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

April 29, 2015

1Q 2015: An Economy in Winter Hibernation

The central question at this moment is whether the lack of growth last quarter was due simply to transitory factors--- and thus of less concern to the Federal Reserve and the financial markets--- or if it is a harbinger of a recovery that is faltering and therefore stay sluggish the rest of the year?

Our assessment of the first three months is that the 0.2% growth rate can ***only be viewed*** as a temporary slowdown and an isolated event. To conclude otherwise is to ignore a host of other key leading indicators that support faster growth in the months ahead.

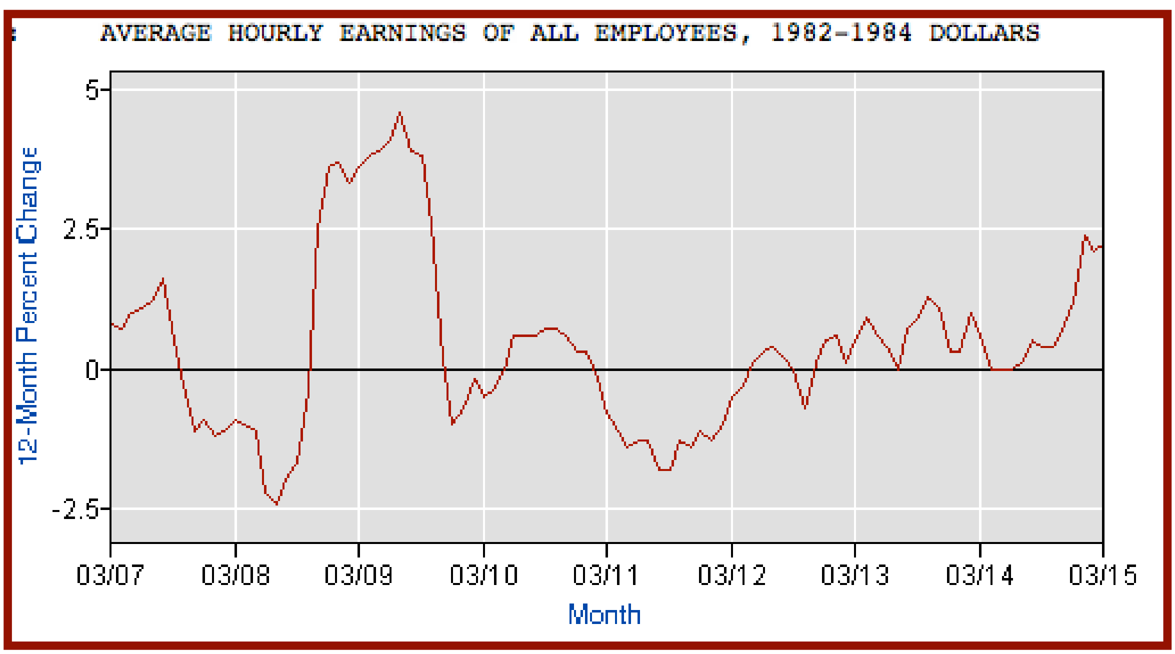
But let's first review the latest 1Q numbers ---and they are admittedly dismal. Clearly, consumers and businesses were hampered by an historically harsh winter, labor disputes on the West Coast (which significantly disrupted the delivery of goods to factories, wholesalers and retailers), a reduction in capital spending by oil producers, and a decline in exports due to the strong dollar. The result could not have been a surprise to anyone. Personal consumption rose at just a 1.9% rate, business spending on equipment was up a miniscule 0.1%, residential investments rose a mere 1.3% and exports slumped 7.5%. Every one of these categories turned out to be the worst in a year.

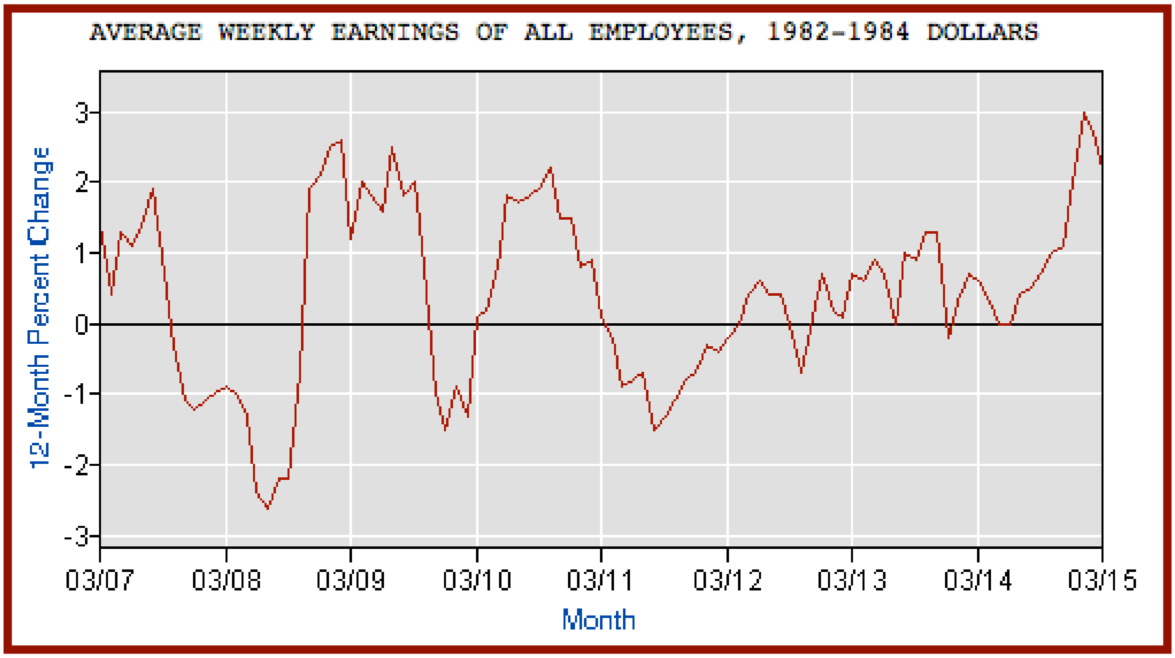
Here's the good news! The first quarter is over and the factors that led to its anemic performance are now history.

