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Economic Research
Published by Raymond James & Associates

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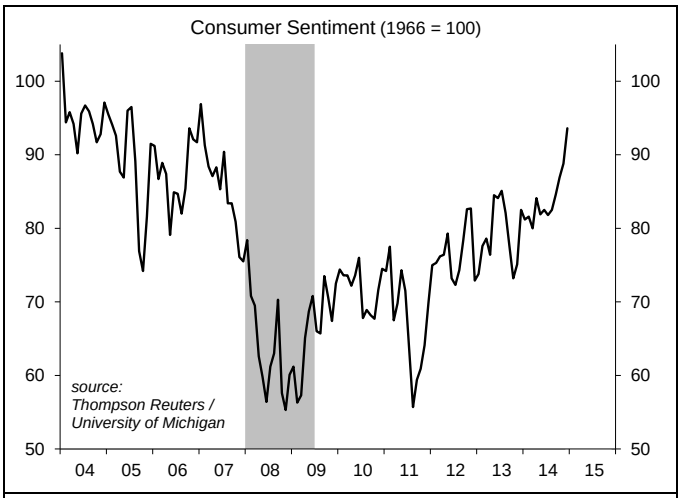
January 5 - 9, 2015

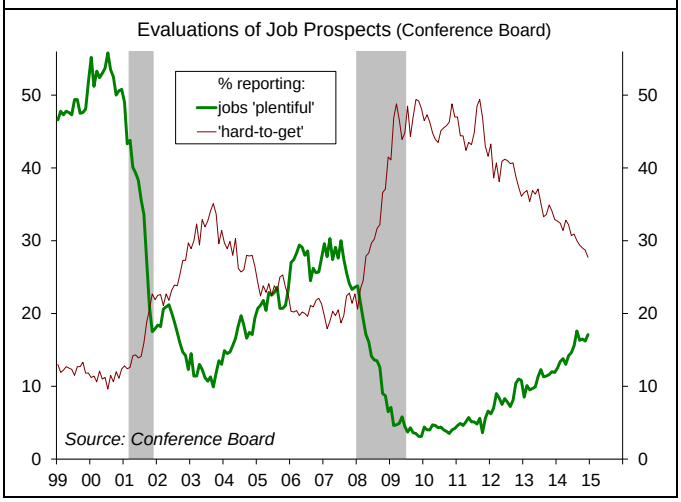
Weekly Economic Monitor

Consumer Outlook – A Strong Start in 2015

Amid all of the recent economic data releases, the consumer spending figures stand out. The near-term outlook for the consumer has improved substantially, but financial market participants have yet to embrace the good news.

The UM Consumer Sentiment Index has risen sharply in the last few months, reflecting an improved job market outlook and the impact of lower gasoline prices. Consumers don't spend confidence; income, wealth, and the ability to borrow are what drive spending. However, consumer attitude measures often provide a convenient assessment of the fundamentals.

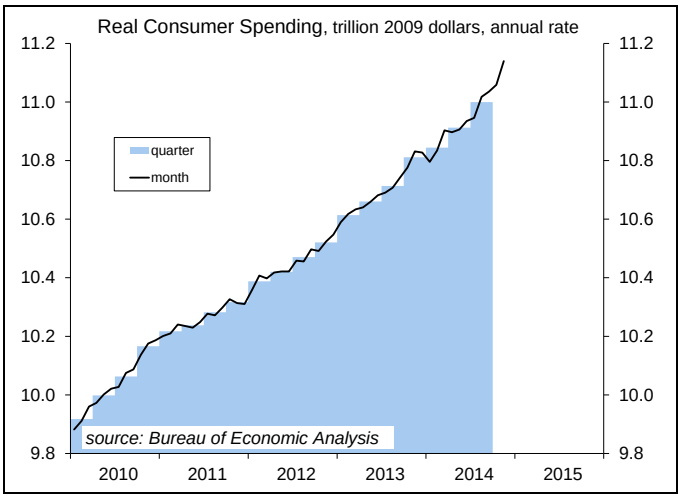




Through the first eleven months of 2014, payroll gains were already the strongest of any full year since 1999. It's no surprise then that job market perceptions are improving. Evaluations of current job market conditions are still far from normal, but they are moving in the right direction. Wage growth has remained subpar, but should pick up as the job market continues to tighten (probably more in the second half of 2015).

