THE ECONOMIC OUTLOOK GROUP

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ECONOMIC TALKING POINTS

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This Economy Shows No Sign of Buckling Under --- Sequester or No Sequester

This has been a remarkably counter-intuitive week for anyone tracking economic indicators. Consider this: Americans have now felt the sting of smaller paychecks for two months now that the hike in social security taxes went into effect this year. Add to that pain how Americans must now dig deeper into their pockets to pay for the 58-cent jump in gasoline prices since the start of 2013. And now throw into that awful pot the constant warnings from Washington of how the automatic federal spending cuts would damage the economy and hurt job growth.

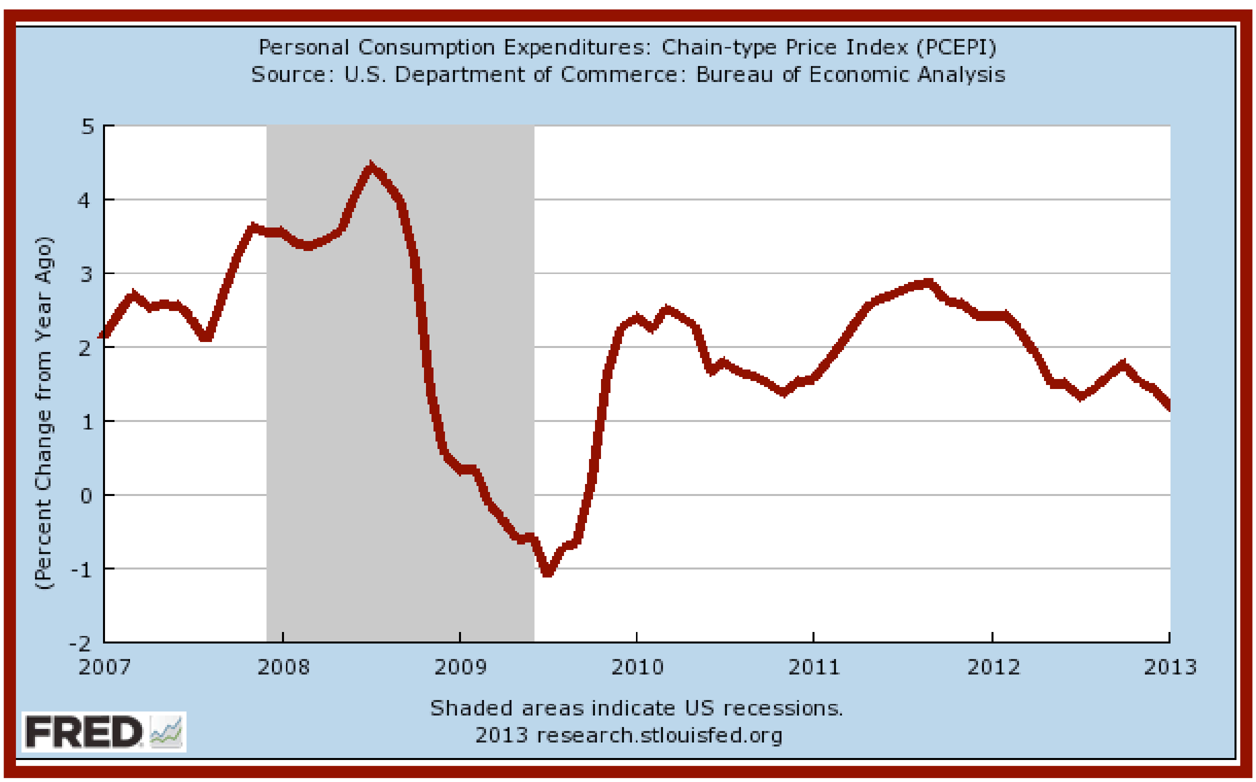
It's hard to come up with a grimmer backdrop for consumers and businesses to function.

Now for the good news. The private sector is not only willing to brush off these concerns, evidence is building the economy is actually gearing up to achieve faster growth. A spate of fresh reports shows that consumers are out shopping again, business leaders are flashing the green light to accelerate capital spending, and investors appear content to drive stock prices toward record highs.

What's behind this take-charge mentality in the private sector? Certainly one explanation is the improving fundamentals in the economy. Corporate and household finances are much healthier and that has set the stage for greater spending and investments. (More on that in a moment.) We have also seen a gradual upturn in the global economy, thanks in large part to the generous monetary policies of the major world central banks.

Evidence is also building that emerging countries across Asia and Latin America are boosting orders for US goods as well. That will lift exports and contribute to GDP growth this year (especially with US oil imports on the decline).

