RAYMOND JAMES

Economic Research
Published by Raymond James & Associates

Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com

August 29 - September 2, 2016

Weekly Economic Monitor

Yellen's Jackson Hole Speech

In Jackson Hole, Fed Chair Janet Yellen was not expected to speak much about the current economic outlook or monetary policy. In line with the general theme of the Kansas City Fed's symposium, she did talk about the Fed's monetary policy toolkit. However, she went out of her way to preface that discussion with *"a few remarks on the near-term outlook for the U.S. economy and the potential implications for monetary policy."* She delivered a strong hint that the Fed is close to raising short-term interest rates. The market reaction was initially disbelief.

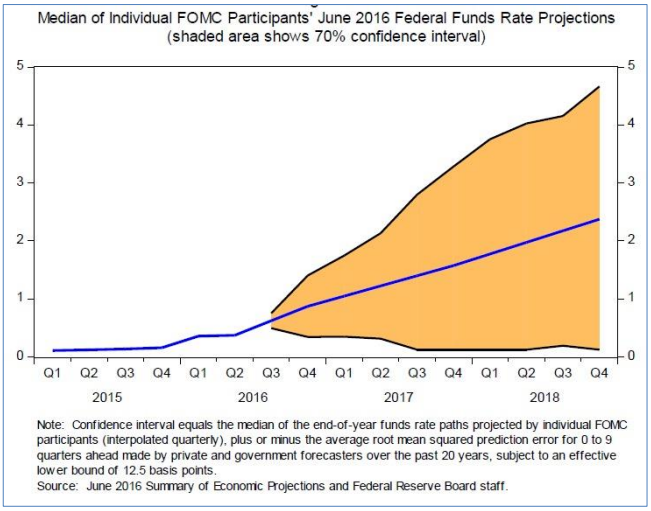
First, let's set the backdrop for Yellen's speech. Recall that the FOMC, in its July 27 policy statement, had seemingly paved the way for a possible September rate hike, by noting that *"near-term risks to the economic outlook have diminished."*

Prior to 1994, the discount rate (the rate that the Fed charges banks to borrow short term) was the Fed's main policy level (prior to that, the FOMC did not announce changes to the federal funds target rate). Unlike the federal funds rate (the market rate that banks charge each other for overnight borrowing), which is set by the Federal Open Market Committee (the five Fed governors, the New York Fed president, and four other district bank presidents who rotate once a year), changes to the discount rate are requested by one or more of the district banks and are approved (or not) by the Fed's Board of Governors. Typically, if an increase in the discount rate is deemed warranted, the governors will raise it at the same time that the FOMC increases the federal funds target rate. The BOG met on July 25 (just ahead of the July 26-27 FOMC meeting) to consider requests to raise the discount rate. Eight of the twelve district banks had requested an increase. The presidents of four of those banks have a vote on the FOMC this year. The BOG will meet again on August 29 to consider changes to the discount rate (but no change is expected).

In the last week or two, New York Fed President Dudley said that *"we are edging closer towards the point in time when it will be appropriate to raise rates further,"* adding that a September move *"is possible."* Fed Vice Chair Stanley Fischer, the grand old man of monetary policy (having taught former Fed Chair Ben Bernanke and ECB President Mario Draghi), said that "*we are close to our targets* (of price stability and full employment)."

Speaking about the current situation, Yellen said that *"while economic growth has not been rapid, it has been sufficient to generate further improvement in the labor market."*

"Looking ahead, the FOMC expects moderate growth in real GDP, additional strengthening in the labor market, and inflation rising to 2 percent over the next few years. Based on this economic outlook, the FOMC continues to anticipate that gradual increases in the federal funds rate will be appropriate over time to achieve and sustain employment and inflation near our statutory objectives. Indeed, in light of the continued solid performance of the labor market and our outlook for economic activity and inflation, ***I believe the case for an increase in the federal funds rate has strengthened in recent months****. Of course, our decisions always depend on the degree to which incoming data continues to confirm the Committee's outlook."*



