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MORNING BRIEFING
July 17, 2017

Bulls Flying with Doves

See the collection of the individual charts linked below.

(1) Brainard: Leading the dovish pack. (2) Melting up with the doves. (3) Dollar matters to the Fed for a change. (4) Flatter Phillips curve. (5) Still undershooting inflation target. (6) Balancing rate hikes with balance-sheet tapering. (7) Brainard and Yellen agree that neutral federal funds rate is in sight. (8) More Fed fairy dust charges up bull again. (9) Swan song. (10) Not surprisingly, Fed favors discretion over rules.

The Fed I: Brainard's Dovish Speech. The bull market in stocks is flying high with the doves. On the other hand, the dollar is losing altitude. Last week, the S&P 500 rose 1.4% to 2459.27, setting yet another new record high (*Fig. 1*). The trade-weighted dollar dropped 1.2% last week to the lowest reading since September 7 of last year (*Fig. 2*). The S&P 500 is right smack dab in the middle of our 2400-2500 forecast for yearend, and it is only July! On March, Joe and I raised the odds of a melt-up scenario from 30% to 40%, lowering the odds of a gradual ascent in stock prices from 60% to 40%. We raised the odds of a meltdown from 10% to 20%, since a melt-up is typically followed by a meltdown. We've been discussing the likelihood of a melt-up since the start of 2013, when the economy didn't go over the widely feared "fiscal cliff."

The financial press attributed the latest bullish stock market advance to the dovish congressional testimony of Fed Chair Janet Yellen on Wednesday and Thursday. Melissa and I agree, but we also credit Fed Governor Lael Brainard's dovish speech on Tuesday. Though it was blandly titled "Cross-Border Spillovers of Balance Sheet Normalization," the speech significantly discussed the impact of monetary policy tightening on the dollar. In the past, Fed officials rarely discussed the impact of their policies on the dollar. Now, it seems, they are strongly signaling that they don't want to see the dollar strengthen as they continue to normalize monetary policy.

In her speech, Brainard focused on the Fed's policy options. Specifically, she weighed the effects of normalizing through the federal funds rate (by hiking it), the balance sheet (by shrinking it), or both in tandem. She discussed several scenarios in a "stylized model" that would have different implications for exchange-rate effects depending on the monetary policy approach. She noted that it is "the commitment adopted by many leading nations to set monetary policy to achieve domestic objectives such that the exchange rate would not be a primary consideration in the setting of monetary policy." However, she mentioned "exchange rate" 47 times in her comments and footnotes, obviously acknowledging that the foreign exchange value of the dollar is now an important consideration.

Brainard stated: "The balance sheet might affect certain aspects of the economy and financial markets differently than the short-term rate due to the fact that the balance sheet more directly affects term premiums on longer-term securities, while the short-term rate more directly affects money market rates. As a result, similar to the domestic effects, while the international spillovers of conventional and unconventional monetary policy may operate broadly similarly, the relative magnitude of the different channels may be sufficiently different that, on net, the two policy strategies have distinct effects." Brainard seemed to conclude that it is best to lean toward the balance-sheet approach, as it should have fewer negative transmission effects, in her opinion (*Fig. 3*).

Oftentimes, Brainard's remarks tend to foreshadow Fed Chair Janet Yellen's thinking and the evolving consensus on the FOMC. Consider the following:

(1) *Inflationary pressures muted.* In a 3/7/16 speech, Brainard anticipated FOMC policy as follows: "If the labor market continues to improve, higher resource utilization should also put some upward pressure on inflation going forward. However, the effect of resource utilization on inflation is estimated to be much lower today than in past decades." She also said that the FOMC should put a high premium on evidence that actual inflation is firming sustainably before moving to tighten monetary policy. The FOMC waited until the end of 2016 to raise the federal funds rate by 25bps, the same one-and-done hike as at the end of 2015 (*Fig. 4*).

(2) *Phillips curve flatter.* In a 9/12/16 speech, she opined that the Phillips curve has flattened, "appearing to be a less reliable guidepost than in the past." In other words, inflation has remained remarkably subdued given the drop in the unemployment rate. More specifically, she said, "The apparent flatness of the Phillips curve together with evidence that inflation expectations may have softened on the downside and the persistent undershooting of inflation relative to our target should be important considerations in our policy deliberations. In particular, to the extent that the effect on inflation of further gradual tightening in labor market conditions is likely to be moderate and gradual, the case to tighten policy preemptively is less compelling."

