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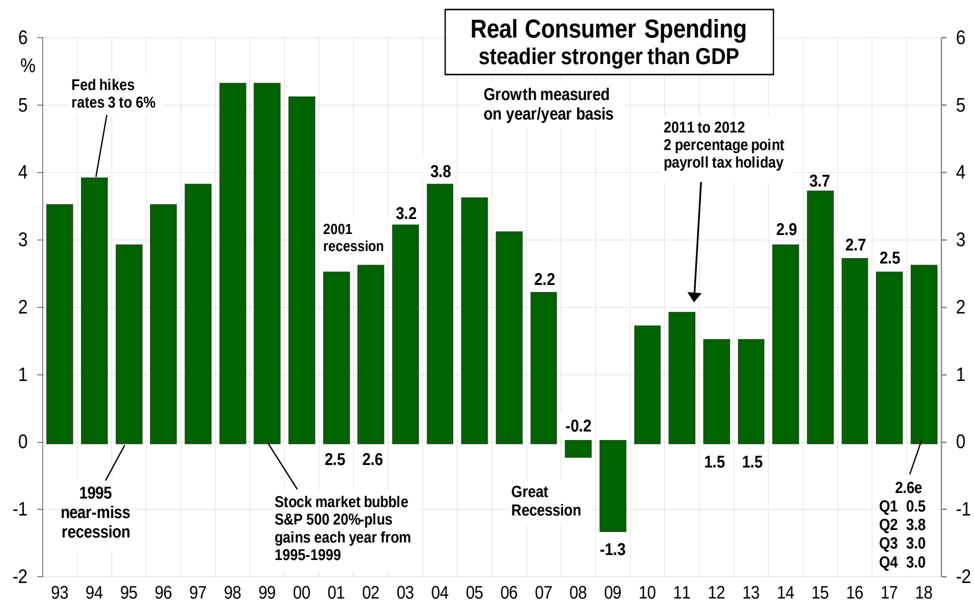
CONSUMER'S GOT TO KEEP SPENDING IT, OR THE ECONOMY'S NOT GOING TO MAKE IT



The ten-year anniversary of the Lehman bankruptcy is here. Been waiting for it. Lots of articles, blogs, newspaper stories about how bad it was. Some people just won't let go of the past. That recession was not <u>that</u> long. There's not much of a lesson to be learned here. The economy is very psychological. The surprise Lehman bankruptcy sparked a financial market crisis that caused businesses and consumers to hit the pause button on their spending plans, and the economy nosedived, the recession deepened as a result. One lesson is don't let large financial firms like Lehman with 65,000 creditors suddenly go bankrupt. It scares people. What did President Sarkozy of France say at the time, something about how we don't even let dry cleaners in our country go bankrupt. We're sure this Sarkozy quote is accurate. Our recollection. Must be out there somewhere on the internet. Check it out.

The sun is out shining today. If you must worry, think about the growing number of recession forecasts in the year 2020. More economists than ever are forecasting a recession in 2020; let risk management departments beware. Maybe that's why bond yields won't move higher; investors are pricing in some bets that the Fed will have to bring the Fed funds rate back down in a couple of years to fight the recession. Bring rates down from the 3.25% level the FOMC forecasts at the end of 2019 we guess the thinking goes, assuming the Fed gets rates that high.

The consumer: famously two-thirds of GDP. Sometimes we think real consumer expenditures can replace GDP itself as a better indicator of current economic conditions. Saves us looking at all those other ingredients that go into that great big $20 trillion sausage they call GDP, where the sharp drop in investment spending is the key driver of economic downturns and recession. Anyway, in this year's benchmark revision to real GDP on July 27, you will be happy to know the last recession, Lehman and all, really wasn't as bad as we thought. Prior to the revision, we thought real consumer spending fell 0.3% in 2008 and 1.6% in 2009. Relax. Now they say real consumer spending fell just 0.2% in 2008 and 1.3% in 2009, so it was only 78% as bad as we thought over the two years... the decline in real consumer expenditures. And if you go back to the 2001 recession, real consumer expenditures actually rose 2.5-2.6% in 2001-02… that was a mild GDP recession anyway: not even two consecutive quarters of negative GDP. The job losses, unemployment rate rising, made it look like a recession however (seemed pretty bad at the time, Greenspan cutting rates from 6.5% to 1.0%). We recovered from that recession too.

