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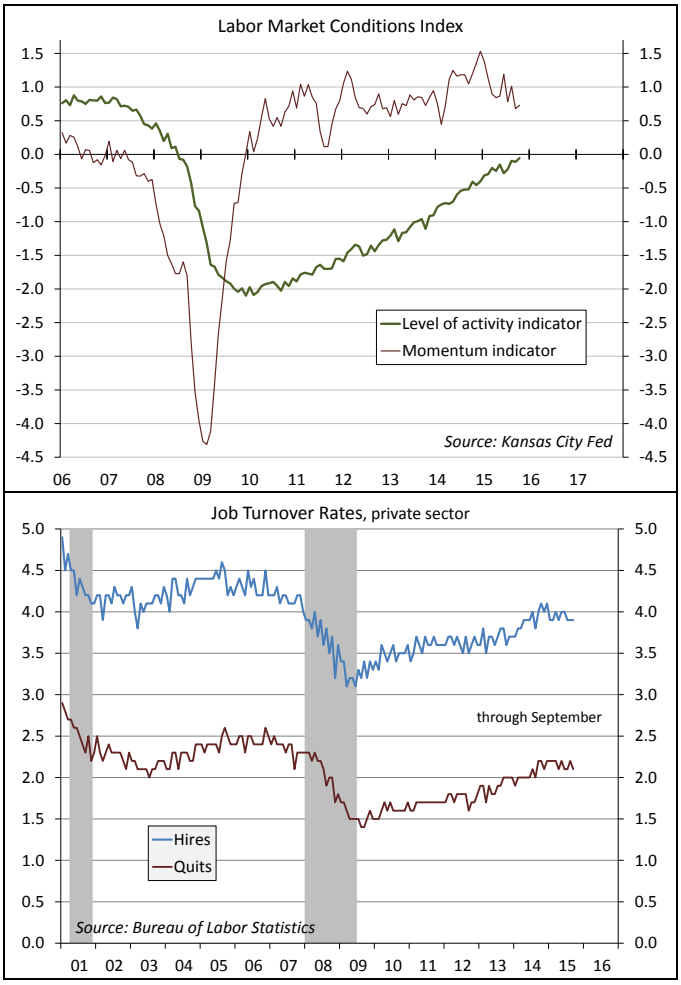
Weekly Market Monitor

Fed Up

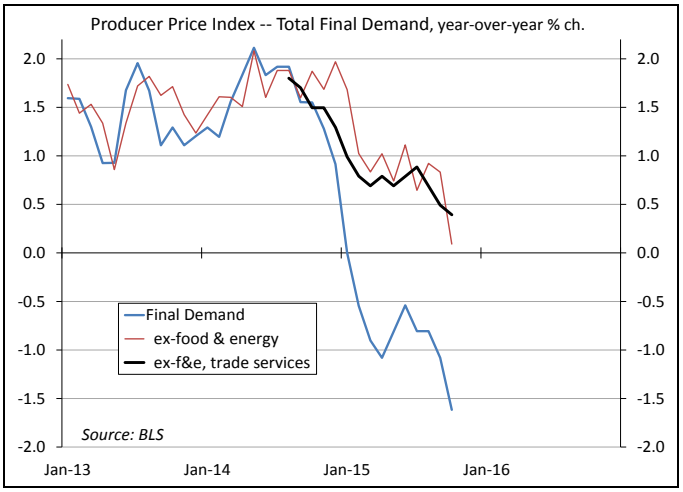
The agonizing over whether the Fed will begin raising short-term interest rates is unlikely to end soon. A 25-basis-point increase shouldn't have much of an impact on the economy, especially if the Fed makes it clear that it intends to go slow with further rate hikes. However, the financial markets believe this to be a big deal. So it is. Fed officials have continued to signal that it *"may be appropriate"* to start in December, but they have also continued to signal that this is not a done deal.

