UnionBank

Financial Market Weekly

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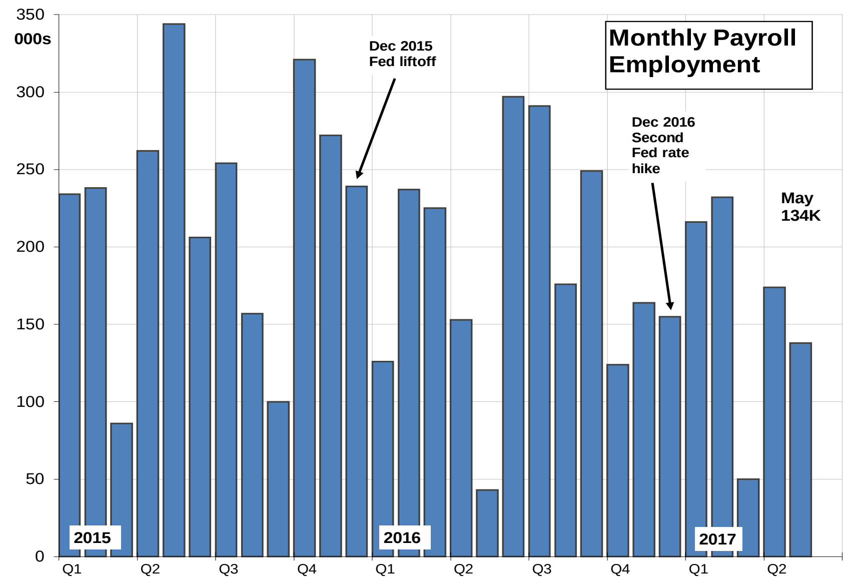
SLOW JOBS REPORT AS ECONOMY RUNS SMACK INTO THE FULL EMPLOYMENT WALL

Breaking economy news. May employment data, payroll jobs up just 138K with 66K of downward revisions to March and April. The unemployment rate incredibly dropped another tenth lower to 4.3% in May which provides some evidence that jobs growth is slowing as the economy hits the wall of full employment where there simply are not enough people out of work to put back to work. Yes, average hourly earnings have not risen any higher, 2.5% year-to-year for May the same annual gain as in April, but wages do not go up immediately once the economy reaches the full employment stage. The best economic theory can say is that wages will move up over the next 12 to 18 months. We would be surprised if wages were still running under 3% for example when we get to the end of 2018. Modest wage gains and continued income inequality do not take Fed rate hikes off the table. We hope.



Slowest three-month total payroll jobs yet will test Fed beliefs. Rock-bottom 4.3% unemployment rate (lagging indicator) versus payroll jobs (coincident indicator). Some might argue that sure the labor market got to its best full employment level, but now it has hit a soft patch. Wait to see if it is temporary.

	May	Apr	Mar	Feb	Jan	Dec
Payroll jobs (000s)	138	174	50	232	216	155
Unemployment rate %	4.3	4.4	4.5	4.7	4.8	4.7
Unemployment (3 decimal)	4.294	4.404	4.496	4.703	4.780	4.716
Average hourly earnings	$26.22	$26.18	$26.13	$26.10	$26.02	$25.98
MTM % Chg	0.2	0.2	0.1	0.3	0.2	0.3
YOY % Chg	2.5	2.5	2.6	2.8	2.6	2.9
Production Worker earnings	$22.00	$21.97	$21.90	$21.86	$21.83	$21.80
MTM % Chg	0.1	0.3	0.2	0.1	0.1	0.3
YOY % Chg	2.4	2.4	2.3	2.5	2.4	2.5

It is a cool spring for the economy with a slower pace of jobs created the last three months. We can only speculate what this means for the Fed's gradual pace of rate hikes this year. The million-dollar question is whether this throws a monkey wrench into any plans Fed officials have made to take another step up on rates in a couple of weeks at the June meeting. Yellen still has enough time to back the committee off a rate hike and she has the ammo with inflation falling the last two months and secondary labor market indicators like the participation rate falling back somewhat to 62.7 from 62.9 percent last month. We can see the dire news headlines now: the number of unemployed fell 195K in May as 608K fell out of the labor force. Back to the weak economy, brother can you spare a dime, thinking of some.