Recession is down the road perhaps, hindsight is 20/20, but at the moment, the consumer is spending their historic tax cuts monies which helps the economy grow. They were spending a lot of money at the shops and malls until the August retail sales data released today.

Retail spending, actual dollars, each month

	$million Aug 2018	% to Total	Percent Changes % Aug	July	Year/year
Total Retail Sales	509,025	100.0	0.1	0.7	6.6
Motor vehicles/parts	101,693	20.0	-0.8	-0.1	4.0
Furniture/furnishings	10,172	2.0	-0.3	0.0	3.5
Electronics/appliances	8,332	1.6	0.4	-0.4	3.9
Building materials/garden	32,525	6.4	0.0	0.1	3.3
Food & beverage	62,333	12.2	0.0	0.8	4.3
Health/personal care	29,429	5.8	0.5	0.3	4.9
Gasoline stations	44,386	8.7	1.7	0.8	20.3
Clothing/accessories	23,191	4.6	-1.7	2.2	6.3
Sporting goods, books	6,635	1.3	0.2	-1.6	-3.9
General merchandise	60,032	11.8	0.1	1.0	3.7
Department stores	12,460	2.4	-1.0	1.4	-0.7
Miscellaneous retailers	10,877	2.1	2.3	-2.3	3.3
Eating & drinking places	61,920	12.2	0.2	1.6	10.1
Nonstore retailers (internet)	57,500	11.3	0.7	1.5	10.4

August retail sales slowed, increasing just 0.1%, the weakest monthly gain since February. People seem to be eating and drinking up a storm though looking at the year/year gain of 10.1%. Internet sales also strong up 10.4% the last year. Only Sporting goods, books and hobbies, those stores have seen sales fall 3.9% the last year. America won't be great again until they take up hobbies again. Model trains, woodworking, needlepoint.

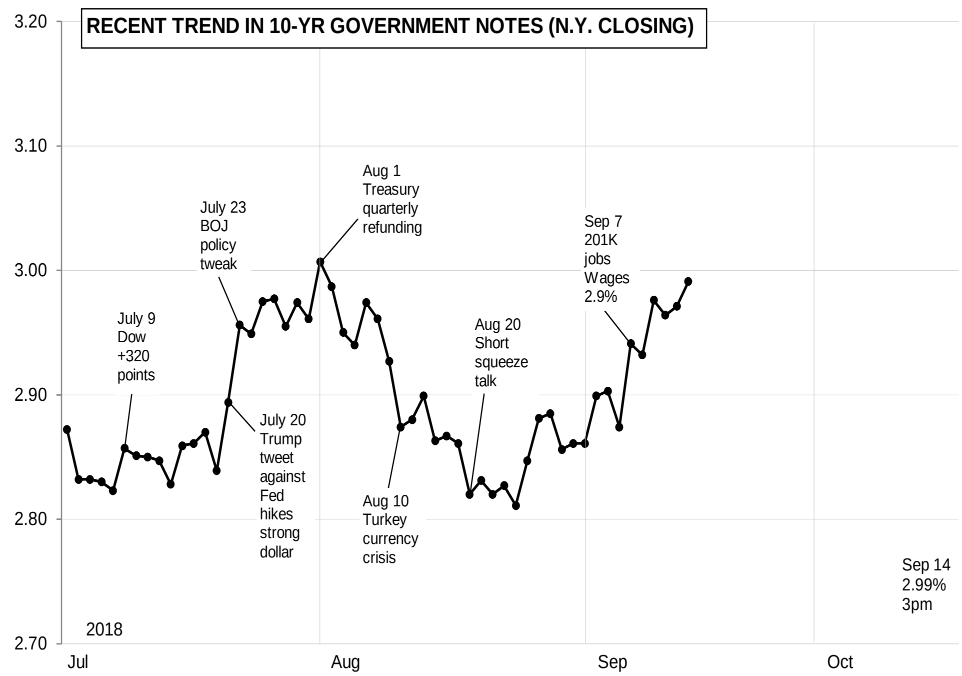
Retail sales vs. Personal Consumption Expenditures (PCE)

