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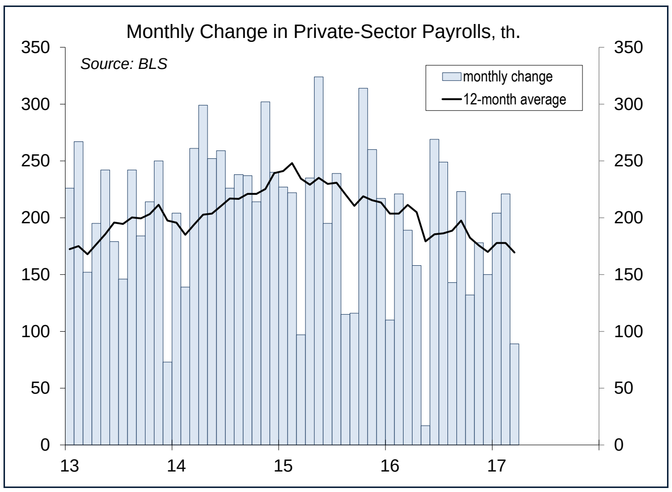
Weekly Economic Monitor

March Payrolls, the FOMC, and Backcasting 1Q17

Nonfarm payrolls were reported to have risen by "just" 98,000 in March, while the unemployment rate fell to its lowest level (4.5%) since May 2007. The March 14-15 FOMC minutes "revealed" that officials plan to begin reducing the size of the Fed's balance sheet later this year. Why this should be news to anybody is a mystery – it's been well telegraphed for some time. Meanwhile, two regional Fed nowcasting models paint drastically different pictures of the 1Q17 economy. Let's see if we can straighten this out…



Bad weather was not a significant factor in March payrolls. The BLS reported that 164,000 individuals were not able to show up to work (during the survey week) due to bad weather (vs. an average of 151,000 over the last 10 years for March). However, mild weather may have pulled forward seasonal job gains that would normally have occurred in March. The late Easter could also be a factor (figures are adjusted for floating holidays, but it's hard to get it right). One should not put much weight on any one particular month, but the three-month average of private-sector job gains (+171,000) matched the average for all of last year (+170,000). The trend in payroll growth since 2015 is lower, but that reflects the fact that the job market is getting tighter. The monthly change in payrolls is reported accurate to ±120,000 (90% confidence interval), which means that we can be 90% certain that the true monthly change for March was between -22,000 and +218,000. On a side note, a 98,000 monthly gain in payrolls is roughly consistent with the pace of growth in the working-age population (that is, enough to keep the unemployment rate from rising).

If payroll growth was reported to have slowed in March, how can the unemployment rate be lower? These figures come from two different BLS surveys. The household survey uses a sample of just 60,000 households – not a lot (given the size of the overall population), but enough to get relatively accurate estimates of ratios, such as labor force participation and the unemployment rate. The unemployment rate is reported accurate to ±0.2%, which means the drop in March was not statistically significant. However, there are plenty of other signs that the job market is getting tighter.

Normally, a tight job market would lead to faster wage growth. Average hourly earnings rose 0.2% in March, up 2.7% from a year earlier. That's not especially strong, but it's higher than we were seeing a couple of years ago.

The Fed expanded its balance sheet during the financial crisis and well into the economic recovery. Some critics feared that this would lead to hyperinflation and a plunge in the dollar – nonsense! Currently, the Fed buys new securities to replace maturing Treasury securities and mortgage-backed securities (and agency debt). The Fed planned to unwind its asset purchases before it even started to buy. Ending the reinvestment policy will allow the size of the balance sheet to decay over time. During Ben Bernanke's tenure as chair, the end of the reinvestment policy was expected to be the first step in policy normalization. Under Yellen's leadership, the end of the reinvestment policy was deferred until after the federal funds target rate had been raised a few times. None of this is news. The Fed has well-telegraphed that this is coming – no big deal. Note that, in order to maintain a steady, appropriate mix of maturities in its portfolio, the Fed expects to both buy and sell securities as the balance sheet shrinks.

Nowcasting models are used to estimate GDP growth. One simply adds the contributions of the various GDP components. The models differ in how they forecast the components. Some are fancier than others. As one adds more variables to the equation, you get a better fit to historical data – however, you're also likely to get poorer forecasts. Parsimony is key.