The CPI inflation rate was back below 2.0% during June, with the headline rate down to 1.6% y/y and the core rate down to 1.7% (*Fig. 5*). This suggests that the core PCED rate, which was 1.4% during May, might have been even lower in June, since it tends to fall consistently below the core CPI inflation rate (*Fig. 6*).

Meanwhile, wage inflation remains remarkably subdued around 2.5% even though the unemployment rate has been below 4.5% for the past three months through June (*Fig. 7*). Job openings are plentiful (*Fig. 8*). When the labor market was this tight by these measures during the past three business cycles, wage inflation was around 4.0%.

(3) *Neutral interest rate lower.* In her latest speech, Brainard said, "the neutral level of the federal funds rate is likely to remain close to zero in real terms over the medium term." Considering that, there would not be "much more additional work to do on moving to a neutral stance" from the moderately accommodative stance now. She added that the FOMC "decided to delay balance sheet normalization until the federal funds rate had reached a high enough level to enable it to be cut materially if economic conditions deteriorate."

The FOMC hiked the federal funds rate again twice this year so far to a target range of 1.00%-1.25%. The federal funds future market is anticipating one more hike over the next 12 months (*Fig. 9*). We agree, but expect the federal funds rate to flatten out around 2.00% at the end of next year through 2019. Meanwhile, the real interest rate in the 10-year Treasury TIPS market continues to fluctuate between 0.00% and 0.80%, as it has since late 2013 (*Fig. 10*).

The Fed II: Yellen's Dovish Testimony. Fed Chair Janet Yellen still knows how to sprinkle the fairy dust. When the Fairy Godmother of the Bull Market speaks, investors listen and get more bullish. The Dow Jones hit a new record high following her semi-annual testimony to Congress on Wednesday, and the S&P 500 did so on Friday. On numerous previous occasions, we have observed that stock prices tend to rise after Yellen speaks (*Fig. 11* and *Fig. 12*).

Confirming Brainard's comments, Yellen said that her goal is to reach a neutral level of interest rates, which is lower than it was historically and not so far off from where the federal funds rate is set now.

Later this year, the FOMC is also expected to begin normalizing its balance sheet, she said, as Brainard discussed a few days before.

(1) *Balance sheet*. In her opening remarks, Yellen rehashed the outline for the plan for balance-sheet normalization, which was previously provided in greater detail in an addendum with the 6/14 FOMC policy statement. Yellen's testimony on the subject seemed rather subdued. She said: "The Committee intends to gradually reduce the Federal Reserve's securities holdings by decreasing its reinvestment of the principal payments it receives from the securities held in the System Open Market Account. Specifically, such payments will be reinvested only to the extent that they exceed gradually rising caps. Initially, these caps will be set at relatively low levels to limit the volume of securities that private investors will have to absorb." She added: "[W]e do not intend to use the balance sheet as an active tool for monetary policy in normal times."

Brainard had suggested a similarly easy-does-it approach toward balance-sheet normalization in her speech: "In light of recent policy moves, I consider normalization of the federal funds rate to be well under way. If the data continue to confirm a strong labor market and firming economic activity, I believe it would be appropriate relatively soon to commence the gradual and predictable process of allowing the balance sheet to run off."

(2) *Balanced view*. Inflation continues to be the sticking point for the Fed's approach to accommodation in terms of its dual mandate to maintain its stability and maximum employment. The headline unemployment rate has dropped substantially since the Great Recession. At the same time, inflation has remained remarkably low.

In her written testimony, Yellen observed: "It appears that the recent lower readings on inflation are partly the result of a few unusual reductions in certain categories of prices; these reductions will hold 12-month inflation down until they drop out of the calculation." During the Q&A with lawmakers, Yellen cited temporary influences holding down prices including mobile-phone plans and prescription drugs. She added: "It is premature to reach the judgment that we are not on the path to 2% inflation over the next couple of years."