2017 % Total		Q4 16	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18	Q3 18
100.0	Real PCE	2.6	1.8	2.9	2.2	3.9	0.5	3.8	
31.2	PCE Goods	2.7	1.9	5.6	4.1	6.8	-0.6	5.4	
10.6	Durable goods	7.1	1.9	8.7	7.7	12.7	-2.0	8.6	
20.6	Nondurable goods	0.6	1.9	4.0	2.3	4.0	0.1	3.7	
68.8	PCE Services	2.5	1.7	1.7	1.4	2.6	1.0	3.1	
	Retail sales	4.1	5.9	2.4	4.4	9.7	1.8	7.3	5.3
	Retail sales ex-autos	3.1	7.2	2.2	4.8	9.1	3.7	7.5	7.1
	Auto sales (mln)	17.6	17.1	16.8	17.1	17.6	17.1	17.2	16.6
	SAAR-Seasonally adjusted annual rates; % Total is nominal expenditures								

Not to worry on the modest 0.1% rise in retail sales for August though. There were upward revisions. The only thing Americans are not buying much of is autos for some reason. Retail sales ex-autos are actually rising 7.1% so far in the third quarter (September data left to go) which is just about as strong as it was in the second quarter. In the second quarter, real consumer spending was 3.8%, backing up that strong 4.2% real GDP number Washington can't stop tweeting about. The consumer seems fine for now. Based on today's retail sales numbers, real GDP should grow at least 3.0% in the third quarter when the first report is due out on Friday, October 26.

MARKETS OUTLOOK

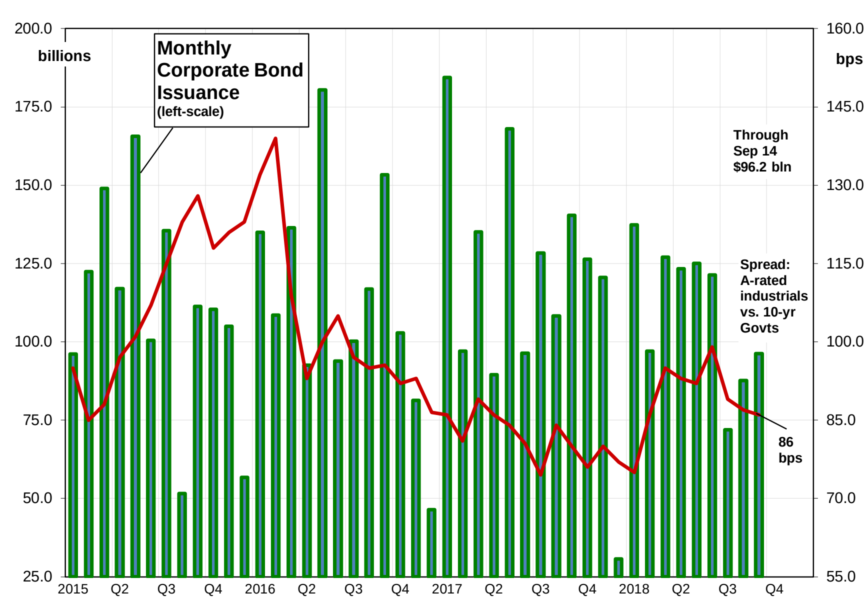
	29-Jun 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
30-Yr Treasury	2.99	3.10	3.20	3.35	3.45	3.60	3.60	3.75	3.85	3.80	3.95
10-Yr Note	2.86	2.90	3.00	3.20	3.30	3.50	3.50	3.70	3.80	3.80	3.95
5-Yr Note	2.74	2.70	2.90	3.10	3.20	3.45	3.45	3.65	3.75	3.80	3.95
2-Yr Note	2.53	2.55	2.80	3.00	3.15	3.40	3.40	3.60	3.75	3.80	4.00
3-month Libor	2.34	2.55	2.80	2.95	3.20	3.45	3.45	3.70	3.95	3.95	4.20
Fed Funds Rate	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50	3.75	3.75	4.00
2s/10s spread	33	35	20	20	15	10	10	10	5	0	(5)



Ten-year Treasury yields rose as high as 3% on Friday versus the 2.94% close the week before. The upward yield trend remains intact, helped along by the Treasury auctions of 3-yr, 10-yr, 30-yr securities on Tuesday, Wednesday, Thursday, this week. Technical (charts) factors seem to be at play. It was telling that 10-yr yields shook off the weak 0.1% rise in August core CPI reported on Thursday. 10-yr yields fell from 2.98 to 2.94 percent on the CPI report, yet closed Thursday at 2.97%. Most market forecasts see 10-yr yields going to 3.5% over the next year as the Fed continues to move rates up. The White House is saying 3.7% for bond yields, but not until 2022. Guess they don't believe the 2020 recession forecasts.