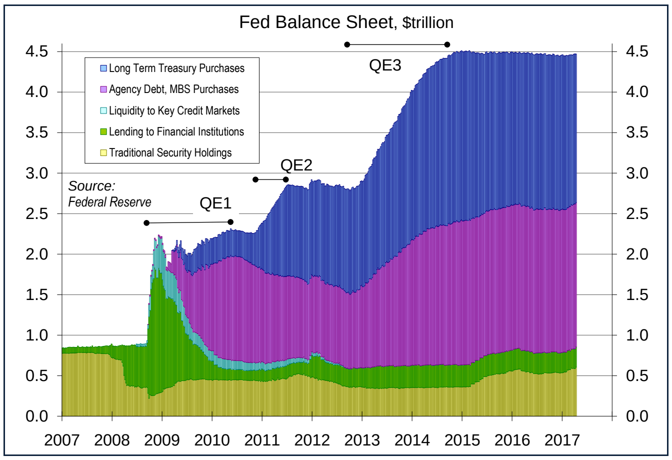
The Atlanta Fed's GDP Now model estimates 1Q17 GDP growth at +0.6%. In contrast, the New York Fed's model has it at +2.8%. A week ago, the monthly personal income and spending numbers through February suggested that inflation-adjusted consumer spending (69% of GDP) was tracking at below a 1% annual rate in 1Q17. Unit auto sales were reported to have fallen in March and retail payrolls fell by nearly 30,000, which is consistent with weak retail sales results. My 1Q17 GDP estimate (now at 1.0%) is closer to the Atlanta Fed's figure.

One soft quarter is not the end of the world. Consumer spending growth (and GDP growth) should pick up in 2Q17. However, the trend in payrolls is consistent with the view that economic growth will be restrained by the job market. The Fed focus is not on GDP growth, but on the job market.

	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
3/10/17	0.75	0.89	1.03	1.36	1.66	2.11	2.58	3.16	1.067	1.216	115.02	1.347	5861.73	2372.60	20902.98
3/31/17	0.76	0.91	1.03	1.27	1.50	1.93	2.40	3.02	1.070	1.254	111.41	1.332	5911.74	2362.72	20663.22
4/07/17	0.82	0.96	1.06	1.29	1.51	1.92	2.38	3.01	1.059	1.237	111.19	1.341	5879.88	2355.55	20656.03

Recent Economic Data and Outlook

Another eventful week in Washington. The U.S. launched airstrikes against a Syrian airbase, but the financial markets unwound the initial overnight reaction ahead of the March Employment Report. The March employment figures were mixed. FOMC minutes contained few surprise, but the market reacted anyway (perhaps looking for an excuse).



The **FOMC Minutes** from the March 14-15 policy meeting showed, no surprise, that *"a change to the Committee's reinvestment policy would likely be appropriate later this year."* Officials saw some upside risks from fiscal policy, although most did not expect any impact until 2018. Some noted business contacts' concerns that trade and immigration policy changes could generate downside risks to the labor market and the growth outlook. Some officials *"viewed equity prices as quite high relative to standard valuation measures."*

The March **Employment Report** was mixed. Nonfarm payrolls rose by 98,000 (median forecast: +180,000), with a net downward revision of 28,000 to the two previous months. The average monthly gain for the first quarter was 178,000, near the 2016 average. Bad March weather was not a factor, although good weather in February may have pulled forward seasonal gains from March and the late Easter may have added some noise. Retail payrolls fell by 29,700, consistent with other signs of softness in consumer spending. The unemployment rate fell to 4.5% (from 4.7%, although the figure is reported accurate to ±0.2%). Labor force participation was unchanged, essentially flat over the last year (normally, at this stage, we'd see some of those on the sidelines lured back into the labor force). Average hourly earnings rose a moderate 0.2% (+2.7% y/y).

Despite increased incentives, unit **Motor Vehicle Sales** fell to a 16.5 million seasonally adjusted annual rate in March, vs. 17.5 million in January and February.

The **ADP Estimate** of private-sector payrolls rose by 263,000 in March, a +259,000 average in 1Q17 (vs. +181,000 in 2016).

The **ISM Manufacturing Index** edged down to 57.2 in March, vs. 57.7 in February and 56.0 in January. Growth in new orders remained strong. Production slowed (but remained relatively strong). Job growth picked up. Input price pressures intensified further. Comments from supply managers remained upbeat.

The **ISM Non-Manufacturing Index** fell to 55.2 in March, vs. 57.6 in February and 56.5 in January. Business activity and new orders continued to advance at a relatively strong pace, although somewhat slower than in February. Employment growth slowed. Input price pressures moderated. Comments from supply managers were mixed, but mostly upbeat.

