PANTHEON MACROECONOMICS

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April housing starts look vulnerable to a weather hit; permits susceptible to mean-reversion.

Manufacturing output seems to have surged in April, but recent gains aren't sustainable.

Core retail sales continue to grind higher, with the trend stuck at about 4% year-over-year.

Downside Risks to April Housing Construction; IP Looks Strong

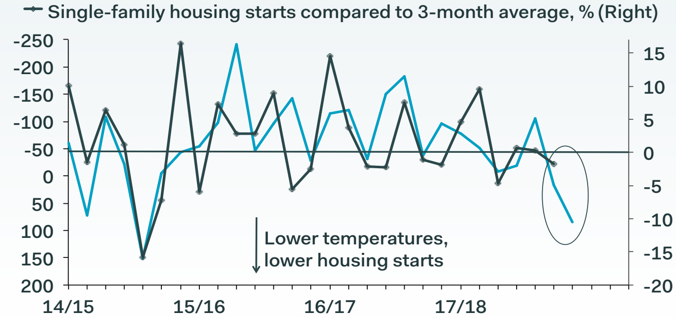
We see downside risk to the housing starts numbers for April, due today. Our core view on housing market activity, both sales and construction activity, is that the next few months, through the summer, will be broadly flat-to-down. ***But the immediate issue for today's report is the likely impact of April's cold and snowy weather on starts.*** Permits, by contrast, are much less vulnerable to the weather, and we look for a small increase in April activity. Note that the annual revisions will be released with this report too.

The correlation between housing starts and variations in the weather, compared to seasonal norms, is far from perfect, as our first chart shows. *But it is real, and the message for April is very clear.* The chart captures the impact of the weather only on the single-family component, because multi-family activity is wild from month-to-month, even when the weather is not a factor.

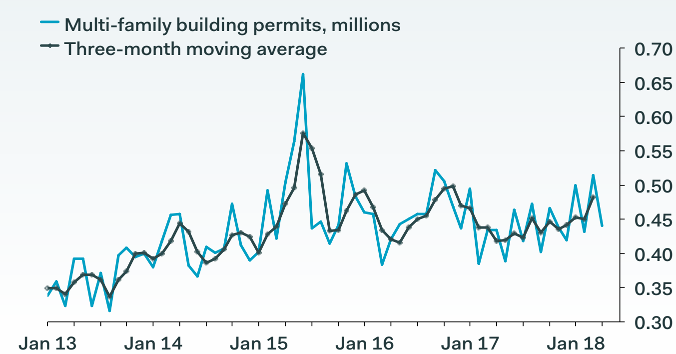
Single-family starts account for some two-thirds of the total, so our approach to the headline number during the late fall, winter, and early spring months, is to follow the message from the weather for the single-family sector and assume mean-reversion in the multi-family sector. *For April, this generates a headline starts forecast of 1,230K, well below the consensus, 1,310K.*

We're assuming, though we can't be sure, that the difference between these numbers means that most

APRIL HOUSING STARTS LOOK VULNERABLE TO A WEATHER HIT...



MULTI-FAMILY PERMITS ARE RISING BUT MARCH OVERSHOT



other forecasters think the weather played no significant role in April. If we were to ignore the weather, and just forecast starts on the basis of the previous month's permits numbers, our estimate would be in line with the consensus. But the weather data clearly suggest that the risk is to the downside.

In the permits numbers, the story is mostly about the multi-family sector, where permits jumped by 19% month-to-month in March, hitting an 18-month high. Such big monthly swings in the numbers are not usual, and they tend to be followed by mean reversion in the following month, so we're assuming a hefty drop in April. Single-family permits, by contrast, tend to track new home sales, but they undershot markedly in March. This was odd—cold weather usually has little impact on permits—so we're assuming a rebound in April, limiting the decline in total permits. *We look for a drop to 1,320K from 1,354K, a bit above the consensus, 1,300K.* The trend over the summer will be about flat.

