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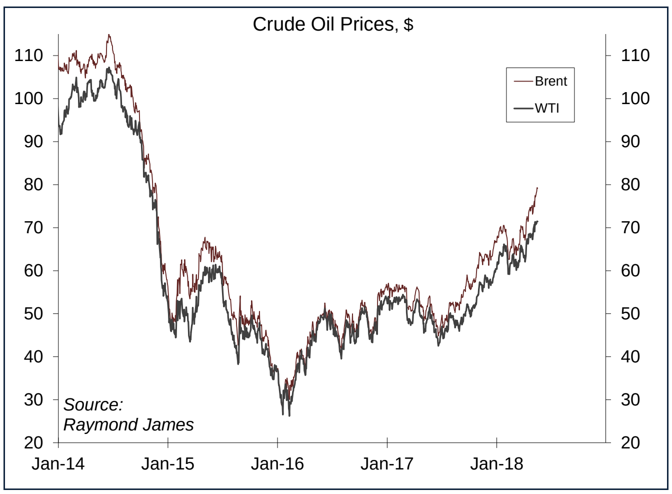
Weekly Economic Monitor

Oil and the Economy

The rise in oil prices is expected to have mixed effects on the U.S. economy. Higher gasoline prices will restrain consumer spending growth to some extent. However, increased energy exploration implies more capital spending, adding to GDP growth. For Federal Reserve policymakers, the key question is whether higher costs of transporting goods may be passed along to consumer prices. This adds to the Fed's difficulties in achieving a soft landing for the economy in the months ahead.

The increase in U.S. energy production has reduced our reliance on foreign oil in recent years. However, oil is still a global commodity. High prices overseas mean high prices here. Political tensions in the Middle East and problems in Venezuela should leave oil prices higher for the foreseeable future.

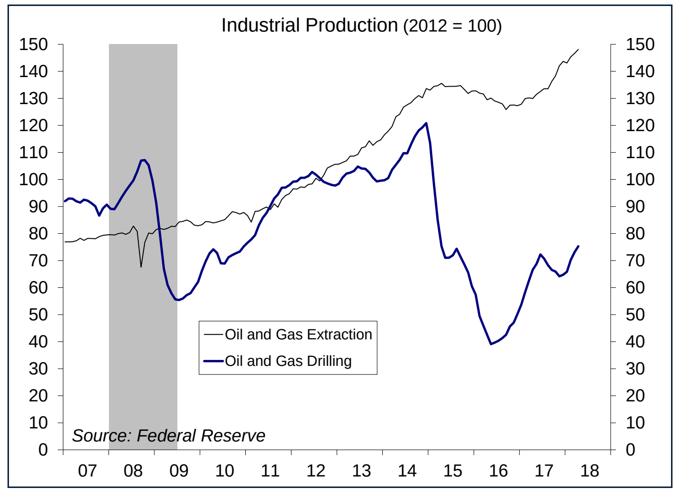


The increase in gasoline prices has already had a noticeable impact on the consumer. Average hourly earnings, adjusted for inflation, are roughly flat on a year-over-year basis. The typical worker may be seen as running in place. You can still get gains in aggregate consumer spending, due to job growth, but the overall pace of spending growth is likely to be somewhat limited. That's important, since consumer spending accounts for about 69% of Gross Domestic Product.

In the Great Inflation of the 1970s and early 1980s, higher oil prices boosted the Consumer Price Index. Many union wage contracts had inflation clauses in them, and non-union wages typically followed what was happening to union wages. The increase in the CPI fueled wage inflation, which in turn, added to consumer price inflation – a vicious cycle, which required a major recession in the 1980s to begin wringing inflation expectations lower. That lesson isn't lost on the Fed.

In recent decades, the impact of oil prices on the economy has changed. Rising oil prices are seen less as a catalyst for higher inflation and more as a restraint on economic growth.