CORPORATES: ABBVIE, ENEL, 3M, WABTEC, ROCHE, AEP, DUKE ENERGY

Corporate offerings were $33.7 billion in the September 14 week versus $62.3 billion in the September 7 week. On Thursday, AbbVie Inc. sold $6 billion 3s/5s/10s/30s. It priced a $1.75 billion 4.25% 10-yr (m-w +25bp) at 138 bps (Baa2/A-). The biopharmaceutical company will use the proceeds to repay its 2.0% senior notes due 2018 and its 3-year 2015 Term Loan Facility. Corporate bond yields (10-yr Industrials rated A2) were 86 bps above 10-yr Treasuries this week versus 87 bps last Friday.



FEDERAL RESERVE POLICY

The Fed meets September 25-26 to consider its monetary policy. Fed funds futures say the odds are still high for a rate hike to 2.25% on September 26 -- 98% at Friday's close. Odds for a fourth hike this year (less reliable) to 2.5% at the December 18-19 meeting are 78%. Eight of fifteen Fed officials (53%) see four rate hikes this year.

On Friday, Chicago Fed President Evans gave a talk on what lies ahead for monetary policy. The former dove now says he is singing the same tune as the rest of the Federal Open Market Committee on the need to raise interest rates to normal levels and slightly beyond. He more or less agrees with the median Fed funds forecasts that policymakers issued in June, the same forecasts that will be updated in a release to the public at 2pm EDT Wednesday, September 26.

He said neutral rates were 2.5 to 3.0 percent. It was reasonable to think that interest rates will move to mildly restrictive levels of 3.0 to 3.5 percent, as the FOMC forecasts say, in the 2019 to 2020 timeframe. Mildly restrictive is his call as long as the economy keeps pushing through full employment, i.e. the unemployment rate continues to drop. Evans expects continued strong growth to bring the unemployment rate down to 3.5% from the August employment report level of 3.9%. It all sounds so reasonable. They are all on the same wavelength. Rates move up gradually. What could go wrong??

Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	12-Sep	5-Sep	29-Aug	22-Aug	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2313.204	2313.202	2324.589	2324.540	479.782
Federal agency debt securities	2.409	2.409	2.409	2.409	0.000
Mortgage-backed securities	1697.016	1697.006	1679.006	1706.731	0.000
Primary credit (Discount Window)	0.065	0.001	0.039	0.010	23.455
Term auction credit (TAF auctions)	0.000	0.000	0.000	0.000	150.000
Asset-backed TALF	0.000	0.000	0.000	0.000	
Maiden Lane (Bear)	1.720	1.719	1.718	1.720	29.287
Maiden Lane II (AIG)	0.000	0.000	0.000	0.000	0.000
Maiden Lane III (AIG)	0.000	0.000	0.000	0.000	
Central bank liquidity swaps	0.091	0.090	0.092	0.068	62.000
Federal Reserve Assets	4258.5	4255.8	4266.3	4276.5	961.7
3-month Libor %	2.33	2.32	2.31	2.31	2.82
Factors draining reserves					
Currency in circulation	1686.970	1688.628	1681.023	1675.101	834.477
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000
Reverse repurchases w/others	1.315	0.010	0.840	1.126	0.000
Reserve Balances (Net Liquidity)	1924.008	1897.901	1880.507	1902.785	24.964
Treasuries within 15 days	0.000	0.000	20.932	20.932	14.955
Treasuries 16 to 90 days	102.160	102.160	77.244	77.244	31.549
Treasuries 91 days to 1 year	315.819	315.819	326.061	326.060	69.272
Treasuries over 1-yr to 5 years	1010.629	1010.628	1016.040	1016.033	170.807
Treasuries over 5-yrs to 10 years	267.465	267.464	267.189	267.171	91.863
Treasuries over 10-years	617.131	617.130	617.123	617.099	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

Fed Individual Forecasts				
Fed funds rate by year-end				Longer
Votes	2018 End	2019 End	2020 End	run
1	1.875	1.875	1.875	2.250
2	1.875	2.125	2.625	2.500
3	2.125	2.625	2.625	2.625
4	2.125	2.875	3.125	2.750
5	2.125	2.875	3.250	2.750
6	2.125	2.875	3.375	2.750
7	2.125	2.875	3.375	2.750
8	2.375	3.125	3.375	3.000
9	2.375	3.125	3.375	3.000
10	2.375	3.125	3.500	3.000
11	2.375	3.125	3.625	3.000
12	2.375	3.375	3.625	3.000
13	2.375	3.375	3.625	3.250
14	2.375	3.375	4.125	3.500
15	2.625	3.625	4.125	
Median	2.375	3.125	3.375	2.875
Meeting	Jun 2018	Jun 2018	Jun 2018	Jun 2018

