MORNING BRIEFING
June 18, 2018

The Strange Case of Dr. Jekyll and Mr. Hyde

See the collection of the individual charts linked below.

(1) Trump's split personality driving stock investors bonkers. (2) Uptrend of monthly indicators suggests Q2 real GDP growth over 4.0%. (3) Jobless claims near record lows. (4) Boom-Bust Barometer at record high. (5) Forward earnings still rising vertically to record highs. (6) Tariffs: From saber-rattling to shooting bullets. (7) Tariffs boosting prices of steel and washing machines. (8) Stocks holding up remarkably well thanks to earnings. (9) Bonds ignoring inflationary signals that may be mostly attributable to rising oil prices, which fell sharply on Friday. (10) The Fed is neither dovish nor hawkish. It is on course. (11) ECB is both hawkish and dovish. (12) BOJ is dovish. (13) Movie review: "Gotti" (- -).

Strategy I: Trump vs Trump. The stock market continues to zig and zag as investors continue to struggle with President Donald Trump's bullish and bearish policy stances. On the one hand, there's Trump, the Deregulator and Tax-Cutter—his benevolent Dr. Jekyll persona. On the other is Trump, the Protectionist—his dark Mr. Hyde. As Dr. Jekyll, Trump has stimulated the US economy and boosted stock prices. As Mr. Hyde, he has unsettled the global economy and depressed stock prices. Consider the following:

(1) *GDP and retail sales*. Below, Debbie discusses May's retail sales report, which was stronger than widely expected. As a result, last Thursday, the Atlanta Fed's GDPNow model raised the Q2 estimate for real GDP growth to 4.8% from 4.6% on June 8 as the estimate for real personal consumption expenditures growth increased to 3.6% from 3.4%. The weekly Consumer Comfort Index has risen this year to the highest readings since 2001 (*Fig. 1*).

As we noted last week, the GDPNow model tends to be too optimistic and to pare the estimate as the release of the actual GDP data approaches. The first official estimate of Q2 real GDP will be reported on July 27. However, the trend of the revisions for Q2 clearly has been rising since early May.

(2) *Jobless claims and Boom-Bust Barometer.* Initial unemployment claims totaled just 218,000 during the June 9 week (*Fig. 2*). That's among the lowest readings this year, which have been the lowest since the early 1970s. As a result, our Boom-Bust Barometer jumped to new record highs this year through early June (*Fig. 3*).

(3) *Forward earnings.* Our Boom-Bust Barometer is highly correlated with S&P 500 forward earnings, which has been dramatically boosted by the cut in the corporate tax rate at the end of last year (*Fig. 4*). Forward earnings is up 14.0% since the end of last year, flying into record-high territory and rapidly closing in on $170 per share, which has been our year-end target!

Multiply that number by a forward P/E of 18, and the S&P would be trading at 3060, close to our 3100 year-end target (*Fig. 5*). At Friday's close of 2780, the forward P/E was 16.6 (*Fig. 6*).

(4) *Tariffs.* Admittedly, our bullish stance on the stock market outlook requires that Jekyll triumphs over

Hyde. The forward P/E has been weighed down by Trump's protectionism. If his tariffs trigger widespread retaliation and an outright global trade war, then earnings will take a dive. We continue to expect that it will all end peaceably. But it isn't heading in that direction right now.

Trump started his protectionist saber-rattling on January 22, when he imposed tariffs on washing machines and solar panels. He next said, on March 1, that he would impose more tariffs as early as next week. It wasn't until May 31, however, that he actually did so, imposing tariffs on aluminum and steel from the European Union, Canada and Mexico. Then last Friday, he slapped tariffs on $34 billion of goods imported from China. The Chinese pulled out their sabers and immediately retaliated by imposing tariffs on the same value of US goods exported to China.

There are many problems with tariffs. First and foremost is that they benefit far fewer people than they harm. They are intended to boost employment in the industries that benefit from such protectionism, but they immediately raise prices of the protected goods for all consumers.

