THE WEEKLY U.S. ECONOMIC MONITOR

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With the FOMC still split, the committee likely won't add the fourth 2018 dot this week...

...The crunch will come later this year, as the labor market tightens further, with no end in sight.

Eventually, the Fed will have to step on the brakes, but it can dodge the hard decisions for a while.

The Fed will Hike this Week, but Likely will Hold Back the Fourth Dot

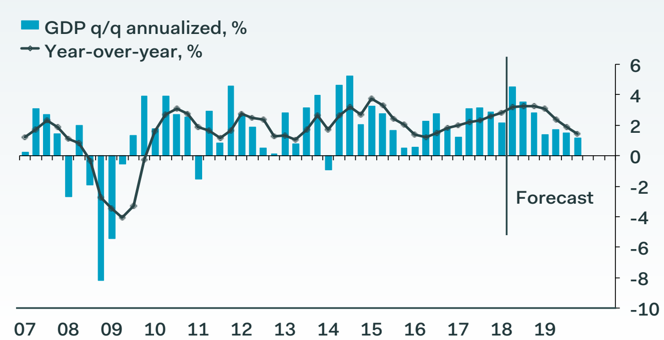
The Fed will raise rates by 25 basis points on Wednesday, but as usual after a widely-anticipated policy decision, most of our attention will be focused on what policymakers say about their actions, and how their views on the economy have changed. ***Our base case is that policymakers won't change the key statement language, and that the dot plot will be unchanged, with three hikes this year and next, with a further two in 2020.*** But the risks are asymmetric; the Fed isn't going to *reduce* its expected tightening, and the language in the statement isn't going to take a dovish turn.

The three key repeating elements of the statement cover inflation expectations, the balance of risks, and the pace of tightening. On inflation, the first paragraph of the statement has ended with "Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance" since March 2016. *We expect that formulation to be repeated this week.*

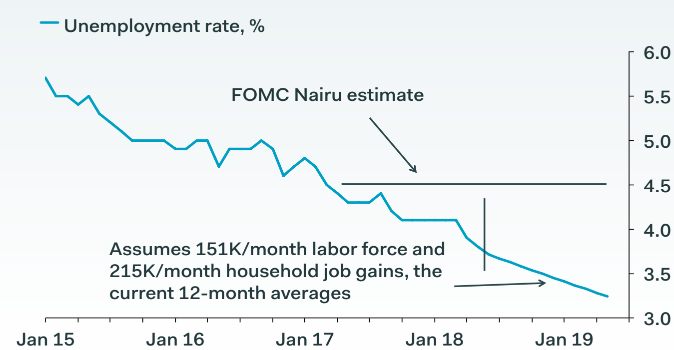
After rebounding over the winter, breakeven inflation rates on 10-year TIPS have barely moved, net, since the March FOMC meeting. The Conference Board's measure of inflation expectations rose to a 20-month high in May, probably in response to higher gas prices. But it remains lower than implied by the current inflation rate, having broken to the downside last year, and, in any event, the equivalent measure in the Michigan sentiment survey is unchanged since March.

The Fed's formulation on the balance of risks is purposefully ambiguous, because it refers to "the economic outlook" rather than growth or inflation specifically. That allows the Fed to choose to overlook, say, a modest uptick in their view on growth if it isn't matched by an increase in their inflation projections. Even allowing for this ambiguity, we think the FOMC will have to move away from the "roughly balanced" line later this year, if GDP growth is as strong as we expect; the 3.3% expansion we expect in the year to the fourth quarter would be the fastest since 2003. *But the absence of immediate inflation threats means that the Fed does not have to make the change right now. Policymakers*

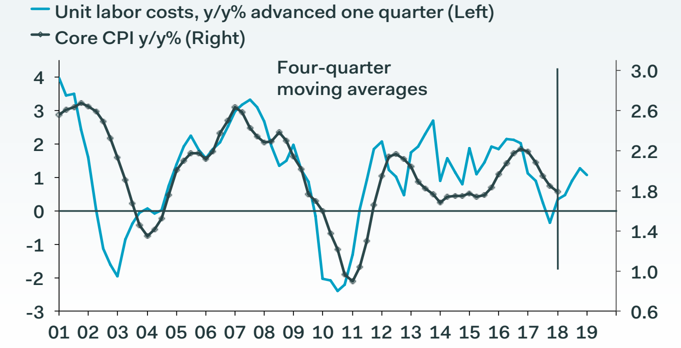
GROWTH WILL REMAINS STRONG FOR SOME TIME YET...