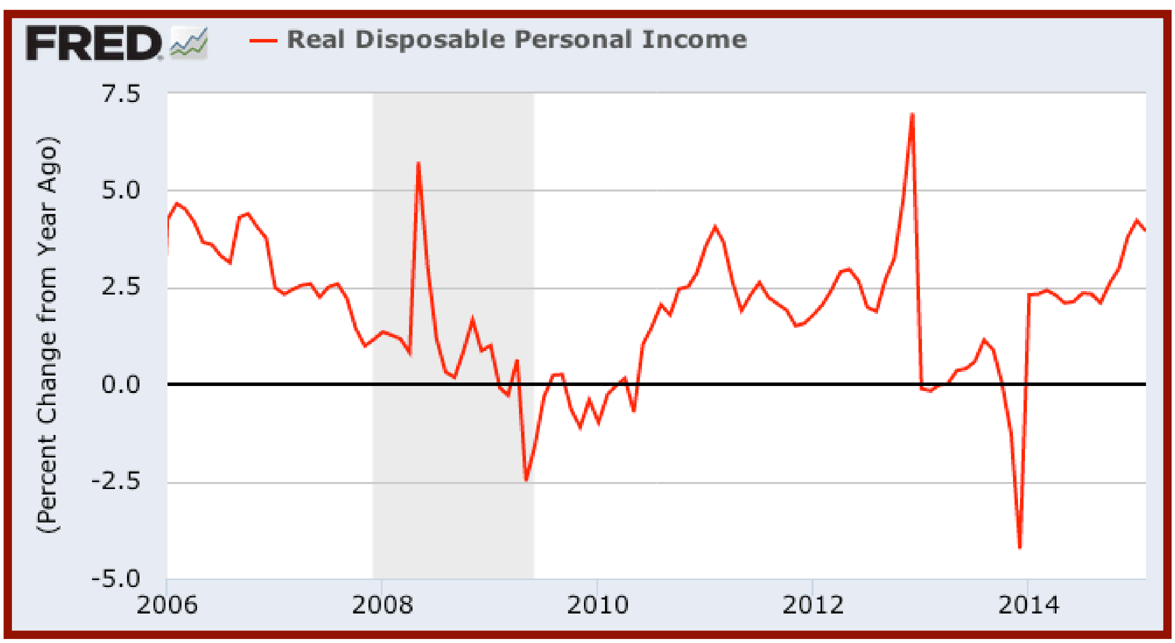
Let's begin with the outlook for consumer spending. Tomorrow's release on personal income and spending is an old metric on household outlays in March. What is more interesting is how consumers jumped back into action during April. The earliest indication of that has come from the weekly chain-store sales figures, which showed Americans, ramped up spending by nearly 5% this month compared with March.

