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IAN SHEPHERDSON, CHIEF ECONOMIST

Payroll growth mean-reverted in March, and Q2 looks set for further solid gains...

...Wage gains will continue to trend higher, but won't force the Fed to act until much later in the year.

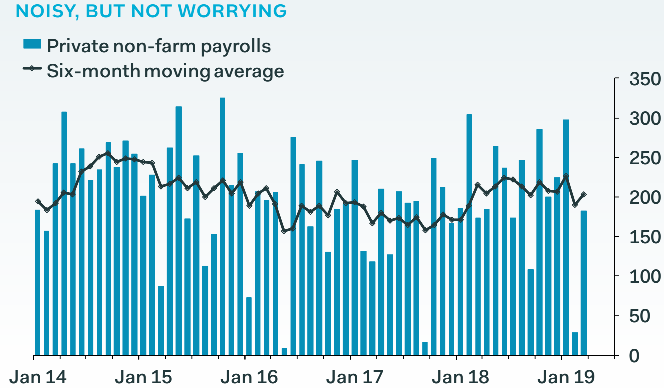
Two unqualified nominees for the Fed board threaten open warfare when rates have to rise again.

Payroll Gains set to be Close to 200K in Q2; Labor Market Still Tightening

The return to normal in the March payroll numbers, with a 196K headline increase, is another nail in the coffin of the "imminent recession" theory. Job growth has been even more volatile than usual recently, and the three month average, at 180K, is the lowest since November 2017. *But it follows an unsustainable surge in the three months to January, when gains averaged 245K, so a correction was always likely.*

The details were less encouraging than the headline, with manufacturing employment falling for the first time since July 2017, while a third of the total increase in private sector employment was in the healthcare sector. *That said, we have learned the hard way that over-analyzing the components of payrolls on a month-to-month basis often is not helpful.* Revisions can change the initial picture substantially, and all the sector

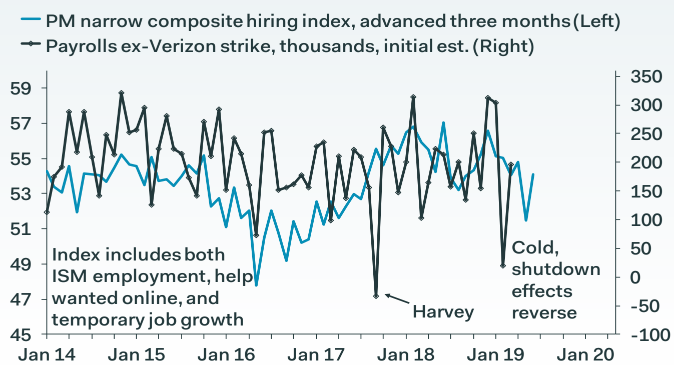
NOISY, BUT NOT WORRYING



numbers are noisy over short periods, regardless of the strength of the underlying trend.

What matters now for markets is whether payroll growth can be sustained close to 200K over the next few months. A real softening in the trend would stop the downward trend in unemployment, conceivably pushing it up, allowing markets and the Fed to look through the likely further acceleration in wages, at least for a while. ***But the key survey-based indicators of future hiring have rebounded after the dip triggered by the drop in stock prices in Q4.*** Our next chart shows that this suggests payroll gains averaging about 200K are a decent bet for the second quarter. Note that we're taking into account the clear tendency for our composite index of hiring surveys to overshoot actual payrolls over the past couple of years, probably because employers can't find all the people they want to hire.

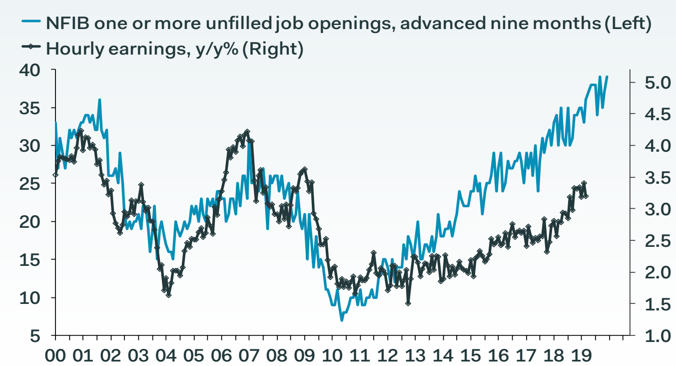
JOB GROWTH AVERAGING HIGH 100'S LOOKS A GOOD BET FOR Q2?