Yellen's remarks on inflation seemed slightly more dovish than during her 6/14 press conference when she harped on temporary influences holding down prices, including mobile-phone plans and prescription drugs. Bloomberg observed that Yellen used the word "partly" to describe the impact of the temporary effects this time versus the word "significantly" last time. Balancing out her remarks, however, Yellen said: "[Several] developments should increase resource utilization somewhat further, thereby fostering a stronger pace of wage and price increases." That effect is uncertain, though, in her view.

The Fed III: A Dove's Swan Song. Commencing the balance-sheet unwinding while potentially raising interest rates closer to neutral at the same time could be Yellen's final act as Fed chair. For now, the markets don't seem too concerned about who will replace the Fed chair when her term is up in February 2018 if she isn't reappointed.

Politico reported on 7/11 that National Economic Council Director Gary Cohn could be Trump's top choice to replace Yellen. But Cohn might not want the job. Also, Cohn's nomination might encounter resistance from the Senate given his close ties to the banking industry as a former Goldman Sachs executive. No matter what, Trump will probably look to nominate a Fed chair who will maintain stimulative policies at least until fiscal policies can take over. Politico observed that Cohn is "viewed as closer to Yellen's preference for gradual rate hikes."

By the way, though Fed officials proclaim their independence from politics, Brainard is a Democrat with a history of working for and contributing to the Democratic party. She doesn't seem to be going anywhere soon, as her term doesn't end until 2026, but her influence could be overshadowed by a new boss. It sure would be interesting to see Cohn step into the Fed chair role. Despite his current role in the Trump administration, Cohn is a registered Democrat, and he has no academic, economic, or monetary policy background. In any case, Yellen is the boss for now, and she seems to highly value Brainard's opinion, which coincides with her own.

The Fed IV: Dove's Rule. The FOMC's projections support the views of Yellen and Brainard. On June 14, the FOMC set the federal funds rate in a target range of 1.00% to 1.25%. According to the Taylor Rule, the federal funds rate should be set at about 2.90%, as of Q2 based on the default inputs into the Atlanta Fed's utility on its website. That figure happens to approximate the Fed's latest median projection for the federal funds rate by 2019. For 2017, the median projection is just 1.40%.

The Fed's 7/7 *Monetary Policy Report* (*MPR*), which accompanied Yellen's congressional testimony, included a section titled "Monetary Policy Rules and Their Role in the Federal Reserve's Policy Process." The basic message is that the FOMC pays attention to models like the Taylor Rule, which prescribe the level of the federal funds rate, but the Fed's policymakers believe that these models ignore too many "considerations" that require their judgment when setting the federal funds rate. In the "rules versus discretion" debate, they clearly favor the latter approach. Here are some key points from the *MPR*:

(1) *Too simple.* "Each rule takes into account two gaps—the difference between inflation and its objective (2 percent as measured by the price index for personal consumption expenditures [PCE], in the case of the Federal Reserve) as well as the difference between the rate of unemployment in the longer run (u^{LR}) and the current unemployment rate. … The small number of variables involved in policy rules makes them easy to use. However, the U.S. economy is highly complex, and these rules, by their very nature, do not capture that complexity."

(2) *Measuring slack.* "[W]hile the unemployment rate is an important measure of the state of the labor market, it often lags business cycle developments and does not provide a complete measure of slack or tightness. In practice, Federal Open Market Committee (FOMC) policymakers examine a great deal of information about the labor market to gauge its health; this information includes broader measures of labor underutilization, the labor force participation rate, employment, hours worked, and the rates of job openings, hiring, layoffs, and quits, as well as anecdotal information not easily reduced to numerical indexes." A footnote makes reference to the Fed's Labor Market Conditions Index, which includes 19 components.

(3) *Measuring inflation.* "[T]here are many measures of inflation, and they do not always move together or by the same amount. … For example, inflation as measured by the consumer price index (or CPI) has generally been somewhat higher historically than inflation measured using the PCE price index (the index to which the FOMC's 2 percent longer run inflation objective refers). Core inflation, meaning inflation excluding changes in food and energy prices, is less volatile than headline inflation and is often used in estimating monetary policy rules because it has historically been a good predictor of future headline inflation."