Year-ends for Interest Rates				
Percent %	2018	2019	2020	2021
Eurodollar futures	2.645	3.135	3.115	3.075
Fed's June forecast	2.5	3.25	3.5	
Eurodollar futures price where 3-month Libor will be in the future.				
Friday, September 14, 2018 3-month Libor 2.34 %				

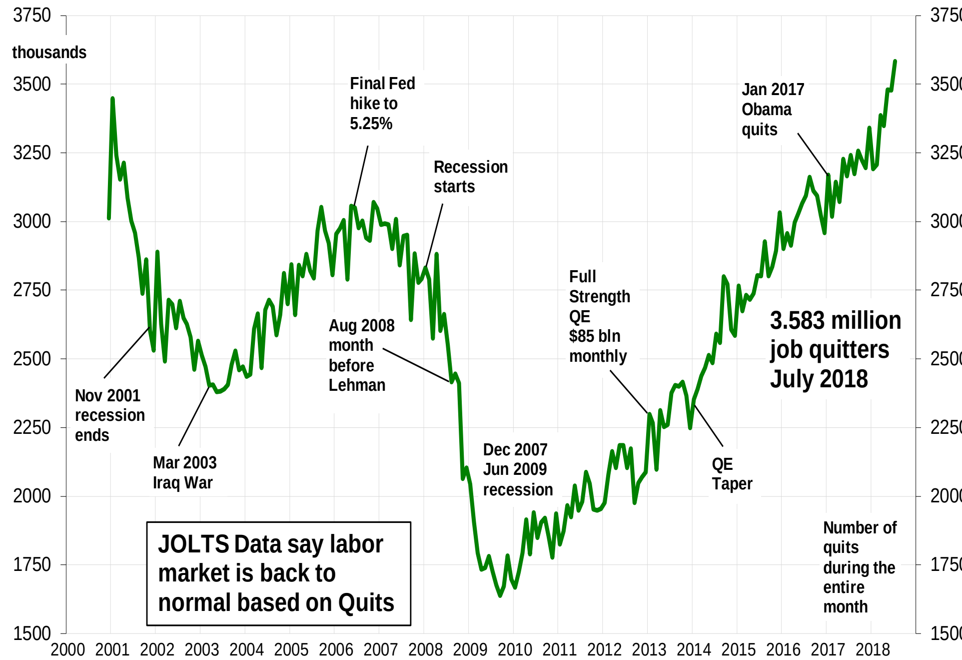
Fed Meeting	2017	2018	2019	2020	Longer run
Jun 18		2.4	3.1	3.4	2.9
Mar 18		2.1	2.9	3.4	2.9
Dec 17	1.4	2.1	2.7	3.1	2.8
Sep 17	1.4	2.1	2.7	2.9	2.8
Jun 17	1.4	2.1	2.9		3.0
Mar 17	1.4	2.1	3.0		3.0
Dec 16	1.4	2.1	2.9		3.0
Sep 16	1.1	1.9	2.6		2.9
Jun 16	1.6	2.4			3.0
Mar 16	1.9	3.0			3.3
Tax cuts and fiscal spending stimulus moved 2020 forecast to 3.4% in March. Now what for 2021?					

OTHER ECONOMIC NEWS THIS WEEK

Ho hum, just another record for job openings in the U.S. (Tuesday)

Breaking economy news. Job openings and labor turnover data, the JOLTS report. Wake up Washington, there's a greater need for labor than there are people out there willing to supply it. Talk all you want about higher wages drawing people off the sidelines and into the labor market, but it isn't happening. Not in sufficient numbers anyway. Job openings are soaring, and the need for help is turning into a desperate plea for help at many companies. We wouldn't want to be in a Human Resources department right now. They aren't going to achieve their goals this year. There is no one left to hire as the economy has reached the goal line of success: full employment; leaving economists scratching their heads about what comes next. We have never seen this before.