Yellen noted that *"as ever, the economic outlook is uncertain, and so monetary policy is not on a preset course. Our ability to predict how the federal funds rate will evolve over time is quite limited because monetary policy will need to respond to whatever disturbances may buffet the economy. In addition, the level of short-term interest rates consistent with the dual mandate varies over time in response to shifts in underlying economic conditions that are often evident only in hindsight."* Fed mid-June officials' projections of the appropriate path of the federal funds target rate vary widely. Yellen said the wide range is because *"the economy is frequently buffeted by shocks and thus rarely evolves as predicted. When shocks occur and the economic outlook changes, monetary policy needs to adjust. What we do know, however, is that we want a policy toolkit that will allow us to respond to a wide range of possible conditions."*

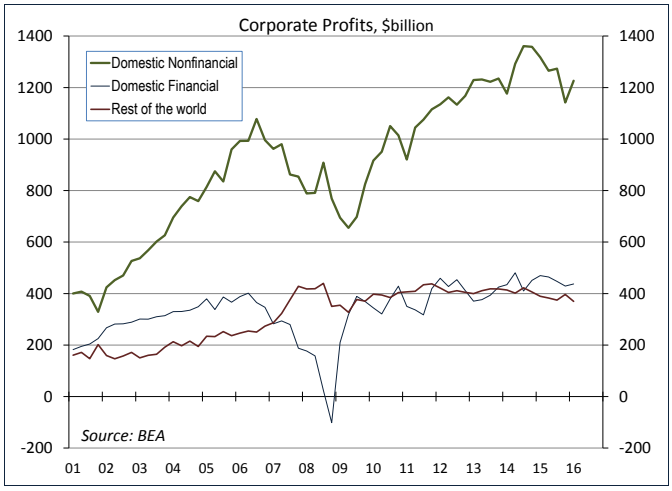
The Fed played a critical role in stabilizing the economy following the financial crisis, but public opinion surrounding the central bank has been decidedly poor (largely reflecting a lack of understanding of what the Fed can do). Monetary policy cannot solve all of the economy's problems. It is ill-suited to address the slowdown in productivity and the widening in income inequality. There were protests for "a people's Fed" in Jackson Hole and Fed officials did meet with community activists. A rate hike in September would raise borrowing costs a little, but the Fed would see a greater good in promoting financial stability.

© 2016 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. All rights reserved.
All expressions of opinion reflect the judgment of the Research Department of Raymond James & Associates, Inc. (RJA) as of the date stated above and are subject to change. Information has been obtained from third-party sources we consider reliable, but we do not guarantee that the facts cited in the foregoing report are accurate or complete. Other departments of RJA may have information that is not available to the Research Department about companies mentioned in this report. RJA or its affiliates may execute transactions in the securities mentioned in this report that may not be consistent with the report's conclusions.

	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
7/29/16	0.28	0.38	0.50	0.67	0.76	1.03	1.46	2.18	1.117	1.327	102.32	1.304	5162.13	2173.60	18432.24
8/19/16	0.30	0.44	0.59	0.76	0.88	1.17	1.58	2.29	1.133	1.306	100.24	1.288	5238.38	2183.87	18552.57
8/26/16	0.33	0.47	0.61	0.84	0.95	1.23	1.62	2.29	1.119	1.313	101.82	1.300	5220.15	2169.04	18395.40

Recent Economic Data and Outlook

Financial market participants seemed to mark time ahead of Janet Yellen's Jackson Hole speech. The Fed chair hinted strongly that policymakers are close to raising rates, but the financial markets seemed not to believe it (federal funds futures barely budged, bond yields initially dipped, and the stock market gained).



In Jackson Hole, Fed Chair **Janet Yellen** spoke at length about the central bank's policy toolkit, which *"played a vital role in stabilizing the economy"* following the financial crisis. However, she unexpectedly went out of her way to preface that discussion with comments regarding the current economic situation and monetary policy. She said *"I believe the case for an increase in the federal funds rate has strengthened in recent months,"* apparently paving the way for a September rate hike (although still data-dependent and not quite a done deal).

