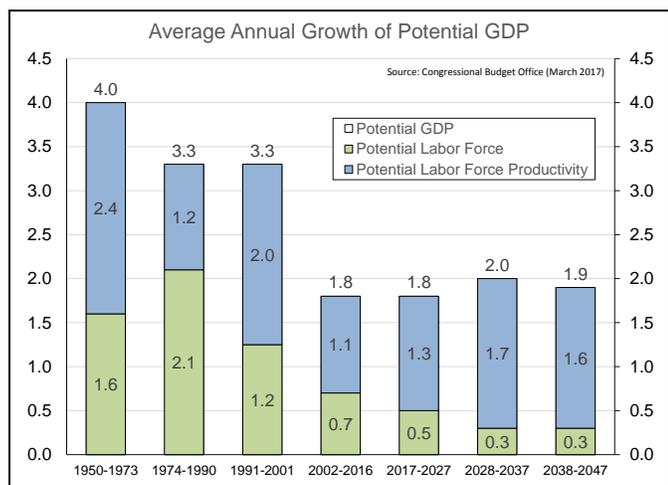


Weekly Economic Monitor

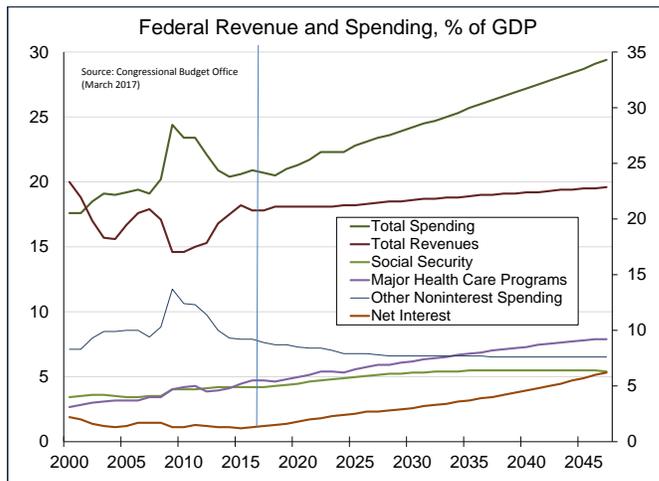
The Federal Budget Outlook

It's a long-standing adage in Washington that the federal debt is a problem only when the other party is in charge. Republicans label Democrats as the party of "tax and spend," while Republicans are deemed the party of "borrow and spend." In truth, the federal budget is about what kind of society we want and who pays for that. Periodically, over the years, the budget has sometimes been seen to be in a crisis. The real concern has always been the long run, which is getting a lot closer.



By now, the demographic story should be well-entrenched. Labor force growth has slowed in recent decades – and will continue to slow in the years ahead. In the last half of the 20th century, the baby-boom generation entered the workforce and female labor force participation rose. Those trends are far behind us now. Growth is simply labor force growth plus productivity growth. Job growth estimates simply reflect the demographics. Productivity growth, which is more uncertain, is seen largely as a function of previous business investment. A softer pace of capital spending following the Great Recession meant slower growth in output per worker over the last decade. Capital spending appears to be picking up now, and advances in artificial intelligence and robotics should lift productivity growth in the years ahead. That will help to offset some of the slowdown in labor force growth. However, it's unlikely that the trend in real GDP growth will be much above 2%. Moreover, if productivity growth doesn't pick up, potential GDP growth would be more likely to center around 1.5%.

The federal budget deficit ballooned to \$1.4 trillion (10% of GDP) during the financial crisis, but that was temporary. The surge merely reflected the magnitude of the economic downturn. Revenues dried up. Recession-related spending (food stamps, unemployment insurance, etc.) rose sharply. The budget deficit was 2.4% of GDP in FY15, but is now rising again.



The long-term budget outlook is troublesome, and we've known that for a number of decades. During the 1980s, President Reagan's National Commission on Social Security, led by Alan Greenspan (before he became Fed chair), made a number of recommendations. One was to build up a trust fund. Workers would pay more into Social Security (and also Medicare) than was coming out. The trust funds would build up. Then, as the baby-boom generation retired, those funds would be tapped, extending the life of these programs. The government has effectively borrowed against these funds. They still exist, as an account, earning interest, but the government cannot reduce them without increasing taxes or borrowing more from the private sector. Can't the government spend less? There's nothing to be done about interest payments. If you don't touch Social Security or Medicare, and want to keep defense spending steady or higher (as a percentage of GDP), there isn't a whole lot left to cut. Something will have to give.