Many market participants viewed the October employment data as being the clincher – a clear catalyst for Fed liftoff. However, Fed officials were already leaning hard in that direction before the jobs data. Recall that the Fed came very close to raising rates in September, but delayed, citing possible downside risks from the rest of the world. Those downside risks are still with us, but they appear to be less worrisome than two months ago. The stronger dollar and weaker global economy have restrained U.S. exports, but it hasn't been a sharp drag.



Domestically, the economy appears to be in relatively good shape, although GDP growth is likely to be somewhat slower in the near term. Retail sales disappointed in October, suggesting less positive momentum for consumer spending into 4Q15, but aggregate wage gains (from the Employment Report) picked up.

Why does the Fed want to raise rates? It's largely about the job market. Monetary policy affects the economy with a long and variable lag (usually taken to be 12 to 18 months). At the current pace, there will be a lot less slack in the job market a year from now. In early 2014, Fed Chair Yellen highlighted hiring and quit rates as important gauges of the job market's strength. Hiring and quit rates improved since the start of the economic recovery, but have flattened out over the last year. Although the unemployment rate has declined, there may be a lot more slack in the job market than that figure would suggest.



In the October 28 policy statement, the FOMC repeated that it wants to see some further improvement in the labor market, but it also needs to be *"reasonably confident"* that inflation will move back toward the Fed's 2% goal. In public speeches, senior Fed officials have repeated the simple logic that inflation should pick up as the impact of low oil prices and low import prices fade. However, over the last couple of weeks, the dollar has strengthened again and commodity prices have dipped. The Producer Price Index showed further downward pressures.

Many see the Fed as being in a box – policymakers can't raise rates, because the markets won't let them. Falling share prices and a stronger dollar will further restrain economic growth and put additional downward pressure on inflation. However, a small rate increase should not have much of an impact on the economy and Fed officials have continued to stress that the path of policy tightening will be data-dependent and likely very gradual. We should get a strong, clear signal from Chair Yellen when she delivers her JEC testimony on December 3.

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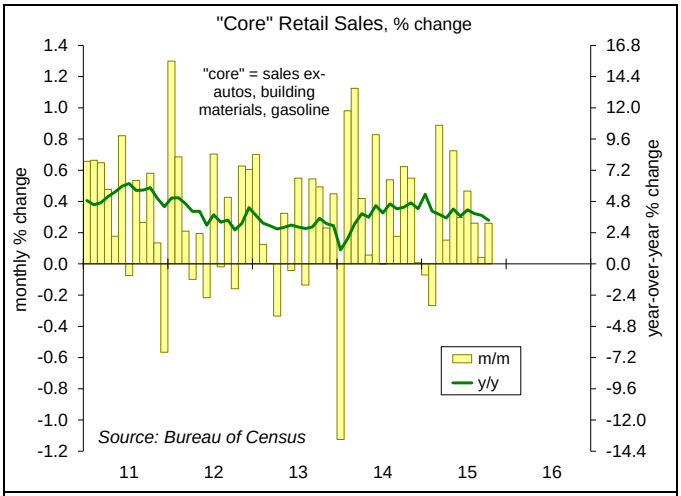
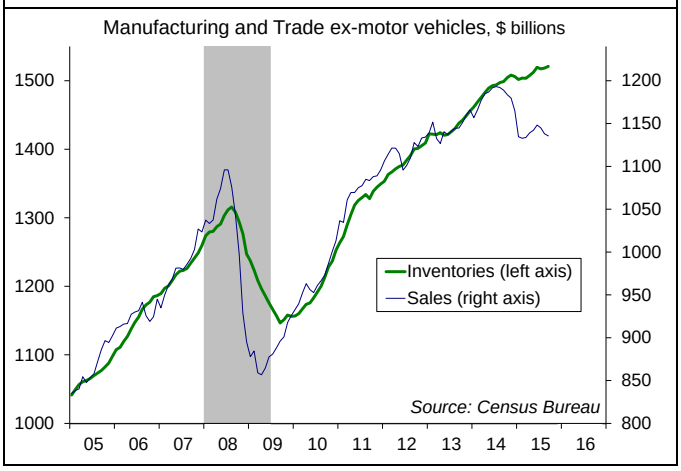
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
10/16/15	0.01	0.07	0.23	0.61	0.91	1.36	2.04	2.87	1.136	1.544	119.60	1.293	4886.69	2033.11	17215.97
11/06/15	0.08	0.32	0.47	0.90	1.23	1.73	2.09	2.34	1.075	1.507	123.20	1.331	5147.12	2099.20	17910.33
11/13/15	0.13	0.30	0.49	0.85	1.19	1.66	2.28	3.06	1.075	1.523	122.62	1.332	4927.88	2023.05	17245.10