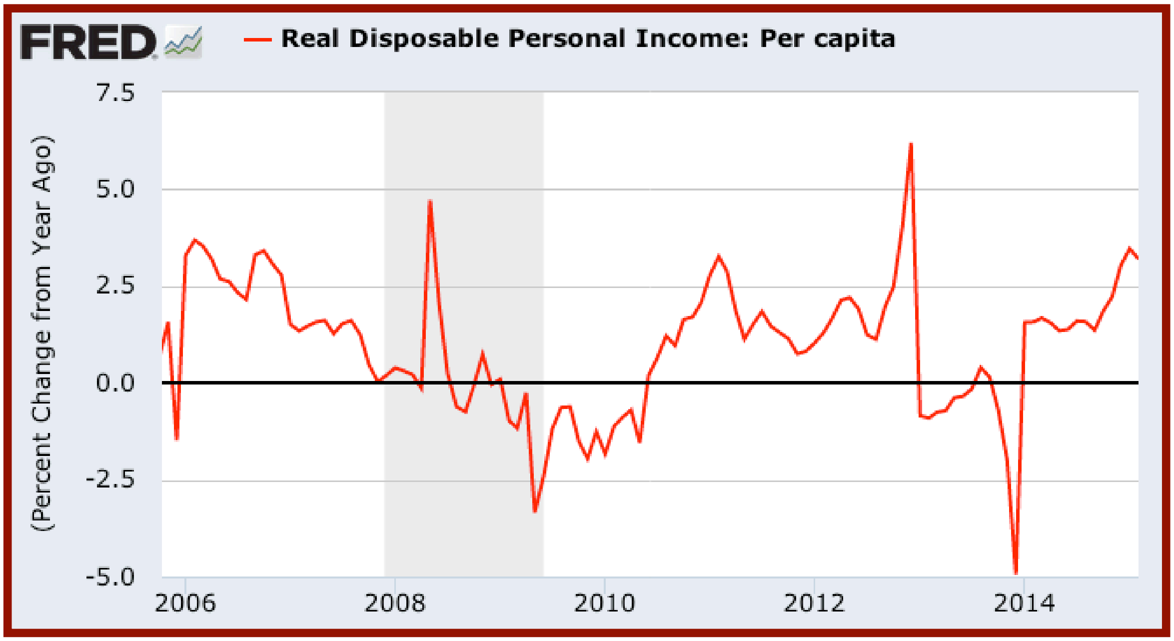
There are other signs personal consumption will significantly accelerate this quarter.

Labor market conditions have clearly improved. Payrolls so far this year has jumped by 591,000, higher than the 579,000 we saw in the first quarter of 2014. Equally important is that **real incomes are growing significantly too.** That last statement may come as a surprise, since time and time again we hear how wage growth has been stagnant. It is true that on a nominal basis, pay gains have not been impressive. However, the real driving force in spending is not increases in nominal pay, but the growth in purchasing power. **As you can see from the four charts below, wages have consistently been growing faster than the cost of living.** (The charts look at year-over year gains for average hourly earnings, average weekly earnings, real disposable personal income, both total and on a per capita basis). In other words, the lack of pricing power by companies historically limits wage gains. So ***any*** nominal increase in pay at a time when inflation is subdued translates into higher real incomes --- and that will help fuel more household spending.




AVERAGE WEEKLY EARNINGS OF ALL EMPLOYEES, 1982-1984 DOLLARS
12-Month Percent Change
3
2
1
0
-1
-2
-3
03/07
03/08
03/09
03/10
03/11
03/12
03/13
03/14
03/15
Month


FRED
Real Disposable Personal Income
(Percent Change from Year Ago)
7.5
5.0
2.5
0.0
-2.5
-5.0
2006
2008
2010
2012
2014



Now, it is true we did get a disappointing report on consumer confidence, with the Conference Board's measure dropping to 95.2 this month, from 101.4 in March. But it would be a mistake to over intellectualize what it implies. Remember, just a week earlier, the University of Michigan's consumer sentiment preliminary index for April jumped to the second highest in more than eight years! When you get such a divergence between two major gauges of confidence, the only real barometer of consumer moods is how Americans actually behave--- and we have already seen them emerge from their homes to ramp up shopping the last several weeks.

What about housing? More good news. The National Association of Realtors just announced that Pending Home Sales leaped up to a 22-month high last month. The number of new contracts signed to purchase an existing home jumped 1.1% to a level last seen in June 2013! In addition, we have seen promising signs that home construction activity will shift in faster gear as well. For one, permits for future construction are being filed faster than actual starts, which means builders have some catching up to do in the coming months. Another of our favorite leading indicators on residential construction is based on the number of empty lots sold to homebuyers. These are lands purchased where builders have yet to broken ground. The number of lots purchased last month rose to its highest level since April 2013!

Lenders are also becoming more forthcoming with loans now that employment and incomes have improved and as regulators in Washington liberalized some rules to allow for more loans. The result: mortgage lending by banks has increased in each of the last four months!

There's one other subject matter that needs to be discussed with greater depth and it is the impact of the dollar on US exports.

It is clear the stronger greenback has resulted in fewer receipts in dollars for exporters. The US currency has appreciated by more than 20% against its major trading partners over the last 12 months. But other than suffering a currency hit on the income side, companies have not seen any meaningful loss in the volume of goods sold. Real exports (adjusted for inflation) so far this year is actually higher than it was for the same two months in 2014 ($237.69 billion vs. $232.66 billion)! Moreover, it's important to keep in mind that the most popular destination for US exports has been in North America. Yet, the dollar has risen less than 10% against the Canadian dollar and 13% versus the Mexican peso. Finally, we expect to see the value of the US dollar plateau in the second half as evidence mounts that Europe is on a more solid growth path, and as China acts more aggressively to prevent its own economy from slipping much below 7% growth.

Bottom line:
Whether or not the Fed acts in June to commence raising rates will be determined by how strongly the economy bounces back in April and the early weeks of May. Since we do expect to see a rebound in consumer and business activity this month, we have not given up on a Fed increase in June. All eyes will be on tomorrow's release of personal spending and PCE inflation. Though it reflects activity in March, which was affected by snowstorms and freezing temperatures, an upward surprise in spending and in PCE inflation would further increase the odds of a rate hike at June's meeting.

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