Tough choices lie ahead, but for Congress, the first rule should be to do no harm. Cutting taxes isn't going to help the situation and raising them won't close the budget gap over time. Voters will dislike cuts to Social Security and Medicare spending.

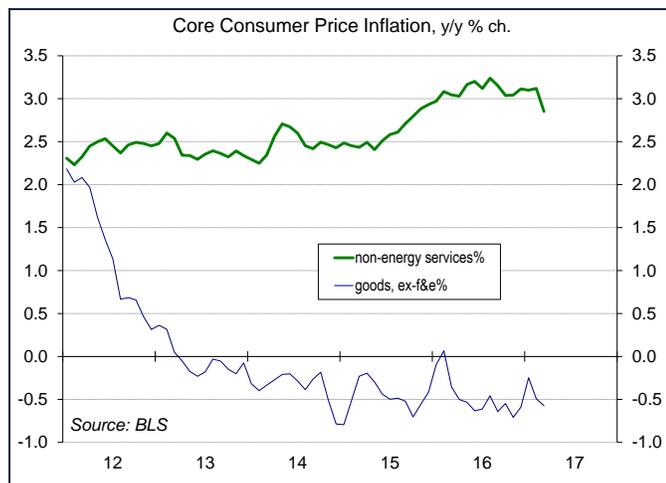
One partial solution would be to boost immigration. Immigrants, legal or otherwise, on average pay more in taxes than they receive in benefits. Instead, the near-term policy push is in the other direction. While labor force growth is slowing down, about 40% of the labor force increase over the next ten years is expected to be immigrants. Current policies may reduce that – further reducing trend GDP growth and adding more strain to the long-term budget outlook.

There is plenty of room for the two parties to reach agreement. The long-term budget situation does not need to be solved overnight. However, it would be helpful if the two sides simply recognized the problem and dropped the rhetoric.

	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
3/17/17	0.73	0.87	1.00	1.33	1.60	2.03	2.50	3.11	1.074	1.237	112.67	1.337	5901.00	2378.25	20914.62
4/07/17	0.82	0.95	1.08	1.29	1.52	1.92	2.38	3.00	1.062	1.240	110.76	1.340	5877.81	2355.54	20656.10
4/14/17	0.81	0.94	1.03	1.21	1.40	1.77	2.24	2.89	1.062	1.253	108.63	1.331	5805.15	2328.95	20453.25

Recent Economic Data and Outlook

The economic calendar was relatively light (the import economic data arrived at the end of the week, when the financial markets were closed for the Good Friday holiday). The stock market reacted negatively to Trump reversals. Bond yields fell.



President Trump reversed his positions on several economic issues. He said his administration would not declare China to be a currency manipulator (an official declaration would have set trade tariffs in motion) and said that the dollar was “too strong.” He now supports the Import-Export bank. He indicated that he might re-appoint Janet Yellen (whose four-year term as chair runs through January 2018). Treasury Secretary Mnuchin said that Trump’s pledge to pay off the national debt in eight years was “hyperbole.” Previously, Trump said that NAFTA would be re-worked around the edges (vs. thrown out completely, as he promised to do in the campaign).

In a sit-down discussion on monetary policy, **Fed Chair Yellen** remained comfortable with a gradual normalization of monetary policy, suggesting that the focus is shifting from “boosting growth” to “sustaining the economic recovery.”

Retail Sales fell 0.2% in March (+5.2% y/y), while February results were revised lower (to -0.3% from +0.1%). Bad weather and the late Easter may have been factors. Ex-autos sales were flat (+5.0% y/y). Ex-autos, building materials, and gasoline, sales rose 0.4% – a 4.1% annual rate in 1Q17 (vs. +3.6% in 4Q16).