The point here is that while the payroll tax hike has meant less take home…and the surge in gas prices is certainly unwelcome…. and just about everyone is by now clearly disgusted by the political trench warfare inside the Beltway, there is another important perspective to consider. First, resumption of the higher payroll tax rate was largely anticipated and not expected (at least by us) to materially alter consumer-spending habits. Second, the rise in gasoline prices has been an annoyance. But Americans drive far less in the winter than they do in summer. Moreover, the burden of higher gas prices may be felt less now that the job market is improving and since all other prices have remained stable. Inflation overall is still the lowest in more than three years! (Check out this morning's release on January's PCE price index; it rose 1.2% over the year, the smallest since October 2009.) As for the follies in Washington, it appears the private sector has concluded the policy paralysis over the budget does not pose a great enough threat to derail the recovery.



You don't have to look far to see this optimism. Check out the major consumer confidence gauges. They all tell the same story.

According to the University of Michigan's survey, February's final read on consumer sentiment jumped to 77.6, better than January's 73.8. When

Americans were asked in that same poll how they felt about current economic conditions and what they expect to see 6-months from now, they showed the most cheer since last November.

In the event you are curious to see if there's been any last minute shift in consumer psychology, just glance at Bloomberg's weekly barometer of household moods. Their Consumer Comfort survey was taken on the eve of the sequester cuts (period ending February 24th) and the main index rose for the fourth straight week to the best level of the year. And how about this! The share of Americans with a positive view of the U.S. economy matched the highest level since March 2008!

Even the Conference Board's consumer confidence numbers were in alignment with the other two polls; their results showed people were far more upbeat in February (index hitting 69.6) than January (58.4).

It should thus come as little surprise that Americans are showing few inhibitions about spending. Personal expenditures rose 0.2% in January, faster than the increase in December, even though incomes plummeted by 3.6% in the first month of the year. That sharp decline, however, was largely anticipated as companies accelerated bonuses and dividends in December in advance of higher income taxes for 2013.

Has January's spending by households been sustained in February? The preliminary data is very encouraging. The latest weekly report on spending at retail chain stores by the International Council of Shopping Centers noted that shopping picked up in the second half of February, compared to the prior month.

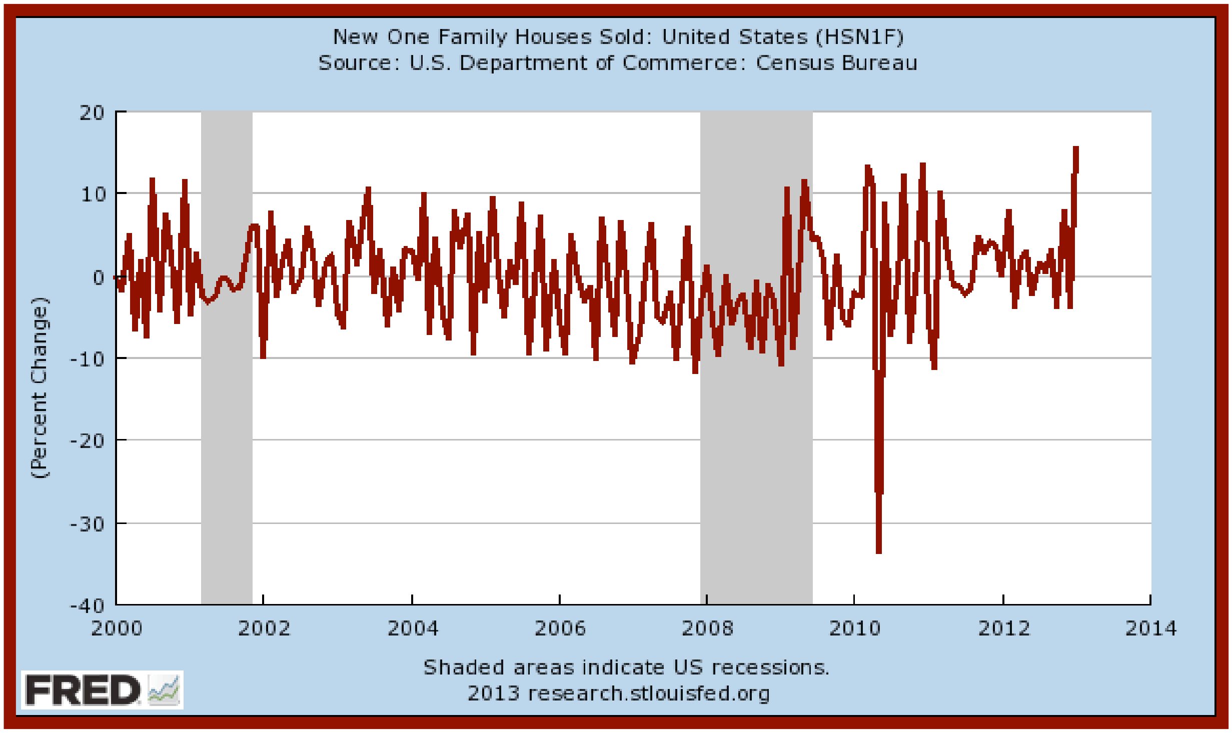
US companies, too, appear unfazed by the impotence in Washington.