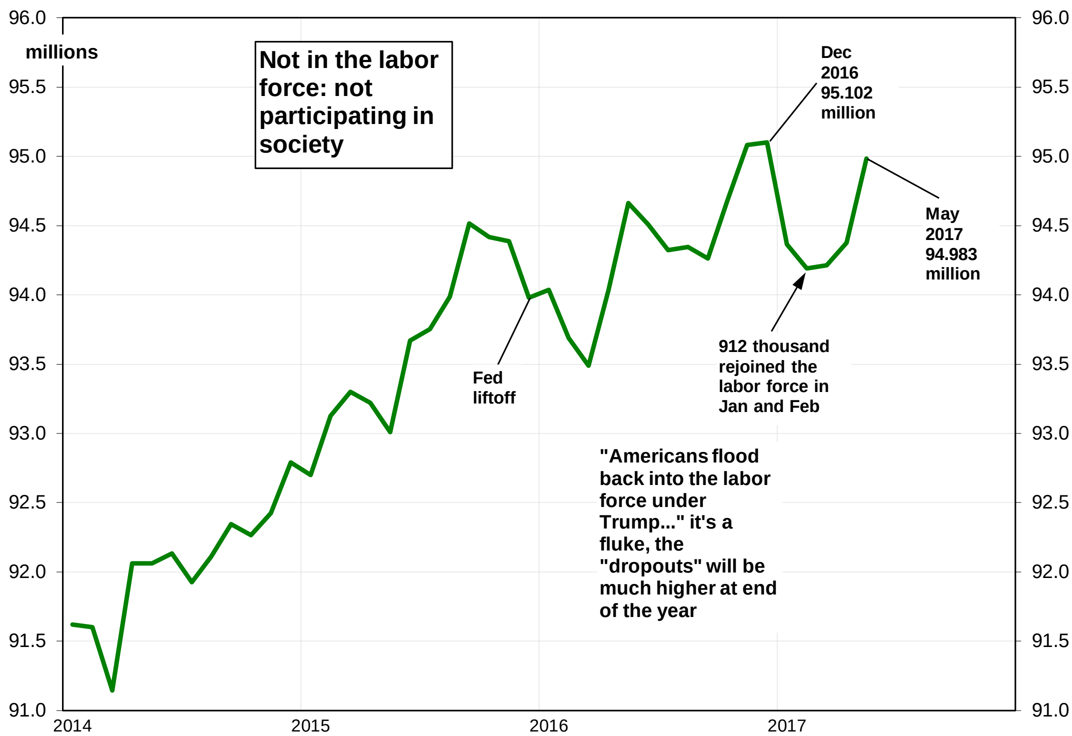
Payroll jobs in year eight following the recession

Dec. 2016 Totals millions		May 17	Apr 17	Mar 17	5 months Dec 16 to May 17	12 months Dec 15 to Dec 16
145.325	Nonfarm Payroll Employment	138	174	50	810	2240
123.026	Total Private (ex-Govt)	147	173	59	805	2039
19.794	Goods-producing	16	19	17	191	64
0.617	Mining	7	8	7	39	-75
12.343	Manufacturing	-1	11	11	55	-16
0.942	Motor Vehicles & parts	-2	2	2	1	17
6.783	Construction	11	-1	0	98	155
103.232	Private Service-providing	131	154	42	614	1975
27.374	**Trade, transportation, utilities**	-6	0	-39	-28	331
15.881	Retail stores	-6	-6	-40	-45	203
3.180	General Merchandise	-6	4	-35	-66	37
3.097	Food & Beverage stores	-5	-5	-4	-15	37
5.048	Transportation/warehousing	4	0	4	2	92
1.465	Truck transport	0	-2	4	9	10
0.668	Couriers/messengers	1	3	-3	-14	31
0.943	Warehousing and storage	0	1	-1	4	63
0.557	Utilities	-1	-1	-1	-4	0
2.762	**Information**	-2	-15	-8	-39	0
8.364	**Financial**	11	14	4	64	176
2.605	Insurance	2	8	-1	20	46
2.169	Real Estate	4	2	0	21	59
1.311	Commercial Banking	4	0	2	9	17
0.933	Securities/investments	0	2	2	6	18
20.416	**Professional/business**	38	38	58	228	534
2.962	Temp help services	13	4	13	55	32
2.259	Management of companies	2	2	1	12	35
1.427	Architectural/engineering	0	0	7	20	27
2.032	Computer systems/services	0	1	0	14	87
1.126	Legal services	2	2	0	1	5
1.000	Accounting/bookkeeping	0	6	2	2	32
22.871	**Education and health**	47	50	16	198	553
5.077	Hospitals	7	4	8	27	119
3.604	Educational services	15	5	-3	-59	85
15.744	**Leisure and hospitality**	31	58	11	148	331
1.950	Hotel/motels	3	7	0	11	11
11.549	Eating & drinking places	30	26	28	123	276
22.299	Government	-9	1	-9	5	201
2.200	Federal ex-Post Office	1	0	-3	-3	30
5.085	State government	-8	-1	1	0	-4
2.414	State Govt Education	-1	2	1	5	3
14.395	Local government	-9	8	-8	9	160
7.945	Local Govt Education	-6	3	1	10	69