The **Consumer Price Index** fell 0.3% in March (+2.4% y/y), partly reflecting a 3.2% drop in energy (+10.9% y/y). Gasoline prices rose 6.2% (+1.1% before seasonal adjustment, and +19.9% y/y). Food rose 0.3% (+0.5% y/y). Ex-food & energy, the CPI edged down 0.1% (median forecast: +0.2%), reflecting declines in wireless telecom services (-7.0%, the largest decline ever), used vehicles (-0.9%), and men’s apparel (-3.1%). The core CPI rose 2.0% y/y. Ex-f&e, consumer goods fell 0.3% (-0.6% y/y)

Real Hourly Earnings jumped 0.5% in March (+0.3% y/y), following a string of soft figures.

The **Producer Price Index** edged down 0.1% in March (+2.3% y/y), reflecting a 2.9% decline in energy (-0.5% before seasonal adjustment). Wholesale gasoline prices fell 8.3% (-0.8% before seasonal adjustment, and +33.5% y/y). Food rose 0.9% (+0.3% y/y) – fruit up 7.1%, vegetables up 7.7%, eggs up 7.6%. Ex-food & energy, the PPI was flat (median forecast: +0.2%), held down by a 0.1% decline in services. Consumer goods ex-f&e rose 0.4% (+2.5% y/y). Pipeline inflation indicators reflected lower energy costs, but moderate upward pressures otherwise. Ex food, energy, and trade services, the PPI figure rose 0.1% (+1.7% y/y)

Import Prices fell 0.2% in March (+4.2% y/y), up 0.3% ex-food & fuels (+0.8% y/y). Ex-fuels, prices of imported raw materials jumped 1.6%, up 4.4% since November (+6.8% y/y). Prices of imported capital goods edged up 0.1% (-0.6% y/y). Prices of imported consumer goods fell 0.2 (-0.2% y/y).

The Index of **Small Business Optimism** edged down to 104.7 in March, vs. 105.3 in February and 105.9 in January. The general business outlook remained optimistic. Sales expectations fell (still elevated following the November election). The earnings trend remained weak (but not as bad as a few months ago). Hiring plans remained moderate. Capital spending picked up.

The **Bank of Canada** left short-term interest rates unchanged, as expected. The BOC noted that while the country’s “recent rebound in GDP is encouraging, it is too early to conclude that the economy is on a sustainable growth path.” While the growth outlook improved, soft business investment has results in lower growth potential – hence, “the output gap is projected to close in the first half of 2018, a bit sooner than the Bank anticipated in January.”

Economic Outlook (2Q17): 2.0-2.5% GDP growth, following around 1.0% growth in 1Q17.

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.

