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ECONOMIC TALKING POINTS

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After a Dismal 1st Quarter, It Didn't Take Long For The Economy To Bounce Back

May's jobs report, along with several other positive indicators recently, should finally put to rest any notion that the economy's weakness in the first quarter will drag into the second quarter.

It was just a few weeks ago when a growing number of economists began to argue that the contraction in the first three months was not just the result of severe winter weather and a labor dispute on West Coast ports. They feared the recovery itself was in the process of losing steam. Even the Federal Reserve Bank of Atlanta issued a gloomy report in April that predicted a miserly 0.9% growth rate for second quarter.

Given the sudden uncertainty about the health of the economy, it is not at all surprising that consumers and businesses stayed on the sidelines for much of April.

Yet, in the weeks since, evidence began to mount that the economy was not moribund, but showing fresh signs of vitality.

Shoppers may have been apprehensive in April, but they came storming back in May. For example, purchases of cars and trucks last month jumped to a 17.8 million unit rate, the fastest pace in nearly a decade! Next week we'll get retail sales for May and we fully expect to see consumption rebound.

It's not just consumers that seem to be re-energized. Factories also shifted in higher gear last month. Manufacturing activity and new orders accelerated, based on data from the Institute for Supply Management (ISM). The jump in new orders tells us factories will continue to be busy in the coming months. The ISM's report on service sector activity also expanded in May, though slightly less than the previous month.

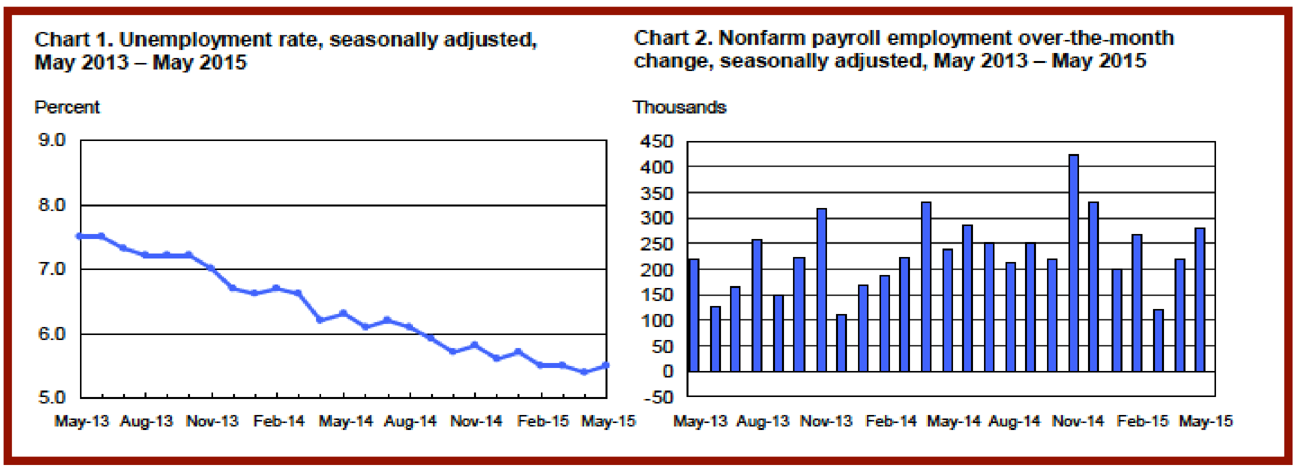
Loan demand, which is one of the best indicators on the underlying strength of the economy, remains strong. Commercial and industrial loans have been growing at double-digit annual rates all year. In addition, total residential mortgages as of the week of May 20th was the most in two years!

Even exports are climbing again, according to the latest stats on US foreign trade. It looks like the dollar's strength is having less and less of an impact on sales to foreign customers.

All this upturn in economic activity was also captured in the Fed's own Beige Book this week and will no doubt be part of the discussion at the FOMC meeting mid-June.

The May jobs report:

Culminating all these economic indicators was the latest employment report, and this time its message was unambiguous. The economy is back on track! Payrolls jumped 280,000 in May, a number that far exceeded consensus expectations of 225,000. Moreover, government revisions for the months of March and April lifted job gains by a net 32,000.



In fact, private employers were sufficiently upbeat about the economic outlook they ramped up hiring last month to 262,000, the fastest pace of the year!

Though the unemployment rate did notch up a tenth of a point to 5.5%, it was because more jobless Americans returned to the labor force and actively resumed looking for work. The 397,000 increase in the work force was the biggest since January and should be viewed as a positive development since it reflects growing confidence among the unemployed that a stronger economy will generate more job opportunities.

That sentiment helped lift the labor force participation rate to 62.9, matching this year's high of January's. **But an even broader measure, known as the employment - population ratio, showed that the percentage of the American population working jumped to 59.5%, the highest in more than six years!**

But let's not stop here. Dive deeper into the employment report and you see more unmistakable signs of an economy gaining new traction. Among the key data points worth noting:

• The number of people who lost jobs in the last five weeks plummeted by 311,000, the biggest monthly drop since December 2013.

• At the other end of the spectrum, Americans out of work 27 weeks or longer, also fell, bringing the size of this demographic to the smallest since November 2008.

• While average weekly hours in the private sector was unchanged at 34.5, firms are coming under more pressure to raise pay as they compete for skilled labor and to discourage their existing staff from leaving. Average hourly earnings has been climbing steadily each month since February, and is now up 2.3% from its year ago level, the biggest increase since August 2013. We see this trend toward higher pay continuing the rest of the year.

• With construction spending now at its highest level in history, builders moved to add another 17,000 to their payrolls, bringing total construction employment to 6.39 million, the most since February 2009.

• Manufacturers, responding to stronger domestic and foreign orders, hired 7,000 additional workers – the most since January. This has brought factory employment up to 12.33 million, the most in six years.

• **Finally, we want to highlight some of our favorite leading metrics in the jobs report: (1) employment in the trucking industry (up another 8,600 in May, the largest monthly increase of the year); (2) child care services (an increase of 3,000 last month, bringing employment in this field to a record high); and (3) the employment agencies themselves (which beefed up their hires by an additional 26,100 people, a pace we haven't seen since last November).**

The compilation of positive economic reports the past few weeks portray an economy that has shaken off the winter blahs and is now growing closer to a 3% pace. Indeed, we expect the government to revisit the dismal first quarter GDP numbers in July and conclude that flawed seasonal adjustment factors underestimated growth that period. In other words, business activity was probably stronger than first thought in the early months of the year.

Monetary policy

So what implications will this upbeat news have for monetary policy? Will the Fed reconsider a rate hike as early as this month? Not likely.

While the economy has accelerated, there are still some near term threats that need to be closely monitored before terminating its zero interest rate policy. On the Fed's radar screen right now, we suspect, are the tortuous Greek debt talks. Will it be resolved at the end of the month, or is a default inevitable? What kind of fallout will we see in the world financial markets? Second, the recent sell off in the global bond markets just accelerated this morning with the release of the strong jobs report. If bond yields climb too high, too quickly, it could pose a threat to the US and international economic recovery.

Look, we believe the Fed is gearing up to normalize short term interest rates this year. But it seems more likely policymakers there will take the cautious route and wait until September to act given the uncertainty over Greece and the ongoing volatility in the fixed income markets.

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	2.9	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	195	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	2.60	2.72	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