High Frequency Economics®
Daily Data Analysis and Assessment of the Global Economy

Daily Notes on the United States

October 12, 2018. Worldwide Edition

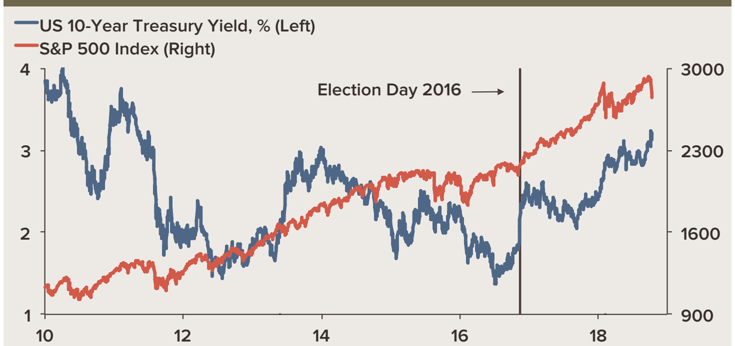
Jim O'Sullivan, Chief Economist

A Little Volatility Won't Stop Fed Tightening

"The problem that I have is with the Fed. The Fed is going wild. I mean, I don't know what their problem is, but they're raising interest rates and it's ridiculous because we're winning—I don't call them trade wars. I say we're doing—you know, we're doing a little bit of battle, not much." That was the president blaming the Fed for this week's selloff in the equity market. It was in response to a question about whether the selloff was because of the "trade war with China." In another interview, he said, "I think the Fed is making a mistake. They're so tight. I think the Fed has gone crazy."

We don't believe the president's criticism will affect the decisions of the current Fed leadership in any significant way, although officials may find they have to step up their messaging on why they are tightening. We also don't believe that monetary policy is "tight" or that Fed officials are "going wild." The funds rate is close to zero in real terms and the quarter-point-per-quarter pace for rate hikes is exceptionally gradual by past standards.

S&P 500 Is Back To Where It Was In July



HFE's Economic & Financial Forecasts

	Q/Q Annual Rate		Cal Avg		Q4/Q4
Real GDP (%ch)	2018 Q1*	2.2	2017 year*	2.2	2.5
	2018 Q2*	4.2	2018 year	2.9	3.2
	2018 Q3	3.5	2019 year	2.8	2.4
	2018 Q4	3.0	2020 year	1.9	1.7

	Latest	19Q2	19Q4	20Q4
CPI (%ch y/y)	2.7	2.5	2.7	3.0
Core CPI	2.2	2.5	2.7	3.1
Unemployment (%, level)	3.7	3.4	3.3	3.3
Interest Rates (%, level, EOP)				
Fed Funds Target	2.0-2.25	2.875	3.375	3.625
10-Year Treasury	3.144	3.5	3.7	4.0
S&P 500 (EOP)	2728.4	2735	2670	2570

*Actual

Key Data Spotlight: October 12

	Period	Previous (-2)	Previous (-1)	New Data Cons	New Data HFE
Import Prices (%m/m)	Sep	-0.1	-0.6	0.2	0.1
Non Oil	Sep	-0.2	-0.2	-0.1	
Michigan Sentiment Index	Oct	96.2	100.1	100.5	100.5
1-Year Inflation	Oct	3.0	2.7		
5-10 Year Inflation	Oct	2.6	2.5		