Business sentiment is peaking

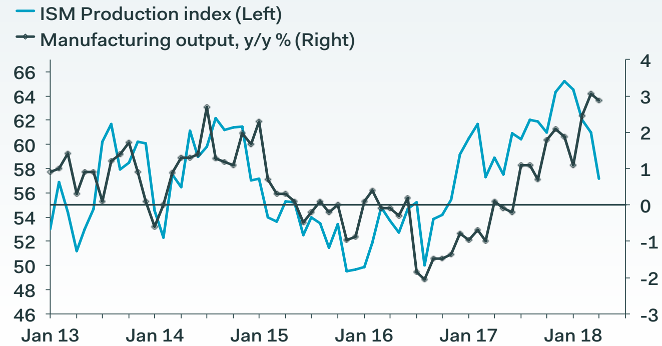
Rather more positively, we're also expecting to see today that the industrial sector was off to a flying start in the first month of the second quarter. *We estimate that the 0.8% jump in manufacturing hours worked, coupled with the strength of the ISM production index, points to a 0.9% increase in output.* The monthly numbers are always choppy but they have been more noisy than usual recently, following the hurricanes last summer and bouts of severe winter weather. But all the signs are that April was a strong month.

The other components of total production should offset each other, more or less. We expect modest declines in coal and oil output, but a clear increase in utility output, thanks to the colder-than-usual April weather. As a result, headline industrial production should also rise 0.9%. Overall, the data will support the idea that the industrial recovery remains on track, despite the clear peaking in the survey numbers, both in the U.S. and globally.

If our forecast is right, manufacturing output will have risen at a 6.6% annualized rate in the three months to April, compared to the previous three months, the best performance on this basis since the summer of 2010. *We would be surprised, though, if output were to continue rising at this pace.* The ISM production index is consistent with year-over-year gains of about 1%, and the levelling-off in core capital goods orders in recent months will weigh on production over the summer.

We're hoping that capex orders will start to rise again in the second half—the recent softness is, in part, a temporary correction from the very strong second half of last year—but it's still probably asking too much for output to keep rising at its recent pace. ***To be clear, we're not suggesting here that the end of the cycle is imminent, but we do expect slower growth in manufacturing production over the late spring and summer.*** This is not a disaster, though, in an economy where 88% of activity is not in the manufacturing sector.

6%-PLUS GAINS IN MANUFACTURING OUTPUT AREN'T SUSTAINABLE

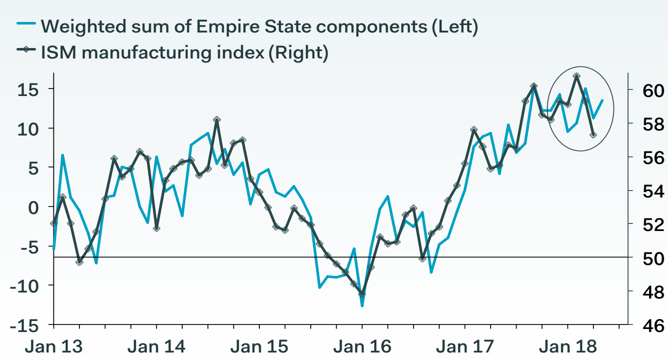


Retail sales grinding higher

The April retail sales numbers reinforced our view that the trend rate of growth has now returned to its pre-hurricane pace, about 4%, with no signs of any imminent change in either direction. Sales spiked after the hurricanes on the back of a wave of replacement spending, but then weakened in the early winter. *Mean-reversion is now complete, and we expect the core to continue rising at a modest pace.* The April numbers were marginally stronger than we expected, but not by enough to move the needle on our forecast for real consumption; we still expect a 0.3% increase.

Elsewhere yesterday, rise in the Empire State index isn't definitive evidence of anything, but the gains in the key subindexes are consistent, at least, with a rebound in the national ISM manufacturing index. *This comes as something of a relief, and supports our view that the ISM has peaked, but isn't seriously weakening.*

SCOPE FOR THE ISM MANUFACTURING INDEX TO REBOUND?



