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ECONOMIC TALKING POINTS

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With the slippery winter now history, the economy is picking up traction again

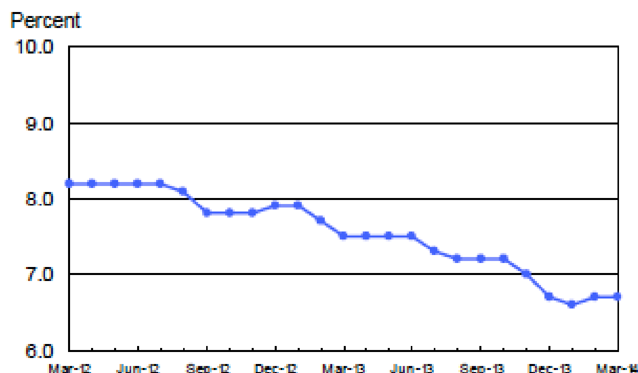
After weeks of debate on whether it was the severe winter or other intrinsic factors that held the economy down the last few months, the issue for us has been settled.

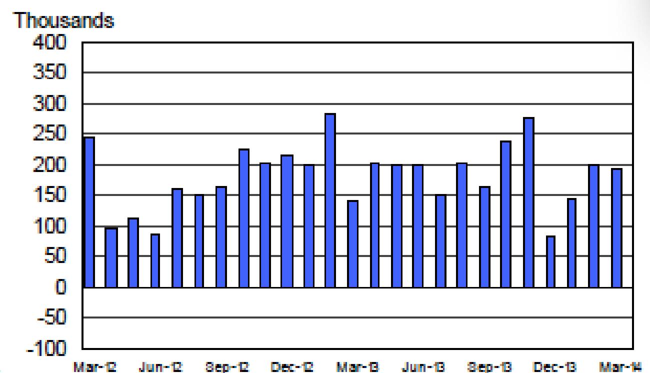
With the arrival of cleaner economic data, we can say with confidence the main culprit that has hampered consumer and business spending and depressed hiring was the unusually brutal weather.

Americans have now started to shake off those seasonal effects and appear eager to resume the kind of activity we last saw in the back half of 2013. This is based not just in the healthier March job numbers but also from the PMI manufacturing and services reports, auto sales, mortgage applications for home purchases and overall consumer confidence. All point to an economy in the process of being re-energized.

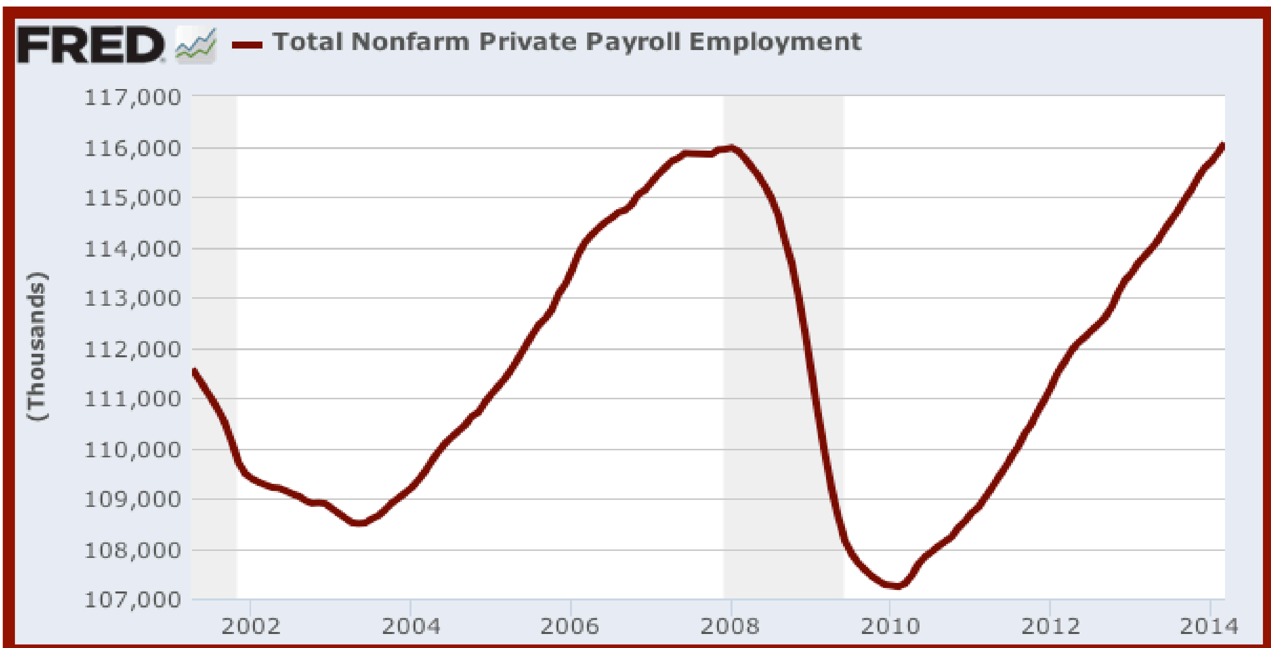
Let's look at these macro indicators individually.

