

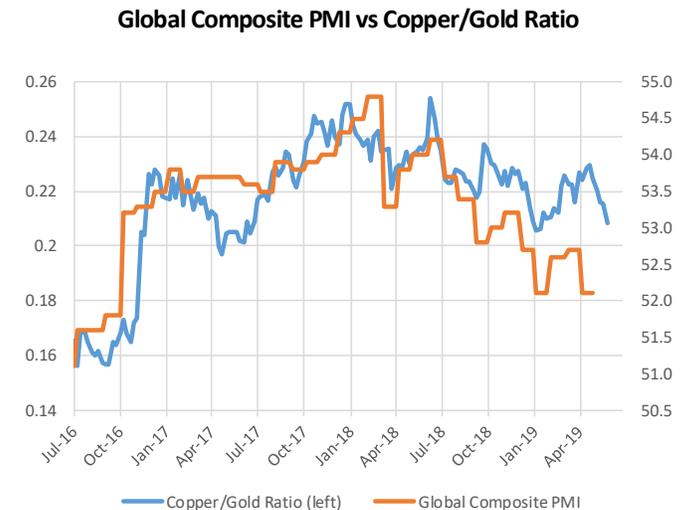


U.S. ECONOMIC AND EVENT OUTLOOK – THURSDAY

Time			(Consensus Ests. in parentheses, Green = DE Above, Red = DE Below)						
Date	(EST)	Economic Indicator	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	
Thu									
5/23	9:45 AM	May P	Markit Composite PMI	54.7	54.4	54.4	55.5	54.6	53.0
		May P	Markit Services PMI	54.7	54.4	54.2	56.0	55.3	53.0
		May P	Markit Manufacturing PMI	55.3	53.8	54.9	53.0	52.4	52.6
10:00 AM	Apr		New Home Sales (Thous)	612	562	625	662	692	645 (675)
			%m/m	10.9	-8.2	11.2	5.9	4.5	-6.8 (-2.5)
1:00 PM		Kaplan, Daly, Bostic, Barkin Panel							

Global Markets

- Among its peers, the Federal Reserve has the greatest capacity to respond effectively to negative global economic shocks, but for the moment appears least willing to act in response to potential risks. Markets have done work by pushing long-term rates lower, but the dollar’s rise risks exacerbating both inflation softness and keeping pressure on emerging market assets.
- **PMI figures this morning** show continued sogginess in Europe and Asia, and firms are buckling in for a lengthy period of trade frictions and disrupted global supply chains. Composite global PMIs may have further to run to the downside (chart).
- **The Eurozone PMIs fail to rebound in May**, the manufacturing figure drifting lower by 0.2 points to 47.7, while the services PMI edges down 0.3 points to 52.5. Weaker economic growth projections and global uncertainties risk becoming a self-reinforcing dynamic the longer negative headlines persist.
- **The French services and manufacturing indices saw clearer rises**, up 1.2 points and 0.6 points, respectively, while German manufacturers (-0.1 point to 44.3) and services (-0.7 points to 55.0) slipped. Acute impacts in the auto sector are more relevant in the latter.
- **Japan’s manufacturing PMI reveals a similar profile, dipping 0.5 points to 49.6**—still up from recent lows in February and March, but failing to show clearer rebound as spring rolls on.
- Global equity markets are firmly in the red this morning, Chinese equities falling 1.8% overnight while Eurozone equities are down 1.3%. U.S. futures are down 0.9%. Sovereign yields are broadly lower.
- Crude oil is nearing \$60 on the front month WTI contract, while Brent dips below \$70.



Sources: Bloomberg, Markit, and Decision Economics, Inc.

In the U.S. the Markit PMI has performed less well than the more closely followed ISM version, though the gap has narrowed this year as the ISM PMI rapidly approaches . Compositional differences are likely to blame, with larger firms (and exporters) having fared better earlier in 2018 as global growth and the tax cuts jolted confidence, while smaller firms saw less of a rise, but also less deceleration as tariffs were less of a direct impact starting in mid 2018.

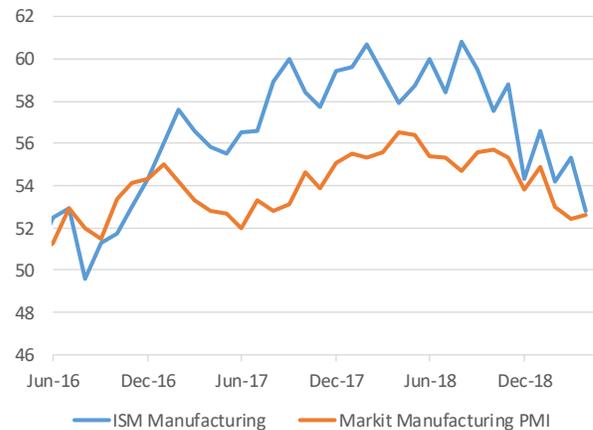
From IHS Markit:

“The ISM panel comprises only very large companies, whereas the IHS Markit PMI is based on a carefully constructed panel that replicates the manufacturing economy according to an analysis of official data on industry sector and company size. As such, the PMI ensures small, medium and large companies are appropriately represented in the IHS Markit survey results each month. With the PMI data showing large companies to have significantly outperformed smaller firms in recent months, extrapolation suggests that the very large firms covered by the ISM may well have been performing even better, hence the surprisingly strong ISM readings.”