Lower gasoline prices are adding to consumer purchasing power. Putting less into their tanks, consumers will have more money to spending on other things. The drop in gasoline prices has been sharp, and at this point, seems likely to last.

The government recently raised its estimate of third quarter GDP growth to a 5.0% annual rate (vs. +3.9% in the 2nd estimate), with most of that revision coming from stronger consumer spending (a 3.2% annual rate, vs. +2.2% in the previous estimate). Moreover, monthly data reflect acceleration in 4Q14. The November figure on personal spending was higher than expected and spending growth was revised higher for each of the four previous months. Doing the math, inflation adjusted consumer spending (70% of GDP) appears to be tracking at a 4.0% to 4.5% annual rate in 4Q14. Of course, the personal spending figures are subject to revision. However, at face value, they paint a much brighter outlook for the consumer.



Note that the recent spending figures do not fully reflect the decline in gasoline prices, which should have a much bigger impact in the first half of 2015. A $1.50 drop in gasoline prices is equivalent to $150 billion in annual consumer expenditures. That's about 0.9 percent of overall GDP. However, the impact will be a lot more than that, as the added spending boosts income. Businesses will also be saving on transportation costs. If sustained, the drop in gasoline prices should easily add more than a full percentage point to GDP growth (even accounting for the decline in energy exploration and production).

The stronger consumer spending outlook does not necessarily bring a Fed rate hike much closer. Labor market slack will be taken up at a somewhat faster pace, but there's still plenty of slack remaining. Consumer price inflation was mild in 2014 (expected at 0.5%, December-to-December) – and some of the drop in gasoline prices is likely to flow through to core inflation, even if the Fed sees the impact as *"transitory."*

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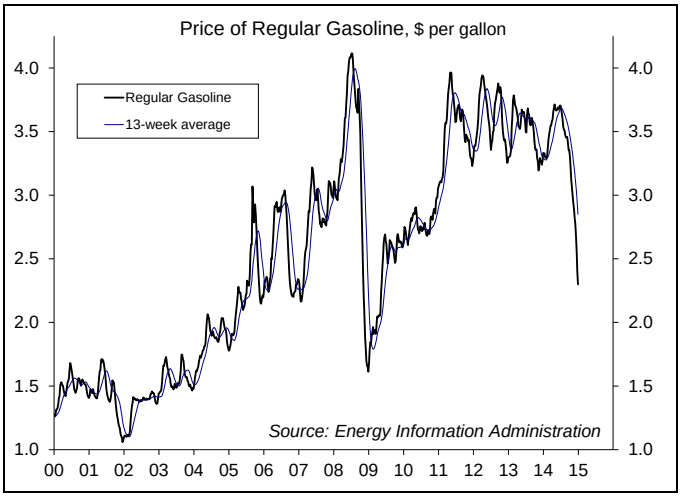
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
12/05/14	0.02	0.08	0.18	0.65	1.09	1.69	2.31	2.97	1.230	1.560	121.38	1.142	4780.76	2075.37	17958.79
12/26/14	0.01	0.10	0.26	0.73	1.19	1.75	2.25	2.81	1.219	1.555	120.45	1.162	4806.86	2088.77	18053.71
1/02/15	0.02	0.11	0.25	0.66	1.07	1.61	2.12	2.69	1.200	1.533	120.45	1.176	4726.81	2058.17	17833.05

Recent Economic Data and Outlook

The consumer spending outlook has improved significantly, but U.S. investors remain concerned about developments in the rest of the world and eventual Fed policy tightening.



The average price of regular **Gasoline** fell to $2.30 in the final full week of December, down 31.0% from a year ago.

The **ISM Manufacturing Index** fell to 55.5 in December, vs. 58.7 in November and 59.0 in October. New orders and production slowed to a moderately strong pace (from a very strong pace in recent months). Employment growth picked up. Input price pressures receded. Comments from supply managers were mixed, reflecting domestic strength, but with some weakness in exports and energy production.