The CPI for laundry equipment has been falling steadily since late 2012 (*Fig. 7*). It jumped 14% from December through May because of the tariff on washing machines and the jump in steel prices. The PPI for steel mill products in the US jumped nearly 10% from February through May after Trump's March 1 threat to impose steel and aluminum tariffs during that month, which he did at the end of May (*Fig. 8*). So why aren't stock prices crashing as protectionist saber-rattling is turning into trade skirmishes, which risk turning into an all-out trade war? Why aren't bond yields soaring on the actual and potential inflationary consequences of tariffs? Good questions.

The S&P 500 is actually up 4.0% ytd (*Fig. 9*). The US MSCI stock price index has recently been outpacing the All Country World ex-US MSCI, particularly in dollars (*Fig. 10*). Nevertheless, the S&P 500 may continue to zig and zag through the summer as the Jekyll and Hyde sides of Trump struggle to dominate his persona. If the market breaks out to new highs, as we expect, that might not happen until after the mid-term congressional elections. Of course, by then, there also has to be some progress in reducing trade tensions.

Meanwhile, the stock market outlook will also be influenced by the path of Fed rate hikes and how that impacts the bond market. We were astonished that the 10-year US Treasury bond yield barely moved when the FOMC announced the 25bps rate hike on Wednesday to 1.75%-2.00%. Granted, it was widely expected, but the yield spread between the two-year and the 10-year Treasury note yields narrowed to just 38bps, the lowest since August 27, 2007 (*Fig. 11*).

Furthermore, inflationary pressures seem to be picking up here and there without rattling the bond market. In the US, the CPI headline inflation rate rose to 2.8% y/y during May, and the core CPI to 2.2% (*Fig. 12*). The ISM prices-paid indexes rose to 79.5 for manufacturing and 68.0 for non-manufacturing in May (*Fig. 13*). In the Eurozone, the headline CPI jumped to 1.9% y/y during May (*Fig. 14*).

However, most of the inflationary pressures may be related to rising oil prices, which fell sharply on Friday, confirming our opinion—as we discussed on Thursday—that the upside may be limited for a while by increasing oil supplies from Saudi Arabia, Russia, and the US. Also, last Thursday, the ECB indicated that while the QE program will be tapered later this year, the Eurozone's central bank is in no rush to raise interest rates, which mostly remain around zero.

The Fed: Staying the Course. Last week, in his 6/13 press conference following the latest FOMC meeting, Federal Reserve Chairman Jerome Powell reiterated that the trajectory of federal funds rate increases will continue to be "gradual," though it will be guided by incoming data. However, the overriding message that Powell delivered is that policy will stay the course for now. Consider the following:

(1) *Ever so slightly faster.* Some Fed watchers harped on the fact that four rather than three rate hikes were included in the Fed's latest Summary of Economic projections for this year. Melissa and I don't think that's such a big deal. As was widely expected, the FOMC decided at the June meeting to hike the federal funds rate another 25bps for the second time this year to a range of 1.75%-2.00%. The median federal funds rate projection for 2018 edged up to 2.40% from March's 2.10% projection, indicating about two more hikes this year rather than one more.

One more Fed official joined the group of those expecting at least four rate increases this year—raising the number to eight of the 15 Fed forecasters. That's up from seven during March, observed the 6/13 *WSJ,* and leaves seven who still expect three hikes or less. Officials also expect to raise rates at a slightly steeper path for 2019, having increased the median federal funds rate projection to 3.10% as of June from 2.90% during March. The median federal funds rate projections for 2020 and the longer run were unchanged at 3.40% and 2.90%, respectively.

(2) *Moving toward neutral.* Some important dovish language was dropped from the June FOMC statement, seemingly signaling a more hawkish tone. However, Powell assured that none of the changes reflect any change in the Fed's policy views. Some analysts also assumed that Powell's announcement that he will hold a press conference after every FOMC decision next year indicated a more hawkish outlook. Powell said that the intent is simply to enhance Fed communications.

Previous FOMC statements had stated that "[t]he federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run." Such levels are often referred to as the "neutral rate of interest." The neutral rate is the level at which monetary policy neither boosts nor slows the economy, but keeps it moving forward on an even keel. The trouble is that the neutral rate cannot be observed with any sort of precision.

Powell said that he believes the neutral rate of interest is in the range of 2.25%-3.50%, but probably closest to the Fed's median federal funds rate projection of 2.90% for the longer run. That's "sort of a full percentage point away from where fed funds is going to trade after" the latest decision, he observed. In other words, the FOMC still needs to do about four more 25bps hikes to get to neutral.