Recent Economic Data and Outlook

Stock market participants generally remained anxious about the prospects for Fed tightening.





Fed Vice Chair Stanley Fischer said that the U.S. economy had weathered the impact of the strong dollar and soft global growth "reasonably well," but noted that the drag on growth would likely continue in 2016. He indicated that "it may be appropriate" to begin raising short-term interest rates at the December FOMC meeting, but implied that a decision hasn't been made yet. He said that consumer price inflation was likely to move higher next year, as the transitory impacts of lower energy and import prices dissipate.

Retail Sales rose 0.1% in the initial estimate for October, following no change over the two previous months (+1.7% y/y). Auto sales fell 0.5% (+6.2%). Sales of building materials rose 0.9% (+4.3% y/y). Sales of gasoline fell 0.9% (+0.8% before seasonal adjustment, -20.1% y/y). Core retail sales (sales ex-autos, building materials, and gasoline) rose 0.3% (+3.4% y/y).

Business Inventories rose 0.3% in September, more than was assumed in the advance GDP report (implying, all else equal, an upward revision to the third quarter growth estimate). Retail inventories rose 0.8% (autos +1.4%, non-autos +0.5%). Wholesale inventories rose 0.5%. Total inventories were 2.5% higher than a year ago, while sales were down 2.8%.

The **Producer Price Index** fell 0.4% in October (-1.6% y/y), partly reflecting a 0.8% decline in food (which also fell 0.8% in September, -4.2% y/y). Energy was flat, with gasoline up 3.8% (-2.2% before seasonal adjustment, -37.9% y/y). Ex-food, energy, and trade services, the PPI fell 0.1% (+0.4% y/y). The report also showed further downward inflation pressure within the pipeline. Ex-f&e, the price index for processed intermediate goods fell 0.4% (-7.6% y/y), while unprocessed intermediate goods fell 1.3% (-16.8% y/y).

Import Prices fell 0.5% in October (-10.5% y/y), down 0.2% ex-food & fuels (-3.0% y/y). Ex-fuels, the price index for imported industrial supplies and materials fell 1.0% (-10.4% y/y). Capital goods edged down 0.1% (-2.3% y/y). Autos fell 0.3% (-1.6% y/y). Consumer goods (ex-autos) rose 0.1% (-0.6% y/y).

The **Small Business Optimism Index** held steady at 96.1 in October (also the same level as in October 2014). Earnings remained under pressure and the general business outlook was somewhat negative, but the outlook for expansion was moderately positive. Hiring plans remained moderately strong, but actual net hiring was near zero.