When oil prices fell in late 2014, the expectation was that we would see a significant boost to consumer spending growth. That pop failed to materialize, as consumers were faced with other constraints, such as rising rents and higher healthcare costs. Moreover, the contraction in (capital-intensive) oil and gas well drilling hit business fixed investment and overall GDP growth. The current rise in oil prices will restrain consumer spending growth, but also add further to business fixed investment.



Finally, we listened so you don't have to:

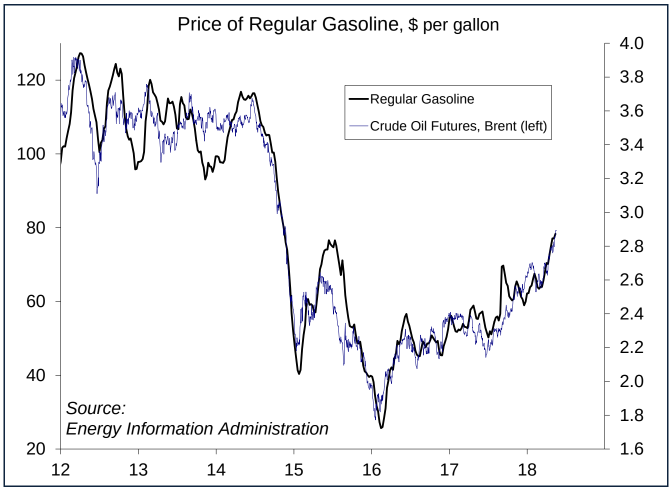
Richard Clarida – Time No Changes

In addition to being a well-respected economist, Fed Vice Chair-nominee Richard Clarida is also musician of sorts. He reportedly busked Beatles tunes at Harvard Square, and it shows in his first album, recorded over several years (two songs at the Abbey Roads Studios) and released in 2016. Beatlesque indeed, Clarida is pleasantly on pitch and has a good sense of harmony (more McCartney than Lennon). Some tracks include French horn and cello. Unfortunately, we get a sense about how Clarida feels about automation. Drums are handled by machine, leaving this reviewer unsatisfied. Ringo Starr was important, dammit! Drumming isn't about keeping time – it's about adding necessary color and complexity to the performance. That aside, Clarida proves himself to be a competent pop composer. The tunes are catchy. The lyrics, on the other hand, are often cringe-worthy. Lots of mushy "love" stuff (and nothing about monetary policy). Will Clarida's approach to monetary policy be similarly "stuck in the 60s"? Hard to say (on a side note, this album could be played to disperse crowds of loitering teenagers). A second album is reported to be in the works. No word yet on whether it will include Chair Powell, who plays electric guitar.

	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
4/20/18	1.85	2.03	2.26	2.49	2.64	2.84	3.03	3.21	1.228	1.403	107.60	1.274	7146.13	2670.14	24462.94
5/11/18	1.92	2.06	2.28	2.54	2.69	2.84	2.97	3.10	1.195	1.355	109.26	1.278	7402.88	2727.72	24831.17
5/18/18	1.90	2.09	2.30	2.55	2.72	2.89	3.06	3.20	1.177	1.348	110.70	1.288	7361.04	2713.01	24715.09

Recent Economic Data and Outlook

The House-imposed deadline for NAFTA negotiations ended with no agreement. Reports pointed to significant fractures among White House officials regarding trade policy. It's unclear whether President Trump will up the stakes, adding uncertainty for those dependent on global supply chains. Oil prices rose further and the 10-year Treasury note yield moved above 3%.



Retail Sales rose 0.3% in the initial estimate for April (+4.7% y/y), about as expected. However, figures for February and March were revised higher, implying a bit brighter outlook for consumer spending growth in 2Q18 (following a lackluster pace in 1Q18). Ex-autos, retail sales also rose 0.3%, with upward revisions to the two previous months (+4.8% y/y). Motor vehicle sales edged up 0.1% (+4.3%). Sales of building materials and garden supplies rose 0.4% (+4.4%). Despite a 3.0% rise in retail gasoline prices (+13.4% y/y), sales of gasoline rose 0.8% in April (+11.7% y/y). Core sales, which exclude autos, building materials, and gasoline, rose 0.3%, also with upward revisions to February and March. Sales for non-store retailers (which includes internet retail) rose 0.6% (+9.6% y/y).

