GLOBAL MACRO, ECONOMICS & RATES STRATEGY RESEARCH

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Weekly Dashboard

The Dashboard will return September 7th

Into the summer doldrums

As we enter the tail end of summer, the markets will have very little economic data to digest over the next three weeks. But a few things in the policy arena should garner the market's attention nonetheless. The FOMC meeting minutes, the annual Jackson Hole Economic Symposium and possible changes to bank regulation should all be on the radar in this classically quiet period.

The FOMC Minutes should bring little new information in terms of the pulse of the economic backdrop or the pace of Fed rate hikes. Indeed, the press statement came and went with few changes overall. The Fed did upgrade their assessment of the backdrop slightly from "solid" to "strong" but this is not significant enough to warrant a shift in expectations about the policy path. Growth is humming along and "gradual" rate increases remain the base case for this Fed.

The most interesting part of the Minutes will be about the balance sheet outlook. Unfortunately, recent speeches by FOMC members suggest that there is not yet a strong consensus, so we think at most we will see the various options being laid out. Eventually, we expect the Fed to adopt a large balance sheet approach, meaning they will need to stop run-off in early 2019 if reserves are exempted from the Leverage ratio or early 2020 if they are not.

In addition, we might see a broader discussion on the 20bp move in IOER in June. We think that is an option for the Fed one more time—pushing IOER and RRP too close together will be destabilizing when banks are under LCR stress (volatile RRP means volatile reserves, which is problematic when banks are close to LCR limits).

On Jackson Hole, the subject of this year's symposium is "Changing Market Structure and Implications for Monetary Policy". For market participants that sounds like an extensive discussion about the Fed balance sheet. However, Jackson Hole tends to be trafficked more by academics, and to an academic ear that topic sounds like a debate about whether there have been changes in the labor market that have altered the Phillips curve, etc.

We don't expect to learn a great deal about the balance sheet outlook, in part because it doesn't seem as if there is an FOMC consensus yet. Our balance sheet thoughts were spelled out in detail in our May 14th piece "How will the Fed manage monetary policy".

Finally, the decision on changes to the Supplemental Leverage Ratio could come at any time. It seems like the large banks will get significant capital relief while smaller banks will not, meaning greater concentration in market making. Relaxed leverage rules mean more balance sheet in the system, which means improved off-the-run liquidity, more RP capacity (and tighter RP bid/offers that will lower RP rates).

In addition, we could see a step towards increasing the Countercyclical Capital Buffer which is an add-on to risk weighted capital requirements. Before raising the CCyB, the Fed first must raise its risk assessment to say systemic vulnerabilities are "meaningfully above normal". In the latest Humphrey-Hawkins report, the risk assessment was "overall vulnerabilities in the US financial system remain moderate on balance". Any notch up in the risk assessment would suggest higher risk-weighted capital requirements are on the way (there is a 12m gap between the announcement of a CCyB increase and when that rule goes into effect).

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Eco Bullet Points

Updates this week: Consumer

Overview: The current economic expansion has been characterized by healing household balance sheets (de-levering) and spending growth driven by aggregate wage growth. Given the lack of imbalances in household credit and no apparent stress in the labor market, we find it very difficult to call for a consumer-led economic slowdown—let alone an outright recession—occurring over the next couple of years (our forecast horizon). But while the fundamental underpinning of the expansion remains firmly in place, calls for an economic slowdown have grown louder as the Fed continues to remove emergency levels of accommodation (often confused with policy tightening). Since economic recessions have typically followed Fed tightening cycles, for some market participants, the current removal of accommodation is seen as the beginning of the end in terms of not only the economic expansion, but the now 9-year long bull market in equities. The significant difference this time around is that the economic expansion has not been characterized by an expansion in household credit nor an overextended corporate borrowing environment. We find it hard to believe that the removal of something that has not managed to accelerate the cycle beyond its organic potential will bring about its demise. Thus we believe the thesis that the Fed's gradual removal of accommodation will lead to a sharp economic slowdown is flawed. For more on this please see our US Economic Focus. With tax cuts adding to an already constructive economic backdrop, topline GDP growth should come in around 3% for the next two years. Please see our 2018 year ahead for more.

Consumer: July retail sales were better beneath the surface with ex autos/gas up 0.6% and control rising 0.5% on the month. Even with the slight downward revision to June our tracking for 3Q personal consumption rose to 2.8% from 2.6% prior and top-line GDP moved to 4.0% from 3.8%. Breadth was quite good with more than 2/3 of major categories expanding on the month. This caps off a 6-month string where breadth has been better than 60%—a healthy run indeed. The consumer expansion continues apace and this is even despite a massive upward revision to the rate of savings we got with the release of 2Q GDP a few weeks ago. This is a good time to remind folks that even though the current expansion has been relentlessly called long in the tooth, the current consumer cycle is far from putting up any records. Note that this is still only the 4th longest uninterrupted consumer expansion since 1950. The consumer was actually on a 16-year+ expansion (a super-cycle of sorts) when the 2008 recession started. Given the organic nature of the dynamics likely to drive strong consumer spending near-term and a household sector that continues to de-lever on net with little signs of asset imbalances, we expect the current consumer cycle to be quite protracted as well.