Construction Spending fell 0.3% in November (+2.4% y/y). Single-family residential rose 1.0% (+12.5% y/y). Nonresidential slipped 0.3% (+4.7% y/y).

Real GDP rose at a 5.0% annual rate in the government's 3rd estimate (vs. +3.9% in the 2nd estimate and +3.5% in the advance estimate). Most of the revision was in consumer spending, which went from a 2.2% annual rate to 3.2%. Domestic Final Sales (GDP less net exports and the change in inventories) rose at a 4.1% pace (vs. +3.2% in the 2nd estimate), up 2.7% from a year ago. While GDP growth in 4Q14 (5.0%) and 3Q14 (+4.6%) was impressive, they followed -2.1% in 1Q14 (the average for the first three quarters of 2014 was 2.4%).

Personal Income rose 0.4% in November (+4.2%), led by a 0.6% increase in private-sector wages and salaries (+5.1%). **Personal Spending** rose 0.6% (+4.0% y/y), with upward revisions to each of the four previous months. Adjusted for inflation, spending rose 0.7% (+2.8% y/y) – on track for an annual rate of 4.0% to 4.5% in 4Q14 (the monthly figures are subject to revisions). The **PCE Price Index** fell 0.2% (-0.172% before rounding, +1.2% y/y), unchanged ex-food & energy (+0.008%, +1.4% y/y).

The Conference Board's **Consumer Confidence** Index rose to 92.6 in the initial estimate for December, vs. 91.0 in November and 94.1 in October. Ratings of current economic conditions were the highest since February 2008. Evaluations of current job availability were less pessimistic (much improved, but still a long way from normal). Expectations, thought to be a driver of big-ticket spending, edged down.

The Reuters/University of Michigan **Consumer Sentiment** Index rose to 93.6 in December, vs. 88.8 in November and 82.5 a year ago. It was the highest level since January 2007 (96.9, the previous cyclical peak). The reported indicated that gains were due to improving job and wage prospects, "and more recently, to falling gasoline prices." Importantly, gains in jobs and wages were "widespread across all population subgroups and regions."

New Home Sales fell 1.6% in November, to a 438,000 seasonally adjusted annual rate (-1.6% y/y). Results were mixed across regions (-12.0% in the Northeast, -6.3% in the Midwest, -6.4% in the South, and +14.8% in the West).

Existing Home Sales fell 6.1% in November, to a 4.93 million seasonally adjusted annual rate (+2.1% y/y). Results were lower in all four regions (-4.2% in the Northeast, -8.9% in the Midwest, -3.2% in The South, and -9.6% in the West).

Economic Outlook (1Q15): Real GDP growth of 2.5-3.0%, following 2.5-3.0% in 4Q14.

Employment: Job growth has strengthened. Labor market slack is being taken up, but considerable slack remains.

Consumers: The underlying trend in nominal average wages has been lackluster, but lower gasoline prices will add to consumer purchasing power in the near term and wage growth should pick up later on as the job market tightens.

Manufacturing: Mixed. A stronger dollar and weakness in the global economy are expected to restrain exports, but domestic demand should strengthen in the months ahead.

Housing/Construction: Supply constraints have eased and affordability has improved. Look for a better balance in 2015 (less speculative buying, better consumer fundamentals).

Prices: The PCE Price Index, the Fed's chief inflation gauge, remains well below the Fed's 2% target on a y/y basis. Pipeline pressures appear mild. Wage pressures are limited. Inflation expectations remain well-anchored, but could decline.

Interest Rates: With the Fed's large-scale asset purchases (QE3) completed, short-term interest rates are expected to remain exceptionally low through the middle of 2015. The Fed's policy moves in 2015 will be dictated largely by job market conditions, but the Fed will also react to financial market conditions.