The two most current releases on labor market activity --- the ADP Employment survey and the main BLS jobs report tell a consistent story. ADP and the BLS were virtually identical in their assessment of hiring in the private sector during March. ADP saw an increase 191,000, and the BLS reported a 192,000 jump (***with the latter showing employment accelerated in each of the last three months!***).





With the March job numbers, not only have US firms finally brought back all of the 8.8 million jobs that were lost since the last recession, total employment in the private sector stands at an all time of 116.09 million. Employment at the federal, state and local levels are still way down, but that is to be expected given the severe constraints on fiscal spending in recent years.



While the unemployment rate needle remained at 6.7%, this is not especially worrisome. After all, the number of people entering the workforce in March surged by 503,000, nearly double that of the previous month, while those who actually found work climbed by 476,000, about ten times more than what was recorded in February. These numbers also helped lift the labor force participation rate to 63.2% (the highest since September, and the employment – population rate to 58.9% ***(the most since August 2009!!).***

Another encouraging sign was the increase in average weekly hours worked in the total private sector to 34.5 (best since November). Most intriguing, however, is what happened in the more cyclically sensitive manufacturing sector. Average weekly hours in this sector was 41.1 in March – ***the most ever recorded by the BLS!*** That may seem a bit strange, since employment at manufacturing plants actually slipped 1,000 last month. However, we believe this impressive jump in hours worked foreshadows more hiring at factories in the coming months.

Moreover, when you drill down and view specific industries that often lead the economy, we get additional good news. Hiring at trucking firms jumped 3,300, the biggest increase since November. Jobs for temp workers surged 28,500, the most this year. Even childcare centers added 1,700 employees last March.

Another important barometer of labor market conditions is the duration of unemployment, and here, too, we have seen an improvement. Both the average and median number of weeks the unemployed have been without jobs have fallen.

HOUSEHOLD DATA
Table A-12. Unemployed persons by duration of unemployment
[Numbers in thousands]