Business Inventories were flat in March (+3.8% y/y). Retail inventories, the only new information in this report, fell 0.5% (autos -1.1%, ex-autos -0.1%). Manufacturing inventories (reported earlier) rose 0.3% and wholesale inventories rose 0.3%. These figures are not adjusted for price changes (for example, petroleum prices). Business sales (factory shipments plus wholesale and retail sales) rose 0.5% in March, up 6.4% y/y.

Industrial Production rose 0.7% in April (+3.5%), with mixed revisions to February and March. The output of utilities rose 1.9% (+6.0% y/y), as temperature generally remained colder than normal. Mining rose 1.1% (+10.6% y/y), with energy extraction up 1.0% (+14.0% y/y) and exploration up 3.0% (+13.1% y/y). Manufacturing output rose 0.5% (+2.0% y/y). Motor vehicle production slipped 1.3%, following strong gains in February and March (+3.1% y/y). Ex-autos, factory output rose 0.6% (+1.6% y/y – not exactly booming, but not weak either).

Building Permits fell 1.8% (±1.3%) in April, to a 1.352 million seasonally adjusted annual rate (+7.7% y/y). Single-family permits, the key figure in the report, rose 0.9% (±1.4%), up 7.9% y/y (±1.0%). Results were mixed across regions (-3.9% in the Northeast, +2.5% in the Midwest, +4.8% in the South, and -6.7% in the West). Unadjusted permits for the last three months rose 6.1% y/y (+3.4% in the Northeast, -2.0% in the Midwest, +4.9% in the South, and +14.6% in the West). **Housing Starts** fell 3.7% (±11.4%), to a 1.287 million annual rate, up 10.5% y/y (±9.7%).

Homebuilder Sentiment rose to 70 in the initial estimate for May, vs. 68 in April (revised from 69). Gains were concentrated in the Midwest, partly reflecting a rebound from April weather. The National Association of Home Builders noted that "builders are buoyed by growing consumer demand for single-family homes," but "the record-high cost of lumber is hurting builders' bottom lines and making it more difficult to produce competitively priced houses for newcomers to the market."

The Index of **Leading Economic Indicators** rose 0.4% in April. Positive contributions were led by the yield curve, the factory workweek, ISM new orders, jobless claims, and consumer expectations. The stock market and building permits were the only negative contributions. The Conference Board noted that the data "suggest that the expansion in economic activity should continue, but the pace of growth is unlikely to accelerate significantly in the near term."

Economic Outlook (2Q18): 2.5-3.0% GDP growth.

Employment: Job growth has remained strong, but the pace should slow as the job market continues to tighten.

Consumers: Real wage growth remains soft on a year-over-year basis. Credit remains easy, except at the low end.

Manufacturing: Sentiment remains strong, but the pace of improvement is likely to moderate in the near term.

Housing/Construction: Job growth has been supportive, but supply constraints and affordability remain key issues.

Prices: Core inflation is trending closer to the Fed's 2% goal. Pipeline pressures remain somewhat elevated, but are not a major threat to the consumer inflation outlook. Wage pressures are moderate, but trending gradually higher.

Interest Rates: The Fed remains in tightening mode, and is expected to continue gradually raising short-term rates. The increase in government borrowing is likely to add some upward pressure on bond yields. Balance sheet reduction is viewed as "background" and should not be disruptive for the markets.

