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THE WEEKLY **U.S.** ECONOMIC MONITOR

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Payroll growth remains robust, despite softer ISM employment numbers as tariff uncertainty rises.

Labor demand still outstrips supply; unemployment will fall further; June's rise is a distraction.

Wage growth still very subdued, but it will be lifted by faster productivity growth and higher inflation.

No Tariff Hit in the Payroll Numbers Yet, but *Some* Surveys are Wobbling

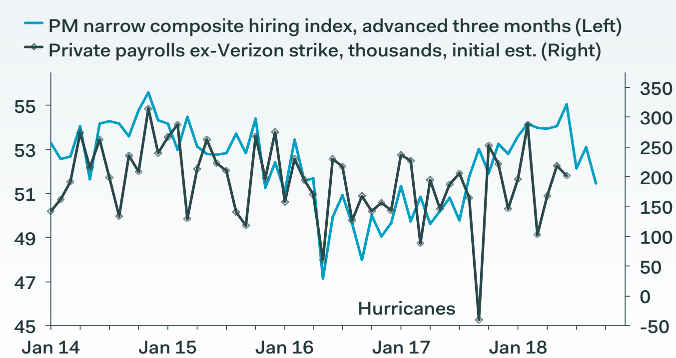
The recent softening in the ISM employment indexes failed to make itself felt in the June payroll numbers, which sailed on serenely even as tariff-induced chaos intensified at the industry and company level. But the lags between shifts in the surveys and the hard data—to say nothing of the potential *further* hit from the latest flaring of the trade wars—mean that it is far too soon to conclude that administration's aggressive stance will have no adverse macro consequences.

For now, though, the trend in payroll growth remains above 200K, as our first chart shows. *Strength in other indicators of labor demand, notably the official JOLTS numbers and the NFIB small business hiring intentions index, appears to be offsetting the hit among the larger firms captured by the ISM surveys.* The very latest NFIB reading, released last Thursday, showed that hiring intentions rose slightly in June, and remain only marginally below their cycle high. The JOLTS data appear with a lag, but both the March and April reports showed the number of job openings rising to record highs. We're now curious to see if that strength was sustained into May, by which time employers will have had time to evaluate the risk from the tariffs, both actual and threatened. The report is released tomorrow.

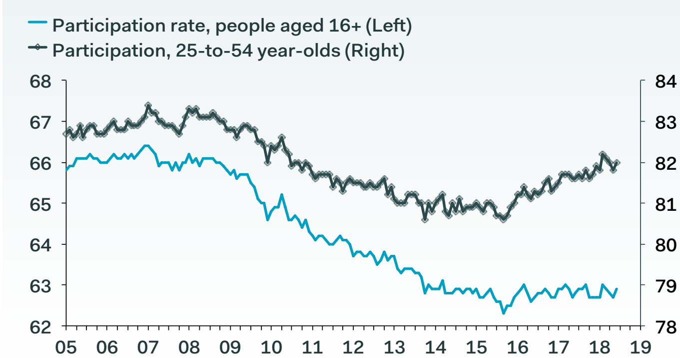
Even if payroll gains moderate to the 175K or so implied by the ISM surveys, that would be more than enough to keep the unemployment rate falling. ***The reported increase in June does not change the big picture at all.*** Labor demand is running far in excess of the rate of growth of labor supply—that's why payroll growth is running slower than implied by our composite hiring index—even if participation nudges up a bit. Accordingly, unemployment is on track to fall towards 3% over the next year. No-one at the Fed can live with that, especially if the trajectory is still clearly downwards.

The unemployment rate increased in June because the participation rate was reported rising by two tenths. *In all probability, this is nothing more than noise.* All the gain in participation was among women, while male

SOME HIRING SURVEYS HAVE SOFTENED; PAYROLLS STILL STRONG



THE TREND IN AGGREGATE PARTICIPATION IS FLAT



participation *dipped* slightly. But focusing on the details misses the point, which is that the participation data are extremely volatile, and short-term movements often can be very misleading.