(3) *Inflation not there yet.* Powell seems comfortable with the below-neutral rate for now even though the US economy is "in great shape," with "strong" labor markets. So it's safe to say that higher inflation isn't keeping him up at night. "I would not say that anything meaningful has happened since March to really change the way I am thinking about inflation," he said. During April, the core PCE inflation rate, which is the Fed's preferred measure of inflation, reached 1.8% y/y.

He added: "If we thought that inflation were going to take off, obviously, we'd be showing higher rates, but that's not what we think will happen." Powell explained: "The recent inflation data have been encouraging, but after many years of inflation below our objective, we do not want to declare victory. We want to ensure that inflation remains near our symmetric 2.00 percent longer-run goal on a sustained basis."

"Sustained" is the key word here, because it confirms—as we've previously discussed—that the Fed won't change course even if inflation slightly overshoots the 2.0% target for a while. The Fed's median core PCE inflation projections for 2019 and 2020 both assume 2.1% y/y. Although above the 2.0% target, the projections still have the federal funds rate on a gradually rising path.

Powell emphasized that he wants to see "inflation expectations remain well anchored at 2.0 percent." It is important to Powell "that inflation not fall below 2.0 percent" because the implications are that the Fed has "less room to cut" in the event of a future recession. He explained: "If you raise rates too quickly, you're just increasing the likelihood of a recession." Powell thinks that a more "sustainable strategy" is to "go a little slower in raising rates." Interestingly, he also stated: "The last two business cycles didn't end with high inflation. They ended with financial instability, so that's something we need to also keep our eye on."

(4) *Trump turbulence.* Notably, Powell does see fiscal policy as providing "meaningful support to demand." The Summary of Economic Projections forecasts 2.8% GDP growth for 2018. In the longer run, the median federal funds rate projection for GDP growth is a lackluster 1.8%, reflecting the fading of fiscal stimulus benefits. But Powell said that he is uncertain about the supply, specifically the amounts and timing of business investment, especially in the context of the recent trade spats. For now, though, Powell doesn't see trade "in the numbers at all" and would "put it down as more of a risk."

(5) *Flatter yield curve aside.* By the way, the financial press recently has written some concerning articles about the flattening yield curve, which traditionally has indicated that a recession is coming. Powell doesn't seem too worried about it, because that's what happens when the Fed raises the short end of the curve, he said. However, he's unsure about what's keeping a lid on longer-term yields. He speculates that it has something to do with the neutral rate running lower than it has in the past.

(6) *ECB set to exit QE.* Another interesting, but somewhat unsurprising, central bank development came out of the ECB last week. Mario Draghi, during his 6/14 press conference, explained that asset purchases will be halved for three months starting in October, then halted. So they'll drop from the current rate of €30 billion per month to €15 billion per month for October through December, then zero after that. That firm commitment might have been viewed as very hawkish were it not counterbalanced by Draghi's commitment to hold the "key ECB interest rates unchanged … at least through the summer of 2019" and "as long as necessary" to ensure a sustainable path of inflation. The news wasn't entirely new but did provide a firmer commitment from the ECB than we had before.

If anything, the ECB's taper-rate hedge signals that the bank is cautiously optimistic that the apparent recent slowdown in the Eurozone and the Italian political crisis will be temporary bumps in the road. But cautious optimism may not be the bank's only reason for tapering. Not long ago, there was speculation that the ECB may need to taper if it ran out of eligible investment-grade bonds to buy. Further, like the Fed, the ECB needs to provide some room to ease policy in the event of a future slowdown.

(7) *Trip to nowhere*. While the Fed and the ECB are slowly normalizing their monetary policies, the BOJ remains stuck in an ultra-easy mode. Last Friday, it kept its short-term interest-rate target at -0.10% and committed to guiding 10-year government bond yields to zero. The BOJ has had a much rougher go of boosting inflation despite its unconventionally ultra-loose monetary policy.

