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ECONOMIC TALKING POINTS

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A Cascade of Economic Indicators This Week Will Shed Light On The Business Outlook

This week should help lift much of the fog about the underlying strength of the economy. For two months, consumers and business leaders turned cautious as economists argued over the significance and implications of the 0.7% GDP contraction in the first quarter.

Many analysts concluded the decline was due mostly to transitory factors plus flaws in the seasonal adjustment process, and that business activity will bounce back the rest of the year with growth climbing closer to a 3% rate. In other words, forget the first three months, they say; They have little predictive value.

Others, however, are much less sanguine and equally vocal. They've studied the same data and detect a more fundamental slowdown underway with growth decelerating to a tepid 1% to 2% this year, essentially crawl speed that is certain to curb future hiring and dry up what little capital spending there has been so far.

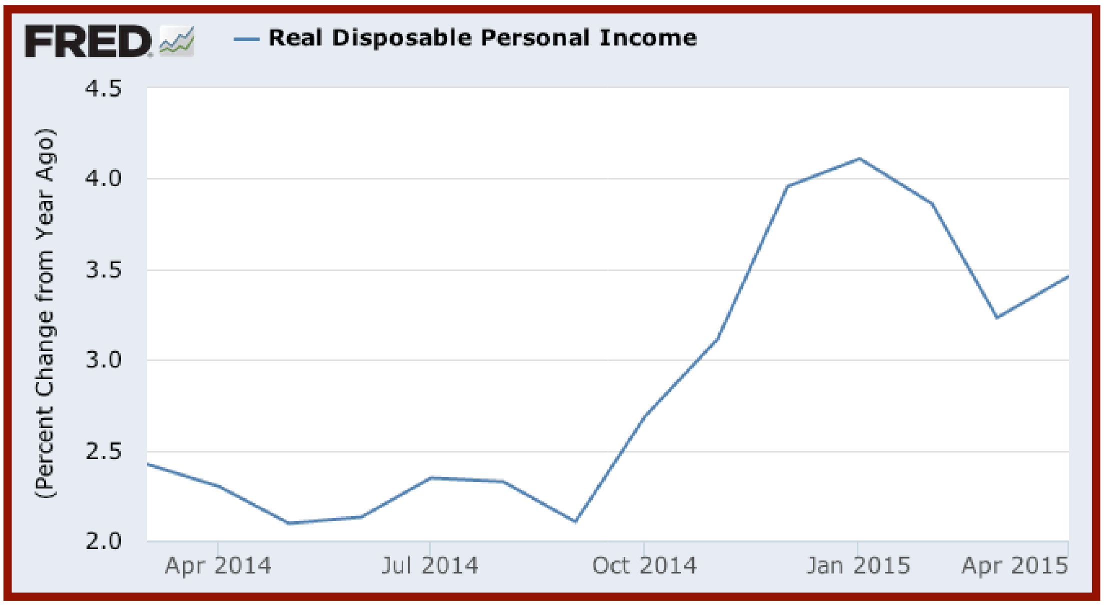
With forecasters so far apart on the outlook, it should come as no surprise that shoppers and CEOs were inclined to pull back on outlays until a clearer picture emerges on the path of the business cycle.

That clarity could come this week with the release of multiple key economic indicators. These metrics should help tilt forecasts more firmly either in the direction of more lackluster activity ahead --- or one showing an economy that has shaken off the winter doldrums and is now transitioning to faster growth.

The first important measure out at the starting gate was personal income and spending during April and the data was largely as expected. Households were clearly not in a shopping mood in April, but then who could blame them given the grim economic numbers from the first quarter. Personal spending that month was flat in both nominal and real dollar terms.

But it's worth pointing out that shoppers stayed on the sidelines *not* because incomes suffered. Personal income jumped 0.4% that month and is up 4.1% over the year. Real disposable personal income --- the best measure of household purchasing power, climbed 0.3% in April and 3.5% (Chart 1) from its year ago level. Instead of ramping up spending, Americans simply chose for the moment to save more of their pay until they had a better sense of future job and income security.