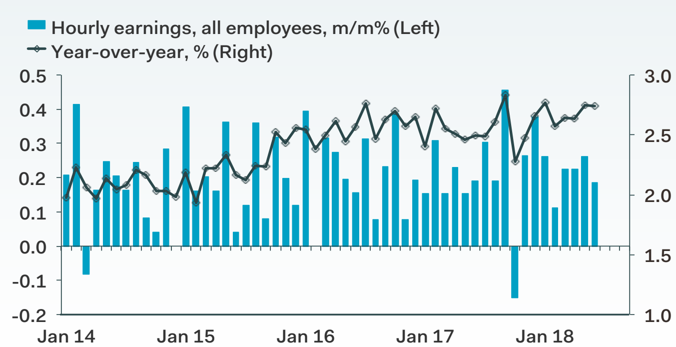
We understand the argument that participation *should* be rising, given that the economy is growing rapidly, unemployment is very low and firms cannot find all the people they want to hire. Indeed, prime-age participation is trending higher but the aggregate number has been flat for several years. *We have seen too many false dawns in the data in recent years to allow ourselves to be convinced that one month's numbers signal a real change.* Note that the Bureau of Labor Statistics itself says that the reported change in participation is not statistically significant over the past one, three, six, nine and 12 months. The data are so unreliable, in other words, that it takes a long time definitively to establish a meaningful change in the trend.

Low unemployment is boosting wage growth, but progress remains painfully slow. The Fed is more interested in the wages component of the employment costs index than the headline hourly earnings numbers, but they tend to move broadly together in the medium-term, and the recent AHE data suggest that the ECI is not on the verge of a serious acceleration.

We think wage growth will rise over the next year on the back of stronger productivity growth, which will boost the real component of total wage gains, and higher inflation. Employees are much less scared of job loss now than earlier in the cycle, and we expect them to push for wage raises to offset higher gasoline and other prices. For now, though, the Fed's hawks can't point to the data as irrefutable evidence that wage increases are becoming a serious threat to the inflation target.

Accordingly, we doubt that the next rate hike, in September, will be accompanied by a serious shift in the Fed's thinking. The doves likely won't be prepared to drop the idea that the risk are still "roughly balanced" and that "gradual rate hike are still appropriate". That will change by December, or next March, if we're right in our view that wage gains will pick up appreciably while unemployment falls to new lows, but the hawks won't be able to act otherwise.

STILL NOT MUCH TRACTION IN HOURLY EARNINGS

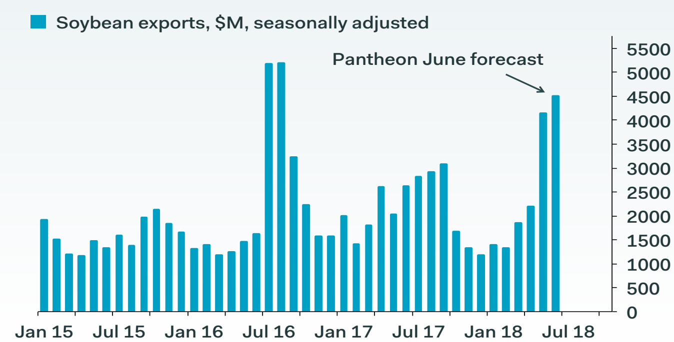


Soybean exports boosted Q2 GDP growth

Friday's detailed international trade report for May showed that more than two thirds of the $3.0B drop in the deficit was due to a surge in exports of soybeans. A rebound in net aircraft exports, mean-reverting after recent gyrations, accounted for the remainder,

Soybean exports likely have been driven higher by Chinese importers seeking to build inventory ahead of the tariffs imposed by the U.S. last week. Weekly data show that soybean exports rose again in June, but we're then expecting to see a steep fall in July. ***In the second quarter, though, we estimate that soybean exports will contribute some 0.6 percentage points to GDP growth, at an annualized rate.*** This probably will reverse in full in the third quarter.

SOYBEAN EXPORTS HAVE ROCKETED, AHEAD OF TARIFFS



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THIS WEEK IN BRIEF

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

Monday, July 9

• Consumer Credit (5)/15:00 EDT
Credit growth has slowed following the post-hurricane surge. The $9.3B April increase was rather smaller than the underlying trend, so we now look for a rebound to **$12B. Consensus: $12.0B.**

Tuesday, July 10

• Redbook Chain Store Sales (7/7)/9:00 EDT
Same-store sales growth rebounded to **4.4%** year-over-year last week, in line with the recent trend.