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	11/16		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***	276	276	a low trend
		8:30	Philadelphia Fed Index	Nov	***NF***	-4.5	-6.0	note: new release time
		10:00	Leading Econ Indicators	Oct	***+0.5%***	-0.2%	0.0%	most components added
		1:00	TIPS Auction					$13 billion in re-opened 10-year TIPS
Friday	11/20		no significant data					note to self: order turkey
Next Week:								
Monday	11/23	10:00	**Existing Home Sales, mln**	Oct	***5.50***	5.55	5.30	still strong
			% change		***-0.9***	+4.7	-5.0	some supply constraints
		1:00	Treasury Note Auction					2-year notes
Tuesday	11/24	8:30	**Real GDP (2nd estimate)**	3Q15	***+2.0%***	+3.9%	+0.6%	+1.5% in the advance estimate
		8:30	Trade Balance in Goods, $b	Oct	***-63.2***	-58.6	-67.2	seen wider
		10:00	**Consumer Confidence**	Oct	***99.2***	97.6	102.6	likely to rebound somewhat
		1:00	Treasury Note Auction					5-year notes
Wednesday	11/25	8:30	Jobless Claims, th.	11/14	***272***	***273***	276	a low trend
		8:30	Personal Income	Oct	***+0.5%***	+0.1%	+0.4%	a rebound in aggregate wage income
			Personal Spending		***+0.2%***	+0.1%	+0.4%	a softer trend into 4Q15
			PCE Price Index ex-f&e		***+0.1%***	+0.1%	+0.1%	still a low trend
		8:30	**Durable Goods Orders**	Oct	***+1.1%***	-1.2%	-2.9%	expecting a rebound in aircraft orders
			ex-transportation		***+0.4%***	-0.3%	-0.9%	mixed, but moderate, otherwise
			nondef cap gds ex-aircraft		***+0.3%***	-0.1%	-1.4%	a soft trend into 4Q15
		10:00	**New Home Sales, mln**	Oct	***505***	468	529	likely to rebound (choppy data)
			% change		***+7.9***	-11.5	+5.2	watch for possible revisions
		10:00	Consumer Sentiment	Oct	***93.0***	90.0	87.2	93.1 at mid-month
Thursday	11/26		Thanksgiving Holiday					markets closed
Friday	11/27		no significant data					market close early

This Week…

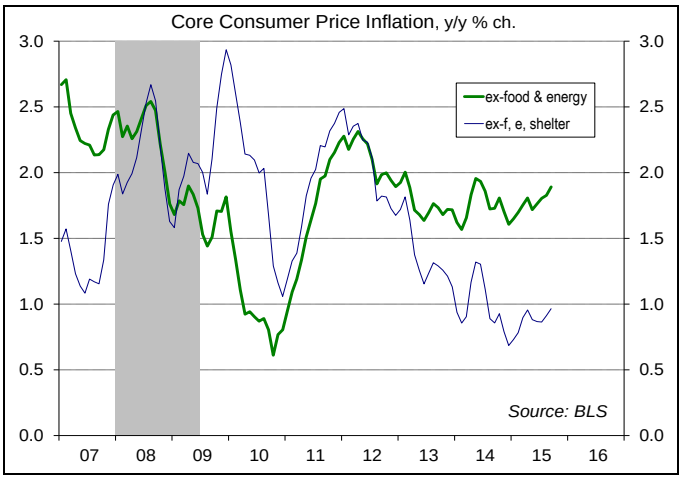
Figures on industrial production and residential construction will help to fill in the economic picture, but financial market participants are likely to be more interested in the FOMC minutes. It's likely that Fed officials were expecting to begin raising rates in December, and we should get more color on why that was (and what might prevent that from happening).

Monday

Empire State Manufacturing Index (October) – These data are squirrelly, but have been very weak in the last couple of months.

Tuesday

Consumer Price Index (October) – Gasoline prices fell about 3% last month, which is less than the usual October decline. Hence, we should see gasoline add a little to the headline figure. Core inflation has been trending close to 2%, but half of that has been in shelter (which accounts for 42% of the core CPI), which has a smaller weighting in the PCE Price Index.