Movie. "Gotti" (- -) (*link*) is about the life of Mafia boss John Gotti, played by John Travolta. The press called Gotti "Teflon John" because he was indicted several times by the government's prosecutors and beat them each time. He was finally found guilty and went to jail, dying there of cancer. The film has been widely panned as the worst gangster movie ever made. That's true for the jerky first half. It got better in the second half, but too late to save the movie. I've seen a much better documentary about Gotti featuring his son "Junior," who has breakfast every morning at the same bakery in my neighborhood in Long Island. He never sits with his back to the window.

CALENDARS

US. **Mon:** Housing Market Index 78, Bostic, Williams. **Tues:** Housing Starts & Building Permits 1.320mu/1.350mu, Bullard. (*Wall Street Journal* estimates)

Global. **Mon:** Draghi. **Tues:** Eurozone Current Account, BOJ Minutes of Policy Meeting, RBA June Meeting Minutes, Draghi. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index rose 0.1% last week, ranking 12th out of the 49 markets in a week when 12 countries rose in US dollar terms and the AC World ex-US index fell 0.9% for its sixth decline in eight weeks. That compares to the US MSCI's 1.6% rise a week earlier, which ranked 15th as 35 markets rose and the AC World ex-US index gained 0.8%. Most regions fell last week, but EMU performed best with a gain of 0.2%, followed by EAFE (-0.5%). The underperforming regions relative to the AC World ex-US were: EMEA (-2.9), EM Eastern Europe (-2.9), EM Latin America (-1.8), EM Asia (-1.7), and BRIC (-1.2). Italy was the best-performing country as it rose 2.5%, followed by Jordan (2.0), Mexico (1.5), and Belgium (1.3). Of the 29 countries that underperformed the AC World ex-US MSCI last week, Argentina fared the worst as it tumbled 12.9%, followed by Turkey (-6.1), Pakistan (-5.2), Korea (-4.2), and Hungary (-4.1). On a ytd basis, the US MSCI improved w/w to a 4.3% gain and remained steady in the ytd performance ranking at 8/49. The US MSCI is ahead of the AC World ex-US (-2.9) in the ytd period as 36/49 countries and all other regions are in negative territory ytd. EM Asia leads all regions with a decline of 0.4% so far this year and is ahead of BRIC (-0.9), EMU (-2.2), and EAFE (-2.5). EM Latin America (-14.2) is biggest laggard relative to the AC World ex-US's performance, followed by EMEA (-9.9) and EM Eastern Europe (-7.1). The best country performers ytd: Finland (9.1), Colombia (8.6), Jordan (6.5), Peru (6.3), and Israel (5.6). The worst-performing countries ytd: Argentina (-35.4), Turkey (-34.9), Brazil (-19.5), the Philippines (-18.3), and Hungary (-17.1).

S&P 1500/500/400/600 Performance (*link*): These three market-cap indexes were mixed last week, but SmallCap rose for a seventh straight week, LargeCap barely rose for a fourth week, and MidCap registered its first decline in seven weeks. SmallCap performed the best with a gain of 0.1%, ahead of LargeCap (0.0%) and MidCap (-0.4). SmallCap is down negligibly from its record high on Tuesday, by just 0.2%. MidCap is down 0.6% from its Tuesday record high, which was among its first since late January. However, LargeCap remains 3.2% below its late-January record high. Seventeen of the 33 sectors rose in the latest week, down from 28 rising a week earlier and the lowest count in 10 weeks. The best performers in the latest week: SmallCap Telecom (5.0), SmallCap Consumer Staples (3.2), LargeCap Utilities (2.6), MidCap Health Care (2.4), and LargeCap Consumer Discretionary (2.2). Energy dominated the biggest underperformers for the week: SmallCap Energy (-4.5), MidCap Energy (-4.4), LargeCap Energy (-3.1), MidCap Financials (-2.6), and MidCap Materials (-2.3). LargeCap is now up 4.0% ytd, trailing MidCap's 4.8% and SmallCap's 11.0% gains. Twenty sectors are now positive to date in 2018, down from 24 a week earlier and up from just three in early February. The best-performing sectors ytd: SmallCap Health Care (31.8), MidCap Health Care (21.9), LargeCap Tech (14.1), LargeCap Consumer Discretionary (13.7), and SmallCap Tech (12.1). The worst performers ytd: LargeCap Telecom (-11.4), LargeCap Consumer Staples (-9.7), LargeCap Utilities (-6.0), LargeCap Real Estate (-4.3), and SmallCap Real Estate (-4.1).