(4) *Broader considerations.* "Finally, monetary policy rules do not take account of broader risk considerations. For example, policymakers routinely assess risks to financial stability. Furthermore, over the past few years, with the federal funds rate still close to zero, the FOMC has recognized that it would have limited scope to respond to an unexpected weakening in the economy by lowering short-term interest rates."

(5) *Different strokes.* “Different monetary policy rules often offer quite different prescriptions for the federal funds rate; moreover, there is no obvious metric for favoring one rule over another.”

CALENDARS

US. Mon: Empire State Manufacturing Index 15.0. **Tues:** Import & Export Prices -0.3%/0.0%, Housing Market Index 68, Treasure International Capital. (Bloomberg estimates)

Global. Mon: Eurozone Headline & Core CPI 1.3%/1.1% y/y, China GDP 1.7%q/q/6.8%y/y, China Retail Sales 10.6% y/y, China Industrial Production 6.5% y/y. **Tues:** Germany ZEW Economic Sentiment 18, UK Headline & Core CPI 2.9%/2.6% y/y, ECB Bank Lending Survey, RBA July Meeting Minutes. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index rose 1.4% last week for its best gain in seven weeks, ranking 38th of the 49 markets as 42 rose in US dollar terms—compared to 22nd a week earlier, when it was unchanged as 21 markets moved higher. The AC World ex-US index outperformed the US MSCI for just the second time in six weeks, surging 2.9% compared to a 0.5% decline a week earlier. EM Latin America had its best performance in over a year and led all regions with a jump of 6.8%, followed by BRIC (5.1%), EMEA (5.0), EM Eastern Europe (4.3), and EM Asia (3.7). EAFE and EMU were the week’s worst-performing regions, albeit with gains of 2.4%. Brazil (8.4) was the best-performing country, followed by Turkey (7.8), South Africa (7.7), Norway (6.0), and Mexico (5.5). Argentina (-1.0) was the worst performer, followed by Pakistan (-0.7), Morocco (-0.4), Sri Lanka (-0.4), and Jordan (-0.4). The US MSCI is up 10.0% ytd, with its ranking falling w/w to 37/49 from 33/49, and continues to trail the AC World ex-US (15.0) on a ytd basis. Forty-seven of the 49 markets are positive ytd, led by Argentina (39.5), Poland (37.2), Austria (35.1), Greece (34.4), and Turkey (34.2). The worst country performers ytd: Pakistan (-12.6), Russia (-11.8), Jordan (0.3), Canada (4.9), and Morocco (6.3). EM Asia is the best-performing region ytd with a gain of 25.7%, ahead of BRIC (21.0), EMU (18.6) and EM Latin America (16.0). The worst-performing regions: EM Eastern Europe (-0.1), EMEA (4.8), and EAFE (13.9).

S&P 1500/500/400/600 Performance (*link*): All three indexes rose last week as LargeCap’s 1.4% gain outperformed MidCap (1.0%) and SmallCap (0.9) for the fourth time in five weeks. Twenty-five of the 33 sectors rose w/w, up from 12 rising a week earlier. LargeCap ended the week at its first record high since June 19, but MidCap was 0.2% below its June 13 high, and SmallCap was 0.4% below its June 13 peak. Energy and Tech shares dominated last week’s top gainers: SmallCap Energy (6.5%), MidCap Energy (5.0), LargeCap Tech (3.8), SmallCap Tech (3.0), MidCap Tech (2.5), MidCap Materials (2.4), and LargeCap Energy (2.1). Telecom dominated last week’s worst performers: SmallCap Telecom (-2.8), MidCap Telecom (-2.5), and LargeCap Telecom (-1.0). Twenty-three of the 33 sectors are positive ytd, with LargeCap (9.8) beating MidCap (6.3) and both easily ahead of SmallCap (3.0). The biggest sector gainers ytd: MidCap Health Care (22.8), LargeCap Tech (21.4), SmallCap Health Care (20.1), LargeCap Health Care (16.2), and MidCap Tech (15.1). Energy and Telecom dominate the worst performers ytd: MidCap Telecom (-38.4), SmallCap Energy (-36.0), MidCap Energy (-29.9), LargeCap Telecom (-15.6), and LargeCap Energy (-13.1).

