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Economic Research

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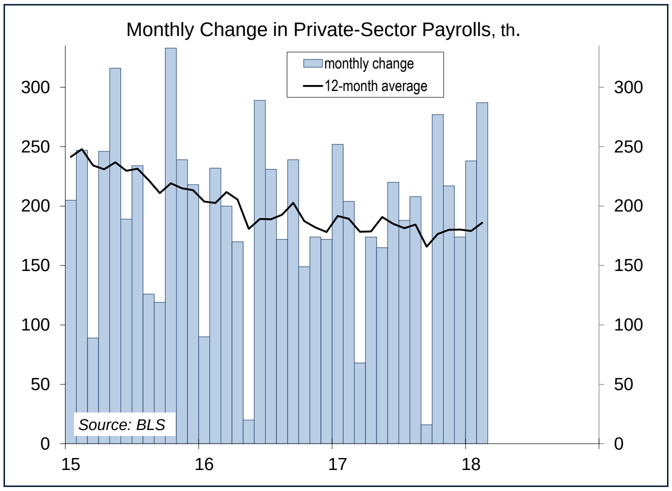
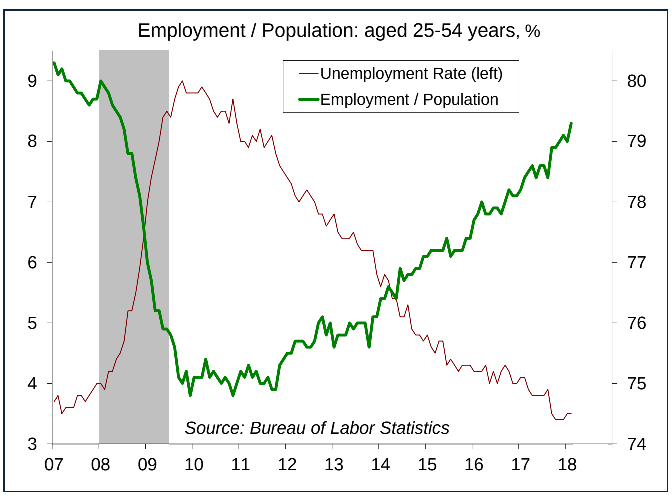
Weekly Economic Monitor

The February Employment Report

Nonfarm payrolls rose by 313,000 in the initial estimate for February, with a net revision of +54,000 to December and January. The unemployment rate held steady at 4.1%, despite a rise in labor force participation. Average hourly earnings rose a modest +0.1%, continuing along a moderate trend (3-month average up 2.7% y/y). What does this mean for Fed policy?

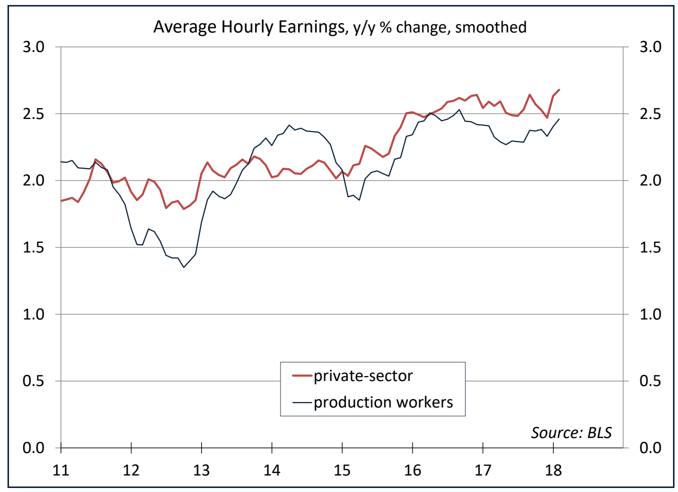


There appear to be some seasonal quirks in the February payroll data. Prior to seasonal adjustment, retail payrolls fell by 130,000 (vs. -226,000 a year ago), while local government education rose by 250,000 (vs. 205,000). Still, there were solid gains in construction, manufacturing, and temp-help services.