This Week:					*forecast*	last	last –1	comments
Monday	5/21		no significant data					Fats Waller (b. 1904)
Tuesday	5/22	1:00	Treasury Note Auction					$33 billion in 2-year notes
Wednesday	5/23	10:00	New Home Sales, th.	Apr	***680***	694	667	reported with a lot of uncertainty
			% change		***-2.0***	+4.0	+3.6	watch for revisions
		11:30	FRN Auction					$16 billion in re-opened 2-year FRNs
		1:00	Treasury Note Auction					$36 billion in 5-year notes
		2:00	**FOMC Minutes**	5/01				seen locking in a June 13 rate hike
Thursday	5/24	8:30	Jobless Claims, th.	5/19	***220***	222	211	a low trend
		10:00	Existing Home Sales, mln.	Apr	***5.65***	5.60	5.54	seen a bit higher
			% change		***+0.9***	+1.1	+3.0	strong demand vs. supply constraints
		1:00	Treasury Note Auction					$30 billion in 7-year notes
Friday	5/25	8:30	**Durable Goods Orders**	Apr	***-1.6%***	+2.6%	+4.5%	Boeing reported a large drop in orders
			ex-transportation		***+0.6%***	-0.1%	+1.3%	moderate
			nondef cap gds ex-aircraft		***+0.6%***	-0.9%	+1.6%	choppy, but likely to improve
		9:20	**Fed Chair Powell Speaks**					*"Fin. Stability and Cen. Bank Transparency"*
		10:00	UM Consumer Sentiment	May	***98.6***	98.8	101.4	98.8 at mid-month
Next Week:								
Monday	5/28		Memorial Day Holiday					markets closed
Tuesday	5/29	10:00	**CB Consumer Confidence**	May	***128.0***	128.7	127.0	still strong
Wednesday	5/30	8:15	**ADP Payroll Estimate, th.**	May	***+170***	+204	+228	the pace is likely to moderate
		8:30	**Real GDP (2nd estimate)**	1Q18	***+2.4%***	+2.9%	+3.2%	+2.3% in the advance estimate
			Priv. Dom. Final Purchases		***+1.9%***	+4.8%	+2.2%	+1.7% in the advance estimate
		8:30	Advance Econ Indicators	Apr				filling in the early 2Q18 picture
			Wholesale Inventories		***NF***	+0.3%	+0.9%	likely slower
			Retail Inventories		***NF***	-0.5%	+0.4%	likely to rebound, but a slower 2Q trend
			Merch. Trade Balance, $bln		***NF***	-68.3	-75.8	narrower into 2Q18
		10:00	BOC Policy Decision					still in tightening mode, but "cautious"
		2:00	**Fed Beige Book**					keep an eye on wages
Thursday	5/31	8:30	Jobless Claims, th.	5/26	***220***	***220***	222	a low trend
		8:30	Personal Income	Apr	***+0.3%***	+0.3%	+0.3%	moderate growth in wages and salaries
			Personal Spending		***+0.3%***	+0.4%	+0.0%	a lackluster-to-moderate pace
			PCE Price Index ex-f&e		***+0.1%***	+0.2%	+0.2%	the core CPI rose 0.098%
			year-over-year		***+1.8%***	+1.9%	+1.6%	edging down slightly y/y
		9:45	Chicago Business Barometer	May	***57.8***	57.6	57.4	moderately strong
		10:00	Pending Home Sales Index	Apr	***+1.0%***	+0.4%	+2.8%	choppy, but should pick up
Friday	6/01	8:30	**Nonfarm Payrolls, th.**	May	***+160***	+164	+135	demographic constraints more binding
			private-sector		***+160***	+168	+135	moderately strong
			Unemployment Rate		***3.9%***	3.9%	4.1%	seen about flat (report accurate to ±0.2%)
			employment/population		***60.3***	60.3%	60.4%	roughly flat over the last year
			Avg. Weekly Hours		***34.5***	34.5	34.5	steady
			Avg. Hourly Earnings		***+0.3%***	+0.1%	+0.2%	rebounding (but watch for revisions)
			year-over-year		***+2.7%***	+2.6%	+2.6%	still relatively moderate considering
		10:00	Construction Spending	Apr	***NF***	-1.7%	+1.0%	likely to pick up
		10:00	**ISM Manufacturing Index**	May	***57.5***	57.3	59.3	moderately strong
		tbd	Motor Vehicle Sales, mln	May	***NF***	17.1	17.4	depends on final weekend
			domestically built		***NF***	13.1	13.4	but trend should be gradually lower