6.939 million job openings in July against 6.234 million unemployed in August. The biggest skills or geographic mismatch of labor in the country's history is growing worse by the minute. The economy cannot move forward if there is no one to man the battle stations and grease the wheels of commerce. Where's my help?



The labor market is so darn tight that people are quitting like never before as they are confident that they can get new work with help wanted signs in every store and shop window in the country. 3.583 million quit their jobs in July 2018 which is a record that speaks volumes about the confidence workers have that there are better opportunities elsewhere. Wages are starting to pick up, and they are going to go even higher as companies seek to hold on to the staff they have now. Pay 'em, or lose 'em. It's never been more true.

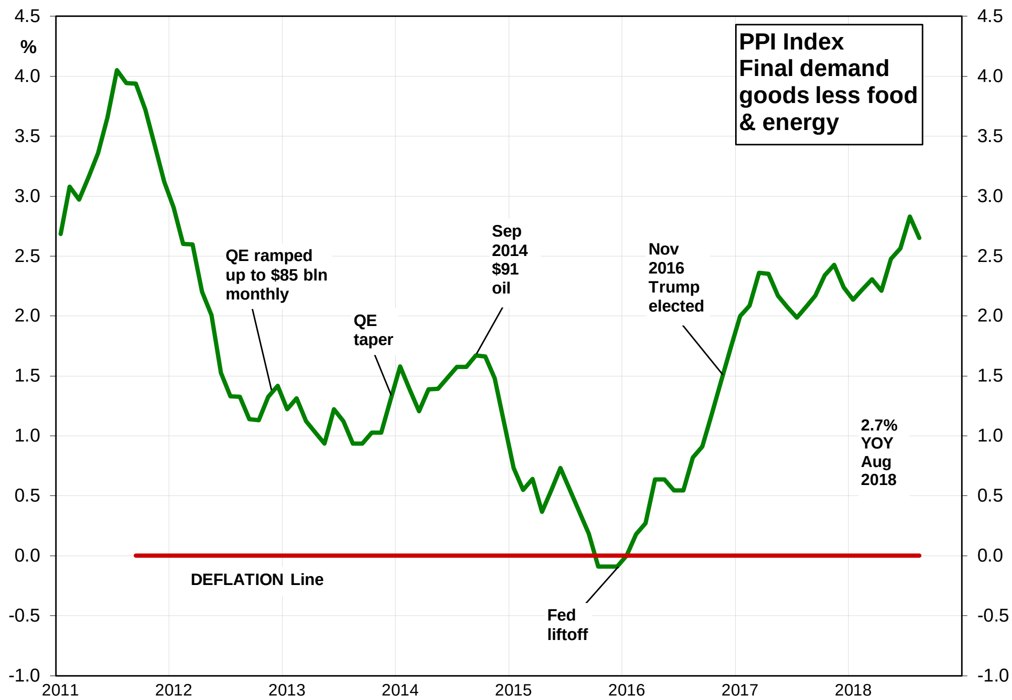
Net, net, the economic expansion is on a collision course with a lack of workers to man the shop floors, work the restaurants, and stores at the shopping malls across America. No workers, no growth, it’s that simple. This isn't something for the Trump administration to brag about, this is not a sign of opportunity, this is something for Washington to worry about. There is the biggest labor shortage that America has ever seen and this may well be the first time in the country's history that growth slams to a halt because we cannot find people to work. There is plenty of capital out there thanks to the Fed's easy money policies, but there is no labor. Many elements of the Administration's immigration policies that restricts the number of people coming in may actually backfire if companies cannot get the help they need to provide the goods they make and services they provide to their customers. Stay tuned. Story developing.

Companies say they don't see any inflation this month?! (Wednesday)

Breaking economy news. Producer prices, the old PPI inflation index, people who make things and sell them to consumers, producer prices were a no-show in August despite the strongest economic conditions seen in decades. Another head scratcher for economists.

Final demand goods prices less food and energy had been on a tear rising 0.3% every single month this year except for a 0.2% increase in May, and now today, August data shows these prices were unchanged. The report says something about iron and steel scrap prices declining. These core commodity prices, if you will, after rising just 0.0% in August are rising 2.7% on a year-over-year basis. It had been rising 2.8% year-on-year in last month's report for July. It doesn't look like there is enough pass-through price pressures, this 2.7% increase, to affect CPI inflation which is running 2.9% in July, or 2.4% for core CPI.