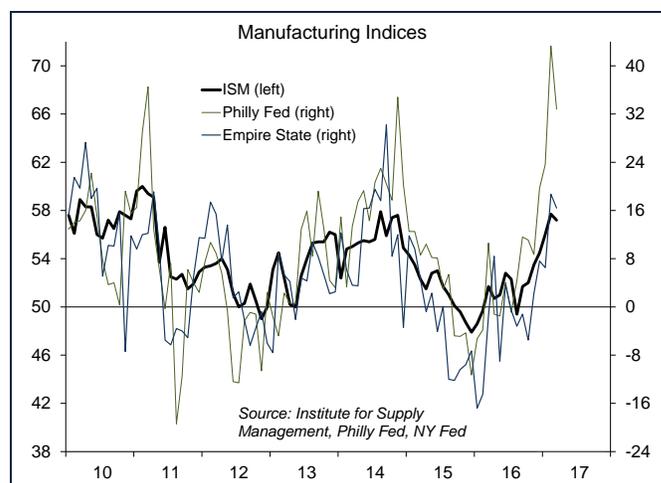
This Week:				<i>forecast</i>	last	last -1	comments	
Monday	4/17	8:30	Empire St. Manf. Index	Apr	NF	16.4	18.7	choppy, but strong in Feb and Mar
		10:00	Homebuilder Sentiment	Apr	NF	71	65	strong in March
Tuesday	4/18	8:30	Building Permits, mln.	Mar	1.210	1.216	1.293	weather was likely a factor
			% change		-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	234	235	subject to some seasonal noise
		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?
Next Week:								
Monday	4/24		no significant data					Hubble Space Telescope launched (1990)
Tuesday	4/25	10:00	New Home Sales, th.	Mar	575	592	558	reported with huge uncertainty
			% change		-2.9	+6.1	+5.3	watch for revisions
		10:00	CB Consumer Confidence	Apr	123.8	125.6	116.1	some moderation seen
		1:00	Treasury Note Auction					2-year notes
Wednesday	4/26	11:30	FRN Auction					2-year Floating Rate Notes
		1:00	Treasury Note Auction					5-year notes
Thursday	4/27	7:45	ECB Policy Decision					no change
		8:30	Jobless Claims, th.	4/22	245	245	236	still a low trend
		8:30	Durable Goods Orders	Mar	+0.8%	+1.8%	+2.4%	aircraft orders should be higher
			ex-transportation		+0.5%	+0.5%	+0.3%	moderate otherwise
			nondef cap gds ex-aircraft		+0.4%	-0.1%	+0.2%	soft in Jan and Feb
		8:30	Advance Econ Indicators	Mar				fine-tuning GDP estimates
			Wholesale Inventories		NF	+0.4%	-0.2%	slower in 1Q17
			Retail Inventories		NF	+0.4%	+0.9%	faster in 1Q17
			Merch. Trade Balance, \$bln		NF	-64.8	-68.8	choppy in Jan and Feb
		10:00	Pending Home Sales Index	Mar	NF	+5.5%	-2.8%	choppy, but a moderately strong trend
		1:00	Treasury Note Auction					7-year notes
Friday	4/28	8:30	Employment Cost Index	1Q17	+0.6%	+0.5%	+0.6%	moderate wage pressures
			year-over-year		+2.3%	+2.2%	+2.3%	still moderate
		8:30	Real GDP (advance est.)	1Q17	+1.0%	+2.1%	+3.5%	soft consumer spending
			Priv. Dom. Final Purch.		+1.8%	+3.4%	+2.4%	follows a strong 4Q
		9:45	Chicago Business Barometer	Apr	57.2	57.7	57.4	moderately strong
		10:00	UM Consumer Sentiment	Apr	97.8	96.9	96.3	98.0 at mid-month

This Week...

We could see some minor market reactions to any surprises, but the economic data reports are unlikely to add much to the overall outlook (a greater reassessment will come in the next few weeks, when we get the first look at 1Q17 GDP, the monthly ISM survey results, and the April Employment Report). The IMF's revised World Economic Outlook may lead to renewed optimism about the strength of the global economy, but possibly a re-evaluation of the risks ahead.

Monday

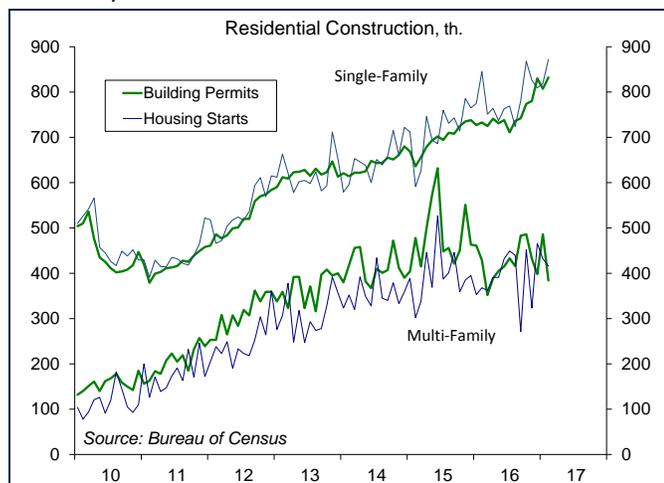
Empire State Manufacturing Index (April) – The two major regional Fed factory sector surveys tend to be volatile from month to month, but they generally track the direction of national manufacturing activity.



Homebuilder Sentiment (April) – The National Association of Home Builders' Housing Market Index jumped in March. The trend has been higher, but monthly figures have been erratic.