Sustained payroll gains of 175-to-200K would push the unemployment rate down over time; we can't see a world in which participation rises strongly enough to push that many people into the labor force every month. *The average monthly increase in the labor force in the two years to March was just 122K, while the household survey's measure of employment growth averaged 158K over the same period.* The upturn in participation since last fall has now partly reversed, taking it back into the range seen over the past few years. This isn't *definitive* evidence that the prior increase was just a statistical aberration, but it certainly puts something of a damper, at least for a while, on the idea that participation finally is breaking to the upside.

Lower unemployment means greater pressure on wage growth, other things equal, and we see no reason at all to think that the minimal 0.1% increase in average hourly earnings in March means that the upward pressure is fading. *March wages likely were constrained by a technicality, triggered by part-timers returning to work after bad weather pushed them off payrolls in February.* Part-timers are relatively low paid, so when they temporarily leave the payroll sample, AHE overshoots - February's gain was +0.4% - and when they return, AHE undershoots. The data are not mix-adjusted. We think the underlying trend in AHE growth is still strongly upwards, despite the dip to 3.2% in March from 3.4% in February, and all the indicators we follow point to a 4% year-over-year rate by the year-end.

THE PRESSURE ON WAGE GROWTH IS ALL TO THE UPSIDE



In the meantime, this report likely changes nothing in terms of the balance of views at the Fed and in the markets. Hawks, if there are any left, will note the rebound in payrolls and the end of the apparent upturn in participation, while doves will be comforted by the small increase in AHE. *We remain of the view that a serious shift in the data is not likely until the summer, but by the fall we are convinced that the Fed will be facing significantly faster wage growth, higher core inflation, and continued downward pressure on the unemployment rate.* At that point, things change.

Nominating hacks to the Fed is not progress

The nomination of one unqualified candidate to the Fed board might just be carelessness. *Two, however, looks like a plan to undermine Chair Powell.* Herman Cain has a good deal of business experience, but that's not necessarily a qualification for making monetary policy and regulatory decisions. He is, though, a strong supporter of the President.

Dozens of conversations with investors in recent months make it very clear to us that the Fed's credibility already is in question, after the sudden swerve to dovishness in the wake of the drop in stocks in Q4. ***At every meeting we've had since the January FOMC, someone has asked if we think Chair Powell is responding to political pressure, despite his frequent protestations to the contrary.***

Our response is that we do not believe Chair Powell is simply doing the President's bidding. But he is human, and people under great and public pressure from their boss might be expected to modulate their decision-making, perhaps subconsciously, in the hope of making their working life more pleasant. Either that, or they quit; Mr. Powell remains in his post.

The addition of two transparent political partisans to the Fed board—one of whom has recently argued erroneously that the U.S. faces deflation, while the other has no discernible coherent views on monetary policy—can only raise more questions over the Fed's independence. *This will become a problem for markets when the Fed faces difficult decisions, likely in the second half of this year.*

This assumes that Mr. Moore and Mr. Cain will be confirmed by the Senate, and that's not a done deal. They might not even be formally nominated, given the difficulties posed by background checks. Financial questions hang over Mr. Moore, and Mr. Cain has been accused of multiple transgressions by several women. If they are appointed to the board, though, we'd expect to see split votes late this year and next, when we think the Fed will need to raise rates, and a great deal of public squabbling. Markets won't like it either.

Ian Shepherdson **+1 914 610 3830**
ian@pantheonmacro.com

THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, April 8

• Factory Orders (2)/10:00 EDT
The 1.6% drop in durable goods orders, led by aircraft, points to a **0.5%** fall in total factory orders. **Consensus: -0.6%.**

Tuesday, April 9

• D: NFIB Survey (3)/6:00 EDT
The strength of the NFIB's labor numbers, released last week ahead of the JOBS report, as usual, suggests that the headline index rose to **103** from 101.7. **Consensus: 101.6.**

• Redbook Chain Store Sales (4/6)/9:00 EDT
We expect little change in same-store sales growth from last week's **4.4%** year-over-year rate, in the middle of the recent range. The downshift in the trend from last year's tax cut-fuelled pace is over.