Net, net, tariffs on imported goods are not widespread as yet, and there is certainly no evidence that the trade war is boosting inflation at the producer level at this point. There were only tariffs on $50 billion of imported goods from China at the end of August anyway which is not enough to move the needle and contribute to inflation pressures in the overall economy. Fed officials can rest easy for today, knowing that trade wars are not boosting costs and warming the kettle on inflation in a worrisome manner.

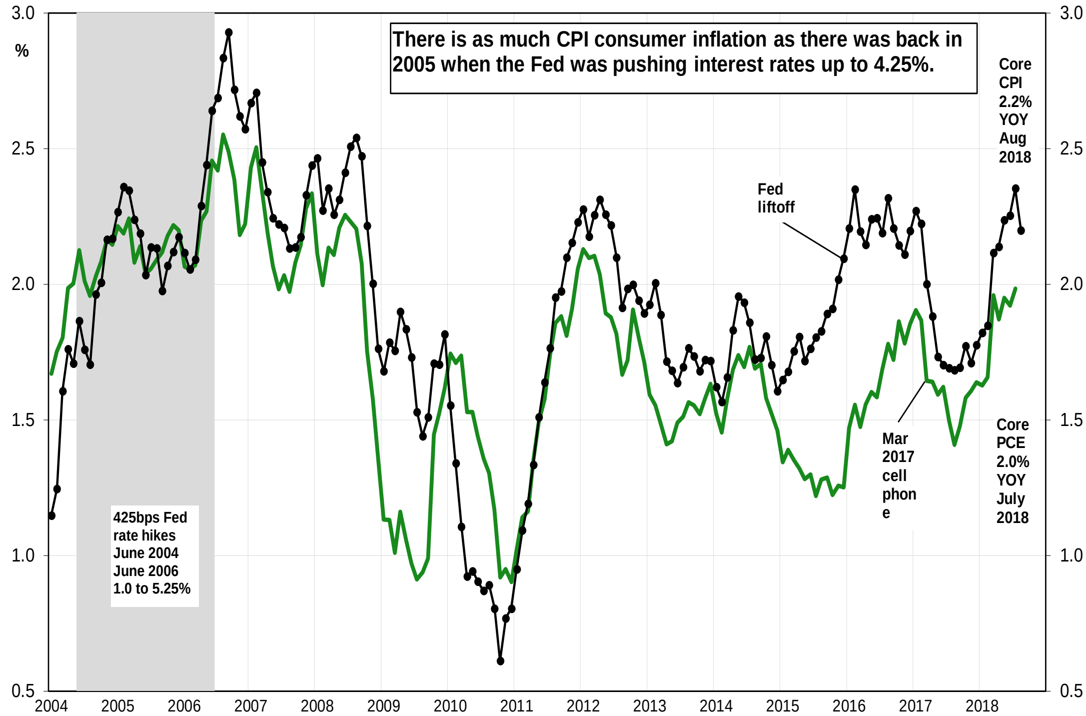


The Fed is likely to continue on its gradual path to normalize interest rates, and today's PPI report tells them there is no need to hurry up. The key to significantly higher interest rates in the next couple of years is just how hot the inflation fires are burning. Right now, inflation pressures look modest for this late in an economic cycle with the economy growing in its tenth straight year.

Economic growth isn't strong enough to engender inflation pressures according to the prices that US companies are paying to produce goods for their customers. There's no need for Fed officials to raise rates too high and possibly threaten the expansion if there is no immediate inflation threat. Stay tuned. Story developing.

Inflation hot or not? Think not! (Thursday)

Breaking economy news. The CPI inflation report. Core CPI just 0.1 percent in August bringing the year to year rate down to 2.2% from 2.4% just a month ago. Inflation pressures aren't building, they are receding. This is not what an economy at full employment and ten consecutive years of growth is supposed to look like.