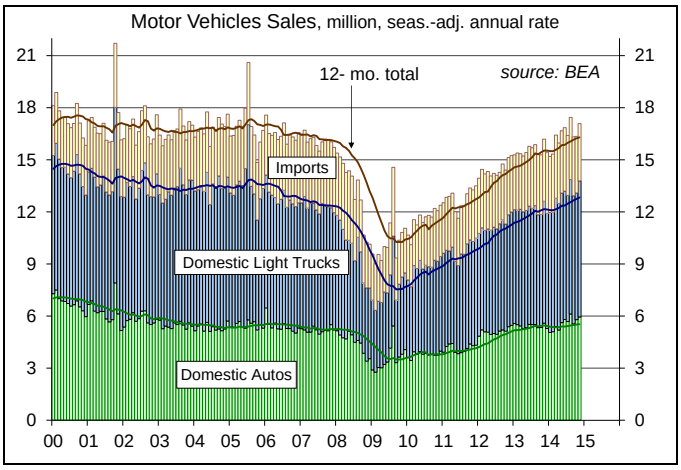
This Week:					*forecast*	last	last –1	comments
Monday	1/05	tba	Motor Vehicle Sales, mln	Dec	***17.3***	17.1	16.3	seen a bit higher
			domestically built		***13.9***	13.8	13.1	lower gasoline prices may help
Tuesday	1/06	10:00	**ISM Non-Manf. Index**	Dec	***59.8***	59.3	57.1	moderately strong
		10:00	Factory Orders	Nov	***-0.8%***	-0.7%	-0.5%	durables down 0.7% + lower oil prices
Wednesday	1/07	8:15	**ADP Payroll Est., th.**	Dec	***+225***	+208	+233	moderately strong (revisions?)
		8:30	Trade Balance, $bln		***-41.6***	-43.4	-43.6	seen somewhat narrower
			goods only		***-60.9***	-62.7	-62.7	lower petroleum prices
		2:00	**FOMC Minutes**	12/17				more insight into the Fed timing outlook
Thursday	1/08	7:00	BOE Policy Decision					no change
		8:30	Jobless Claims, th.	1/03	***290***	298	281	seasonal adjustment adds uncertainty
		10:00	Philadelphia Fed Index					annual benchmark revisions
Friday	1/09	8:30	**Nonfarm Payrolls, th.**	Dec	***+230***	+321	+243	a moderately strong gain (revisions?)
			private-sector		***+220***	+314	+236	near recent trend
			Unemployment Rate		***5.7%***	5.8%	5.8%	likely to edge lower
			employment/population		***59.3%***	59.2%	59.2%	trending gradually higher
			Avg. Weekly Hours		***34.6***	34.6	34.5	seen flat
			Avg. Hourly Earnings		***+0.2%***	+0.4%	+0.1%	mild wage pressures
Next Week:								
Monday	1/12	1:00	Treasury Note Auction					3-year notes
		20:30	**CFP National Championship**					Oregon vs. Ohio State
Tuesday	1/13	7:30	Small Business Optimism	Dec	***NF***	98.1	96.1	improving
		10:00	JOLTS: hiring rate	Nov	***NF***	3.6%	3.6%	a gradual trend of improvement
			JOLTS: quit rate		***NF***	1.9%	2.0%	still below normal
		1:00	Treasury Note Auction					10-year notes
		2:00	Treasury Budget, $bln	Dec	***NF***	+53.2	-1.2	higher outlays (a calendar quirk)
Wednesday	1/14	8:30	Import Prices	Dec	***-1.4%***	-1.5%	-1.2%	lower oil prices
			ex-food & fuels		***-0.2%***	-0.2%	-0.3%	mild disinflationary pressure for the U.S.
		8:30	**Retail Sales (advance)**	Dec	***+0.5%***	+0.7%	+0.5%	a relatively strong trend
			ex-autos		***+0.3%***	+0.5%	+0.4%	lower gasoline prices will subtract
			ex-autos, bld mat, gasoline		***+0.5%***	+0.6%	+0.7%	a moderately strong trend in core sales
		10:00	Business Inventories	Nov	***NF***	+0.2%	+0.3%	a slower pace in 4Q14?
		1:00	Treasury Bond Auction					30-year bonds
		2:00	**Fed Beige Book**					likely to reflect an improving economy
Thursday	1/15	8:30	Jobless Claims, th.	1/10	***292***	***290***	298	subject to seasonal noise
		8:30	**Producer Price Index**	Dec	***-1.0%***	-0.2%	+0.2%	lower gasoline prices
			ex-food & energy		***+0.1%***	0.0%	+0.4%	a low trend
			ex-f, e, & trade services		***+0.1%***	0.0%	+1.5%	mild core inflation
		8:30	Empire St. Manf. Index	Jan	***NF***	-3.6	10.2	erratic in recent months
		10:00	Philadelphia Fed Index	Jan	***NF***	24.5	40.8	figures can be volatile
Friday	1/16	8:30	**Consumer Price Index**	Dec	***-0.4%***	-0.3%	0.0%	lower gasoline prices
			year-over-year		***+0.5%***	+1.3%	+1.7%	dropping sharply
			ex-food & energy		***+0.1%***	+0.1%	+0.2%	mild core inflation
			year-over-year		***+1.7%***	+1.7%	+1.8%	a low trend
		8:30	Real Weekly Earnings	Dec	***NF***	+0.9%	+0.1%	lower gasoline prices will help
			Real Hourly Earnings		***NF***	+0.6%	+0.1%	should support spending growth
		9:15	**Industrial Production**	Dec	***+0.3%***	+1.3%	+0.1%	more moderate weather
			manufacturing output		***+0.4%***	+1.1%	+0.4%	mixed, but mostly positive
			Capacity Utilization		***80.2%***	80.1%	79.3%	a mild increase
			manufacturing		***79.4%***	79.2%	78.4%	near the long-term average
		9:55	Consumer Sentiment	m-Jan	***94.2***	93.6	88.8	lower gasoline prices helping