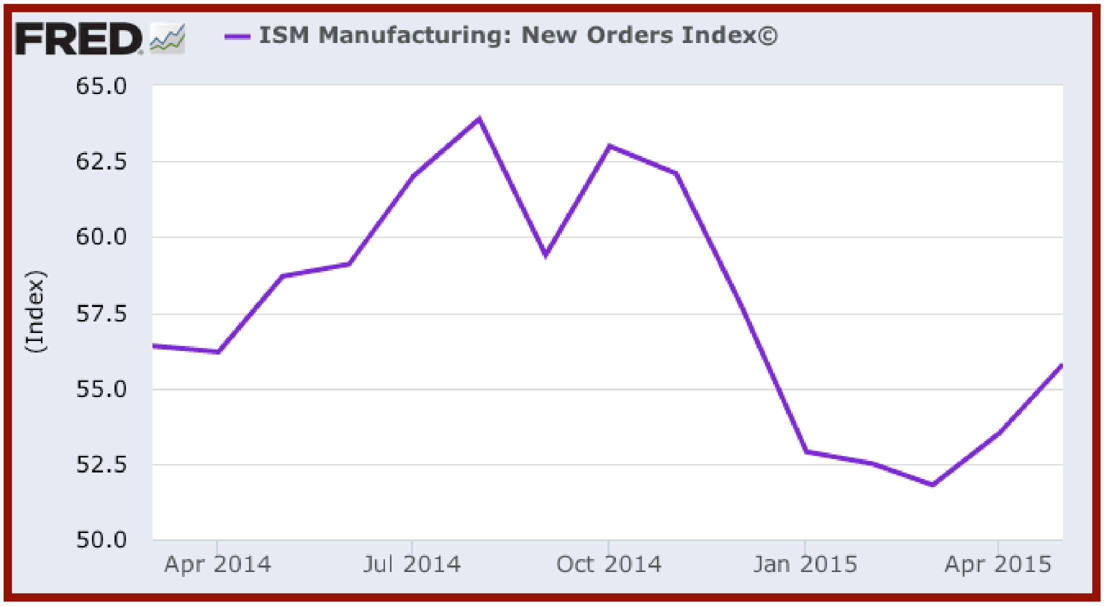
Chart 1.



With the savings rate now up to 5.6%, the second highest since December 2012, consumers are adding to their financial resources, funds that will fuel greater spending in the coming months as evidence mounts the economic outlook looks brighter.

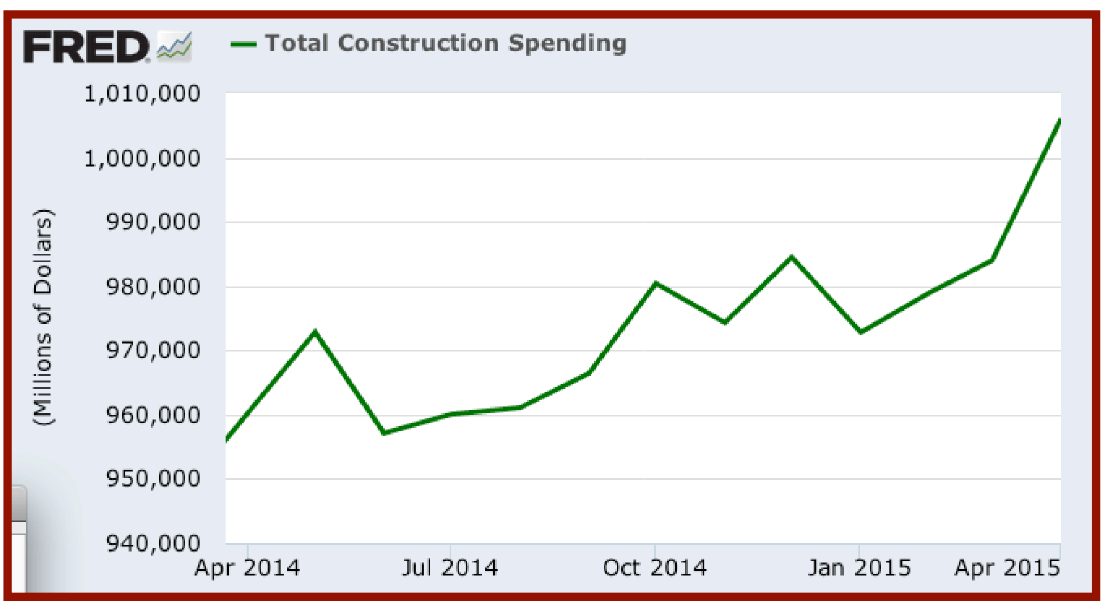
Certainly one key piece of good news out today was May's impressive purchasing manager's index (PMI) of manufacturing activity. It rose to 52.8 last month, from 51.5 in March, with nine of the ten components moving higher (only exports eased back). New orders in May surged to its highest level of the year (Chart 2) and caused the orders backlog index to swell to 53.5, up 4 percentage points in a single month. In an effort to fulfill orders more quickly, manufacturers stepped up hiring in May, with the employment index rebounding to 51.7, the best showing since January.