...SO THE FED WILL HAVE TO DEAL WITH NEAR-3% UNEMPLOYMENT



THE NEAR-TERM INFLATION PICTURE, THOUGH, IS BENIGN



learned the hard way in 2015 and 2016 not to offer hostages to fortune.

The FOMC's new forecasts, though, likely will be a bit more bullish than in March. We expect GDP growth for this year to be revised up a bit from the previous estimate, 2.7%, and the unemployment rate likely will tick down a tenth, to avoid the absurdity of forecasting no net change through the second half of the year, even though the underlying trend is clearly falling. *The core PCE numbers for the end of this year likely need to rise too, as the Fed hinted in the May minutes, when it pointed out twice that the inflation target is "symmetric".*

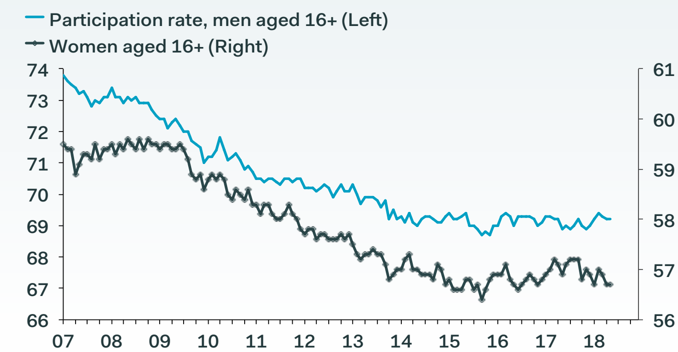
Finally, we expect the Fed to repeat yet again that the economy likely will require further "gradual increases" in the funds rate, continuing the normalization. This won't be the meeting when the Fed tells markets that the object of policy is positively to slow down the economy, but that day is coming, likely in December or March next year. The May minutes suggest that some FOMC members think the funds rate soon will not be at accommodative levels, but the spread of opinion on where exactly the neutral rates still stands appears to be quite wide.

For now, then, we think Chair Powell will be content to signal to markets that the Fed is on track, and that no significant adjustment is required in the pace or expected extent of the rate hikes over the next couple of years. Modest changes in the forecasts will be passed-off as merely housekeeping. With the committee clearly still split on the implications of the very low unemployment rate for future wage growth and inflation, and on the likely response in the real economy to continued tightening, the most likely course of action this week—bearing in mind the absence of clear and present inflation danger—is to do as little as possible.

We are sticking to our view, though, that everything will change by the end of this year or early next year, as the Fed grapples with a combination of rapid growth, rising inflation—both prices and wages—and an astonishingly low unemployment rate, which is unlikely to have bottomed-out. The Fed's forecasts for next year, if they are to have any credibility, will have to address the potential consequences of an unemployment rate heading towards 3%, unless a miraculous surge in the labor participation rate gets policymakers off the hook. We see no sign of that, though we haven't quite given up all hope just yet.

When the turn comes—when the Fed adds more dots to the forecasts for next year, and/or switches to much more aggressive language in the statement, and/or shocks the markets with a rate hike at one of the "dead" meetings—it will be a clear signal that the end of the cycle is coming. At that point, the Fed will need the cycle to end, and they will make it happen. *That point has not been reached yet, but it will, and an innocuous statement this week won't change the story at all.*

RISING PARTICIPATION SEEMS UNLIKELY TO RESCUE THE FED



I will be hosting a webinar today at 10:25 am EST/15:25 pm London time/16:25 pm CET with the topic: "The End is Coming... But When, How, and What Will it Look Like?" Click here to register for this event.

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THIS WEEK IN BRIEF

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

Monday, June 11

- **No significant data released.**

Tuesday, June 12

- **Redbook Chain Store Sales (6/9)/9:00 EDT**
Same-store sales growth likely will dip a bit after last week's strong **4.0%** year-over-year; the trend is nearer 3½%.