Duration	Not seasonally adjusted			Seasonally adjusted					
	Mar. 2013	Feb. 2014	Mar. 2014	Mar. 2013	Nov. 2013	Dec. 2013	Jan. 2014	Feb. 2014	Mar. 2014
NUMBER OF UNEMPLOYED									
Less than 5 weeks	2,067	2,145	2,064	2,497	2,439	2,255	2,434	2,373	2,461
5 to 14 weeks	3,040	3,091	2,766	2,843	2,585	2,506	2,429	2,568	2,581
15 weeks and over	6,708	5,657	5,708	6,355	5,786	5,530	5,336	5,464	5,417
15 to 26 weeks	2,051	1,771	1,913	1,779	1,742	1,651	1,689	1,615	1,677
27 weeks and over	4,657	3,886	3,795	4,576	4,044	3,878	3,646	3,849	3,739
Average (mean) duration, in weeks	37.9	36.3	36.2	37.0	37.1	37.1	35.4	37.1	35.6
Median duration, in weeks	19.0	16.0	17.3	18.1	17.0	17.1	16.0	16.4	16.3
PERCENT DISTRIBUTION									
Less than 5 weeks	17.5	19.7	19.6	21.4	22.6	21.9	23.9	22.8	23.5
5 to 14 weeks	25.7	28.4	26.2	24.3	23.9	24.4	23.8	24.7	24.7
15 weeks and over	56.8	51.9	54.2	54.3	53.5	53.7	52.3	52.5	51.8
15 to 26 weeks	17.4	16.3	18.2	15.2	16.1	16.0	16.6	15.5	16.0
27 weeks and over	39.4	35.7	36.0	39.1	37.4	37.7	35.8	37.0	35.8

Other major economic indicators:

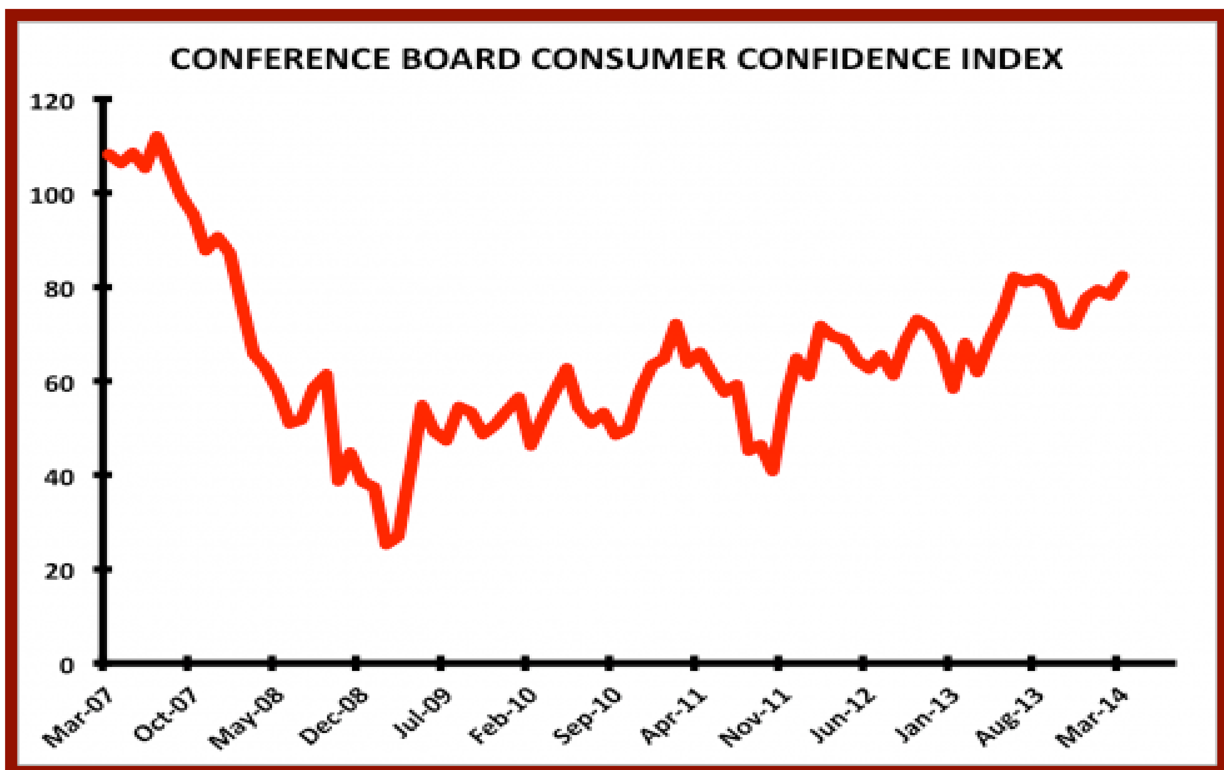
ISM

Last month's improvement in the labor market also followed other positive news on the economy. The Institute for Supply Management just noted that both manufacturers and service companies saw an acceleration in new orders last month. A jump in such bookings typically leads to greater production and hiring within the next 2 to 4 months. What was particularly

