THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

May 9, 2014

Are Eco-skeptics Losing Their Grip On Reality?

It has always been a source of humor and bemusement to us of how some people are neurally wired to contort even the healthiest economic numbers and portray them in the bleakest terms. There are at least half a dozen high profile market and economic analysts who have a proclivity to mock virtually all upbeat economic data before repeating the tired apocalyptic warnings of doom ahead for the US economy.

True, a divergence of views on the economic outlook helps make a market. And that is good. But at some point, you have to wonder: What is the point of being a perennial economic cynic when there is an abundance of unambiguous signals that show an economy gaining more growth momentum? It all conjures up the imagery of a desert scene with dogs furiously barking under a moonlit night, yet the caravan ignores the noise and keeps moving along.

Case in point, just look at the series of economic reports out this week and last.

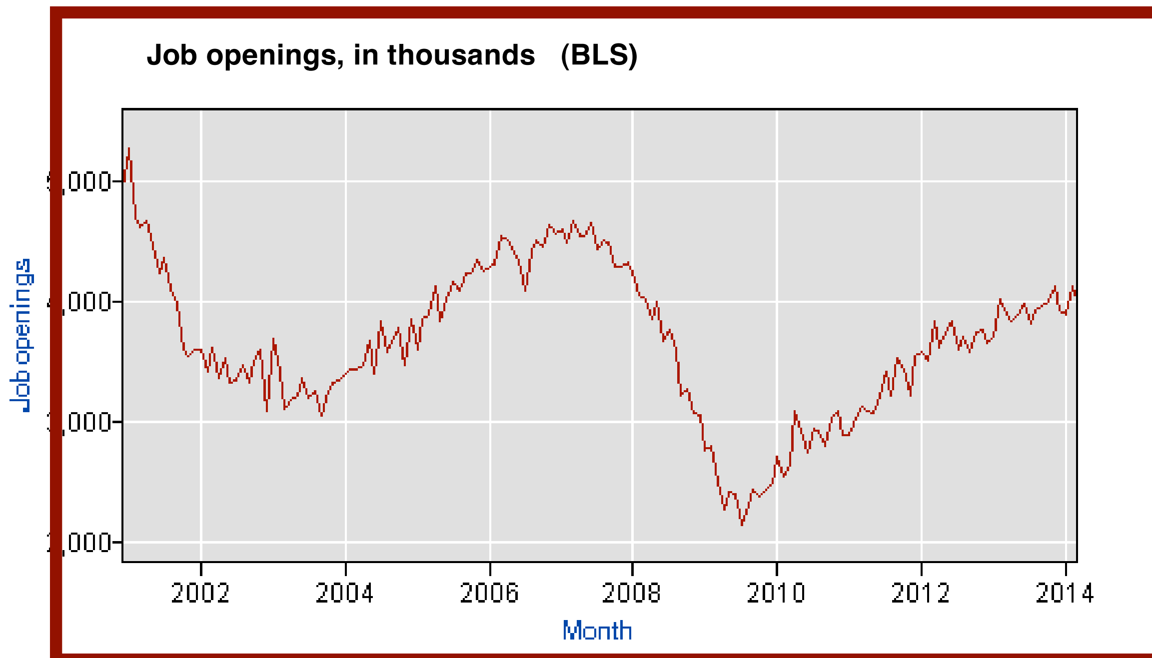
JOLTS

The BLS just released the results of the Job Openings and Labor Turnover Survey (JOLTS). March job vacancies did slip fractionally to 4.01 million, from 4.13 million in February. The “ecoskeptics” will undoubtedly point to the microscopic decline in March as evidence of an economy losing momentum.

In contrast, we prefer to point out that the total number of jobs waiting to be filled exceeded 4 million in both February and March, the first time we have seen two such back-to-back numbers in six years! And leading the charge to hire more workers has been the private sector.

Keep in mind this report came on the heels of the latest employment news which showed corporate payrolls in the month of April surged by 288,000, the most in two years (which brings it to three consecutive months of above 200,000 in net new payrolls) and raised total employment in private industry now to a record high of 116.38 million.