Minutes of the July 25 meeting of the Fed's Board of Governors to discuss possible changes to the **Discount Rate** (the rate the Fed charges banks for short-term borrowing) showed that 8 of 12 Fed district banks had requested an increase (not approved by the BOG, obviously). Presidents of four of those banks have a vote on the Federal Open Market Committee this year.

Real GDP rose at 1.1% annual rate in the 2nd estimate for 2Q16 (vs. +1.2% in the advance estimate). Consumer spending rose at a 4.4% pace (vs. 4.2%), while business fixed investment fell 0.9% (vs. -2.2%). Inventories fell more than initially estimated, which suggests more potential for a rebound in 3Q16. Real disposable income rose at a 2.3% annual rate (vs. +1.2% in the advance estimate). Corporate profits fell by $24.1 billion (vs. +$66.0 billion in 1Q16). Profits of domestic nonfinancial corporations fell $58.2 billion (vs. +$84.8 billion in 1Q16).

Durable Goods Orders rose 4.4% in July, reflecting a rebound in aircraft orders (note that, prior to seasonal adjustment, orders fell 13.7% – so take the adjusted figure with a grain of salt). Transportation orders rose 10.5% (motor vehicles +0.0%, civilian aircraft +89.9%, defense aircraft +20.3%). Ex-transportation, orders rose 1.5% (median forecast: +0.5%). Results were higher across industries (primary metals +1.4%, fabricated metals +1.5%, machinery +1.6%, computers and electronics +3.6%, electrical equipment and appliances +2.6%). Orders for nondefense capital goods ex-aircraft jumped 1.6% (median forecast: +0.3), while shipments fell 0.4%, suggesting that business fixed investment will remain a bit soft in 3Q16.

New Home Sales rose 12.4% (±12.7%) in July, to a 654,000 seasonally adjusted annual rate (+31.3% y/y). While large, the July increase was not statistically different from 0%. Strength was concentrated in the South (+40.0% ±62.0%). Unadjusted sales for May-July were up 21.6% from the same period in 2015.

Existing Home Sales fell 3.2% in July, to 5.39 million seasonally adjusted annual rate (-1.6% y/y). Results were mixed across regions (-13.2% in the Northeast, -5.2% in the Midwest, -1.8% in the South, and +2.5% in the West). Unadjusted sales for May-July were up 0.2% from the same period in 2015.

The **Chicago Fed National Activity Index**, a composite of 85 economic indicators, rose to +0.27 in July (0 represents trend growth). At -0.10, the three-month average was consistent with growth slightly below its historical trend (a three-month average below -0.70 is consistent with an increased likelihood that a recession has begun).

Economic Outlook (3Q16): about a 3.0% annual rate.

Employment: Monthly payroll figures have been uneven. The underlying trend in private-sector payrolls remains relatively strong, but has slowed somewhat in 2016.

Consumers: Spending was strong in the first half of the year, but real income growth appears to have slowed. That may be temporary. Aggregate wage income improved in July.

Manufacturing: Mixed across sectors in recent months, but relatively soft overall, reflecting the contraction in energy exploration and the strong dollar's impact on exports. Lean inventories suggest some potential for a pickup in production.

Housing/Construction: Single-family construction has been trending higher, but multi-family activity has moderated following a very strong pace in 2015. Mortgage rates remain low, but home prices are rising (contributing to affordability issues). Credit for first-time buyers is still relatively tight.

Prices: Ex-food & energy, the PCE Price Index has continued to trend below the Fed's 2% target. There is little inflation in consumer goods. Inflation in consumer services has been boosted by higher rents. Wage gains are moderate.

Interest Rates: The Fed remains in tightening mode, but is expected to proceed cautiously as it normalizes policy. Most Fed officials expect one or two 25-bp hikes by the end of 2016.