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THIS WEEK IN BRIEF

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

Monday, May 14

- **No significant data released**

Tuesday, May 15

- **Redbook Chain Store Sales (5/12)/9:00 EDT**

Same-store sales growth jumped unexpectedly to **4.9%** year-over-year, the best performance since the final week of 2017. One good week is not definitive evidence of anything, so we're very curious to see if this pace can be sustained.

- **D: Empire State Survey (5)/8:30 EDT**

The headline index rose to **20.1** from 15.8. Among the subindexes, new orders rebounded, and employment, inventories, and shipments rose. Prices received increased to the highest level since January 2012.

- **D: Retail Sales (4)/8:30 EDT**

Both total and non-auto sales rose **0.3%,** with the control measure up **0.4%.** The gains in core sales were broad-based and mostly modest, though clothing sales jumped by 1.4%. The sales data are consistent with real consumers' spending rising by a solid 0.3% in the first month of the second quarter.

- **Business Inventories (3)/10:00 EDT**

Total inventories were **unchanged,** with a 0.5% fall in the retail component, led by a 1.1% drop in the auto sector, offsetting gains of 0.3% in both manufacturing and retailing.

- **D: NAHB Homebuilder Survey (5)/10:00 EDT**

The headline index rose two points to **70,** but all the increase was in the present sales component, with expected future sales and buyer traffic both unchanged.

Wednesday, May 16

- **Mortgage Applications (5/11)/7:00 EDT**

We expect little change in the purchase index from last week's **257.7.** The trend, re-adjusted to remove residual seasonality, dipped early this year but has been broadly flat recently.

- **D: Housing Starts (4)/8:30 EDT**

The modest rise in permits in March points to rising starts in April, but the cold and snowy weather likely depressed activity. We think starts fell to about **1,230K** from 1,319K. Permits probably fell to about **1,300K** from 1,379K, thanks to mean-reversion in the multi-family sector, after a big jump in March. **Consensus: Starts 1,310K, permits 1,300K.**

- **D: Industrial Production (4)/9:15 EDT**

We expect a **0.9%** rebound in total production, led by manufacturing—which also likely rose **0.9%**—and a weather-related 3.0% jump in utility energy output. **Consensus: Total industrial production 0.6%, manufacturing 0.5%.**

Thursday, May 17

- **D: Jobless Claims (5/12)/8:30 EDT**

The trend in claims appears to have fallen yet again. We look for **210K** this week, after 211K last week. **Consensus: 215K.**

- **D: Philadelphia Fed Survey (5)/8:30 EDT**

Like the Empire State index, we expect little change, with the May index at about **23;** it was 23.2 in April. **Consensus: 21.2.**

- **D: Index of Leading Indicators (4)/8:30 EDT**

We expect a modest **0.2%** increase. **Consensus: 0.4%.**

Friday, May 18

- **No significant data released.**

THIS WEEK'S FUNDING

Monday 14	Auction: $48B 3-month, $42B 6-month bills
Tuesday 15	Auction: four-week bills
Wednesday 16	Nothing
Thursday 17	Announcement: 3-month, 6-month bills (May 21)
	Announcement: 2-year notes (May 22)
	Announcement: 5-year notes (May 23)
	Announcement: 7-year notes (May 24)
	Announcement: 2-year FRN (May 23)
	Auction: $11B 10-year TIPS (settles May 31)
Friday 18	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Tues.	**Jun**	**Sep**	**Dec**	**Mar**
Fed funds target	1¼-to-1½	1¾-to-2	2-to-2¼	2¼-to-2½	2½-to-2¾
2-yr	2.58	2.40	2.60	2.80	3.00
10-yr	3.07	3.20	3.40	3.50	3.50
30-yr	3.19	3.40	3.50	3.60	3.60
Curve 10-2	49	80	80	70	50
Curve 30-2	61	100	90	80	60
S&P 500	2,711	2,700	2,775	2,850	2,850
Dollar/Yen	110.3	106	108	106	106
Euro/Dollar	1.18	1.20	1.18	1.15	1.15
Sterling/Dollar	1.35	1.38	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 first	2.3%	*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)