Employment: The continued cyclical recovery in labor participation remains critically important in terms of the near-term sustainable pace of payroll growth. We've highlighted the thesis that given a significant "re-entrance" back into the labor force from the cyclical cohort (25-54 year olds), trend payroll growth can remain in the neighborhood of 175-200k for some time still. What really matters in terms of the longevity of the current expansion is the fact that this cyclical recovery of the prime working age cohort only began in early 2016. This is a very positive trend that should continue to pay dividends via much firmer than "potential" job growth (i.e., what is dictated by population growth alone) and much more persistent downward pressure on the u-rate. That said, this trend should also help temper wage growth somewhat in the near-term. So while wages should continue to firm, they would likely run at a much faster clip if not for this labor force dynamic.

Inflation: The run-up in inflation to the Fed target (headline PCE inflation was 2.0% for the third straight month in May) is not merely an energy story. We track pricing trends for the volatile and non-volatile components of PCE inflation and find that the low-vol basket accelerated to a 1.6% y/y pace in May from as low as 1.3% back in October. Note the current run-rate also compares to a 1.9% pace in May of last year (so it's not easy comps driving the advance in this case). The volatile series is certainly doing its part, running up to 4.2% after being in near deflation territory this time last year. But the fact that even non-volatile, trendy inflation components are rising toward the Fed target suggests this is not merely a transitory phenomenon defined by firming gasoline prices and softer year-ago comparables.

Housing: We would argue that a rising rate environment is not necessarily a reason to throw in the towel on housing. If the increase in rates is happening for the "right" reasons—i.e., rising growth prospects, then the generally better backdrop would significantly offset any increase in mortgage costs. Note that the cost of ownership still remains exceptionally low by historical standards. The mortgage payment/income ratio is sitting at just 15% and it has largely moved sideways in the post-recession era. Critically, the rates back-up needed to make an impact is sizeable. Given current home prices and the level of median family income, the average mortgage rate would have to rise all the way back to 6.25% in order for this mortgage payment/income ratio to hit the pre-bubble "norm" of 20%. From a valuation standpoint, despite the significant recapture of lost home equity, current real estate assets relative to their replacement cost remain well off the peak in each of the last three prior economic expansions.

Fed: Our base case for 2018 has long been that the Fed will hike at least 4 times and thus the added momentum to both economic growth and inflation merely cements this long-held view. Beyond that, we see no reason why the Fed would all of a sudden pause hard in 2019—especially when we consider the step up in tax savings to households that could accelerate consumer spending further. Thus we see a clear path for the Fed to maintain a hike at every other meeting in place through the end of 2019, with the top of the target range at 3.5% by then. With the neutral rate also likely to rise as potential GDP accelerates, terminal FF should eventually be in the neighborhood of 4%. This would leave cyclical short rates at about 100bps above neutral, which in the past has been the minimum level of terminal tightening.

Eco Indicators and Fedspeak

The FOMC minutes (Wed) and the Jackson Hole Symposium (Thurs-Sat) are the highlights in a quiet week for data.

Mon	20-Aug	Indicator	Period	RBC	Consensus	Prior
	11:00	*Fed's Bostic Speaks on U.S. Economic Outlook in Tennessee*				
Bottom Line:	Slow start to a relatively quiet week.					

Tue	21-Aug	Indicator	Period	RBC	Consensus	Prior
Bottom Line:	Nothing major on the docket.					

Wed	22-Aug	Indicator	Period	RBC	Consensus	Prior
	10:00	Existing home sales	Jul	5.50m	5.45m	5.38m
	14:00	*FOMC meeting minutes*				
Bottom Line:	The FOMC Minutes should bring little new information in terms of the pulse of the economic backdrop or the pace of Fed rate hikes. Indeed, the press statement came and went with few changes overall. The Fed did upgrade their assessment of the backdrop slightly from "solid" to "strong" but this is not significant enough to warrant a shift in expectations about the policy path. Growth is humming along and "gradual" rate increases remain the base case for this Fed. Aside from the macro/rates outlook, we might get some operational tidbits on the balance sheet. Meanwhilem, given the recent performance of pending home sales (signed contracts), existing home sales (closings) should not deviate much from the recent trend of about 5.5m annualized.					