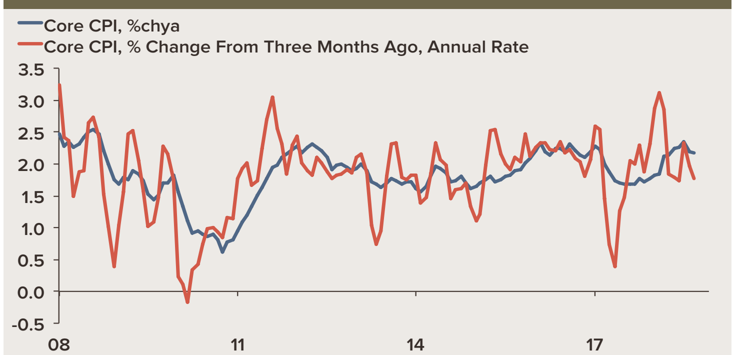
Fed officials will, of course, have to take equity markets—and financial developments broadly—into account when they decide whether and how much to tighten in the months and quarters ahead. The purpose of Fed tightening is to make financial conditions less accommodative, and the more the equity market falls/rises, the less/more the Fed will have to raise rates. This is what we wrote in our latest *Weekly Notes*: "The amount of Fed tightening required will ultimately depend on many variables, including not just the data but also the extent to which a rising funds rate leads to tightening of financial conditions broadly. We are assuming that the U.S. equity market falls in the next year, but only modestly." *Specifically, in our forecast we have the S&P 500 down to 2670 by the end of 2019 from 2728 currently and 2931 at the all-time high a few weeks ago.*

In that context, this week's selloff in equities still looks relatively innocuous. The S&P 500 is now down 6.9% from the recent high, which is not even large enough to be a "correction." It is still up 2.0% since the year began and 27.5% since the 2016 election. It fell 2.1% on Thursday following a 3.3% drop on Wednesday. *That said, our tone will have to change if equities keep falling.*

Modest Net Rise In Core Inflation In The Past Year

The tamer-than-expected CPI data for September probably helped prevent a larger decline in equities on Thursday, as they lessened the likelihood that Fed officials will have to step up the pace of tightening. Both the overall CPI and the core index rose just 0.1% month-over-

Core CPI Inflation Still Shows A Modest Pick-Up In The Past Year



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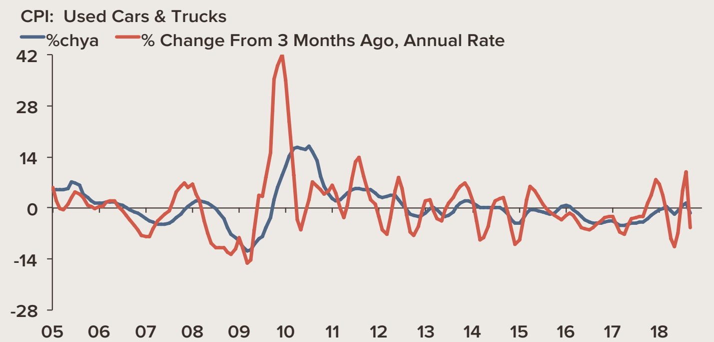
Used Vehicle Prices Held Down The Core CPI In September



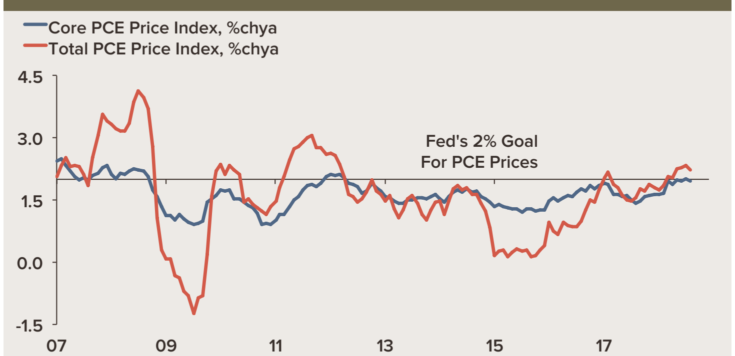
month. The 12-month change in the overall index slowed to 2.3% from 2.7%, while the 12-month change in core prices remained at 2.2%. The 12-month change in core prices was 1.7% a year ago.