S&P 500 Sectors and Industries Performance (*link*): Five sectors rose last week and outperformed the S&P 500's relatively flat performance. That compares to 10 rising a week earlier, when six outperformed the S&P 500's 1.6% rise. Utilities was the best-performing sector with a 2.6% gain, ahead of the performances of Consumer Discretionary (2.2%), Consumer Staples (1.9), Health Care (0.8), and Tech (0.5). Energy was the biggest underperformer with a drop of 3.1%, followed by Telecom (-2.0), Financials (-1.9), Industrials (-1.4), Materials (-1.4), and Real Estate (-1.2). Just four sectors are in the plus column so far in 2018, down from seven a week earlier and down from nine in early March. Just two sectors are ahead of the S&P 500's 4.0% ytd gain: Tech (14.1) and Consumer Discretionary (13.7). The nine ytd underperformers: Telecom (-11.4), Consumer Staples (-9.7), Utilities (-6.0), Real Estate (-4.3), Financials (-1.6), Materials (-1.2), Industrials (-1.0), Energy (2.6), and Health Care (3.5).

Commodities Performance (*link*): The S&P GSCI index tumbled 2.6% w/w for its worst drop in 18 weeks as just three of the 24 commodities that we follow moved higher, the lowest count since early December. That compares to last week's 0.2% rise when 11/24 commodities rose. Last week's strongest performers: Cocoa (4.6), Natural Gas (4.3), Feeder Cattle (0.5), Sugar (-0.1), and Coffee (-0.5). Last week's biggest decliners: Soybeans (-4.8), Aluminum (-4.7), Unleaded Gasoline (-4.7), Cotton (-4.4), and Brent Crude (-4.3). The S&P GSCI commodities index is up 4.8% ytd and near its highest level since December 2014, but remains nearly 50% below its record high in July 2008 just before the financial crisis. The top performer so far in 2018 is Cocoa (33.1), followed by Kansas Wheat (25.0), Wheat (20.3), Nickel (19.0), and Cotton (14.3). The biggest laggards of 2018 to date: Sugar (-18.5), Live Cattle (-13.8), Zinc (-7.4), Coffee (-6.9), and Silver (-3.4).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 4/24 commodities, 3/9 global stock indexes, and 16/33 US stock indexes, compared to 10/24 commodities, 7/9 global stock indexes, and 28/33 US stock indexes rising a week earlier. Commodities' average spread fell w/w to 3.6% from 6.0%. Sixteen commodities trade above their 200-dmas, down from 17 a week earlier. Nickel now leads all commodities at 17.6% above its 200-dma, followed by Cotton (14.8%), which tumbled 6.0ppts for last week's worst performance among commodities. Cocoa rose 4.4ppts to 12.5% for the best w/w performance among commodities. Live Cattle trades at 9.1% below its 200-dma and is now the lowest of all commodities. The global indexes trade at an average of 1.2% below their 200-dmas, down from 0.7% below in the prior week. Four of the nine global indexes trade above their 200-dmas, unchanged from a week earlier. Japan (3.3) now leads the global indexes, just a hair ahead of Canada (3.2), but Germany (1.7) gained 1.8ppts for the best w/w improvement among global assets. Brazil (-10.8) is now the biggest laggard among global indexes and all assets, as it dropped 2.7ppts w/w for the biggest decline among global indexes. The US indexes trade at an average of 5.1% above their 200-dmas, with 26 of the 33 sectors above, down from 5.4% a week earlier, when 27 sectors were above. SmallCap Health Care (22.9) continues to lead the US stock indexes and all assets, but SmallCap Telecom (9.8) rose 5.0ppts w/w for the biggest gain among US stock indexes and all assets last week. LargeCap Telecom (-4.7) now trades the lowest among all US stock indexes, but MidCap Energy (12.3) fell 6.1ppts w/w for the worst performance among US stock indexes and all assets.