Thur	23-Aug	Indicator	Period	RBC	Consensus	Prior
	8:30	Initial jobless claims	18-Aug	210k		212k
	10:00	New home sales	Jul	640k	650k	631k
	20:00	*Jackson Hole Economic Symposium - program released*				
Bottom Line:	The subject of this year's Jackson Hole Symposium is "Changing Market Structure and Implications for Monetary Policy". For market participants that sounds like an extensive discussion about the Fed balance sheet. However, Jackson Hole tends to be trafficked more by academics, and to an academic ear that topic sounds like a debate about whether there have been changes in the labor market that have altered the Phillips curve, etc. We don't expect to learn a great deal about the balance sheet outlook, in part because it doesn't seem as if there is an FOMC consensus yet. Our expectation, which was spelled out in detail in our May 14th piece "How will the Fed manage monetary policy", is that the Fed needs stop shrinking its sheet in early 2019 if reserves are exempted from the Leverage ratio, and in early 2020 if they are not.					

Fri	24-Aug	Indicator	Period	RBC	Consensus	Prior
	8:30	Durable goods orders headline, ex transports, capex	Jul	0.8, 1.0, 1.2	1.0, 0.5, 0.5	0.8, 0.2, 0.2
	9:00	*Jackson Hole Economic Symposium*				
Bottom Line:	Headline durable goods orders will be weighed down slightly by softer aircraft orders. That said, the internals should look decent. One important data point that suggests a healthy 2H profile for capex is the fact that lending standards for commercial and industrial loans continue to ease. Indeed, the latest Fed Sr. Loan Officer Survey (for 3Q) showed that a net 15.9% of banks loosened standards for business lending. This was the sharpest easing in five years. Not surprisingly, this leads capex spending by a couple of quarters. When we throw in corporate tax reform—including some juicy provisions for capex deductibility—it is not hard to have a constructive view on business spending in the near term.					

* This calendar shows only the economic indicators that RBC forecasts. For a comprehensive list of indicators, please see the rolling calendar at the back of this document.
Source: RBC Capital Markets US Economics, Bloomberg

Economic and Rates Forecasts

July retail sales was better than expected and we marked our consumer spending estimate for 3Q higher accordingly.

Real Economic Activity													
% q/q saar, unless indicated	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	2017	2018	2019
Real GDP	2.8	2.3	2.2	4.1	4.0	3.1	2.0	3.1	3.1	3.1	2.2	3.0	3.0
Consumer Expenditures	2.2	3.9	0.5	4.0	2.8	2.8	1.7	3.2	3.2	3.2	2.5	2.6	2.7
Residential investment	-0.5	11.2	-3.4	-1.0	5.0	5.0	5.0	5.0	5.0	5.0	3.3	1.4	4.6
Non-Res Investment	3.4	4.9	11.5	7.4	4.7	5.1	5.1	5.1	5.1	5.1	5.3	6.9	5.2
Capex	10.1	6.7	10.9	4.5	7.0	8.0	8.0	8.0	8.0	8.0	6.9	8.1	7.7
Exports	3.5	6.6	3.6	9.3	3.0	4.0	4.0	4.0	4.0	4.0	3.0	5.1	4.2
Imports	2.8	11.8	3.0	0.5	4.0	5.0	5.0	5.0	5.0	5.0	4.6	4.3	4.6
Net Exports ($b)	-846	-899	-902	-850	-865	-881	-899	-916	-934	-952	-859	-875	-925
Inventory change ($b)	64	16	30	-28	30	50	55	60	65	70	23	21	63
Government	-1.0	2.4	1.5	2.1	1.0	1.0	1.0	1.0	1.0	1.0	-0.1	1.3	1.1
Final Sales	1.8	3.2	1.9	5.1	2.7	2.7	1.9	3.0	3.0	3.0	2.2	2.9	2.8
Private Domestic Final Sales	2.3	4.4	2.0	4.3	3.2	3.2	2.4	3.6	3.6	3.6	3.0	3.2	3.2
Nominal GDP	4.8	5.1	4.3	7.4	5.6	5.1	4.8	4.9	5.0	5.0	4.2	5.3	5.2
Contribution to GDP													
percentage points	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	2017	2018	2019
Consumer Expenditures	1.5	2.6	0.4	2.7	1.9	1.9	1.1	2.2	2.2	2.2	1.7	1.8	1.9
Residential investment	0.0	0.4	-0.1	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2
Non-Res Investment	0.5	0.6	1.5	1.0	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.9	0.7
Capex	0.8	0.5	0.8	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.6	0.6
Net Exports	0.0	-0.9	0.0	1.1	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	0.0	-0.2
Inventories	1.0	-0.9	0.3	-1.0	1.3	0.4	0.1	0.1	0.1	0.1	0.0	0.0	0.2
Government	-0.2	0.4	0.3	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.0	0.2	0.2
Other key metrics													
	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	2017	2018	2019
Headline CPI (% yoy)	2.0	2.1	2.2	2.7	2.8	2.4	2.1	2.0	2.0	2.0	2.1	2.5	2.0
Core CPI (% yoy)	1.7	1.8	1.9	2.2	2.5	2.3	2.2	2.1	2.0	2.1	1.8	2.2	2.2
Headline PCE prices (% yoy)	1.6	1.8	1.9	2.2	2.3	2.0	2.0	2.0	1.9	1.9	1.8	2.1	1.9
Core PCE prices (% yoy)	1.5	1.6	1.7	1.9	2.0	1.9	2.1	2.0	2.0	2.0	1.6	1.9	2.0
Unemployment (%)	4.3	4.1	4.1	3.9	3.8	3.7	3.6	3.5	3.4	3.3	4.4	3.9	3.5
Housing starts (thou units)	1172	1259	1317	1262	1325	1330	1300	1325	1350	1350	1208	1309	1331
Interest rates													
% end of period	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	2017	2018	2019
Fed Funds*	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.50	1.50	2.50	3.50
2-year	1.47	1.89	2.27	2.52	2.65	2.80	3.00	3.25	3.40	3.55	1.89	2.80	3.55
5-year	1.92	2.20	2.56	2.73	2.95	3.10	3.25	3.45	3.55	3.65	2.20	3.10	3.65
10-year	2.33	2.40	2.74	2.85	3.15	3.30	3.45	3.60	3.70	3.75	2.40	3.30	3.75
30-year	2.86	2.74	2.97	2.98	3.45	3.60	3.70	3.75	3.80	3.85	2.74	3.60	3.85
*top of the target range													