The first big report on business activity during February showed manufacturers were the busiest they have been in 19 months! The ISM factory index climbed to 54.2, a level not seen since June 2011. Just as significant was the pick up in new orders. Of the 16 industries surveyed by the ISM, 15 reported an increase in demand for their products. It drove the orders index to 57.8, the most in nearly two years. Exports last month was also strong, rising for the third consecutive month

Most other key economic reports out this week pointed to a strong, more resilient economy.

• The government reported that orders for core capital goods by business were up in January by the most in a year. This was the fifth straight monthly increase, a pattern we haven't seen since March of 2006.

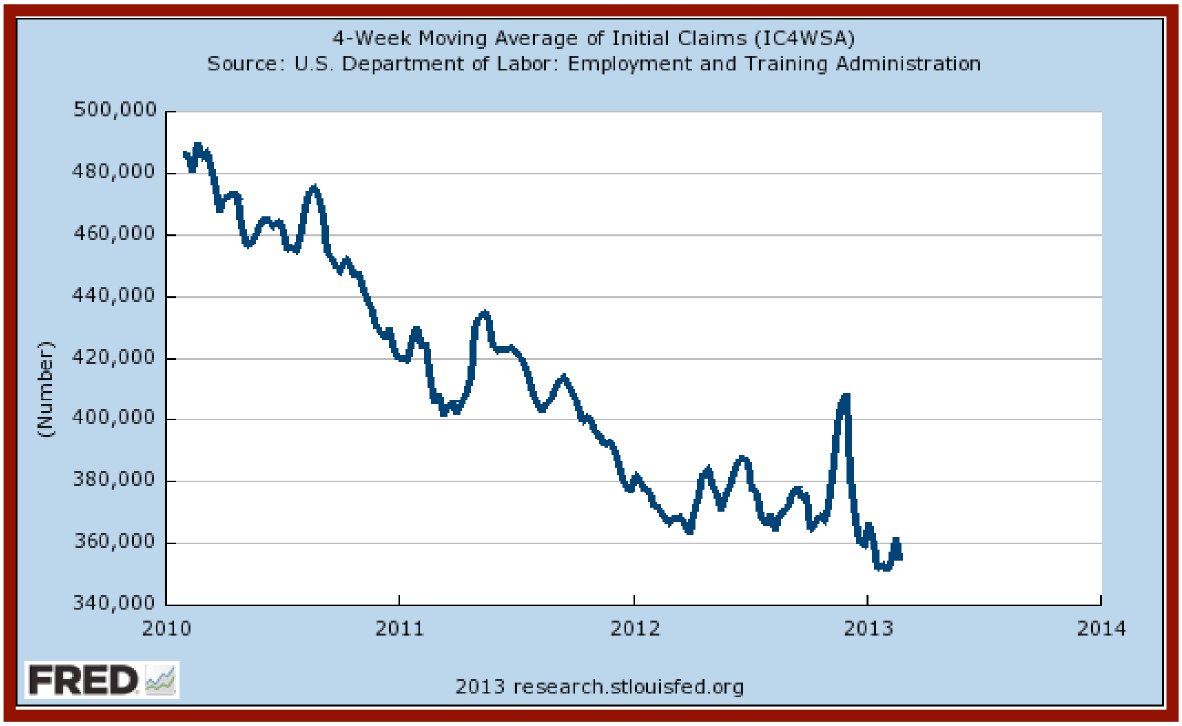
• New home sales jumped in January by 15.6%, the biggest increase seen in nearly 20 years. The inventory of new homes on the market is now the lowest in 8 years. Such tight supplies mean homebuilders will speed up new construction in the months ahead.



• Contracts signed to purchase existing homes rose to the highest level since April 2010.

• Home prices for the 20 main cities tracked by S&P/Case-Shiller are climbing at the fastest pace since July 2006.

• The latest trends on employment are looking better too. The four-week moving average for initial jobless claims is now lower than it was in December and the number of people collecting jobless compensation has dropped has dropped to 3.07 million, the fewest since June 2008, according to the latest report by the BLS.



Bottom line:
We have argued since last fall that the stage has been set for the US economy to show stronger organic growth this year and a multitude of economic indicators now bear this out. Of course, what is going on in Washington is worrisome to Americans, but not enough to endanger the powerful growth momentum underway in the private economy. The wrangling in the nation's capital cannot offset other realities: (1) The cost of credit remains historically low and banks have made credit more available. (2) Consumers, buoyed by the rebound in household wealth and a recovering job market, appear eager to unleash some of the pent-up demand that has accumulated in recent years. (3) Business leaders are more comfortable accelerating capital investments now that the global economic outlook looks brighter. To sum it up, over the last several months the private sector has gotten up, shaken off the unease caused by Washington, and forged ahead --- and hasn't looked back since.

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