The early market reaction was subdued in the first fifteen minutes post-release time with 10-yr Treasury yields falling 4 bps from 2.20 to 2.16 percent. Dow stock futures were up 71 points and now up just 25 points. The S&P 500 just closed last night at record levels up 8.5% year-to-date. Stocks investors are certainly not panicking that the economy's growth engines are about to go into reverse. July Fed funds futures don't have their thinking caps on this morning, and are unchanged at 1.125% which implies an 86% chance they hike rates on June 14.

The soft patch for payroll jobs extended another month after seeing the backward revisions today. The relative dearth of new jobs can be seen in the tepid gains of 138K May, 174K in April, and that clunker 50K reading in March. There was a continued retrenchment in retail jobs which have tumbled 81K since January. We can't find the line for Internet jobs created as an offset in today's report. Manufacturers have stopped giving in to the President apparently with a loss of 1K jobs in May after average monthly factory job gains of 15K per month since the President was elected in November. The pressure is off manufacturing executives the last several weeks with the President's attention focused elsewhere.

Net, net, the employment report shows fewer jobs for Americans out there the last few months. Time will tell if the Fed pulls its widely anticipated rate hike and chickens out as inflation falls away from its 2.0% target. This meeting will be a supreme test of whether the Fed is data-driven or theory driven. The unemployment rate at 4.3% is lower than any time during the Greenspan housing bubble years a decade ago so inflation pressures are likely to build over the next few years. The Fed funds rate of 1% is a couple hundred basis points below normal, so they risk falling behind.



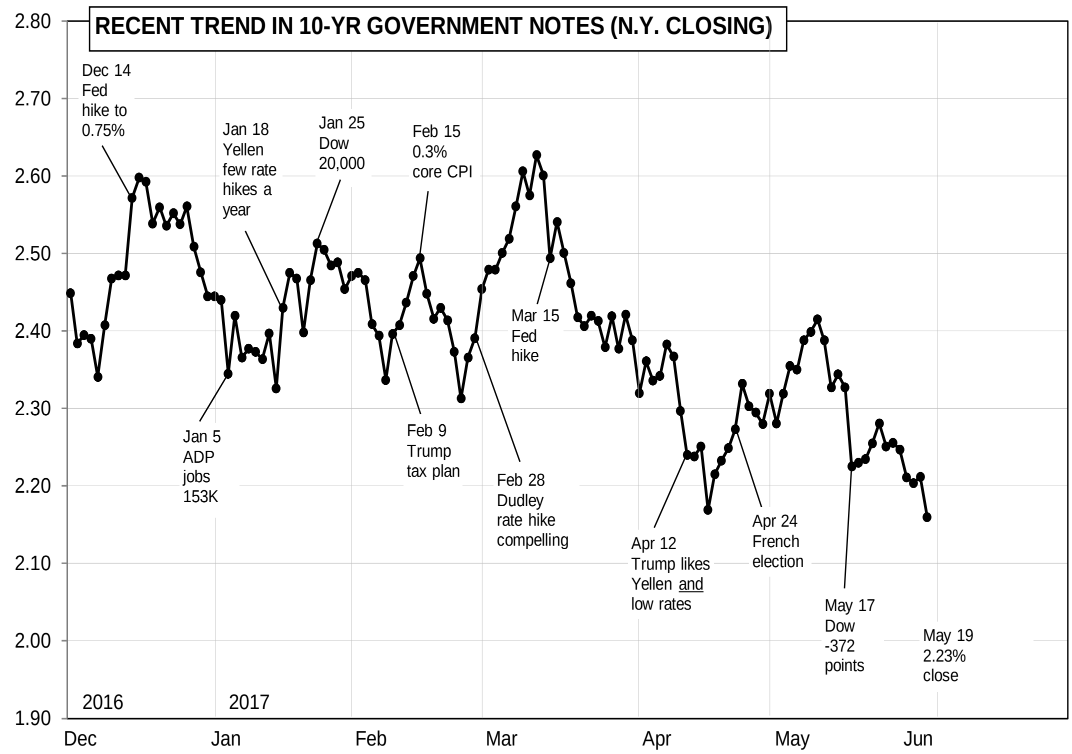
On the other hand, the Doves on the Committee have taken a what's the hurry stance for the last few years now and are unlikely to press the case for a rate hike in June now with the cooling of payroll jobs and inflation. Let's not forget car & light truck sales have been weak, and are running in the 16 million annual rate range the last three months at the same time jobs growth hit a soft patch. The economic slowdown could be real we suppose. Maybe this isn't just a benign case of the jobs market seeing the first signs of new trend after hitting full employment where there are simply fewer people out there for companies to hire. Stay tuned. Story developing. This Fed decision is likely to go down to the wire even though market based odds continue to give Fed officials the green go light for a rate hike.