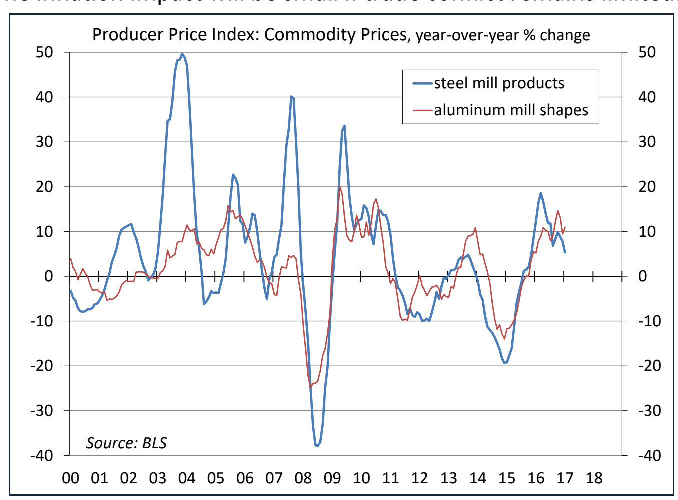


Despite strong job growth, the unemployment rate has been essentially unchanged since October. Labor force participation increased in February, suggesting that there may have been more slack in the job market than was commonly believed, but it's only one month and the strengthening in the prime-age cohort data is clear (and for the Fed, unsustainable).

A tight labor market should lead to faster wage growth. Average hourly earnings (AHE) rose only slightly in February. While labor cost pressures are an important factor in the Fed's policy outlook, financial market participants put far too much emphasis on the monthly figure, which is often revised. Smoothing the data by taking the year-over-year change in the three-month average reduces a lot of the noise. Wage inflation here is moderate over the last year: +2.7% for private-sector employee and +2.5% for nonsupervisory workers, with no sign of a sharp acceleration. That likely reflects a decades-long shift in wage bargaining power away from labor and towards firms. The Fed sees low productivity growth as a likely factor as well.



Whatever job gains we see in steel and aluminum production will be more than offset by losses in downstream industries. The inflation impact will be small if trade conflict remains limited.

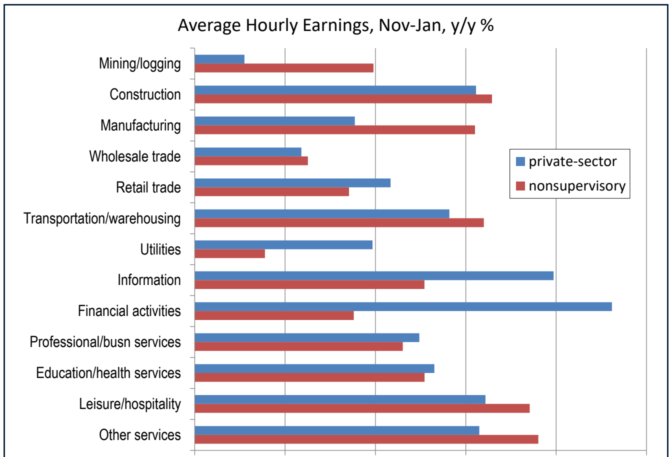


A strong job market is good, and inflation pressures remain moderate, but the Fed will see the current pace as unsustainable. You can't count on reducing the unemployment rate and a widening trade deficit forever.

	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
2/09/18	1.55	1.73	1.89	2.05	2.26	2.52	2.83	3.14	1.223	1.379	108.44	1.260	6874.49	2619.55	24190.90
3/02/18	1.67	1.89	2.05	2.25	2.42	2.63	2.86	3.13	1.231	1.377	105.65	1.288	7257.87	2691.25	24538.06
3/09/18	1.68	1.88	2.03	2.27	2.44	2.66	2.90	3.16	1.231	1.385	106.85	1.282	7545.52	2786.56	25335.81

Recent Economic Data and Outlook

Trump imposed tariffs on steel and aluminum as expected, but excluded Canada and Mexico. Nonfarm payrolls rose a lot more than expected, but wage growth was modest. Stocks rallied.