S&P 500 Sectors and Industries Performance (*link*): Nine of the 11 sectors rose last week and four outperformed the S&P 500’s 1.4% gain. This compares to four sectors rising a week earlier, when four outperformed the S&P 500’s 0.1% gain. Tech’s 3.8% gain made it the best-performing sector for the first time in nine weeks, ahead of the gains for these sectors: Energy (2.1%), Materials (2.0), and Real

Estate (1.5). Telecom (-1.0) was the worst-performing sector for a second week, followed by Financials (-0.6), Consumer Staples (0.3), Utilities (0.8), Health Care (1.0), Consumer Discretionary (1.1), and Industrials (1.2). Telecom has been the worst performer recently with a four-week losing streak. So far in 2017, nine of the 11 sectors are higher, and five have outperformed the S&P 500's 9.8% gain. The best performers in 2017 to date: Tech (21.4), Health Care (16.2), Materials (10.9), Consumer Discretionary (10.8), and Industrials (10.3). The six sectors underperforming the S&P 500: Telecom (-15.6), Energy (-13.1), Real Estate (4.6), Consumer Staples (6.1), Utilities (6.8), and Financials (6.8).

Commodities Performance (*link*): Sixteen of the 24 commodities we follow rose last week as the S&P GSCI commodities index rose 2.2%, up from nine commodities rising a week earlier when the GSCI index fell 1.8%. Energy commodities dominated the week's best performers: Nickel (7.5%), Feeder Cattle (6.2), Crude Oil (5.7), Brent Crude (5.3), Heating Oil (4.9), GasOil (4.7), and Natural Gas (3.7). Last week's laggards: Lean Hogs (-19.3), Kansas Wheat (-5.4), Wheat (-4.5), and Corn (-4.1). The best performers in 2017 so far: Wheat (25.2), Feeder Cattle (23.2), Kansas Wheat (22.7), Lead (15.2), and Aluminum (13.8). The energy-related commodities still dominate this year's laggards: Sugar (-26.7), Natural Gas (-20.2), Brent Crude (-13.5), Crude Oil (-13.0), Heating Oil (-12.1), and GasOil (-11.2).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 8/24 commodities, 3/9 global stock indexes, and 9/33 US stock indexes compared to 8/24, 3/9, and 9/33 rising a week earlier, respectively. Eleven commodities trade above their 200-dmas, unchanged from a week earlier as Gold turned positive w/w and Lean Hogs turned negative. Commodities' average spread rose w/w to -0.5% from -0.8%. Among assets, Commodities walked away the top three spots last week: Wheat leads all commodities and all assets at 17.0% above its 200-dma, followed by Kansas Wheat (15.9%) and Feeder Cattle (15.8). Nickel (-5.0) performed the best of all commodities and all assets last week as it improved 6.8ppts. Sugar (-21.4) trades the lowest of all commodities, but Lean Hogs (-1.3) tumbled 25.0ppts last week for the worst performance of all commodities and all assets. The global indexes trade at an average of 6.1% above their 200-dmas, up from 4.7% above in the prior week. Eight of the nine global indexes trade above their 200-dmas, up from seven a week earlier as Brazil (3.2) surged 4.7ppts for the best performance among global assets and turned positive for the first time in six weeks. South Korea (12.6) leads the global indexes, followed by Chile (10.7) and China (7.6). Canada (-1.0) and UK (2.4) are trading the lowest relative to their 200-dmas of the global assets, but Indonesia (6.5) performed the worst of its country peers last week, rising only 0.1ppt. The US indexes trade at an average of 1.8% above their 200-dmas, with 25 of the 33 sectors above, up from a 1.0% average a week earlier, when 25 sectors were above. SmallCap Telecom turned down w/w and MidCap Real Estate turned positive. MidCap Health Care leads all US stock indexes at 14.2% above its 200-dma, followed by SmallCap Health Care (13.5). SmallCap Energy improved the most among the US stock indexes, by 5.1ppts to -24.3%. MidCap Telecom trades 27.5% below its 200-dma, now the lowest among the US stock indexes and all assets, but SmallCap Telecom (-0.7) fell 3.2ppts w/w for the worst performance of the US stock indexes.