Construction Spending rose 0.8% in February (+3.0% y/y). Private-residential construction spending rose 1.8% (+6.4% y/y). Nonresidential slipped 0.3% (+7.5% y/y). Public construction spending rose 0.6% (-8.0% y/y).

The U.S. **Trade Deficit** narrowed unexpectedly to $43.6 billion in February, after widening to $48.2 billion in January. These figures are often a bit suspect during this time of year, but at face value, they suggest that net exports won't make a major subtraction from 1Q17 GDP growth (as was seen earlier).

Factory Orders rose by 1.0% in February (+7.3% y/y). Orders for nondefense capital goods ex-aircraft slipped 0.1% (+2.9% y/y).

Economic Outlook (2Q17): 2.0-2.5% GDP growth, following around 1.0% growth in 1Q17 (reflecting a much slower pace of consumer spending growth).

Employment: Job growth has remained relatively strong, although the pace should slow as the job market tightens.

Consumers: Job gains and wage growth are supportive, but purchasing power has decreased (gasoline prices). Debt levels are manageable, with few signs of strain in the aggregate.

Manufacturing: Improving in the near term, reflecting good weather, strengthening capital goods orders, and an improved global economic outlook.

Housing/Construction: Job growth has remained supportive, but higher home prices and higher mortgage rates are a restraint for first-time buyers. Tax cuts are expected to help fuel the demand for vacation homes and second homes.

Prices: Ex-food & energy, the PCE Price Index has continued to trend below the Fed's 2% target, but not by a lot. There is little inflation in consumer goods. Inflation in services has been boosted by higher rents. Wage gains are moderate, but rising.

Interest Rates: The Fed remains in tightening mode, and is expected to be more aggressive in raising rates in 2017 than in 2016 and 2015, but policy will remain data-dependent.

This Week:					forecast	last	last –1	comments
Monday	4/10	1:00	Treasury Note Auction					$24 billion in 3-year notes
		4:00	Yellen "Policy Talk"					at Gerald R. Ford School of Public Policy
Tuesday	4/11	6:00	Small Business Optimism	Mar	*NF*	105.3	105.9	still strong
		10:00	JOLTS: hiring rate	Feb	*NF*	4.1%	4.1%	trending about flat, but moderately high
		10:00	JOLTS: quit rate	Feb	*NF*	2.5%	2.4%	highest since before the recession
		1:00	Treasury Note Auction					$21 billion in re-opened 10-year notes
Wednesday	4/12	8:30	Import Prices	Mar	*NF*	+0.2%	+0.6%	petroleum prices lower
			ex-food & fuels		*NF*	+0.3%	0.0%	mild trend otherwise
		10:00	BOC Policy Decision					steady, but pressure to follow the Fed
		1:00	Treasury Bond Auction					$12 billion in re-opened 30-year bonds
Thursday	4/13	8:30	Jobless Claims, th.	4/08	*250*	234	259	there may be some start-of-quarter bias
		8:301	**Producer Price Index**	Mar	*+0.1%*	+0.3%	+0.6%	seas adj amplifies gasoline price decline
			ex-food & energy		*+0.2%*	+0.3%	+0.4%	moderate old core
			ex-f, e, trade services		*+0.2%*	+0.3%	+0.2%	moderate new core
		10:00	UM Consumer Sentiment	m-Apr	*95.6*	96.9	96.3	seen somewhat lower
		2:00	SIFMA: early bond close					full session for the stock market
Friday	4/14		Good Friday Holiday					markets closed
		8:30	**Consumer Price Index**	Mar	*+0.0%*	+0.1%	+0.6%	seas adj amplifies gasoline price decline
			year-over-year		*+2.6%*	+2.7%	+2.5%	reflects higher energy costs
			ex-food & energy		*+0.2%*	+0.2%	+0.3%	moderate core inflation
			year-over-year		*+2.3%*	+2.2%	+2.3%	trending higher than core PCE Price Index
		8:30	Real Hourly Earnings	Mar	*+0.2%*	+0.1%	-0.4%	nominal earnings rose 0.2%
		8:30	**Retail Sales**	Mar	*+0.0%*	+0.1%	+0.6%	moderate
			ex-autos		*+0.1%*	+0.2%	+1.2%	lower gasoline prices
			ex-autos, bld mat, gasoline		*+0.3%*	0.0%	+0.9%	moderate
		10:00	Business Inventories	Feb	*+0.3%*	+0.3%	+0.3%	pace seen slower in 1Q17
Next Week:								
Monday	4/17	8:30	Empire St. Manf. Index	Apr	*NF*	16.4	18.7	choppy, but strong in Feb and Mar
		10:00	Homebuilder Sentiment	Apr	*NF*	71	65	strong in March
Tuesday	4/18	8:30	Building Permits, mln.	Mar	*1.210*	1.216	1.293	weather was likely a factor
			% change		*-0.5*	-6.0	+5.3	reflects volatility in multi-family
			Housing Starts		*1.240*	1.288	1.251	seen lower
			% change		*-3.7*	+3.0	-1.9	but watch for revisions
		9:00	IMF World Econ Outlook					updated
		9:15	**Industrial Production**	Mar	*+0.5%*	+0.1%	-0.1%	weather
			Manufacturing Output		*-0.2%*	+0.5%	+0.6%	aggregate hours reported at -0.4%
			Capacity Utilization		*76.2%*	75.9%	75.9%	still relatively low
Wednesday	4/19	2:00	**Fed Beige Book**					still modest-to-moderate? wages?
Thursday	4/20	8:30	Jobless Claims, th.	4/15	*245*	*250*	234	still a low trend
		8:30	Philadelphia Fed Index	Apr	*NF*	32.8	43.3	unusually strong in Feb and Mar
		10:00	Leading Econ Indicators	Mar	*+0.4%*	+0.6%	+0.6%	components mixed, but mostly positive
		1:00	TIPS Auction					5-year TIPS
Friday	4/21	10:00	Existing Home Sales, mln.	Mar	*5.40*	5.48	5.69	seen roughly steady
			% change		*-0.5*	-3.7	+3.3	weather?