• D: NFIB Small Business Survey (6)/6:00 EDT
The key labor market components of the headline index, released last week ahead of the official payroll report, as usual, were strong. We expect the headline index to nudge up to 105 from 104.8. **Consensus: 105.8.**

• JOLTS (5)/10:00 EDT
We expect a correction in the number of job openings after successive record highs, with the headline dropping to perhaps **6,400K** from 6,698K. **Consensus: 6,660K.**

Wednesday, July 11

• Mortgage Applications (7/6)/7:00 EDT
The purchase index was little changed last week, at **245.5.** The trend is falling, slowly, in the face of higher rates and slightly tighter lending standards.

• D: Producer Prices (6)/8:30 EDT
The headline should rise **0.2%,** slightly constrained by lower gas prices, while the core should increase by **0.3%** for the fourth time in the past five months. That would lift the year-over-year rate to 2.7% from 2.4%. **Consensus: Headline 0.2%, core 0.2%.**

• Wholesale Inventories (5)/10:00 EDT
We have no reason to expect a change from the preliminary estimate that inventories rose **0.5%. Consensus: 0.4%.**

Thursday, July 12

• D: Jobless Claims (7/7)/8:30 EDT
The seasonals look very tough for the week of July 4, so we expect claims to jump to **250K** from 231K. The trend likely is still in the low 220s, and probably is still falling, slowly. **Consensus: 226K.**

• D: Consumer Prices (6)/8:30 EDT
The headline and core should both rise **0.2%.** Weakness in the used cars and lodging components should be offset by increases in rents, airline fares, and medical services. **Consensus: Headline 0.2%, core 0.2%.**

• Treasury Budget (6)/14:00 EDT
The CBO has not yet released its monthly estimate, but the deficit in June last year was **$90.2B. Consensus: $80.0B.**

Friday, July 13

• Import Prices (6)/8:30 EDT
Total import prices should rise **0.3%,** thanks mostly to higher oil prices. Ex-oil, we expect a 0.1% increase. **Consensus: 0.1%.**

• D: Univ. of Michigan Consumer Sentiment (7p)/10:00 EDT
The TIPPOnline survey points to an increase in the Michigan outlook component, but the current conditions index looks poised for a modest correction. Overall, then, we think the index will be little changed at about **98,** after 98.2 in June. **Consensus: 98.0.**

THIS WEEK'S FUNDING

Monday 9	Announcement: four-week bills Auction: $48B 3-month, $42B 6-month bills
Tuesday 10	Auction: four-week bills Auction: $33B 3-year notes (settles July 15)
Wednesday 11	Auction: $22B 10-year notes (settles July 15)
Thursday 12	Announcement: 3-month, 6-month bills (July 16) Announcement: 1-year bills (July 17) Announcement: 10-year TIPS (July 19) Auction: $14B 30-year bonds (settles July 15)
Friday 13	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Fri.	**Sep**	**Dec**	**Mar**	**Jun**
Fed funds target	1¾-to-2	2-to-2¼	2¼-to-2½	2½-to-2¾	2¾-to-3
2-yr	2.55	2.70	3.00	3.20	3.30
10-yr	2.83	3.25	3.50	3.50	3.50
30-yr	2.93	3.30	3.50	3.60	3.60
Curve 10-2	28	55	50	30	20
Curve 30-2	38	60	50	40	30
S&P 500	2,760	2,800	2,850	2,800	2725
Dollar/Yen	110.4	110	110	115	115
Euro/Dollar	1.17	1.15	1.10	1.10	1.10
Sterling/Dollar	1.33	1.38	1.40	1.40	1.40

PANTHEON'S ECONOMIC FORECASTS

GDP	Q2	3.1%	2015 year:	2.6%
	Q3	3.2%	2016 year:	1.6%
	Q4	2.9%	2017 year:	2.3%
	Q1 third	2.0%	*2018 year:*	*3.0%*
	Q2	*>4%*	*2019 year:*	*2.0%*
	Q3	*3%*		

CPI	May 0.2% (2.8% y/y); core 0.2% (2.2% y/y)
	Dec. 2018 forecast: 2.5% y/y; core 2.4% y/y
	Mar. 2019 forecast: 2.5% y/y; core 2.6% y/y

Unemployment: Dec. 2018: 3.5%; March 2019: 3.4%.

Federal budget: FY 18 forecast: -$750B (3.8% of GDP)