S&P 500 Technical Indicators (*link*): The S&P 500 index remained in a Golden Cross last week for a 64th week (after 17 weeks in a Death Cross). However, the index's 50-day moving average (50-dma) relative to its 200-dma weakened for a second week, falling to 4.7% above its 200-dma from 4.8%. That's down from a 34-month high of 5.4% in early April and compares to a six-month low of 2.0% in early December and a 52-month low of -4.5% in March 2016. The S&P 500's 50-dma moved higher for a 34th week as the index closed above its 50-dma for a 12th week, after trading below for two weeks during late April for the first time since the November election. The S&P 500 improved to 1.6% above its rising 50-dma from 0.4%, but is down from an 11-week high of 2.5% in early June. These readings compare to a 23-week low of -1.0% in mid-April, a 38-week high of 4.8% on December 13, and a 52-month high of 6.2% in March 2016. The S&P 500 jumped to a three-week high of 6.3% above its rising 200-dma last week from 5.3% above the week before, but is down from an 11-week high of 7.4% in early June. That's up from mid-April's 19-week low of 4.2%, but down from a 38-month high of 9.4% on March 1. The 50-dma and 200-dma both rose together for a 32nd week.

S&P 500 Sectors Technical Indicators (*link*): Nine of the 11 sectors improved w/w relative to their 50-dmas and 200-dmas (all but Financials and Telecom). Seven of the 11 sectors trade above their 50-day moving averages (50-dmas), up from four a week earlier as these three turned positive w/w: Consumer Discretionary, Real Estate, and Tech. These four sectors remain below their 50-dmas: Consumer Staples, Energy, Telecom, and Utilities. Energy was below for a 26th straight week; Telecom has been below in 16 of the past 17 weeks; Consumer Staples for a fourth; and Utilities for a third week. During mid-April, just three sectors were above their 50-dmas, which was the lowest since the election. All 11 sectors had been above their 50-dmas during mid-January, and all 11 were below the week before the election, for the first time since December 11, 2015. The longer-term picture is better: Nine of the 11 sectors were above their 200-dmas last week, unchanged from a week earlier, as Energy remained below its 200-dma for a 21st week, and Telecom was below for a 17th week. Nine sectors are in a Golden Cross, with 50-dmas higher than their 200-dmas, unchanged from a week earlier and leaving Energy and Telecom still out of the club. All 11 had been in a Golden Cross during a 21-week streak that ended October 24, the longest such stretch since October 2014. Eight of the 11 sectors have rising 50-dmas, up from six a week earlier as Consumer Discretionary and Utilities turned up w/w. Energy's 50-dma dropped for a 23rd week, Telecom's fell for a 22nd, and Consumer Staples for a second. Nine sectors have rising 200-dmas, up from eight a week earlier as Real Estate turned up. These two sectors continued their 200-dma downtrends: Telecom's fell for a 17th week, and Energy's for a 12th.

US ECONOMIC INDICATORS

Retail Sales (*link*): Retail sales in June remain stalled around record highs, falling unexpectedly for the second month, though we estimate real retail sales rose for the fourth straight month to new highs. Headline sales fell 0.2%, while May's (to -0.1% from -0.3%) decline was smaller than first estimated. Core retail sales ticked down 0.1% after no change in May; sales had jumped three of the first four months of the year by 1.7%. (BEA uses this core retail sales measure to estimate personal consumption expenditures each month.) Meanwhile, we estimate real retail sales rose 0.2% in June and 1.8% the past four months. These sales accelerated by 4.9% (saar) in the three months through June, based on the three-month average, up from March's 0.7% and the largest increase since last summer. Real core retail sales expanded 0.2% m/m and 7.8% (saar) over the comparable three-month period—the strongest three-month growth rate since March 2015, suggesting that real consumer spending will accelerate this quarter from Q1's anemic pace. Six of the 13 major nominal retail sales categories fell in June, while seven rose. The biggest declines were posted by miscellaneous store retailers (-3.1%) and gasoline service stations (-1.3); sales for restaurants (-0.6), sporting goods stores (-0.6), food & beverage stores (-0.4), and clothing retailers (-0.1) were fractionally lower. Gains recorded by retailers fell within a narrow band of 0.1% to 0.5%, with building materials (0.5), nonstore (0.4), and general merchandise (0.4) sales at the top of the pack. Within general merchandise, however, department-store sales dropped 0.7% after a 0.8% loss in May.