This Week…

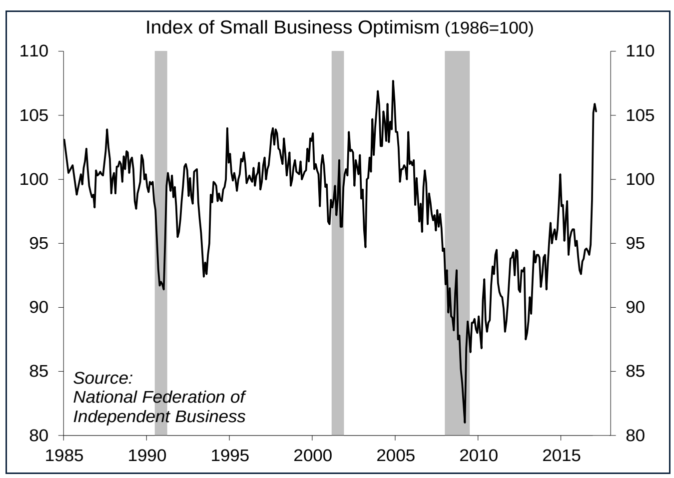
The important economic data reports (CPI, retail sales) show up on Friday, when the markets will be closed for Good Friday. Fed Chair Yellen speaks after the market close on Monday.

Monday

Fed Chair Yellen Speaks – Still on a gradual path of tightening.

Tuesday

Small Business Optimism (March) – Surveys of consumers show sharp divisions by political affiliation. Most small business owners are Republicans. Hence, the recent surge in the NFIB's sentiment gauge is not surprising. Whether that will translate into actual improvement in the economy is another story.



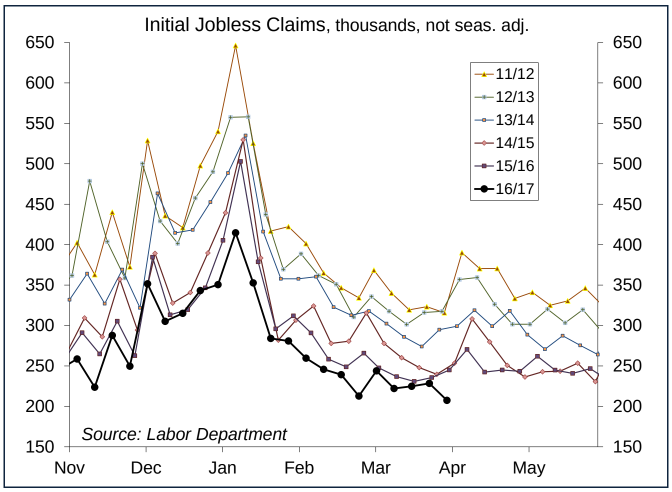
Wednesday

Import Prices (March) – The headline figure depends on oil prices. Details should show moderate gains in prices of raw materials, but limited inflation pressure in finished goods.

Bank of Canada Policy Decision – The BOC is expected to keep short-term interest rates steady, but there ought to be pressure to follow the Fed (in raising rates) in the months ahead.