revealing in those report were some of the comments made by the purchasing managers polled: *"Business beginning to heat-up, along with the weather."* *"Business is good and we are optimistic that orders will continue to come in at a decent pace."*

Consumer spending

Consumers also appear eager to resume spending. Auto sales exceeded all expectations in March as purchases climbed to an annual rate of 16.4 million, far above the 15.2 million of a year ago, and the strongest since May 2007. The outlook for housing looks sunnier too after mortgage applications to purchase a home jumped for the third consecutive week. Given this backdrop, it is not surprising consumer confidence rebounded last month to its highest level since January 2008, according to the Conference Board. This improvement was supported by the latest weekly upturn in Bloomberg's own measure of consumer comfort. (Only the University of Michigan saw a decline in consumer sentiment for March, but we expect the mid-April report will show more optimism.)



Federal Reserve

Standing by to support further economic growth this year is, of course, the Federal Reserve. With Janet Yellen at the helm, the Fed will continue to pursue an extremely accommodating monetary policy. She jettisoned the 6.5% unemployment rate as a marker to consider when to begin raising

short-term rates and replaced it with a broader dashboard of labor and inflation indicators. This dashboard includes changes in private payrolls, part time work for economic reasons, duration of unemployment, the quit rate, the U-6 measure of unemployment, wage growth, labor force participation rate, and the percentage of long term unemployed.

Based on these varied gauges, Yellen has clearly stated her view that there remains far too much slack in the labor markets and thus no timetable exists on when the FOMC may end its zero bound interest rate policy. About the only conclusion one can make based on the March 19th FOMC meeting, is that 14 of the 16 participants expect to see the fed fund rate higher by the end of next year. But, again, how much higher it will be at the end of 2015 will depend largely on whether employment conditions have markedly improved and if inflation approaches the Fed's target of around 2%. Our take is that the fed funds rate will begin a very shallow climb late in second half of next year.

For now, Yellen's view is quite clear. The economy is strong enough to withstand further tapering of quantitative easing, but still lacks the energetic growth and depth that warrants higher short-term rates.

So what's next?

In our opinion, the biggest challenge facing the Federal Reserve and the US economy will come by mid-year. How so? Even if the effects of the polar vortex are diminishing, looming larger by the day is a geopolitical vortex. It consists of two potentially disruptive events that are now swirling around the US and international economy.

One is China and the possibility of a more pronounced slowdown in its economy. The government targeted a 7.5% growth rate for 2014. But given the threat of more onshore bond defaults, higher cost of domestic credit, a real estate bubble, and a government that wants to introduce moral hazard, the fear is China's economy is simply no longer on solid ground. Growth may drop back to less than 6.5% or less this year and that could trigger domestic social unrest and perhaps even precipitate a liquidity crisis that could spread globally.

The other threat is the risk of a dangerous standoff between the two nuclear superpowers. A Russian military incursion into Ukraine can trigger higher oil prices and also raise the specter of a military confrontation with the West. With the Europe's economy barely growing at 1% a year, the region has absolutely no cushion to deal with such a major geopolitical shock and may well slip back to recession if tensions worsen. Nor will it take long for the rise in geopolitical uncertainties to seep into the mindset of

US consumers and business leaders and cause a pull back in spending and hiring.

Bottom line:

While there are genuine reasons to be optimistic about US economy, the future path of business activity in the US and globally may now rest more with what unfolds in China and on the Ukraine – Russian border.

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