Source: BLS

Citing national security concerns, **President Trump** signed proclamations imposing a 25% tariff on imported steel and a 10% tariff on imported aluminum effective March 23, but exempted (for the time being) Canada and Mexico.

Eleven nations (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam) signed the **Comprehensive and Progressive Agreement for Trans-Pacific Partnership** (but the U.S. wasn't down with TPP).

The Fed's **Beige Book** noted that economic growth continued to expand at a *"modest to moderate"* pace across the 12 Federal Reserve districts. Across the country, *"contacts observed persistent labor market tightness and brisk demand for qualified workers."* Most districts reported that *"employers raised wages and expanded benefit packages in response to tight labor market conditions."* Inflation was described as *"moderate."* Four districts saw *"a marked increase in steel prices, due in part to a decline in foreign competition."*

The February **Employment Report** was mixed. Nonfarm payrolls rose by 313,000 (median forecast: +200,000), reflecting fewer unadjusted job losses in retail, increased temp hiring, plus solid gains in local education, manufacturing, and construction. The unemployment rate held steady at 4.1%, despite a 0.3 percentage point jump in labor force participation (the employment/population ratio rose to 60.4%, from 60.1% in January and 60.0% in February 2017). Average hourly earnings (AHE) rose 0.1%, up 2.6% (three-month average: +2.7% y/y). For nonsupervisory workers, AHE rose 0.3% (+2.5% y/y).

The **ADP Estimate** of private-sector payrolls rose by 235,000 in February, after +244,000 in January and +249,000 in December.

The U.S. **Trade Deficit** widened to $56.6 billion in January, close to what was suggested by the advance estimate of merchandise trade. Petroleum imports rose 20.6% (+24.5% y/y), reflecting a 6.9% increase in quantity and a 12.9% increase in prices.

Factory Orders fell 1.4% in January, reflecting a sharp drop in aircraft orders. Orders for nondefense capital goods ex-aircraft fell 0.3%, vs. -0.5% in December (+6.3% y/y).

The **ISM Non-Manufacturing Index** was little changed in February (59.5, vs. January's 59.9). Growth in business activity and new orders picked up (from an already strong pace). Employment growth moderated. Input price pressures remained elevated. Comments from supply managers were mixed, with some impact from labor market constraints.

The **Bank of Canada** maintained its target for the overnight rate at 1.25%. The statement noted that "trade policy developments are an important and growing source of uncertainty for the global and Canadian outlooks." The economic outlook is expected to warrant higher interest rates over time, according to the BOC, although "some continued monetary policy accommodation will likely be needed to keep the economy operating close to potential and inflation on target."

The **European Central Bank** left short-term interest rates unchanged, as expected, and did not alter its asset purchase program. The statement removed a phrase indicating that the ECB could increase asset purchases if the economic outlook or financial conditions deteriorated, but ECB President Draghi included the phrase in his opening statement.

Economic Outlook (1Q18): around 3.0-3.5% GDP growth, likely to be boosted by lower imports (which had surged in 4Q17).

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

Consumers: Real wage growth has been lackluster, but reduced tax withholding boosted take-home pay in February. Credit is easy, except at the low end.

Manufacturing: Sentiment remains strong. Figures are often choppy at the start of the year, but the underlying trends in orders and production appear to be moderate.

Housing/Construction: Job growth has been supportive. Monthly figures are often erratic and supply constraints remain, but the underlying trends are relatively strong.

Prices: Core inflation has continued to trend below the Fed's 2% target, partly reflecting a "one-off" plunge in wireless telecom services. Wage pressures are moderate.

Interest Rates: The Fed remains in tightening mode, and is expected to continue gradually raising short-term rates, but personnel changes add uncertainty. Balance sheet reduction has begun and should not be disruptive for the markets.