Thursday

Jobless Claims (week ending April 8) – Figures have been a bit noisy in recent weeks, possibly reflecting the aftermath of previous bad weather. Prior to seasonal adjustment, the trend has remained low, but we usually see some catch-up in the reported numbers at the start of the quarter

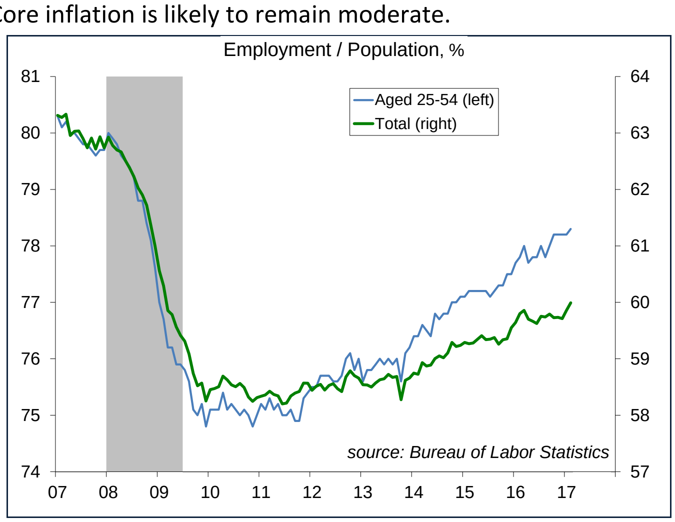


Producer Price Index (March) – Seasonal factors expect a 7.5% rise in gasoline prices (they rose, but not that much). Hence, the headline figure should be biased a little lower. Core inflation is likely to remain moderate, with limited pipeline pressures.

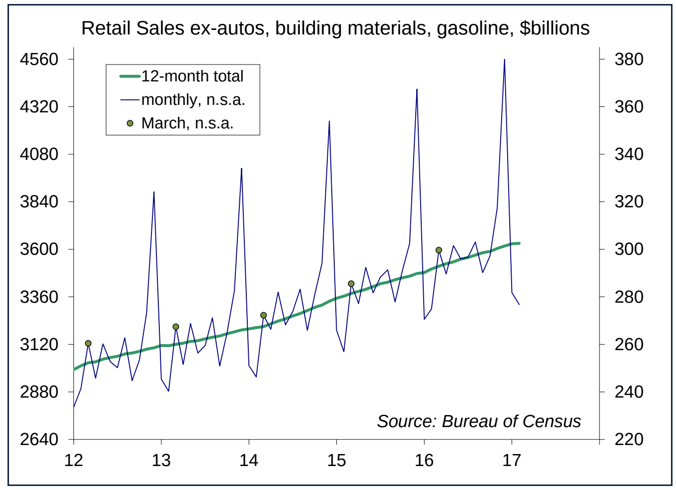
Friday

Good Friday Holiday – Markets closed.

Consumer Price Index (March) – Seasonal factors will be looking for an 8.2% rise in retail gasoline prices. Instead, they rose about 1%. Hence, the headline figure should be about flat. Core inflation is likely to remain moderate.



Retail Sales (March) – Unit auto sales were reported to have fallen last month. Retail payrolls fell by 29,700 (+10,900 before seasonal adjustment). Unadjusted core sales normally pick up in the spring, but the retail payroll data suggest disappointment. Note that retail sales data (and payroll figures) are adjusted for floating holidays, such as Easter, but it's hard to get that right (especially coming on top of strong seasonal shifts). One should take the March sales figures with a grain of salt. The reports for April and May will be more critical to the consumer outlook.



Next Week ...

The important data (residential construction, industrial production) arrive on Tuesday. Spring construction numbers are important, but weather was likely a factor. Industrial production figures were constrained in January and February by a warmer-than-usual winter (reduced output of utilities), but factory output was relatively strong. The Fed's Beige Book shows up on Wednesday afternoon, but should remain consistent with a gradual pace of tightening.

Coming Events and Data Releases

April 25	CB Consumer Confidence (April)
April 27	Durable Goods Orders (March)
April 28	Real GDP (1Q17, advance)
May 3	FOMC Policy Decision (no press conference)
May 5	Employment Report (April)
June 14	FOMC Policy Decision, Yellen press conference
July 26	FOMC Policy Decision (no press conference)
September 20	FOMC Policy Decision, Yellen press conference
November 1	FOMC Policy Decision (no press conference)
December 13	FOMC Policy Decision, Yellen press conference