MARKETS OUTLOOK

	31-Mar 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
30-Yr Treasury	3.03	3.10	3.20	3.40	3.60	3.70	3.80	4.00	4.10	4.10	4.10	4.20
10-Yr Note	2.40	2.50	2.70	3.00	3.20	3.40	3.50	3.70	3.80	3.90	3.90	4.00
5-Yr Note	1.93	2.10	2.40	2.70	3.00	3.20	3.30	3.50	3.60	3.70	3.70	3.90
2-Yr Note	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.20	3.35	3.35	3.50
3-month Libor	1.15	1.50	1.70	1.95	2.20	2.45	2.70	2.95	3.20	3.45	3.45	3.70
Federal Fund Rate	1.00	1.25	1.50	1.75	2.00	2.25	2.50	2.75	3.00	3.25	3.25	3.50
2s/10s spread	115	100	95	100	95	90	75	70	60	55	55	50
Libor/funds spread	15	25	20	20	20	20	20	20	20	20	20	20

Bonds yields fell from 2.20% on the weaker than expected jobs report on Friday. The market normally favors the payroll jobs count over the movement in the unemployment rate. Payroll jobs in May rose 138K and the consensus forecast was +182K, end of story. The 10-yr Treasury yield was 2.16% fifteen minutes after the report and closed at 2.16%, touching as low as 2.14% before 12 noon.

The 2.16% 10-yr yield is mispriced of course if the Fed funds rate median forecast of 2.25% is reached as Fed officials think at the end of 2018. We guess bonds think the Fed will never get the funds rate that high for some reason if the bond market is capable of thinking. On the other hand, maybe fixed income investors are not expecting the Fed to push rates higher than 2.25%. There is no real yield pickup for savers starved for investment income either with CPI inflation of 2.2 percent the last 12 months. Not a great America time to retire and dine out on your nest egg.



Bonds are in a technical uptrend with a new yield low made on Friday for 2017. It has filled a gap in the charts left a few nights after Trump's surprise victory. Yields closed at 2.06% the day of the election results on November 9. With the Fed announcement of a rate hike on June 14 dead-ahead, it would be surprising to see the rally continue. Maybe geopolitical risks could carry it further, but 2.00 percent seems to be quite a barrier technically. Before the last two Fed rate hikes in December and then in March yields were above 2.50%. The only thing moving up in yield is 3-month Libor closing at 1.22% this week, yet the market still has an intense desire to pay this lower floating rate yield. 3-month Libor is moving up while 3-month Libor in December 2019 [Eurodollar futures; when the Fed says the funds rate will be 3%) is moving down closing at 1.92% on Friday. Two and a half years from now and only 70 bps higher than where 3-month Libor is today. Hard to explain rationally. Meanwhile, July Fed funds futures closed Friday at 1.13% or rate hike odds of 88% at the June meeting despite the softer employment report. At least someone is certain about the future in the markets. Fed funds futures say a rate hike is coming on June 14. Bet on it.

