

U.S. economic data this week was mixed, but capped by a weaker-than-expected payroll number for May. This, in combination with the threat by the Trump Administration of increased trade tariffs on Mexico and China, puts the Federal Reserve in the spotlight as it prepares for the upcoming Federal Open Market Committee meeting over June 18-19.

We expect the Fed to leave the fed funds rate unchanged on June 19. But we expect them to provide forward guidance to indicate that a rate cut is coming in the near future, possible as early as July 31. Market expectations for at least one fed funds rate cut this year have increased in recent weeks. Currently, the fed funds futures market shows an implied probability of 64 percent that rates will remain unchanged on June 19. However, the implied probability of at least one rate cut by the end of this year is now 99 percent. The implied probability of two or more 25 basis point rate cuts before the end of this year now stands at 88 percent.

The official Bureau of Labor Statistics job count for May showed a weaker-than-expected gain of 75,000 jobs for the month. This follows the weak ADP Employment Report for May, issued on Wednesday, that showed a gain of just 27,000 net new private-sector jobs. The unemployment rate remained low at 3.6 percent in May. Average hourly earnings were up a weak-to-moderate 0.2 percent for the month and were up 3.1 percent over the previous 12 months. The tepid gain in wages reinforces the interpretation of the soft payroll numbers. The average workweek was unchanged at 34.4 hours. Revisions to March and April payrolls were negative, totaling -75,000 jobs for the two months.

Other labor-related data for May looks better. Initial claims for unemployment insurance were unchanged at 218,000 for the week ending June 1. Continuing claims gained 20,000 for the week ending May 25. This is well within the range of normal and should not cause alarm.

The nominal U.S. international trade gap narrowed slightly in April after widening in March. Exports dropped by \$4.6 billion in April after increasing for three consecutive months. Imports dipped by \$5.7 billion as imports of goods decreased by \$5.4 billion. After adjusting for price changes, the real trade balance in goods for April was below the first quarter average, suggesting that as of now, trade will be a moderate positive for Q2 GDP. This could change easily with two more months left to report in the second quarter.

The ISM Non-Manufacturing Index for May does not corroborate the weak employment data. In May, the ISM Non-Manufacturing Index increased from 55.5 to a solid 56.9, indicating moderate expansion for the bulk of the U.S. economy. The business activity, new orders and employment sub-indexes all improved and are all well above the break-even 50 mark. Anecdotal comments were generally positive, but did show concern about the impact of trade tariffs. Only the agriculture industry reported worsening conditions.

The ISM Manufacturing Index decreased from 52.8 in April to a still-positive 52.1 in May. This is the lowest reading for the index since October 2016. Momentum in the manufacturing sector has clearly dissipated since the recent high headline reading of 60.8 from last August. Six industries reported contraction in May.

Fed Funds Rate

Fed Funds Rate (Effective): After FOMC Meeting of 6/18-6/19

We expect the Fed to keep the fed funds rate range unchanged at 2.25-2.50 percent at the next Federal Open Market Committee meeting over June 18-19.

The Week Ahead

May Producer Price Index (6/11, Tuesday)

Headline PPI was up 0.2 percent in April, pushed up by higher energy prices. Lower energy prices in May will keep the headline numbers in check. Unchanged in May. Consensus: 0.1 percent

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The Week Ahead, Continued**May Producer Price Index Ex. Food, Energy and Trade (6/11, Tuesday)**

Core PPI was up 0.4 percent in April. Up by 0.1 percent in May. Consensus: 0.2 percent

May Consumer Price Index (6/12, Wednesday)

Headline CPI was up 0.3 percent in April. Lower energy prices in May will keep headline CPI unchanged. Consensus: 0.1 percent

May Consumer Price Index Ex. Food and Energy (6/12, Wednesday)

Core CPI was up 0.1 percent in April. Up by 0.2 percent in May. Consensus: 0.2 percent

May Retail Sales (6/14, Friday)

Retail sales decreased by 0.2 percent in April. Boosted by stronger unit auto sales. Up by 0.6 percent in May. Consensus: 0.7 percent

May Retail Sales Ex. Autos (6/14, Friday)

Retail sales excluding autos were up by 0.1 percent in April. Held in check by lower gasoline prices in May. Up by 0.4 percent. Consensus: 0.5 percent

May Industrial Production (6/14, Friday)

Industrial Production decreased by 0.5 percent in April. Boosted by manufacturing and utilities in May. Up by 0.2 percent. Consensus: 0.2 percent.

May Capacity Utilization (6/14, Friday)

Capacity utilization slowed to 77.9 percent in April. Up to 78.1 percent in May. Consensus: 78.0 percent

Chart of the Week**Auto Sales Back Up in May**

Millions, SAAR



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