The same appears true for other country PMIs, including those in China, where the private sector PMIs tend to lag their longer-running government counterparts.

The renewed tariff spat over the last week and a half may not be fully present in this month’s responses, just as it wasn’t a factor in the upside surprises in the handful of regional Fed PMIs last week.

Markit PMIs vs ISM PMIs: Compositional Differences?



Sources: Census Bureau, Bloomberg, ISM, and Decision Economics, Inc.

GLOBAL AND U.S. POINTS – WEDNESDAY

The Minutes to the May 1st FOMC meeting yield no major surprises, and in any event were old news given the surprise flare-up in the U.S. China trade war. Growth risks there, and from some deterioration in Brexit scenarios over the last two weeks, will loom larger come the June meeting.

Powell Had Backing on Transitory Inflation Comments

On the inflation front, debate about the causes continues, but a modest surprise is that “many” saw recent inflation softness as likely transitory—that wasn’t just Powell shooting from the hip in the post-meeting presser.

The Minutes cite a lurch lower in apparel prices and financial services prices (the latter large but arithmetically oversold as a driver of headline inflation softness) as among the transitory factors.

(At 0.2% of the index, even the observed 5-6% reduction in the y/y rate of growth in financial services prices earlier this year accounts for a 0.01-0.02% drag on headline inflation, effectively imperceptible.)

Weighing What Happens to the Balance Sheet Longer Term

There was a staff presentation on what the Fed’s portfolio should look like over the long term, with two options discussed: (1) one roughly proportional to the maturity profile of outstanding Treasuries, and (2) a short-term portfolio of three years or less. “Many” noted the advantage of option 2, which would allow space for a maturity extension program (MEP) as a policy tool in the event of a future downturn.

The argument against that could be a higher term premium on other securities, which all else equal would require a lower fed funds rate path to provide the same level of accommodation. That lower funds rate path would provide less scope for direct short term policy rate adjustments. (There always an offset somewhere!) However, with the long-run neutral rate already likely to remain lower, the latter problem would likely persist regardless of which balance sheet option members chose.

Financial Conditions Improved, Most Comfortable with Hold/Patience for “Some Time”

The Fed acknowledged its own impact on markets as “prices for equities and other risk assets reportedly were buoyed by perceptions of an accommodative stance of monetary policy”

With regard to risks to the economic outlook, “Some participants viewed risks to the downside for real GDP growth as having decreased, partly because prospects for a sharp slowdown in global economic growth, particularly in China and Europe, had diminished. These improvements notwithstanding, most participants observed that downside risks to the outlook for growth remain.” So, a patient approach would still be warranted for “some time” even given what participants knew at the end of April.

There was no mention of a possible rate cut, indeed “a few” still pointed to the potential need to firm policy if the economy evolved as expected as “the Committee would need to be attentive to the possibility that inflation pressures could build quickly in an environment of tight resource utilization.”

Others were not convinced on the tight economy assessment, as “a few other participants observed that subdued inflation coupled with real wage gains roughly in line with productivity growth might indicate that resource utilization was not as high as the recent low readings of the unemployment rate by themselves would suggest.”

Beyond that, “Several participants commented that if inflation did not show signs of moving up over coming quarters, there was a risk that inflation expectations could become anchored at levels below those consistent with the Committee’s symmetric 2 percent objective—a development that could make it more difficult to achieve the 2 percent inflation objective on a sustainable basis over the longer run.”

Bottom Line: Watching Incoming Data and Risks

Taken together, there is little appetite for a near-term hike, nor is there much appetite for a preemptive cut in the Minutes, nor in recent Fedspeak.

It’s worth noting that even dove Bullard noted Monday that China-U.S. tariffs might have to stay in place for six months before weighing on Fed policy—a benign view that is not the market’s current conclusion.

On Monday, Fed Chair Powell noted that the outcome of trade talks are unknown, and that it would be “premature” to judge or act. The central bank took a similar tack with tax cuts, adjusting forecasts and acting only after legislation was passed and the early economic impacts became clearer.

There will be changes ahead, but over the near term it’s a holding pattern as the U.S. economy and labor market perform well, with investors and the Fed attentive to risks in an environment of moderate inflation pressures.