© 2016 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. All rights reserved.

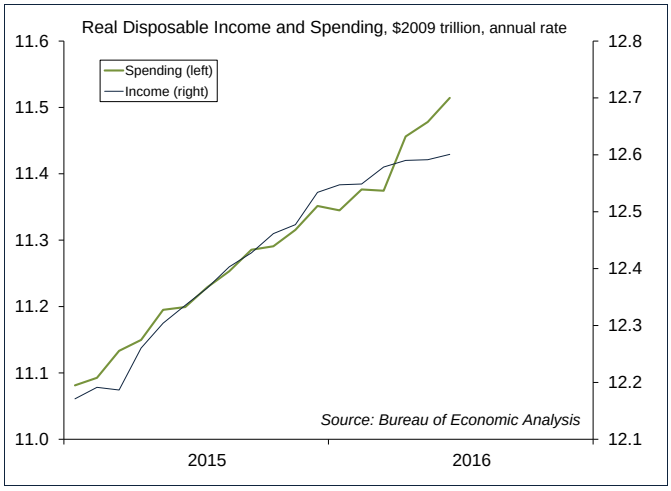
This Week:					*forecast*	last	last –1	comments
Monday	8/29	8:30	Personal Income	Jul	***+0.6%***	+0.2%	+0.2%	a pickup in wage income (w/ ↑revisions)
			Personal Spending		***+0.3%***	+0.4%	+0.4%	auto sales higher, gasoline prices down
			PCE Price Index ex-f&e		***+0.1%***	+0.1%	+0.1%	the core CPI rose 0.088%
Tuesday	8/30	10:00	**Consumer Confidence**	Aug	***97.8***	97.3	97.4	range-bound
Wednesday	8/31	8:15	**ADP Payroll Estimate, th.**	Aug	***+160***	+179	+176	likely to trend somewhat lower
		9:45	Chicago PM Index	Aug	***56.2***	55.8	56.8	moderate
		10:00	Pending Home Sales Index	Jul	***+0.6%***	+0.2%	-3.7%	a bit choppy, but a moderate trend
Thursday	9/01	8:30	Jobless Claims, th.	8/27	***265***	261	262	trending low
		8:30	Productivity (revised)	2Q16	***-0.6%***	-0.6%	-2.4%	-0.5% in the preliminary estimate
			Unit Labor Costs		***+2.1%***	-0.2%	+5.7%	+2.0% in the preliminary estimate
		10:00	Construction Spending	Jul	***NF***	-0.6%	-0.1%	an unexpectedly soft trend in 2Q16
		10:00	**ISM Manf. Index**	Aug	***53.4***	52.6	53.2	mixed, but likely moderate
		tbd	Motor Vehicle Sales, mln	Aug	***17.2***	17.8	16.7	likely to pullback following strong July
			domestically built		***13.3***	13.8	12.8	underlying trend should be flattening
Friday	9/02	8:30	**Nonfarm Payrolls, th.**	Aug	***+150***	+255	+292	government likely to pullback somewhat
			private-sector		***+165***	+217	+259	likely to post a more moderate increase
			Unemployment Rate		***4.8%***	4.9%	4.9%	mostly steady
			employment/population		***59.8%***	59.7%	59.6%	edging higher
			Avg. Weekly Hours		***34.5***	34.5	34.4	seen steady
			Avg. Hourly Earnings		***+0.2%***	+0.3%	+0.1%	moderate wage pressures
		8:30	Trade Balance, $bln	Jul	***-39.7***	-44.5	-41.0	seen narrower
			goods only		***-60.7***	-66.0	-62.2	reflecting an increase in food exports
		10:00	Factory Orders	Jul	***+1.9%***	-1.6%	-1.2%	durable goods orders reported up 4.4%
Next Week:								
Monday	9/05		Labor Day Holiday					markets closed
Tuesday	9/06	10:00	**ISM Non-Manf. Index**	Aug	***56.0***	55.5	56.5	moderate
Wednesday	9/07	10:00	JOLTS Report	Jul				quit rate, hiring rate trending flat
		10:00	BOC Policy Decision					no change
		2:00	**Fed Beige Book**					still modest to moderate?
Thursday	9/08	7:45	ECB Policy Decision					no change
		8:30	Jobless Claims, th.	9/03	***265***	***265***	261	trending low
		10:00	Quarterly Services Survey	2Q16				some implications for 2Q16 GDP
Friday	9/09		no significant data					1947: first computer bug (it was a moth)