Business Sales & Inventories (*link*): Both nominal business sales in May and real sales in April remained stalled around record highs. The details: Nominal manufacturing & trade sales (MTS) slipped 0.2% in May after no change in April and a 0.1% loss in March; these sales were up 5.1% y/y. Inflation-adjusted MTS fell 0.3% in April after gains of 0.1% in each of the prior two months; these sales were up 2.7% y/y. Real sales of retailers climbed to a new record high in April, while wholesalers' remained stalled at record highs; manufacturers' sales gave back some of their recent gains. April's real inventories-to-sales ratio remained at 1.41, matching December's reading, which was the lowest since January 2015; it was at a cyclical high of 1.45 last May. May's nominal inventories-to-sales ratio moved up to 1.38 after holding at a two-year low of 1.37 for five months; it had peaked at 1.42 during the first four months of 2016.

Industrial Production (*link*): Industrial production rose in June for the fifth straight month, boosted by continued gains in mining output and a rebound in factory production following May's loss. Mining output rose for the fifth time this year, up 1.6% m/m and 8.9% ytd. Manufacturing production recovered 0.2% last month after a 0.4% loss and a 1.0% gain (the most since February 2014) the prior two months. It expanded 1.3% (saar) in the three months through June, based on the three-month average, a percentage point better than May's comparable period but below February's peak of 2.9%. June's gain in manufacturing production was driven by a 1.0% rebound in consumer durable goods output; within business equipment, production of industrial (0.3) and transit (0.1) equipment also moved higher. The yearly growth rate in manufacturing production (1.2) continued to hover just above 1.0%. Looking ahead to July production, the two manufacturing surveys had conflicting messages: The ISM survey saw their production index (to 62.4 from 57.1) jump back near its cyclical high this month, while Markit's expanded at its slowest pace in nine months.

Capacity Utilization (*link*): The headline capacity utilization rate in June climbed to a 22-month high of 76.6% from 76.4% the previous two months, still 3.3ppts below its long-run (1972-2016) average. Manufacturing's capacity utilization rate edged up to 75.4% after sliding from 75.7% to 75.3% in May. Last month's reading was 3.0ppts below its long-run average. The capacity utilization rate for mining continued to climb, jumping to a 27-month high of 84.8%, though remained below its long-run average; the operating rate for utilities rose was unchanged at its high for the year of 76.4%.

Consumer Sentiment (*link*): The post-election bump appears to be fading, though optimism remains relatively high. The Consumer Sentiment Index fell to 93.1 in mid-July, the lowest reading since just before the election; it was at a cyclical high of 98.5 in January. The present situation component returned to March's cyclical peak of 113.2 after falling to 111.7 in May. The expectations component sank to 80.2, its lowest reading since right before the election; it peaked at 90.3 at the start of the year. "Overall, the recent data follow the same pattern repeatedly recorded around past cyclical peaks: expectations start to post significant declines while assessments of current economic conditions continue to reach new peaks" according to Richard Curtin, director of the University of Michigan consumer survey. However, he went on to say, "To be sure, the data do not suggest an impending recession. ... Much steeper declines in expectations typically precede recessions." Curtin did observe, however, that recent data have dashed hopes for a prolonged period of 3% GDP growth sparked by Trump's victory.

GLOBAL ECONOMIC INDICATORS

European Car Sales (*link*): In June, EU passenger car registrations—a proxy for sales—rose only 2.1 y/y, though in volume terms (about 1.5 million units) recorded its best performance in a decade. Results among the five biggest markets were mixed: Italy (12.9% y/y) posted a double-digit gain in sales, while Spain's (6.5) and France's (1.6) were in single digits; the UK and Germany saw sales fall 4.8% and 3.5%, respectively. Worth noting is the strong performance of the new EU member states, which recorded sales 12.0% above a year ago. Through the first half of 2017, EU sales grew 4.7%, with Italy (8.9%), Spain (7.1), Germany (3.1), and France (3.0) in the plus column and the UK (-1.3) recording a slight decline.

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