S&P 500 Technical Indicators (*link*): The S&P 500 price index was essentially flat last week and weakened relative to both its short-term 50-day moving average (50-dma) trend line and its long-term 200-dma for the first time in four weeks. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 112th straight week (after 17 weeks in a Death Cross) as the index's 50-dma relative to its 200-dma improved for a second week following 17 weeks of deterioration. That Golden Cross reading is still well below its 55-month high of 7.2% in early February and compares to a 25-month low of 1.0% at the end of May and a four-year low of -4.5% in March 2016. The S&P 500's 50-dma rose for a third week, but has fallen in eight of the past 13 weeks. It had fallen for four weeks through mid-April for its worst performance since before the 2016 election. The index fell to 2.8% above its rising 50-dma from an 18-week high of 3.4% above a week earlier. That compares to a 25-month low of 5.6% below its falling 50-dma near the end of March and a two-year high of 6.2% above its rising 50-dma on January 29. The 200-dma continued to rise, as it has done since May 2016, but near the slowest pace since October 2011. The S&P 500 appears to have successfully tested its 200-dma again recently, but dropped to 4.4% above its rising 200-dma from an 11-week high of 4.6% above a week earlier. That compares to 0.6% below its rising 200-dma on April 3 (the lowest reading since June 2016), a seven-year high of 13.5% above its 200-dma on January 29, and a four-year low of -10.1% in August 2015.

S&P 500 Sectors Technical Indicators (*link*): Among the 11 S&P 500 sectors, last week saw four improve relative to their 50-dmas and 10 relative to their 200-dmas: Consumer Discretionary, Consumer Staples, Health Care, and Utilities. Seven sectors now trade above their 50-dmas, down from 10 a week earlier, as Energy, Financials, and Telecom moved below in the latest week. Utilities remained below its 50-dma for a fifth week. All 11 sectors had been trading below their 50-dmas at the end of March (a first since February 2016). The longer-term picture—i.e., relative to 200-dmas—shows 6/11 sectors trading above, down from eight a week earlier, as Financials and Real Estate fell into negative territory. That's up from just four sectors trading above their 200-dmas in early May (which matched the lowest count since January 2016). Financials is testing its 200-dma for the first time in 40 weeks after being mostly above since early 2016. Telecom remained below its 200-dma in the latest week, where it's been for most weeks since April 2017, and Utilities was below for a 26th straight week. Sectors trading the longest above their 200-dmas: Tech (above 200-dma for 102 straight weeks), Consumer Discretionary (84 straight weeks), and Energy (10 weeks). Those trading below for a long time include: Consumer Staples was below for a 17th week, Telecom below for a 14th week, and Utilities below for a 26th week. All 11 sectors had been above both their 50-dmas and 200-dmas briefly in mid-December (for the first time since July 2016). Just four sectors are in a Golden Cross (with 50-dmas higher than 200-dmas), the lowest count since March 2016. All 11 had been in a Golden Cross in mid-January for the first time since a 26-week streak ended in October 2016. Telecom was out for an 11th week, Consumer Staples for a 13th, Real Estate for a 19th, and Utilities for a 21st. Health Care was out for only a fifth week, but for the first time since February 2017. Eight sectors have rising 50-dmas now, unchanged from a week earlier. Consumer Staples, Telecom, and Utilities are the only members of the declining 50-dma club. That compares to all 11 sectors with falling 50-dmas during early April (the worst count since before the election in November 2016). Consumer Staples' 50-dma fell for a 19th straight week, Telecom's for a 17th week, and Utilities' for a second week. Nine sectors have rising 200-dmas, unchanged from a week earlier, and up from six in early February, which was the lowest since May 2017. The 200-dma for Utilities fell for a 23rd straight week, Consumer Staples' dropped for a 17th week, and Telecom's fell for a sixth week, though it has been mostly declining since December 2016.

