First Trust
Monday Morning OUTLOOK
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Fed Policy Not in Tune With Data

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – Dep. Chief *Economist*
Strider Elass – *Economist*

If the Fed were completely honest and transparent, its statement on monetary policy on Wednesday would be only two words: "We goofed."

Back in June, the self-identified "data dependent" Fed walked back expectations of rate hikes with a dovish policy statement and lower projections of future rate hikes, which was odd because these changes happened despite very little change in the tone of economic data.

In reality, the Fed simply over-reacted to one bad employment report – the kind we get from time to time even when the labor market is improving at a healthy pace. Brexit fears probably played a role, too.

Since then, the dire Brexit fears have proved silly and economic data have clearly turned for the better. The ISM Manufacturing index rose to 53.2 in June from 51.3 in May while the ISM Service index rose to 56.5 from 52.9. Payroll growth surged in June, growing 287,000. And in the past three weeks, new claims for unemployment insurance have remained below 255,000, a new consistent low reached while claims have remained below 300,000 for 72 consecutive weeks.

Worker pay is accelerating. Average hourly earnings are up 2.6% from a year ago, which is a 30% acceleration in the growth rate from the 2.0% growth during the year ending in June 2015. "Core" retail sales, which exclude volatile components like autos, building materials, and gas, are up 4.3% from a year ago and have risen in 15 of the last 16 months. Tell us again about the freaked out consumer?

Home building continues to recover. Single-family housing starts are up 13.4% from a year ago on top of a 14.3% gain in the year ending in June 2015. Meanwhile, price gains and low inventories of both new and existing homes signal plenty of room in the year ahead for a continued increase in home building.

In other words, the Fed ought to be upgrading its view of the economy and the speed of rate hikes. Especially with equities at new record highs, after mindless fear over Brexit knocked them down. Add in the fact that "core" consumer prices (which exclude food and energy) are up 2.3% from a year ago, it's clear the Fed is actually falling behind the curve.

Putting all this together, and given the natural inclination for government officials to save face, we're not holding our breath that the Fed will admit they could (and should) have hiked in June. Instead, look for a statement with no great changes from last time. The Fed will recognize the economy is better than it thought, but the language won't change much.

However, when the Fed releases the more detailed minutes from this week's meeting (on August 17th) we expect some financial fireworks. Those minutes will show that the Fed is more confident about the economy and more willing to raise rates than is now baked into the federal funds futures market. Right now, that market thinks the most likely outcome is zero rate hikes in 2016. By contrast, we think the Fed is highly likely to raise rates at least once, and that the odds of two rate hikes is higher than the odds of none at all.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-26 / 9:00 am	New Home Sales – Jun	0.560 Mil	**0.546 Mil**		0.551 Mil
9:00 am	Consumer Confidence – Jul	96.0	**95.4**		98.0
7-27 / 7:30 am	Durable Goods – Jun	-1.1%	**-2.4%**		-2.3%
7:30 am	Durable Goods (Ex-Trans) – Jun	+0.3%	**0.0%**		-0.3%
7-28 / 7:30 am	Initial Claims - Jul 23	264K	**263K**		253K
7-29 / 7:30 am	Q2 GDP Advance Report	2.6%	**2.3%**		1.1%
7:30 am	Q2 GDP Chain Price Index	1.9%	**1.0%**		0.4%
8:45 am	Chicago PMI	54.0	**54.5**		56.8
9:00 am	U. Mich Consumer Sentiment- Jul	90.0	**90.0**		89.5