Source: RBC Capital Markets US Economics and US Interest Rate Strategy, Haver

Rolling Calendar

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
20-Aug	**21-Aug**	**22-Aug**	**23-Aug**	**24-Aug**
		07:00 Mortgage Apps 10:00 Existing Home Sales 14:00 FOMC Meeting Minutes	08:30 Jobless Claims 10:00 New Home Sales Jackson Hole Economic Symposium	08:30 Durable Goods Jackson Hole Economic Symposium
27-Aug	**28-Aug**	**29-Aug**	**30-Aug**	**31-Aug**
	08:30 Advance Trade 08:30 Wholesale Inventories 10:00 Consumer Confidence	07:00 Mortgage Apps 08:30 GDP (2Q S) 10:00 Pending Home Sales	08:30 Personal Income & Spending 08:30 Jobless Claims	09:45 Chicago PMI 10:00 U. of Mich. Sentiment
03-Sep	**04-Sep**	**05-Sep**	**06-Sep**	**07-Sep**
LABOR DAY US Markets Closed	10:00 Construction Spending 10:00 ISM Manufacturing Auto Sales (throughout the day)	07:00 Mortgage Apps 08:30 Trade Balance	08:15 ADP Employment 08:30 Jobless Claims 08:30 Productivity 10:00 ISM Non-Manf 10:00 Factory Orders	08:30 **Employment Report**
10-Sep	**11-Sep**	**12-Sep**	**13-Sep**	**14-Sep**
15:00 Consumer Credit	06:00 Small Business Optimism 10:00 JOLTS	07:00 Mortgage Apps 08:30 PPI 14:00 Fed Beige Book	08:30 CPI 08:30 Jobless Claims	08:30 Import & Export Prices 08:30 Retail Sales 09:15 Industrial Production 10:00 Business Inventories 10:00 U. of Mich. Sentiment
17-Sep	**18-Sep**	**19-Sep**	**20-Sep**	**21-Sep**
08:30 Empire Manufacturing	10:00 NAHB Housing 16:00 TIC Flows	07:00 Mortgage Apps 08:30 Housing Starts	08:30 Philly Fed 08:30 Jobless Claims 10:00 Existing Home Sales	
24-Sep	**25-Sep**	**26-Sep**	**27-Sep**	**28-Sep**
	10:00 Consumer Confidence	07:00 Mortgage Apps 10:00 New Home Sales **14:00 FOMC Statement & Econ Projections** **14:30 Fed Chair Press Conf**	08:30 Advance Trade 08:30 Wholesale Inventories 08:30 Durable Goods 08:30 Jobless Claims 08:30 GDP (2Q T) 10:00 Pending Home Sales	08:30 Personal Income & Spending 09:45 Chicago PMI 10:00 U. of Mich. Sentiment

Source: RBC Capital Markets US Economics, Bloomberg

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