This Week…

With Fed policy remaining data-dependent, fresh August data will be important. ISM manufacturing data have some market-moving potential, but the focus is expected to be on the employment report. Seasonal adjustment can be quirky in July and August. Factors that boosted July may unwind in August.

Monday

Personal Income and Spending (July) – The spending figure here is the same as in the GDP report (only monthly instead of quarterly), and (given that consumer spending accounts for about 70% of GDP) these data should help to fill in the economic picture for early 3Q16. Yet, market reaction is likely to be modest at best. That's because we usually get a good idea on income from the employment report (which suggested a strong pickup in wage income in July) and the retail sales report provides a reasonable approximation of overall consumer spending (lackluster in July). Ex-food & energy, the PCE Price Index is likely to have risen modestly. Note that the June data showed strength in consumer spending, but some slowing in inflation-adjusted personal spending. However, the 2nd report on 2Q16 showed disposable income growing nearly twice as fast as initially reported – we will see revisions in the monthly data.



Tuesday

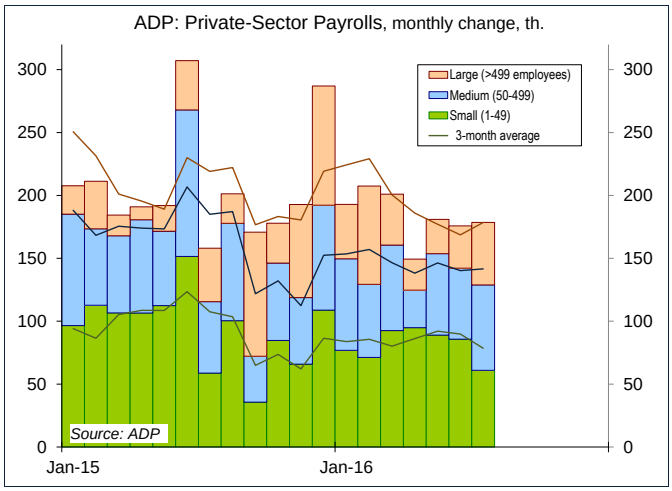
Consumer Confidence Index (August) – The Conference Board's gauge is likely to remain range-bound in the near term.

Wednesday

ADP Payroll Estimate (August) – The ADP estimate of private-sector payrolls has been less volatile than the official BLS data. However, the trend in job growth, while still relatively strong,

© 2016 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. All rights reserved.

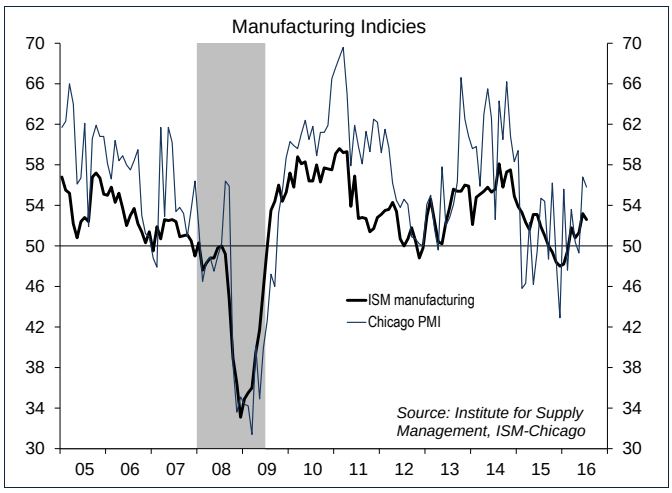
has slowed somewhat this year. That could reflect more cautious hiring, tighter job conditions, or some combination.