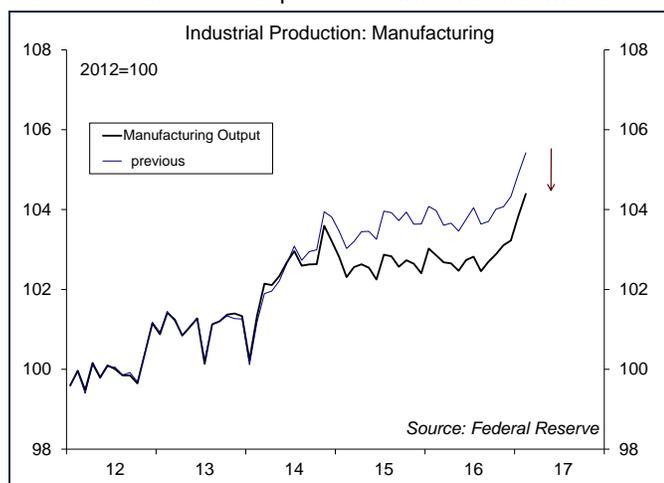
Tuesday

Building Permits, Housing Starts (March) – Poor weather may have been a factor in March and these figures can be choppy. The trend in single-family activity is higher, but the more volatile multi-family sector is flat to down.



IMF World Economic Outlook (update) – The IMF is expected to adjust its expectations for global growth higher, mostly reflecting improvement in the outlook for emerging economies. Still, the assessment should highlight a number of potential risks.

Industrial Production (March) – The recent (March 31) benchmark revision showed a lower level of activity over the last two years (still a flattish trend). The headline IP figure was restrained by moderate temperatures (lower output of gas and electric utilities) in January and February. That impact should unwind in the March report. Manufacturing output has risen sharply in the last few months, likely reflecting increased business confidence. The question is whether that will last.



Wednesday

Fed Beige Book – Growth has been described as modest-to-moderate growth over the last several months, but the Fed's policy focus is on the job market and the inflation outlook.

Thursday

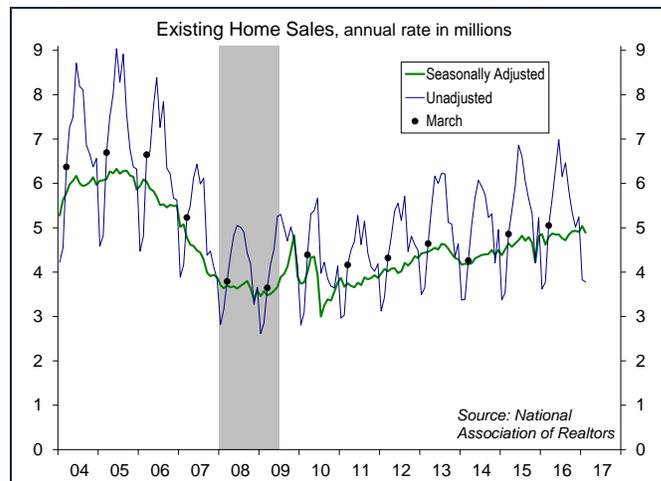
Jobless Claims (week ending April 15) – There's often some noise before and after the Easter holiday. The four-week average has remained remarkably low, consistent with tight job conditions.

Philadelphia Fed Index (April) – Almost ridiculously high in recent months. Expect some moderation in April.

Leading Economic Indicators (March) – Components were mixed, but mostly higher. A (temporary) pickup in jobless claims and a shorter factory workweek will subtract.

Friday

Existing Home Sales (March) – The March data (which measure closings) fall between the winter lull and the spring season.



Next Week ...

The focus will be on the advance GDP estimate for 1Q17. The financial markets usually put far too much weight on the headline GDP number. The story is what's important. While consumer spending growth may have been soft, that followed a strong fourth quarter. Note that a soft GDP figure would not force the Fed to the sidelines (the focus is on the job market).

Coming Events and Data Releases

May 1	ISM Manufacturing Index (April)
May 3	ADP Payrolls Estimate (April) ISM Non-Manufacturing Index (April) FOMC Policy Decision (no press conf.)
May 5	Employment Report (April)
May 12	Consumer Price Index (April) Retail Sales (April)
May 29	Memorial Day (markets closed)
June 14	FOMC Policy Decision, Yellen press conf.
July 26	FOMC Policy Decision (no press conf.)
September 20	FOMC Policy Decision, Yellen press conf.
November 1	FOMC Policy Decision (no press conf.)
December 13	FOMC Policy Decision, Yellen press conf.