This Week…

The economic calendar is relatively sparse. Home sales figures are more important in the spring, but are also noisy. The report on durable goods will be key. Orders for nondefense capital goods ex-aircraft slowed sharply in 1Q18. Was that a temporary lull? Investors will look for new clues in the FOMC minutes, but we're unlikely to learn much (a June 13 rate hike is a near certainty at this point). Minutes of the previous policy meeting noted that "several" Fed officials thought that the federal funds rate might eventually need to be set above a neutral level for a period. Fed Chair Powell will speak on Friday, but his comments are unlikely be market-moving and many investors will have already checked out ahead of the three-day weekend.

Monday

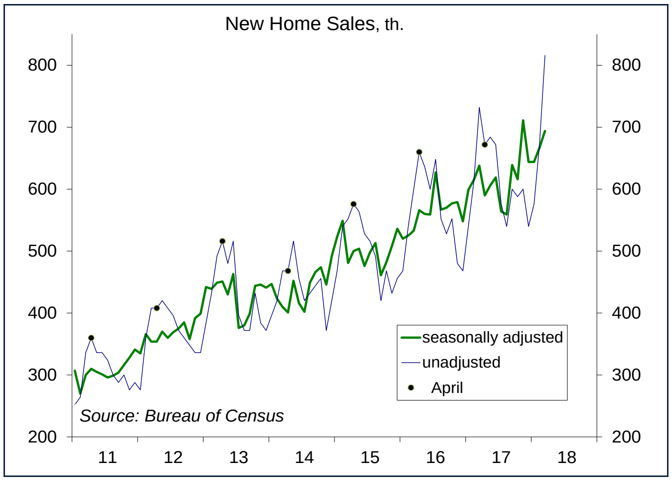
No significant data.

Tuesday

No significant data.

Wednesday

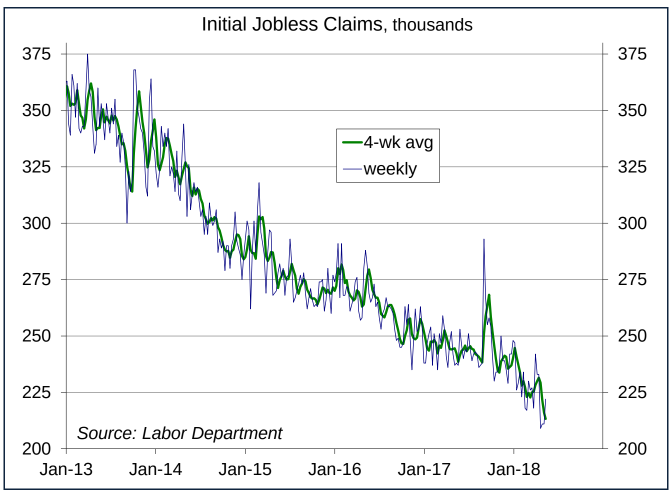
New Home Sales (April) – The Census Bureau's monthly figures are reported with a gigantic amount of statistical uncertainty. So, surprises are the norm. The initial figure for March seemed unusually strong. Prior to seasonal adjustment, March and April are the high points for the year. A strong job market helps, mortgage rates are a mild restraint, but affordability is an issue.