Thursday

Jobless Claims (week ending August 27) – Claims are a leading economic indicator and have not suggested weakness. Job destruction remains very limited.

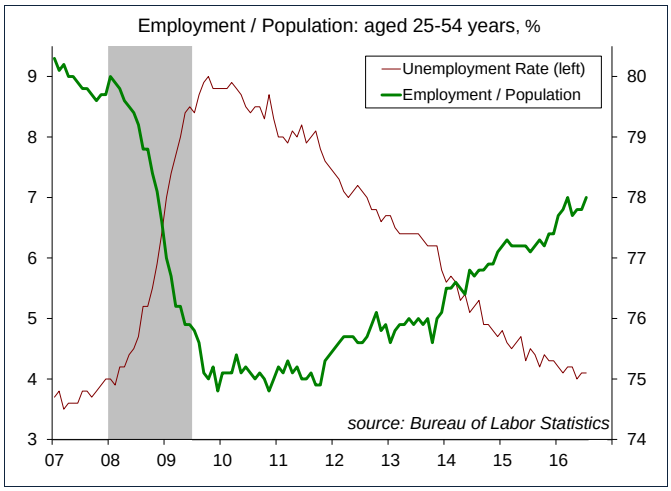
ISM Manufacturing Index (August) – Economic data are often quirky, but one should be very careful in trying to interpret figures for July and August (when seasonal adjustment can be especially difficult). Results are likely to reflect mixed, but generally moderate conditions across industries.



Motor Vehicle Sales (August) – Unit sales were unexpectedly strong in July. We ought to see some pullback in August.

Friday

Employment Report (August) – Market participants should be aware that the monthly payroll figure (reported accurate to ±115,000) is subject to statistical uncertainty. Relatively strong figures for June and July made people forget the bad reading for May. It's possible that seasonal quirks boosted the July numbers to some extent, in which case we ought to see a correction (that is, more moderate gains) in August. One should focus on the three-month average (that's what the Fed is going to be looking at). The pace of decline in the unemployment rate has slowed in recent months, but the employment/population ratio is trending higher. Many Fed officials believe that we are near full employment. A number of gauges suggest that there is still a lot of slack in the job market, but that slack is being taken up over time. So, even if there is more "room to run," the Fed is justified in moving gradually toward a more neutral policy position. Average hourly earnings are expected to have risen moderately, but these figures often surprise (but note that the average hourly earnings estimates are often revised in the following month).



Trade Balance (July) – The advance estimate of trade in goods showed a sharp narrowing in the trade deficit in July, due largely to a 31.3% increase in food exports (up 6.9% before seasonal adjustment). Imports of consumer goods (non-auto) were down 3.4% (-0.8% before seasonal adjustment).

Next Week …

Labor Day marks the unofficial end of summer. The economic calendar will be thin, with the ISM Non-Manufacturing Index and the Fed's Beige Book being the only important items (although the NFL season gets underway Thursday evening and the U.S. Open finals are set for the weekend). We ought to hear some Fedspeak (likely hawkish) along the way.

Coming Events and Data Releases

September 15	Retail Sales (August) Industrial Production (August)
September 16	Consumer Price Index (August)
September 21	FOMC Policy Decision, revised Fed projections, Yellen press conference
September 26	1st Presidential Debate (Hempstead, NY)
October 9	2nd Presidential Debate (St. Louis, MO)
October 11	Columbus Day (bond market closed)
October 19	3rd Presidential Debate (Las Vegas, NV)
November 2	FOMC Policy Decision (no press conference)
November 8	Election Day
December 14	FOMC Policy Decision, Yellen press conference

© 2016 Raymond James & Associates, Inc., member New York Stock Exchange/SIPC. All rights reserved.