- **D: NFIB Survey (5)/6:00 EDT**
The key labor market numbers from the survey, published in advance, as usual, point to little change in the headline index. We look for **105,** after 104.8 in April. **Consensus: 105.0.**

- **D: Consumer Prices (5)/8:30 EDT**
Both the headline and core indexes probably rose by **0.2%.** Weakness in medical commodities and recreation prices in April likely reversed, but a further drop in used car prices means that a second straight 0.1% core is gain more likely than a consensus-busting 0.3% gain. **Consensus: Headline 0.2%, core 0.2%.**

- **Treasury Budget (5)/14:00 EDT**
The CBO reckons the deficit jumped to **$144B** from $88B in May last year, partly due to adverse calendar effects, but also because of the tax cuts and increases in discretionary spending. **Consensus: $127B.**

Wednesday, June 13

- **Mortgage Applications (6/1)/7:00 EDT**
Expect little change in the purchase index from last week's **242.7.**

- **D: Producer Prices (5)/8:30 EDT**
Higher energy prices mean the headline should rise **0.5%,** with the core up **0.3%. Consensus: Headline 0.3%, core 0.2%.**

- **D: FOMC Announcement/14:00 EDT**
We expect a **25bp** hike, but the FOMC will repeat that inflation expectations are still "low", risks are "roughly balanced" and that a "gradual" normalization will continue. We expect no net change in the fed funds dot plot. **Consensus: 25bp.**

- **D: Powell Press Conference/14:30 EDT**
The Chair will re-affirm that the Fed sees no reason yet to change its expected path for rates.

Thursday, June 14

- **D: Jobless Claims (6/9)/8:30 EDT**
Expect a modest increase to **225K** from 222K. **Consensus: 222K**

- **D: Retail Sales (5)/8:30 EDT**
We think total sales rose **0.2%,** held back by weak auto sales. Non-auto sales should be up **0.6%,** with "control" sales up **0.7%. Consensus: Total sales 0.4%, ex-autos 0.5%, control 0.3%.**

- **Import Prices (5)/8:30 EDT**
The jump in oil prices last month means import prices likely rose by **1.0%.** Ex-oil, we expect a 0.4% increase. **Consensus: 0.5%.**

- **Business Inventories (4)/10:00 EDT**
Advance data signal a **0.3%** increase, following no change in March. **Consensus: 0.3%.**

Friday, June 15

- **D: Empire State Survey (6)/8:30 EDT**
Renewed talk of tariffs and trade wars should push the index down to about **15** from 20.1. **Consensus: 18.5.**

- **D: Industrial Production (5)/9:15 EDT**
A sharp drop in utility energy production will depress total output; we expect a **0.3%** drop. Manufacturing output likely dipped **0.1%. Consensus: Total production 0.2%, manufacturing 0.1%.**

- **D: Univ. of Michigan Consumer Sentiment (6p)/10:00 EDT**
Higher gas prices likely nudged the index down slightly to about **97** from 98.0. **Consensus: 98.4.**

THIS WEEK'S FUNDING

Monday 11	Announcement: four-week bills
	Auction: $48B 3-month, $42B 6-month bills
	Auction: $32B 3-year notes (settles June 15)
	Auction: $22B 10-year notes (settles June 15)
Tuesday 12	Auction: four-week bills
	Auction: $14B 30-year bonds (settles June 15)
Wednesday 13	Nothing
Thursday 14	Announcement: 3-month, 6-month bills (June 18)
	Announcement: 1-year bills (June 19)
	Announcement: 30-year TIPS (June 21)
Friday 15	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Fri.	**Jun**	**Sep**	**Dec**	**Mar**
Fed funds target	1¼-to-1½	1¾-to-2	2-to-2¼	2¼-to-2½	2½-to-2¾
2-yr	2.50	2.40	2.60	2.80	3.00
10-yr	2.95	3.20	3.40	3.50	3.50
30-yr	3.09	3.40	3.50	3.60	3.60
Curve 10-2	45	80	80	70	50
Curve 30-2	59	100	90	80	60
S&P 500	2,779	2,700	2,775	2,850	2,850
Dollar/Yen	109.5	106	108	106	106
Euro/Dollar	1.18	1.20	1.18	1.15	1.15
Sterling/Dollar	1.34	1.35	1.38	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 second	2.2%	*2018 year:*	*3.0%*
	Q2	*>4%*	*2019 year:*	*2.0%*
	Q3	*3%*		

CPI	Apr. 0.2% (2.5% y/y); core 0.1% (2.1% y/y)
	Jun. 2018 forecast: 2.9% y/y; core 2.4% y/y
	Dec. 2018 forecast: 2.5% y/y; core 2.6% y/y

Unemployment: June 2018: 3.8%; December 2018: 3.5%.

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