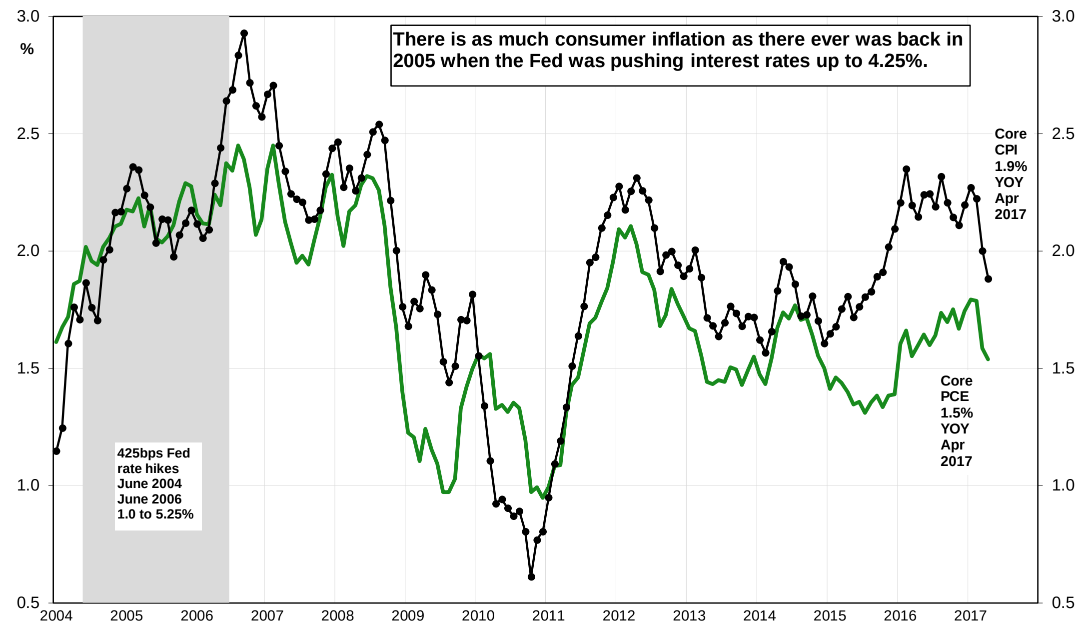
Selected Fed assets and liabilities					Sep 10
Fed H.4.1 statistical release					2008**
billions, Wednesday data	31-May	24-May	17-May	10-May	pre-LEH
Factors adding reserves					
U.S. Treasury securities	2464.696	2464.660	2464.638	2464.815	479.782
Federal agency debt securities	8.834	8.834	8.834	11.829	0.000
Mortgage-backed securities	1770.958	1780.383	1778.109	1769.016	0.000
Primary credit (Discount Window)	0.016	0.011	0.023	0.000	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)	1.709	1.710	1.709	1.709	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	0.000
Central bank liquidity swaps	0.035	0.041	0.036	0.035	62.000
Federal Reserve Assets	4505.9	4517.5	4513.6	4520.0	961.7
3-month Libor %	1.21	1.20	1.18	1.18	2.82
Factors draining reserves					
Currency in circulation	1556.472	1551.551	1548.437	1548.378	834.477
Term Deposit Facility	16.347	16.347	0.000	0.000	0.000
Reverse repurchases w/others	270.326	184.946	167.270	187.269	0.000
Reserve Balances (Net Liquidity)	2129.606	2206.163	2247.673	2219.918	24.964
Treasuries within 15 days	0.000	11.910	11.910	20.483	14.955
Treasuries 16 to 90 days	44.608	44.608	44.608	37.862	31.549
Treasuries 91 days to 1 year	259.257	230.778	230.777	223.204	69.272
Treasuries over 1-yr to 5 years	1174.320	1195.577	1195.573	1170.574	170.807
Treasuries over 5-yrs to 10 years	353.768	349.059	349.054	384.944	91.863
Treasuries over 10-years	632.743	632.730	632.716	627.747	101.337
**September 10, 2008 is pre-Lehman bankruptcy of 9-15-08					

OTHER ECONOMIC NEWS THIS WEEK

Inflation goal elusive, slip sliding away, but consumers are back spending it

[Commentary written after the news was released on Tuesday, May 30]

Breaking economy news. The Fed's preferred inflation measure has backed off to 1.7% year-on-year in April from 1.9% in last month's report. Fed Chair Yellen has said it is core inflation that matters most and this has backed down to 1.5% in April even further away from the 2.0% central bank's goal. Current inflation argues for a gradual pace of rate hikes, but potential inflation pressures are paramount and these can only be expected to build like a pressure-cooker on a hot stove top because of the very low 4.4% unemployment rate that shows the economy has moved beyond full employment.



In short, inflation may not here today, but it will be tomorrow based on economic theory and Fed policy needs to position interest rates for conditions two or three years from now. We won't shelve our call for a rate hike in a couple weeks simply because inflation isn't a hot topic today. The Fed has damned near broken the plumbing of the financial system keeping rates so low for this amount of time. The Fed funds rate is still too low at just 1% relative to the Fed's idea of normal which is 3%.

