CNN Money

The U.S. economy is showing cracks

America's economy is starting to see cracks after closing out 2014 with Superman strength.

By Patrick Gillespie March 29, 2015

The U.S. job market had its best year of gains last year since 1999, and economic activity hit a whopping 5% in the third quarter -- the best quarter since 2003.

Three months later, the U.S. economy is looking a little tired. It's losing momentum in puzzling ways. Hiring is still strong, but experts are starting to scale back their growth forecasts.

Federal Reserve chair Janet Yellen summed it up well in a speech Friday: "If underlying conditions had truly returned to normal, the economy should be booming."

Economists say there are two main problems: Workers' wages aren't growing much, if at all. As a result, Americans aren't going out and spending much. On top of that, many foreign economies are slowing down, which puts pressure on the U.S.

The question going forward is whether we're just in a blip or a bigger shift is taking place.

"The consumer really hasn't kicked in at full speed ahead," says Peter Cardillo, chief market economist at Rockwell Global Capital. "We're going through a soft patch."
With March's jobs report out on Friday, this economic head-scratcher will be in full focus this week.

Still strong on jobs: The U.S. added over half a millions jobs in the first two months of this year alone. That's a 50% increase from the same two-month stretch a year ago when the Polar Vortex had much of America in a funk.

Job gains have come across the board: health care, construction, the service sector and retail businesses have all seen strong pick up. The unemployment rate is down to 5.5%, its lowest mark in seven years.

It would be a full-steam story on jobs except for one thing: wage growth. Hourly wages only grew 2% in February. That's a marginal bump up, but it's too little for most Americans to notice the recovery's progress. It's also well below the Federal Reserve's roughly 3.5% goal.

Wages are typically the economy's last yardstick to move in the right direction. Some economists say there's a six month "drag" on wage growth compared to the unemployment rate. In other words, the wage growth we see now reflects the unemployment rate in in September (when it was 5.9%).
"If you grow at 2% -- that's growth -- but that's certainly not growth that's going to expedite a change in wages," says Cardillo.

Pay attention to wage growth Friday as an equally important measure. It's beginning to be as important a number as the unemployment rate because it's a good indicator of consumer confidence.

Signs of slippage: People don't go out and spend unless they feel confident about the future. There was hope that cheap gas would spur people to feel better about the economy and their pocketbooks. A gallon of gas was $3.53 a year ago. Now it's $2.42, according to AAA.

But a lot of people are still holding onto that savings. Retail sales and construction on new homes both fell in February, missing estimates. The latest numbers on manufacturing are also weaker than hoped for. All this could just be a winter slowdown, but it's raising red flags.

"Most of it was due to the inclement weather we had...I think that kept a lot of shoppers at home," says **Bernard Baumohl, chief economist at the Economic Outlook Group,** a research firm.

Baumohl sees the economy rebounding in the second quarter -- much as it did last year. But shoppers -- and investors -- are in a "wait and see" mode right now. Businesses are also sitting on record levels of cash, an indication they might not be feeling confident enough to spend big, either.

Analysts forecast that first quarter earnings for S&P 500 companies could be down 4.6% from the same quarter last year, according to FactSet Research. That would be the first earnings pullback in about two years. It has investors on edge, which is why the Dow is negative for the year and S&P 500 is flat.

Still slow around the globe: If the U.S. is the hare, everyone else around the world seems like the tortoise right now.

Europe is just starting to move its economy in the right direction after years of going at a glacial pace.Japan continues to be mired in deflation as concerns mount that its stimulus plan isn't working. Oh yeah, Greece is still a problem and Yemen faces a grave crisis.

But the worst developments for an economic perspective are China's slowdown and the strong dollar. China's economic growth was basically breaking the sound barrier the last few years. Now it's just cruising at a lower altitude, which means there's less demand for U.S. exports to China. The U.S. dollar is on its fastest rise in 40 years, making U.S. goods more expensive than foreign ones. That's great for U.S. travelers, but it hurts major U.S. employers like Microsoft and Caterpillar.

All the foreign volatility is rocking the U.S. stock market. Add on the dollar dilemma, sluggish consumer outlook and, not to mention, Fed rate hike fears and this year is quickly shaping up to be a rocky rollercoaster ride. "We still have a long way to go," says Laurence Ball, an economics professor at Johns Hopkins University.

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