US ECONOMIC INDICATORS

Retail Sales (*link*): Consumers continued their shopping spree in May, pushing retail sales up to another new record high. Sales expanded a larger-than-expected 0.8% last month, after gains of 0.4% (vs 0.3% initial estimate) and 0.7% the prior two months. It was the fourth consecutive advance in sales, which had stalled in December and January. Core retail sales rose 0.5% in May, following an upwardly revised gain in April (to 0.6% from 0.4%) and an unrevised 0.5% increase in March. (The BEA uses this core retail sales measure to estimate personal consumption expenditures each month.) We estimate real retail sales rebounded 0.7% in May after no change in April and a 1.3% jump in March. These sales accelerated 5.1% (saar) during the three months through May, based on the three-month average—virtually back at the pace recorded at the end of last year; this three-month rate had contracted during March and February. We estimate real core retail sales rose for the fourth month, up 0.3% in May after gains of 0.2% and 1.1% the previous two months. These sales jumped 4.9% (saar) over the comparable three-month period—the best pace since last summer. Ten of the 13 major nominal sales categories rose in May, led by sizeable gains in miscellaneous (2.7%), building materials (2.4), gasoline (2.0), clothing (1.3), food & drinking (1.3), and general merchandise (1.2) retailers. Furniture (-2.4) and sporting goods (-1.1) stores weren't swept up in the spending spree, recording declines in sales; food & beverage stores showed flat sales during the month.

Consumer Sentiment (*link*): Consumer sentiment increased for the first time since reaching a 14-year high in March, but the components were mixed. The Consumer Sentiment Index (CSI) edged up to 99.3 in mid-June after retreating the prior two months from March's cyclical high of 101.4 to 98.0 in May. (The CSI has held in a tight eight-point range from 93.4 to 101.4 since the November 2016 election.) The present situation component climbed from 111.8 last to 117.9 this month—the second-highest reading since 2000—as a record number of households mentioned recent income gains. Meanwhile, the expectations component slipped from 89.1 to a five-month low of 87.4 this month on concerns about the new tariffs. "Consumers see the tariffs negatively affecting business prospects," according to Richard Curtin, director of the University of Michigan, consumer survey. "But it did not affect the five-year outlook. Only it was concentrated on the one-year business outlook as though consumers expect the kerfuffle about trade to be over shortly and not lead to a long-lasting trade war." This helped boost the expected one-year inflation rate to a three-year high of 2.9%.

Business Sales & Inventories (*link*): Nominal business sales in April climbed to another new record high, while real sales in March were just shy of a new record high, recovering nearly all of its recent setback. The details: Nominal manufacturing & trade sales (MTS) rose for the third month, after a brief dip into negative territory in January, climbing 0.4% in April and 1.4% over the period. These sales had rebounded 6.2% during the last 10 months of 2017. Inflation-adjusted MTS rebounded 0.8% during the two months ending March, after contracting 1.0% in January from December's record high; it was the first decline in these sales in nine months. The real sales of retailers reached a new record high in March, while wholesalers' sales held below November's record high; manufacturers' sales remained stalled at their cyclical high. March's real inventories-to-sales ratio edged down to 1.41; it's been on a fairly steady downtrend since reaching a cyclical high of 1.47 at the start of 2016. April's nominal inventories-to-sales ratio held at its recent low of 1.35, down from 1.36 during the first two months of this year and considerably below the seven-year high of 1.43 posted two years ago.

Industrial Production (*link*): Headline production unexpectedly fell in May, from April's record high, as manufacturing output was hit by a major fire at a parts supplier for trucks in Eaton Rapids, Michigan. Total production slipped 0.1% last month after rising six of the prior seven months by 4.1%. Of the three industry groupings, manufacturing production sank 0.7% from April's cyclical high, posting its steepest decline since January 2014, while mining (1.8%) and utilities (1.1) output continued to climb. Output of consumer goods slumped an auto-related 1.0% last month, after a two-month jump of 1.4% to a new cyclical high. Meanwhile, business equipment (-1.1) production fell for the first time this year, dragged down by a 3.5% plunge in transit equipment, while output of information processing equipment (-0.1) was little changed after a 3.6% surge the first four months of this year to a new record high. Production of industrial equipment remains in a volatile flat trend around multi-year highs, ticking down 0.4% in May after a 1.7% gain and a 0.7% loss the prior two months.

Capacity Utilization (*link*): The headline capacity utilization rate in May slipped to 77.9% after climbing the prior three months from 77.0% in January to 78.1% in April—which was the highest reading since March 2015. Still, it's 1.9ppts below its long-run (1972-2017) average. Manufacturing's capacity utilization rate sank to 75.3% from 75.9% in April—which was the highest reading since August 2015. May's rate was 3.0ppts below its long-run average. The utilization rate for mining rose for the fourth month from 87.5% in January to a cyclical high of 92.4% in May—which is 5.5ppts above its long-run average—while the capacity utilization rate for utilities jumped 5.9ppts the past three months to 79.4% in May, though was still nearly 6.0ppts below its long-run average.