This Week:					*forecast*	last	last –1	comments
Monday	3/12	11:30	Treasury Note Auction					$28 billion in 3-year notes
		1:00	Treasury Note Auction					$21 billion in re-opened 10-year notes
		2:00	Treasury Budget, $bln	Feb	***-216.0***	-192.0	-192.6	revenue down about 8.6% y/y
Tuesday	3/13	6:00	Small Business Optimism	Feb	***NF***	106.9	104.9	still elevated
		8:30	**Consumer Price Index**	Feb	***+0.2%***	+0.5%	+0.2%	gasoline in line with seasonal adjustment
			year-over-year		***+2.2%***	+2.1%	+2.1%	slightly higher
			ex-food & energy		***+0.2%***	+0.3%	+0.2%	moderate core inflation
			year-over-year		***+1.8%***	+1.8%	+1.8%	seen steady
		8:30	Real Hourly Earnings	Feb	***-0.1%***	-0.2%	+0.2%	nominal earnings rose 0.1%
		1:00	Treasury Bond Auction					$13 billion in re-opened 30-year bonds
Wednesday	3/14	8:30	**Retail Sales**	Feb	***+0.4%***	-0.3%	0.0%	unit auto sales edged a bit lower
			ex-autos		***+0.6%***	0.0%	+0.1%	rebounding from January weather
			ex-autos, bld mat, gasoline		***+0.5%***	0.0%	0.0%	revisions to January?
		8:30	Producer Price Index	Feb	***+0.2%***	+0.4%	0.0%	energy in line with seasonals
			ex-food & energy		***+0.2%***	+0.4%	-0.1%	moderate old core
			ex-f, e, trade services		***+0.2%***	+0.4%	+0.1%	moderate new core
		10:00	Business Inventories	Jan	***+0.6%***	+0.5%	+0.4%	seen faster in 1Q18
Thursday	3/15	8:30	Jobless Claims, th.	3/10	***225***	231	210	a low trend
		8:30	Import Prices	Feb	***NF***	+1.0%	+0.2%	some pressure in raw materials
			ex-food & fuels		***NF***	+0.5%	-0.1%	but little in finished goods
		10:00	Homebuilder Sentiment	Mar	***72***	72	72	likely to remain strong
Friday	3/16	8:30	Building Permits, mln	Feb	***1.290***	1.377	1.300	volatility in multi-family
			% change		***-6.3***	+5.9	-0.2	y/y strength in single-family
			Housing Starts		***1.280***	1.326	1.209	volatility in multi-family
			% change		***-3.5***	+9.7	-6.9	reported w/ a huge amt of uncertainty
		9:15	**Industrial Production**	Feb	***+0.4%***	-0.1%	+0.4%	more moderate temperatures on average
			Manufacturing Output		***+0.8%***	+0.1%	0.0%	aggregate hours jumped 0.9%
			Capacity Utilization		***77.8%***	77.5%	77.7%	no threat to the inflation outlook
		10:00	UM Consumer Sentiment	m-Mar	***99.2***	99.7	95.7	still strong
Next Week:								
Monday	3/19		no significant data					
Tuesday	3/20		no significant data					vernal equinox
Wednesday	3/21	10:00	Existing Home Sales, mln	Feb	***5.46***	5.38	5.56	rebound from weather
			% change		***+1.5***	-3.2	-2.8	but continued supply constraints
		2:00	**FOMC Policy Decisions**		***+25 bps***	0	+25 bps	quarter-point hike all but certain
		2:00	**Fed: Summary of Econ Proj**					includes a revised dot plot
		2:30	**Powell Press Conference**					still data-dependent
Thursday	3/22	7:00	BOE Policy Decision					a bit more hawkish at previous meeting
		8:30	Jobless Claims, th.	3/17	***225***	***225***	231	a low trend
		10:00	Leading Econ Indicators	Feb	***+0.6%***	+1.0%	+0.6%	most components positive
Friday	3/23	8:30	Durable Goods Orders	Feb	***NF***	-3.6%	+2.7%	still waiting on Boeing figures
			ex-transportation		***+0.4%***	-0.3%	+0.8%	should rebound from bad weather
			nondef cap gds ex-aircraft		***+0.5%***	-0.3%	-0.5%	choppy, but a moderately strong trend
		10:00	New Home Sales, th.	Feb	***615***	593	643	seen rebounding
			% change		***+3.7***	-7.8	-7.6	reported with a huge degree of uncertainty