• JOLTS (2)/10:00 EDT
We expect little change in the number of job openings from January's 7,581K, only just shy of November's all-time high. **Consensus: 7,566K.**

Wednesday, April 10

• Mortgage Applications (4/5)/7:00 EDT
The purchase index jumped to an 11-week high of **276.6** last week, completing the reversal of February's seasonal drop.

• D: Consumer Prices (3)/8:30 EDT
A rebound in gas prices means the headline CPI likely rose **0.3%.** The core probably rebounded to a **0.2%** increase, after February's below-trend **0.1%** rise. **Consensus: Headline 0.3%, core 0.2%.**

• D: FOMC Minutes (3/20)/14:00 EDT
The Fed dropped both its dots for 2019, in our view over-reacting to the immediate economic data and external risks which are not likely to crystallize.

• Treasury Budget (3)/14:00 EDT
The CBO has not yet released its estimate but the trend is deteriorating; in March last year deficit was $209B. **Consensus: 59.0**.

Thursday, April 11

• D: Jobless Claims (4/5)/8:30 EDT
We expect claims to rebound to about **215K** after last week's unexpected drop to 202K, the lowest since December 1969. California's claims were estimated last week, and we think an upward revision today is a good bet. **Consensus: 210K.**

• D: Producer Prices (3)/8:30 EDT
We expect a **0.5%** jump in the headline index, thanks to rebounding gas prices, but the core probably rose only **0.1%. Consensus: Headline 0.3%, core 0.2%.**

• Clarida Speech/9:30 EDT
Vice Chair Clarida speaks at the Institute of International Finance, with a Q&A session.

Friday, April 12

• Import Prices (3)/8:30 EDT
The rebound in oil prices means total import prices likely jumped by **0.8%,** with prices ex-oil up 0.2%. **Consensus: All imports 0.4%.**

• D: Univ. Michigan Consumer Sentiment (4p)/10:00 EDT
We expect a modest dip to about **97** from 98.4, thanks to the continued rebound in gas prices. **Consensus: 98.0.**

THIS WEEK'S FUNDING

Monday 8	Auction: $42B 3-month, $36B 6-month bills
Tuesday 9	Announcement: four-week bills, eight-week bills Auction: $38B 3-year notes (settles Apr. 15)
Wednesday 10	Auction: $24B10-year notes (settles Apr. 15)
Thursday 11	Auction: four-week bills, eight-week bills Announcement: 3-month, 6-month bills (Apr. 15) Announcement: 5-year TIPS (Apr. 18) Auction: $16B 30-year bonds (settles Apr. 15)
Friday 12	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Fri.	Jun	Sep	Dec	Mar
Fed funds target	2¼-to-2½	2¼-to-2½	2½-to-2¾	2¾-to-3	3-to-3¼
2-yr	2.34	2.50	2.80	3.10	3.20
10-yr	2.50	2.70	3.10	3.30	3.30
30-yr	2.91	3.10	3.20	3.30	3.20
Curve 10-2	16	20	30	20	10
Curve 30-2	57	50	40	0	-10
S&P 500	2,893	2,850	2,750	2,650	2,650
Dollar/Yen	111.7	111	110	110	110
Euro/Dollar	1.12	1.15	1.17	1.20	1.20
Sterling/Dollar	1.30	1.36	1.38	1.40	1.40

PANTHEON'S ECONOMIC FORECASTS

GDP	Q2	4.2%	2015 year:	2.6%
	Q3	3.4%	2016 year:	1.6%
	Q4 third	2.2%	2017 year:	2.3%
	Q1 forecast	*1-to-2%*	2018 year:	2.9%
	Q2 forecast	*3%*	*2019 year:*	*2.2%*
	Q3 forecast	*2%*		

CPI	Feb. 0.2% (1.5% y/y); core 0.1% (2.1% y/y)
	June forecast: 1.6% y/y; core 2.3% y/y
	December forecast: 2.3% y/y; core 2.6% y/y

Unemployment: June 2019: 3.7%; December 2019: 3.6%.

Federal budget: FY 19 forecast: -$950B (4.5% of GDP)