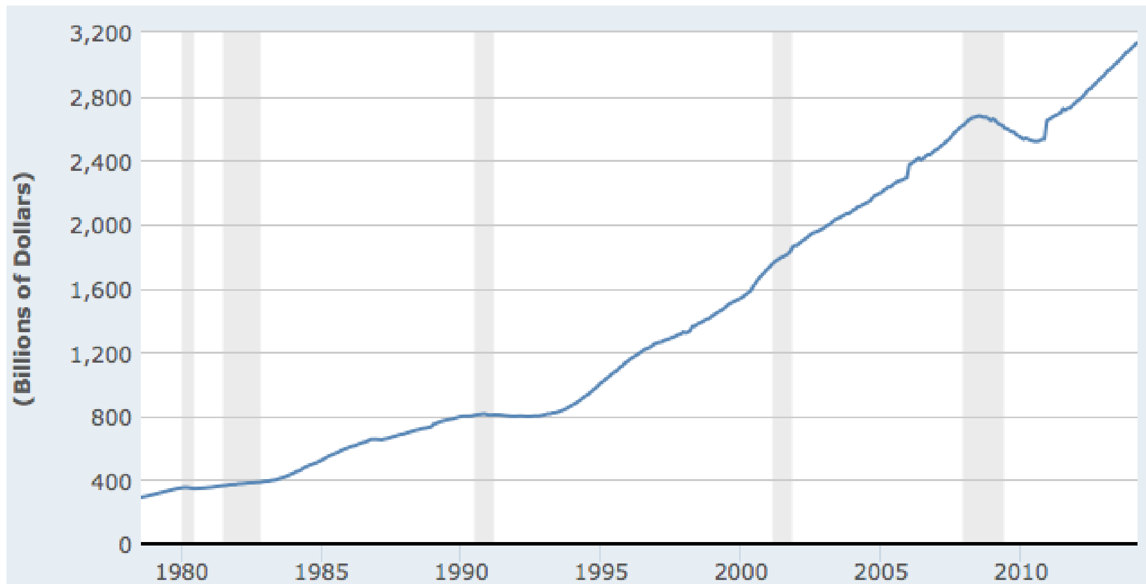
Adding yet more evidence of a jobs recovery has been the persistent decline in new applications for unemployment insurance. Evidence is clearly building that the labor market is strengthening and we so expect to see next rising average hourly and weekly earnings in the coming months.



Consumer spending

In the meantime, with people feeling more secure about their jobs and future income, we should see evidence of greater consumer spending. And that is precisely what the Gallup Survey on Consumer Spending reported this week. Americans spent an average of $88 a day in April, which was not only more than in March but it was among the most households ever spent for the month of April, according to Gallup's records which goes back to 2008.

Want even more confirmation that people are ramping up shopping? The Federal Reserve noted this week that consumer credit jumped in March by $17.53 billion, the largest increase in more tan a year. Both revolving credit and non-revolving debt contributed to this rise. Consumer credit has now increased every month since August 2011.



Has that trend continued into April? Absolutely! The Fed released its weekly report on assets and liabilities of commercial banks and it shows that lending to consumers accelerated every week last month, both from credit cards and other types of personal loans.

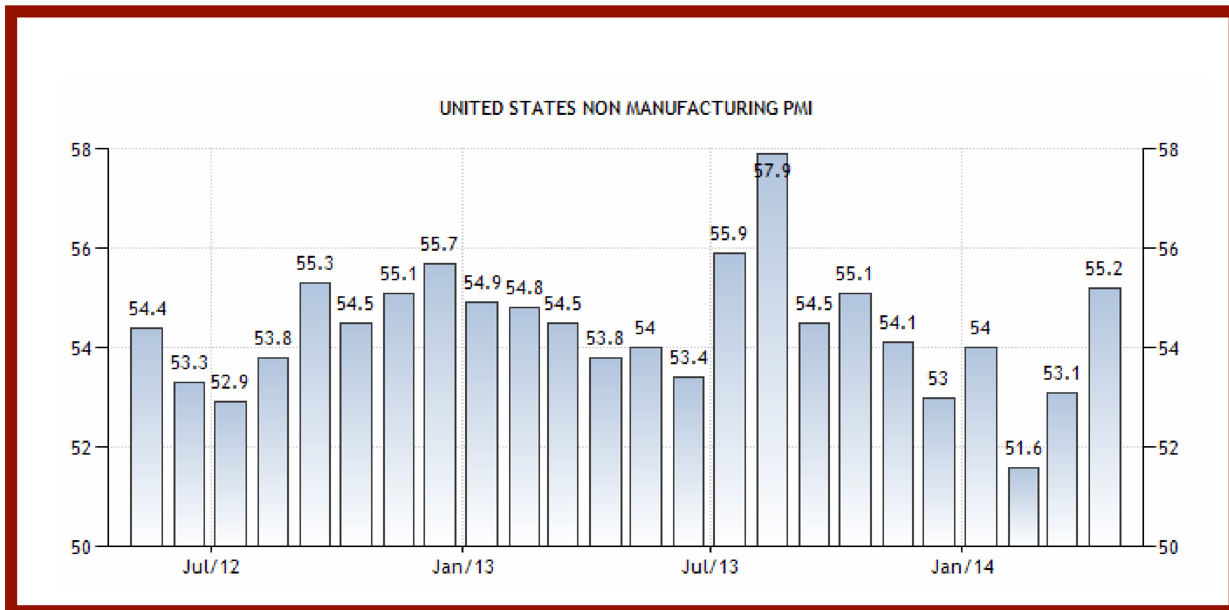
With shoppers clearly shaking off the winter doldrums, you would also expect to see the business sector respond positively as well. They have.