The 0.1% rise in core prices—0.12% before rounding—was held down by a 3.0% decline in the volatile used vehicle component. We believe the trend in monthly changes is still closer to 0.2% than 0.1%; the plunge in used vehicle prices subtracted 0.09 percentage points from the change in core prices in September. *We also still believe the trend is up: We expect the 12-month change in the core index to be up to 2.7% by the end of next year. We expect acceleration to remain quite gradual, allowing the Fed to move gradually.*

Core PCE Inflation Likely Fell To 1.9% Y/Y In September

We estimate the core PCE price index rose 0.1% month-over-month in September as well—it will be reported on October 29. *The 12-month change will probably fall back to 1.9% from 2.0% in August, although that would still be up from 1.5% a year earlier.*

Core PCE Inflation Likely Slowed A Little In September



Jim O'Sullivan
josullivan@hifreqecon.com
White Plains, NY
+1-914-773-2121

This Week's Funding

Tue	Auction—4-week bills
	Auction—3-month, 6-month bills
	Auction—1-year notes
Wed	Auction—3-year notes
	Auction—10-year notes
Thurs	Announcement—3-month, 6-month bills (October 15)
	Announcement—30-year TIPS (October 18)
	Auction—30-year bonds

This Week In Brief

Note: "SS" prefix denotes Snapshot for these data.

Monday, October 8

- **Columbus Day Holiday**

Tuesday, October 9

- **SS: NFIB Survey (9)/6:00 EDT**
  The index fell to a still-high **107.9**, near the 108.0 consensus, from the all-time high of 108.8 in August. Based on past averages, the level remains high enough to be consistent with a 6-to-7% pace for real GDP growth, but it has been exaggerating strength since the 2016 election. The selling price series fell to 15 from 17, but that is sill up from 7, on average, last year.

Wednesday, October 10

- **MBA Mortgage Applications (10/5)/7:00 EDT**
- **SS: Producer Prices (9)/8:30 EDT**
  The overall final-demand index rose **0.2%**, matching the consensus. The main core series also rose **0.2%**, matching the consensus. The "core-core" measure, which excludes highly volatile and erratic trade services—retail and wholesale margins—as well as food and energy items, rose **0.4%**, above the 0.2% consensus.
- **Wholesale Inventories (8r)/10:00 EDT**
  Inventories rose **1.0%**, above the 0.8% consensus.

Thursday, October 11

- **SS: Consumer Prices (9)/8:30 EDT**
  Both the overall index and the core index rose **0.1%**, below the 0.2%/0.2% consensus. The weakness in core prices was led by a 3.0% plunge in the volatile used car and truck prices component. The 12-month change in the overall index slowed to 2.3% from 2.7%. The 12-month change in core prices remained at 2.2%; that is still a pick-up from 1.7% a year earlier.
- **SS: Initial Jobless Claims (10/6)/8:30 EDT**
  Claims rose 7K to **214K**, above the 207K consensus but still quite low. Seasonally adjusted claims in the Carolinas—based on the seasonally adjusted state data calculated by Haver Analytics—were unchanged at 14K, so they did not contribute to the rise, but the 14K level is up from around 5K per week before Storm Florence hit. As a result, the "ex-Florence" level appears to have been around 205K. The data continue to signal strong momentum in the labor market.

Friday, October 12

- **Import Prices (9)/8:30 EDT**
  Consensus: 0.2%. HFE: 0.1%. Oil prices were up modestly.
- **SS: University of Michigan Sentiment (10p)/10:00 EDT**
  Consensus: 100.5, after 100.1. HFE: 100.5. Confidence indexes have generally remained high.
- ***Treasury Budget (9)/14:00 EDT (Date Not Set)***
  Consensus: $75.0B, following $7.9B in September 2017. HFE: $116.0B. The release date for the September report, the last of FY18, has not yet been announced. The CBO estimates that the deficit rose to $782B, or 3.9% of GDP, in FY18 from $666B/3.5% in FY17.

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