This Week…

The Consumer Price Index is a backward indicator. It tells us what inflation was over the last 12 months. The Fed is concerned about *future* inflation. Nevertheless, the financial markets will be sensitive to an upward surprise in the core CPI for February. Retail sales is the other important release. However, February is a transitional month for most retailers. We should see some pickup in sales, but one shouldn't put much weight on that. March and April data will give a better assessment of consumer spending.

Monday

Treasury Budget (February) – Not market-moving. Revenues will be lower compared to February 2017.

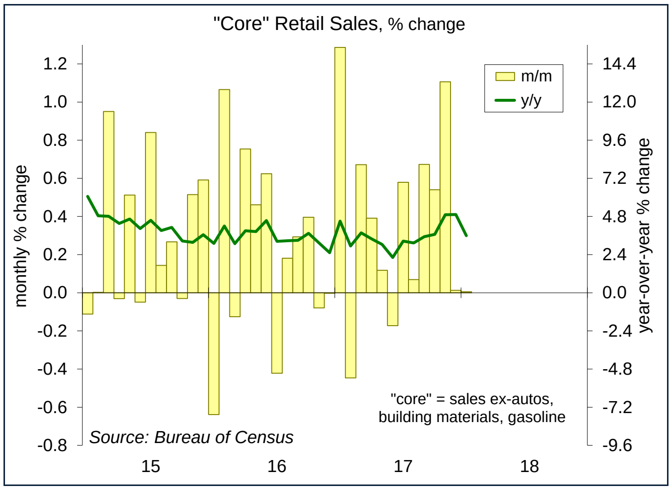
Tuesday

Consumer Price Index (February) – Retail gasoline prices rose roughly in line with the seasonal adjustment. Core inflation is likely to be moderate. We had a surprise in the core figure for January (+0.3%, but very nearly revised to +0.4%). However, it's not unusual to see a pop at the start of the year (presumably as firms try to raise prices to see if the stick). A January pickup could be followed by a correction (a lower core figure), but that may still be a month or two away.

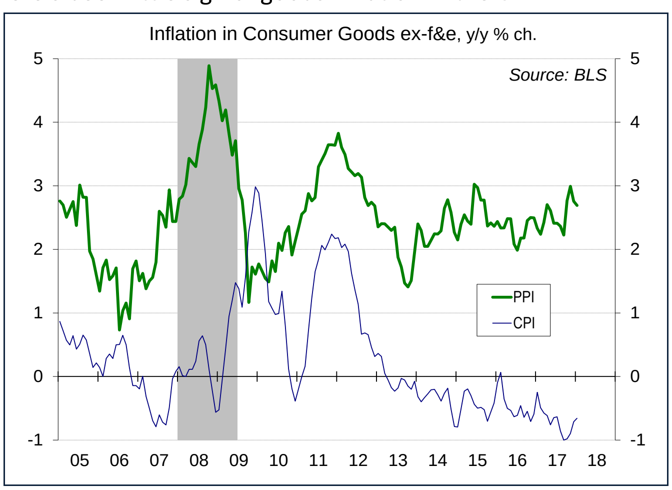
Real Hourly Earnings (February) – Inflation-adjusted earnings have been relatively soft year-over-year. Nominal earnings rose 0.1% (+0.3% for nonsupervisory workers), which will keep the year-over-year gain in real hourly earnings modest.

Wednesday

Retail Sales (February) – Retail payrolls rose by 50,300 last month after adjustment, reflecting lower seasonal layoffs (unadjusted retail payrolls fell by 130,300, vs. -226,500 in February 2017). Hence, February's "pickup" in retail payrolls may not reflect consumer spending strength. Nevertheless, we ought to see a rebound from January weather and withholding went down (leaving workers with more take-home pay).