Chart 2.



Another upbeat report centered on building activity. Total construction spending rocketed in April to its highest level in more than 6 years (Chart 3)! Builder outlays rose to a $1 trillion annual rate, the most since November 2008, as both residential and commercial construction activity picked up pace. By the way, the government also completely reversed its initial finding for March, which it first reported as a 0.6% decline in construction outlays but now showed a *gain* of 0.5%!

Chart 3.



So, while we began the week with some fairly positive news on the economy, it hasn't moved the needle much on when the Federal Reserve will begin to raise rates. The latest metrics are encouraging, but the Fed has not yet seen sufficient evidence that its favored inflation measure is moving up towards its the 2% target. In fact, today's release on personal income and spending noted that the PCE price index headed in the opposite direction in April. Headline PCE inflation decelerated to 0.1% in the past 12 months ---the smallest since October 2009. Remove food and energy from the price measure and core PCE inflation edged up just 1.2% over the year--- the least annual increase since February 2014.

Does this mean the Fed will likely postpone a rate hike to 2016? Not at all. Inflation is a lagging indicator, which means it is certain to turn up after the economy gathers more steam. That's why this is such a pivotal week.

We expect the economic indicators out the next four days --- especially motor vehicle sales, factory orders, international trade (watch imports here), ISM services, consumer credit and of course the latest job numbers--- to further support our view that the fundamentals of the economy are strong and that growth is accelerating. That should lead to higher inflation this summer and pave the way for the Fed to raise rates by September.

Key Economic Forecasts

- Actual
- Forecast

United States

	I 2014	II 2014	III 2014	IV 2014	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016
Real Gross Domestic Product (GDP):												
%	-2.1	4.6	5.0	2.2	-0.7	2.8	4.2	3.2	2.3	3.5	3.2	2.8
Personal Consumption Expenditures:												
PCE	1.2	2.5	3.2	4.4	1.8	3.1	3.4	2.8	2.7	3.6	3.2	3.3
Inflation, end of period, year-over-year:												
CPI %	1.5	2.1	1.7	0.8	-0.1	0.6	1.0	1.3	2.0	2.3	2.3	2.5
Unemployment Rate (end of period):												
%	6.7	6.1	5.9	5.6	5.5	5.3	5.3	5.1	5.0	4.9	4.8	4.7
Non-farm Payrolls, monthly avg. thousand:												
	189	267	237	324	184	255	270	275	235	245	250	250
Treasury 10-yr Note Yield % (end of period)												
	2.72	2.52	2.51	2.17	1.93	2.30	2.65	2.80	3.05	3.25	3.75	4.00
Federal funds rate % (end of period)												
	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.75	2.00

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
US	1.8	-0.3	-2.8	2.5	1.6	2.3	2.2	2.4	2.6	3.1
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.9	1.7	1.9
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	2.6	2.8	3.0
Japan	2.1	-0.7	-5.4	4.6	-0.4	1.6	1.5	0.0	1.2	1.9
Canada	2.7	0.7	-2.8	3.2	2.5	1.7	2.0	2.5	2.3	2.9
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	7.5	6.5	7.0
China	14.2	9.6	9.2	10.5	9.3	7.8	7.7	7.4	6.7	6.4
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	-0.1	0.5	2.2
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.4	1.9	3.4	4.0
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.5	2.7	3.0
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	0.6	-3.9	1.0
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	3.2	3.9	5.4

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
USD/Yen	91	93	81	77	87	105	119	125	110
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.37	1.21	1.18	1.26

Oil (Brent spot) & Gasoline (Average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
Crude oil per barrel	46	78	95	107	111	111	58	73	84
Gasoline	1.61	2.57	3.00	3.27	3.30	3.32	2.26	2.45	2.70

Major Stock Indexes

	End 2012	End 2013	End 2014	% Change '14	End 2015	% Change '15
DJIA	13,104	16,577	17,823	7.5	19,300	8.3
S&P 500	1,426	1,848	2,059	11.4	2,199	6.8
NASDAQ	3,019	4,177	4,736	13.4	5,157	9.1
RUSSELL 2000	849	1,164	1,205	3.5	1,277	6.0