ISM Manufacturing & Services

A week ago, the Institute for Supply Management said manufacturing growth in April picked up for the third straight month, to show the best reading since the end of last year. Indeed, of the 18 manufacturing industries tracked by ISM, 17 reported faster growth. This was due not only to the increase in domestic demand, but from foreign sources as well. New export orders in April were coming in at the fastest pace this year.

Typically, a growing US economy draws in more imports too. So it should come as no surprise that new import orders by US manufacturers soared. (April's import index jumped to 58; the only time it was higher was in 2007 when economic activity last peaked).

Even better overall results were to be found in the much larger service sector of the economy. According to the ISM survey of non-manufacturing industries, service activity rose in April at the fastest pace in eight months. New orders, which can serve as leading indicator of future output and job growth, jumped to its highest level in seven months.



Cass Freight Index

With US firms powering up output, we should also see greater activity in the supply chain distribution network. After all, more commodities and finished goods need to be transported to satisfy higher demand. For this we look to the a little followed yet important barometer of "stuff' being shipped around the country, the Cass Freight Index. This metric gauges the volume of freight being carried in North America's transportation system (trucks, railroads, and planes). It turns out the volume of shipments in April rose to its highest level since June 2011. In fact, the trucking industry is operating so close to 100% utilization (according to the latest FTR Trucking Conditions Index), they are looking for drivers. The BLS jobs report showed that trucking firms last month added 6,800 to their payrolls, the most for a single month in a year, and that hiring boosted total employment in this field to 1.40 million, the highest in six years!

Housing

To be fair, one important sector of the economy that has been disappointing is housing. But we do not subscribe to the view that this industry is stuck in a rut and will only marginally contribute to growth this year. Consider our reasons for optimism;
---The severe winter (which depressed sales and real estate showroom traffic) is now history;

---The combination of improving labor market conditions and higher household income;
--- A deceleration in home price increases (according to Case Shiller's 20-cities index);
--- The slide in all cash purchases by institutional investors;
--- The most dovish Federal Reserve in US history (which should keep mortgage rates low);
--- A gradual easing of lending standards by banks (minimum FICO scores have dropped below 700);
---Mortgage originators gaining more experience complying with the new Qualified Mortgage rules;

All suggest housing will rebound in the coming months.

We already have seen incipient signs of that upturn. The increase in housing starts, pending home sales, real estate lots sold to buyers (an excellent leading indicator from the Census Department) and mortgage applications to purchase a home (it jumped in the week of May 2nd to the highest level since January) --- could well represent an inflection point toward greater activity in residential real estate.

Bottom line:

When we connect the dots above (and they represent only a partial list of bullish indicators), the conclusion we draw is of an economy that is being re-charged.

With a stronger economy should come greater and healthier corporate earnings, which means we do not view the equity market as being overvalued or approaching a bubble. In fact, with nearly all the firms reporting in the S&P 500, first quarter profits have been higher than expectations in about 70% of the cases. That exceeds the 63% quarterly average of upward surprises since 1994. We believe this bull market is about to get its second wind.

Does this mean that treasury bond prices are now close to peaking? Is a bond crash coming that will push yields sharply higher. No.

As we have said in our earlier reports, demand for treasury securities will continue to remain quite strong even as the Fed scales back new purchases. The buyers? Financial firms will remain under pressure to add US treasuries to their balance sheets in their campaign to beef up capital and liquidity ratios that comply with guidelines set by the Federal Reserve, Dodd Frank, and the Basel III.

Moreover, so long as the geopolitical pot keeps boiling furiously (choose your external threat: Russia's aggression in Ukraine, the hotly contested islands in the Western Pacific, nuclear talks with Iran, the looming credit crisis in China, Al Qaeda on the Arab Peninsula's (AQAP) threat to destabilize Yemen and Saudi Arabia, and….well, you get the point), it will sustain demand from global investors who view official US debt as a safe way to park some of their money. ***At the same time,*** the supply of new debt sold by the Treasury Department will now shrink because of the rapid decline in the US budget deficit. Our forecast is for the 10 yr. Treasury yield to remain well below 4.5% by the end of 2015.

So, from our perspective, while the “ecoskeptics” will continue to shout out the many perils facing this economy, the caravan of positive economic news keeps marching ahead.

================================

THE ECONOMIC OUTLOOK GROUP, L.L.C.
475 Wall Street
Princeton, New Jersey 08540

www.EconomicOutlookGroup.com
Tel: (609) 529-1300

© Copyright 2014 ALL RIGHTS RESERVED
THE ECONOMIC OUTLOOK GROUP, LLC

Some email may be caught by a spam filter. Ensure delivery to your inbox of our Economic Talking Points by turning off the spam filter for this timely report.