Producer Price Index (February) – While the focus is on the headline data, the figures for the earlier stages of production have indicated some buildup of pipeline pressures. However, there's been little sign of goods inflation in the CPI.



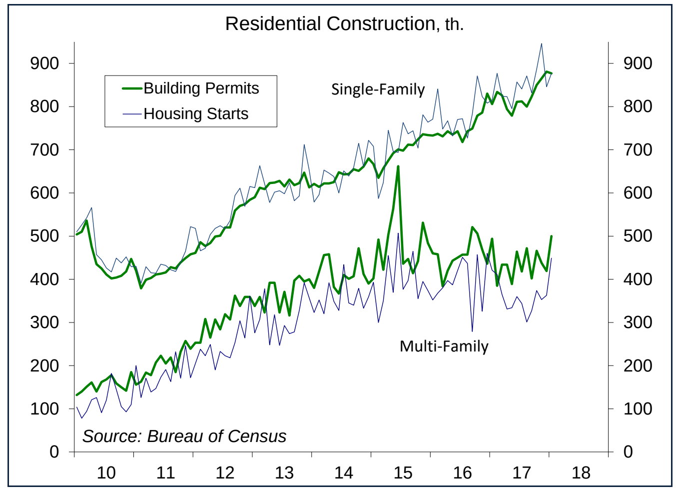
Thursday

Jobless Claims (week ending March 10) – The trend has remained extremely low, consistent with tighter job market conditions, but also a less dynamic economy (less job-hopping).

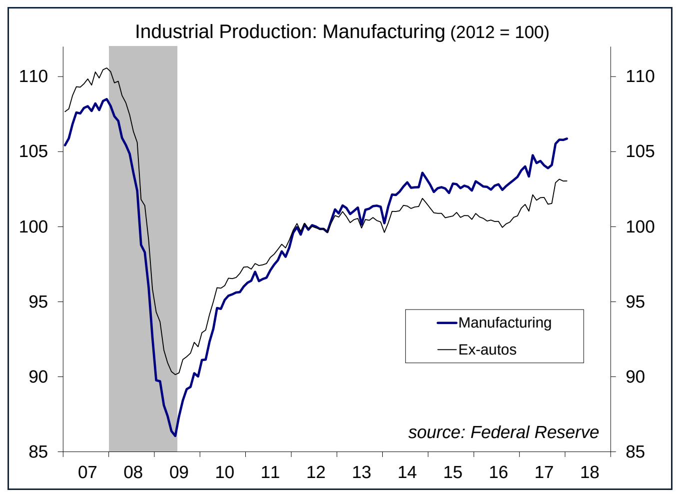
Import Prices (February) – Figures over the last year show a general pickup in inflation in imported raw materials, but prices of imported finished goods have been flat or up modestly.

Friday

Building Permits, Housing Starts (February) – On top of the usual statistical uncertainty, construction data will be subject to weather and seasonal adjustment noise in February. Keep an eye on single-family permits, the key figure in the report.



Industrial Production (February) – January was COLD. February was more moderate (relative to the norm). Reduced utility output should therefore restrain the headline figure. Manufacturing output, uneven but stronger over the last half of 2017, should post a strong gain, partly reflecting a rebound from January's weather.



Next Week …

The Federal Open Market Committee is widely expected to raise short-term interest rates. Investors will be looking for clues about the expected future pace of tightening, which, while data-dependent, should be reflected in the revised dot plot and Powell's post-meeting press conference (his first).

Coming Events and Data Releases

March 27	CB Consumer Confidence (March)
March 28	Real GDP (4Q17, 3rd estimate)
March 30	Good Friday Holiday (markets closed)
April 6	Employment Report (March)
May 2	FOMC Policy Decision (no press conf.)
June 13	FOMC Policy Decision, press conf.
November 6	Election Day