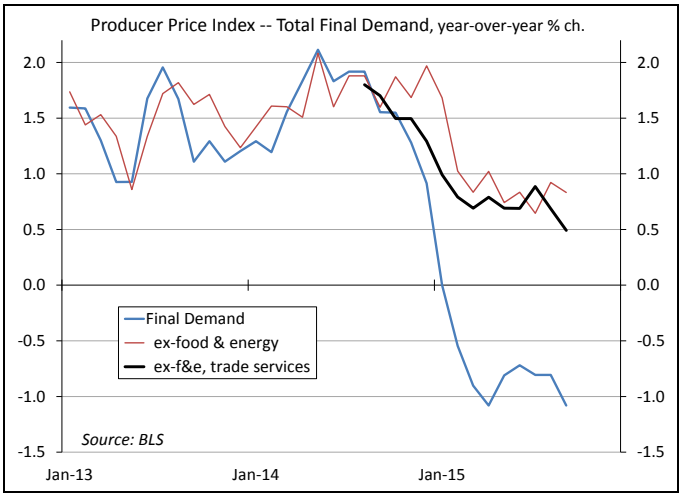
Fed Vice Chair Fischer Speaks (*"Incorporating Financial Stability into Monetary Policy"*) – Financial stability is a key issue for the Fed. Worries about the possible downside risks to the U.S. economy from global economic and financial developments prevented the Fed from raising rates in September. Fischer is expected to tell us how the Fed currently sees the risks.

Friday

Retail Sales (October) – Unit motor vehicle sales remained strong last month, although the correlation to dealership sales in the retail sales report isn't perfect (the Bureau of Economic Analysis uses unit sales in the GDP calculation). Gasoline prices are likely to have risen moderately after seasonal adjustment. Core retail sales showed some loss of momentum at the end of 3Q15, but seem likely to pick up in early 4Q15.



Producer Price Index (October) – The seasonal adjustment expects a 5.8% decline in wholesale gasoline prices in October, so we may see a small increase in the adjusted figure. Core inflation in the PPI has been trending low in recent months.



Next Week …

The mid-month economic data may have some impact, but market participants are likely to be more interested in the October 27-28 FOMC minutes.

Coming Events and Data Releases

November 23	Existing Home Sales (October)
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
April 27	FOMC Policy Decision (no press conference)
June 15	FOMC Policy Decision, Yellen press conference