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WEEKLY ECONOMIC COMMENTARY

July 24, 2017

Data Calm before the Earnings Storm

While most of the nation slips into summer doldrums in uninterrupted fashion, Wall Street has an odd hitch in the process. Just when sultry July days are causing eyes to slip to half-mast at mid-afternoon, calendar 2Q earnings seasons arrives like a swarm of bees at a summer picnic.

Earnings, economic data, and (this year at least) Washington goings-on have been the key market drivers in 2017. Earnings will soon hog the spotlight. After a tumultuous first six months, turmoil in Washington appears to have died down, or at least shifted into "new normal" status that is no longer driving ups and downs in the stock market. The latest twist in the healthcare reform saga – John's McCain's pending surgery, which has prompted Mitch McConnell to postpone a Senate vote – is likely quietly welcome on Wall Street, as it will remove a potential distraction at least for a few weeks.

Quietly, economic data is confirming the steady if slow pace of economic growth. Most data will be subsumed in the earnings tsunami. Before that happens, it is worth reviewing a handful of reports for what they say about the economy partway into summer.

INDUSTRIAL, CONSUMER ECONOMY RISING

A logical jumping point for our economic data review is the June nonfarm payrolls report – because that was also the jumping off point for this latest rally leg that has brought stocks to new all-time highs. As reported on 7/7/17, June nonfarm payrolls totaled 222,000, well above the 12-month trend of 180,000 and besting expectations for a gain of 179,000. As a sweetener on the report, April and May payrolls were revised higher by a net 47,000 jobs.

Growth was led by professional and business services, healthcare and food services, all in the service economy. The hoped-for renaissance in manufacturing is not yet visible, but neither is the nation hemorrhaging factory jobs. Also on the industrial front, mining ticked higher. The U3 unemployment report ticked higher, to 4.4%, reflecting job seekers returning to the workforce.

The most notable data point in the June jobs report was 2.5% annual growth in wages. Investors seeking to determine the pace of Fed rate hikes too often focus on the pace of economic activity while stinting the trend in pricing pressures. Chair Yellen and the other FOMC members and Fed governors are likely to hone in on that number, which is above the desired 2% pace of inflation consistent with a well-functioning economy.

The June producer price index nudged up 0.1% month-over-month while rising 2.0% on a year-over-year basis. The June annual pace did represent a step-down from the 2.4% annual rate reported for May, while still signaling that price appreciation has become steady, rather than erratic. Consumer prices have been more subdued, rising 1.6% for the all-items index and 1.7% for the core index (less food and fuel) over the past 12 months.

The Fed released its Beige Book in mid-July, confirming its concerns regarding wage pressures for both low- and high-skilled jobs. Economic activity expanded across all 12 Federal Reserve districts in June, as the U.S. grew at a "slight to moderate" pace reflecting some regional variation. Household spending held up, despite weaker auto unit sales and worsening challenges for traditional mall-based retail.

One of the key inflection changes during July has been the recent recovery in energy prices, as crude rose 5% in the mid-month week. The positive trend began after the Energy

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Information Agency on 7/8/17 reported a decline in oil inventories; that data also confirmed a like report from the American Petroleum Institute.

Second-quarter pressure on energy prices partly reflects increased supply coming on line from the global swing producers, which are mainly U.S. energy companies primarily operating in the major shale basins. That increased activity is being reflected in industrial production, which rose a solid 0.4% in June. Capacity utilization nudged down a tick, but at 76.6% remains above the 75% level at which this index was mired for years.

The Commerce Department reported a 0.2% drop in retail sales, representing a second consecutive decline after May's 0.1% drop. The data reflects the transformation whereby consumers are shifting away from the mall and more fully toward online commerce. Other areas that are only moderately impacted by the internet, such as casual dining, have also backed down. We have pointed out that year-over-year trends in core and control retail sales look better than the Commerce Department numbers, but the consumer does appear to be suffering wallet fatigue.

Another down note was sounded by the Mortgage Bankers Association (MBA), which reported a 7% decline in mortgage applications for the 7/7/17 week even after adjusting for the July 4 holiday. However, the MBA also reported that mortgage applications for new home purchases increased 10% in June 2017 compared with June 2016.

We expect June housing data, to be reported later in the month, to generally show continued momentum in areas including permits, starts, new home sale and existing home sales. Housing data points, mainly released in the July 23 week, will likely be overshadowed as the earnings flow moves to firehose strength. July will wrap up on the data front with the advance report on 2Q17 GDP, to be released on the penultimate trading day in the month.

CONCLUSION

In a few weeks, with earnings reported and digested, Wall Street will begin its real summer season, which runs from mid-August to Labor Day (or maybe a week past). For now, investors are pleasantly abuzz in anticipation of what should be a good earnings season.

After summer vacations wind down, the market will resume its focus on key economic data releases. These include payrolls, industrial production, the pricing indexes, and consumer-economy indicators that measure housing and autos as well as sentiment.

In a sense, the upcoming strong earnings season and solid economic growth go hand in hand. We would expect positive feedback from both to keep the stock market moving forward as fall gets underway, even if stocks indulge in their usual summer siesta.

Jim Kelleher,
Director of Research

Investors