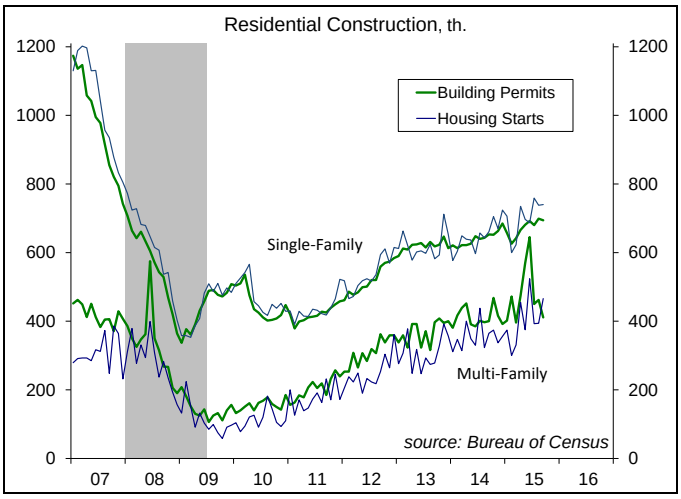


Industrial Production (October) – Factory output has been mixed in recent months, reflecting continued strength in motor vehicle production and soft demand for U.S. exports. U.S. trade figures have shown a drop in exports, but not the sharp decline that many had feared. A further strengthening of the dollar would likely dampen export activity further, but not enough to send the overall economy into a recession.

Homebuilder Sentiment (November) – The National Association of Home Builders' Housing Market Index jumped in October, but seems likely to stabilize in November.

Wednesday

Building Permits, Housing Starts (October) – Recent figures have remained consistent with improvement in single-family construction activity, but the headline numbers reflect the high degree of volatility in the multi-family sector. Single-family permits are the key figure in the report. Many homebuilders continue to face a variety of constraints (a scarcity of skilled labor, tight bank credit for the smaller builders).



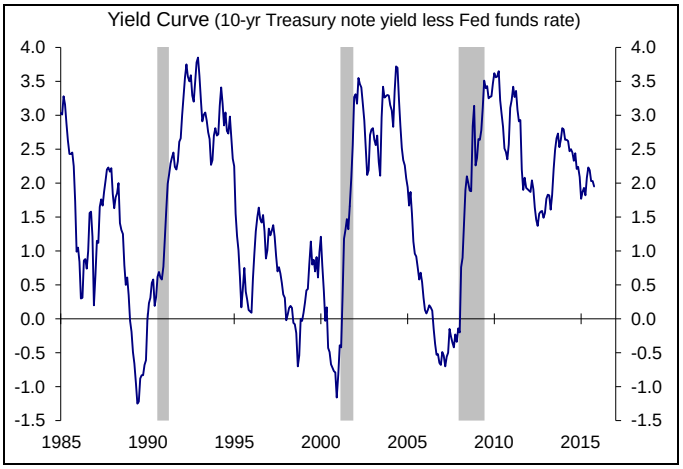
FOMC Minutes (October 28-29) – The October policy meeting minutes are likely to show most Fed officials to be on board with a December rate increase. The Fed was very close to raising rates in September, but delayed, citing possible downside risks from the rest of the world. Those downside risks are still with us, but they appear to be a lot less worrisome than they did two months ago. Note that prior to the September FOMC meeting, eight of the 12 Federal Reserve districts had requested that the Fed's Board of Governors approve a 25-basis-point increase in the primary credit rate (often called "the discount rate"). The minutes should help to clarify why the Fed is thinking about an initial rate hike (it's about moving gradually to a more neutral policy) and what it would take to delay in December (bad economic data or financial market turmoil).

Thursday

Jobless Claims (week ending November 14) – Still very low.

Philadelphia Fed Index (November) – Weak in recent months, we may see some slight improvement in November, but these figures can be erratic.

Leading Economic Indicators (October) – Components were mostly higher (it's a published formula, so it's largely a question of rounding errors). The most significant leading indicator is the slope of the yield curve (still positive).



Friday

No significant economic data.

Next Week …

A feast of economic data (home sales, consumer confidence, durable goods orders, and revised GDP) before the holiday.

Coming Events and Data Releases

December 1	ISM Manufacturing Index (November)
December 2	Fed Beige Book
December 3	ECB Policy Decision ISM Non-Manufacturing Index (November) 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