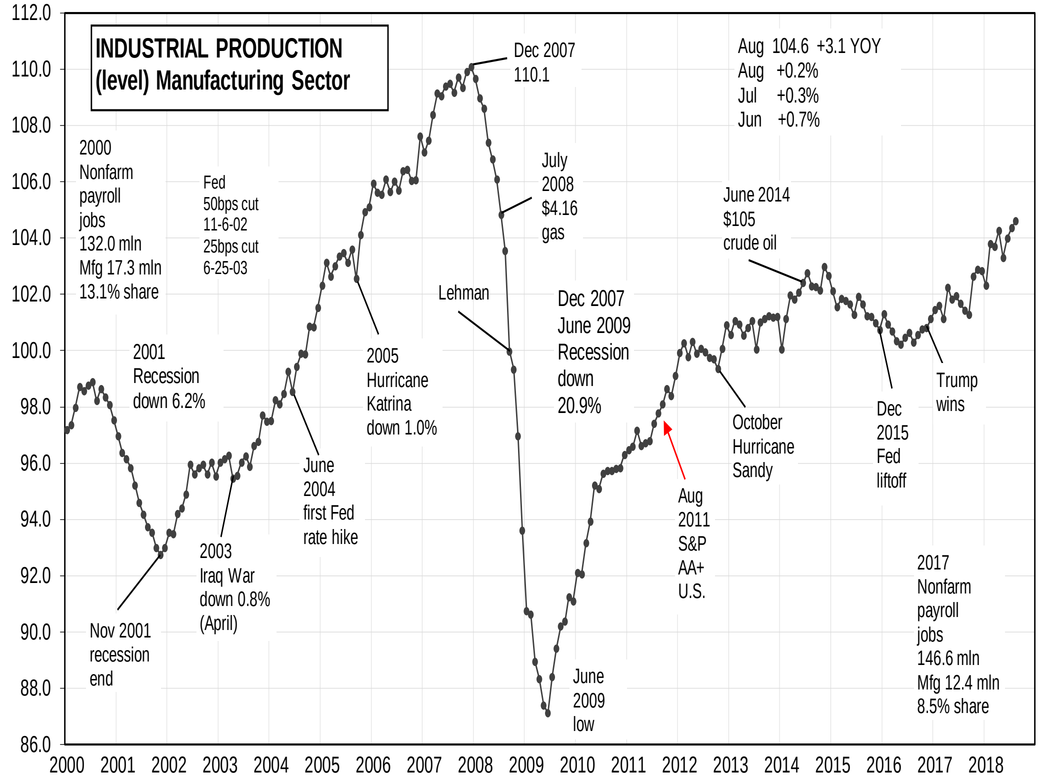
Trade wars aren't pushing up t-shirt prices for Americans yet with a sharp drop of 1.6% for Apparel prices. And what is with medical care services falling 0.2%, and medical care commodities falling 0.3% in August following July's 1.1% drop. At least those presidential tweets are doing something to lower the cost of living for Americans. It's a head scratcher, this "no inflation" report today. Gasoline prices at the pump are up 20.3 percent the last year, yet no one is complaining, or trying to pass on these rising energy costs to other prices.

Each inflation report that comes up short means you lose a Fed official who is dead set on moving interest rates above normal. It is going to be a real battle at the Fed once rates start to rise to 2.5%. This economy isn't setting off the dangerous sparks of inflation so there is less urgency to put the interest-rate brakes on the economy. Let it run, what's the hurry is what this inflation report tells the Fed. A rate hike later this month is a slam dunk, but after that, the path ahead for interest rates grows foggy.

Net, net, the labor market is on fire but there are no sparks to light up inflation yet. Economists at the Fed are going to have to rethink their models because it sure looks different this time. Get ready to readjust those higher interest rate forecasts because if the economy can run this fast without producing inflation then the Fed is sure not going to risk sending the economy into another recession like they did in the mid-2000s. The gradual pace of policy tightening might get more gradual under Fed Chair Powell. Bet on it.

Manufacturing production moves higher with the auto sector in August (Friday)

Breaking economy news. The Fed's very own economic statistic, industrial production. If factories are streaming back to the USA, we will see greater production in the monthly data. Total industrial production, manufacturing, mining and utilities rose 0.4% in August and is up 4.9% the last year. Manufacturing production rose 0.2%, but this was due to a 4% jump in motor vehicle production; manufacturing production would have been flat without autos. Certainly, with car and light truck sales at a slower pace of 16.6 million at an annual rate, motor vehicle production cannot keep improving for long. But the data look good for today. Continued gains in monthly production means there are no storm clouds of recession out there on the horizon.



Percent changes			Industrial Production August 2018		
Aug	July	June	YOY		Weight
0.4	0.4	0.6	4.9	Total Index	100.0
0.2	0.3	0.7	3.1	Manufacturing	75.5
0.7	0.7	1.8	14.1	Mining	14.1
1.2	0.1	-1.5	4.8	Utilities	10.4
			Manufacturing payroll jobs 12.7 million +254K YOY 10.0% of Private Payroll Jobs		

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