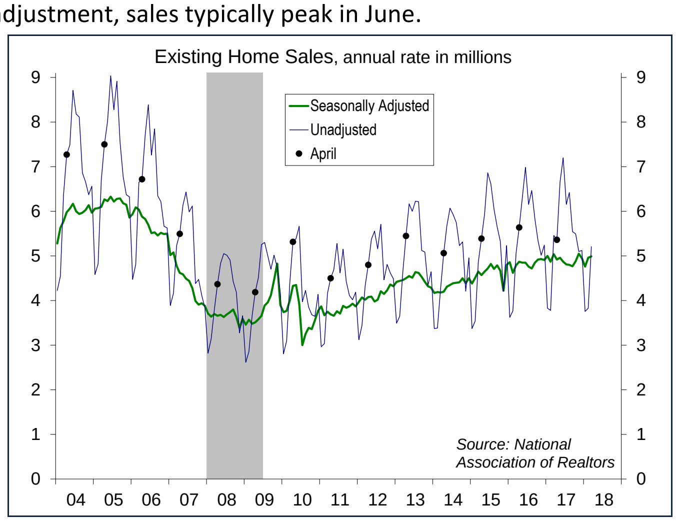
FOMC Minutes (May 1-2) – The internal debate is unlikely to show significant disagreement among Fed officials. All signs should point to a likely June 13 rate hike.

Thursday

Jobless Claims (week ending May 19) – The recent dip in the four-week average suggests that the tight job market is tighter still.

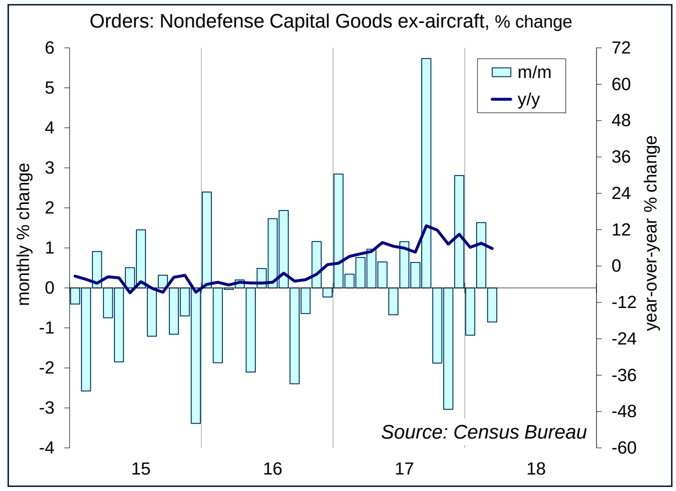


Existing Home Sales (April) – Sales are expected to remain at a moderately strong pace, limited by the number of homes for sale. March and April are transitional months. Prior to seasonal adjustment, sales typically peak in June.



Friday

Durable Goods Orders (April) – Boeing reported lower orders for April, which should drive the headline figure lower. Ex-transportation, orders are likely to post a moderate gains. Orders for nondefense capital goods ex-aircraft rose at a 1.7% annual rate in 1Q18, a relatively lackluster pace by historical standards. Hence, the April figures will help to determine whether the first quarter was a fluke, or the start of a more concerning trend of softness in capital spending.



Fed Chair Powell Speaks (panel discussion at a Sveriges Riksbank conference) – The topic is "350 Years of Central Banking." Not likely to be market-moving, but you never know.

Next Week …

Following the Memorial Day holiday, market participants will return to a heavy week of economic data. Friday's job market report is expected to be the focus, but there are plenty of other releases that are potentially market-moving (including the Conference Board's Consumer Confidence Index, the 1Q18 GDP revision, and the core CPE Price Index). Nonfarm payrolls (reported accurate to ±120,000) will likely reflect supply constraints in the face of strong demand for workers. The unemployment rate (reported accurate to ±0.2%) is expected to remain low. Average hourly earnings growth should pick up.

Coming Events and Data Releases

June 5	ISM Non-Manufacturing Index
June 12	Consumer Price Index (May)
June 13	FOMC Policy Decision Fed Summary of Economic Projections Powell Press Conference
June 14	Retail Sales (May)
July 4	Independence Day (markets closed)
July 6	Employment Report (June)
August 1	FOMC Policy Decision (no press conf.)
September 26	FOMC Policy Decision, press conf.
November 6	Election Day