The biggest news in today's report is that the consumer has restarted their engines making the Fed look smart in guessing the first quarter slowdown would be just transitory or fleeting, here today, gone tomorrow. Real consumer spending slowed to 0.3% in the first quarter and was revised higher to a big 0.6% gain in Friday's GDP revision. But now given the strong momentum in real consumer expenditures at 0.5% in March and a 0.2% gain today for April, the second quarter is starting out with a bang. Real consumer spending is up 2.2% already this quarter without any data yet for May or June. The economy's got the wind at its back for now.

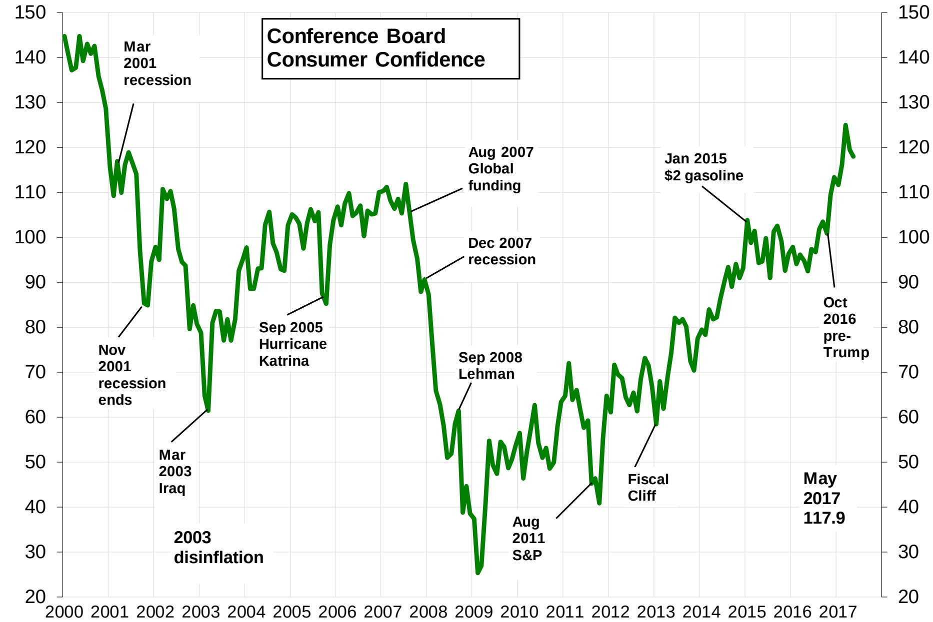
Net, net, consumers are back out in force this quarter, spending their hearts away after taking the first quarter of the year off. Real spending is running 2.2% early this quarter after the slow 0.6% advance in the first quarter of 2017. This is making us feel much more secure with our 2.9% second quarter real GDP forecast, wait for it, the second quarter data are due out Friday, July 28.

And don't think consumers are simply robbing their piggy banks to fuel their profligate spending ways. The saving rate has been steady at 5.3% for three straight months now. The consumer's got the money and they are spending it. Their personal incomes are up 3.6% the last year, keeping in mind there are more workers with incomes out there. Nonfarm payroll jobs are up 2.2 million the last year, an increase of 1.0% to 146.1 million strong. America is Great Again already. Millions of jobs. And more to come. Bet on it. Fed officials can continue with their gradual pace of rate hikes as the economy remains on course for stronger growth this quarter and throughout the rest of the year.

Consumers tire of waving their hands in the air

[Commentary written after the news was released on Tuesday, May 30]

Breaking economy news. It looks like the consumer is starting to tire just a little bit of waving their hands in the air since the election waiting for great things to happen. Okay, not a whole lot in the scheme of things.



Consumer confidence is flagging and we can't point to the economy certainly as the reason as these are still good economic times for most Americans. In fact, those saying jobs are hard to get is now down lower at just 18.2% from 19.4% a month ago. These are the best levels seen since the Greenspan housing bubble economy years. So it's not just the official unemployment rate statistics saying it is a stronger labor market. This finding is also backed up by what consumers see is actually going on out there in the labor market. The economy is at full employment and very few cannot find jobs.

Net-net the economy is not going off the rails here certainly. Consumer confidence data, the index, has come off one and a half percentage points - 117.9 from 119.4 before which is still a high degree of confidence. But we would argue that confidence cannot go any higher for now without seeing some progress down there in Washington as elected officials work to make America great again.

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