Regional M-PMI (*link*): Activity in the New York Fed district, the first to report on manufacturing for this month, accelerated at its fastest pace in eight months. The composite index climbed for the second month from 15.8 in April to 25.0 this month—back near October's 37-month high of 28.1. Both the new orders (21.3) and shipments (23.5) indexes moved back above 20.0 this month, accelerating steadily from 9.0 and 17.5, respectively, in April. Labor market indicators pointed to a substantial increase in employment (to 19.0 from 8.7) this month and longer workweeks (12.0 from 11.1). Delivery times (13.2 from 13.7) continued to lengthen, and inventories (5.4 from 10.1) edged higher, though at a slower pace than April. The prices paid (52.7 from 54.0) index held near May's reading, which was the highest since June 2011, while prices received (23.3 from 23.0) remained elevated at a multi-year high. Looking ahead, the index for future business conditions improved for the second month, from 18.3 in April to 38.9 this month, heading back toward its recent high of 50.5 in February.

PPI (*link*): The PPI for final demand accelerated 0.5% in May from 0.1% in April, matching January's one-year high. Prices for final demand goods jumped 1.0% last month—the biggest monthly gain in three years—while prices for final demand services climbed 0.3%, faster than April's 0.1% advance. Over 80% of the increase in prices for final demand goods can be traced to the index for final demand energy, which jumped 4.6%—with gasoline prices soaring nearly 10%. Meanwhile, 80% of the advance in the index for final demand services can be traced to margins for final demand trade services. The yearly inflation rate for the headline series accelerated 3.1% y/y, the highest since January 2012, as the goods (4.4% y/y) rate posted its largest increase since the end of 2011. The rate for final demand services remained at 2.4%, down from March's 2.9% peak. Meanwhile, the core (2.4) rate ticked up from 2.3% in April, though held below March's 2.7%, which was the highest since November 2011; the core ex trade services rate edged up from 2.5% to 2.6% y/y, remaining below its record high of 2.9% in March.

Import Prices (*link*): Import prices in May once again were boosted by a big jump in petroleum prices; nonpetroleum prices remained subdued. Total import prices climbed 0.6% last month, matching April's (to 0.6% from 0.3%) gain—which was double the initial estimate; petroleum prices soared 5.9% last month and 10.6% during the two months ending May. Meanwhile, nonpetroleum prices ticked up 0.1% in both May and April, after no change in March; these prices had advanced 1.0% during the first two months of the year. The yearly rate for import prices in May was 4.3% y/y, the highest since February 2017; prices for nonpetroleum imports rose 1.8% y/y, hovering just below 2.0% for the fifth month. Import prices for capital goods (0.9% y/y) remain on an accelerating trend, though dipped below 1.0% in May, after moving above earlier this year; this rate had been negative from October 2014 through May 2017. Import prices for consumer goods ex autos are showing little change over the past year, climbing 0.7% y/y, though prices are accelerating in recent months. Petroleum prices were 31.9% over a year ago, the highest rate in just over a year.

GLOBAL ECONOMIC INDICATORS

Eurozone CPI (*link*): May's CPI rate matched its flash estimate, accelerating to a 13-month high of 1.9% y/y—reaching the ECB's goal of just under 2.0% for the first time since April 2017, as rates in Germany, France, and Spain exceeded 2.0%. Looking at the main components, energy (6.1% from 2.6%) had the highest annual rate in May—more than double April's rate—followed by food, alcohol, and tobacco (2.5 from 2.4) and services (1.6 from 1.0); the rate for non-energy industrial goods continues to hover around zero, remaining at 0.3% y/y last month. The core rate—which excludes energy, food, alcohol, and tobacco—accelerated to an eight-month high of 1.1% y/y from a 13-month low of 0.8% in April. Of the top four Eurozone economies, inflation rates in France (2.3% y/y), Germany (2.2), and Spain (2.1) were above the Eurozone's 1.9% rate, while Italy's (1.0) was below. Ireland (0.7) and Greece (0.8) posted the lowest rates among the Eurozone countries.

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