This Week…

The focus is expected to be on the December Employment Report, which is subject to some seasonal noise. While the financial markets may react to any surprise in the headline payroll figure, it's the trend that matters (November's gain may have been overstated). The FOMC minutes may shed a little more light into the Fed's policy timing outlook, but are unlikely to provide any definitive answers. Still, there's always a chance that the markets will take something out of context.

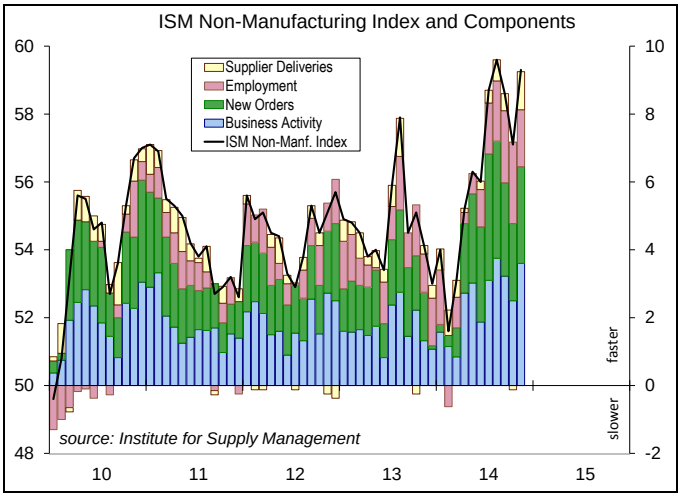
Monday

Motor Vehicle Sales (December) – Vehicle sales fell sharply during the financial crisis, but have improved steadily in the recovery, supported by two key factors. One is that cars wear out and have to be replaced. The other is that banks have been very willing to make auto loans. The pace of sales is now near the pre-recession level. We may see some further boost in the near term due to lower gasoline prices, but the trend is likely to flatten out in the second half of the year.



Tuesday

ISM Non-Manufacturing Index (December) – The ISM's other survey has been relatively stronger in recent months, consistent with brisk growth in the overall economy. Further improvement is likely in the December survey, indirectly reflecting the sharp drop in gasoline prices in recent weeks.



Wednesday

ADP Payroll Estimate (December) – ADP's estimate of private-sector payrolls missed the BLS figure by a wide margin in November. We could see a revision, but the trend is likely to remain moderately strong.

Trade Balance (November) – Lower oil prices should put some downward pressure on imports, but a stronger dollar and an improving economy should boost non-petroleum imports over time. Exports are likely to reflect a soft global economy, but trade activity does not turn on a dime. The monthly trade data tend to be choppy, but we should see a wider deficit in 2015.

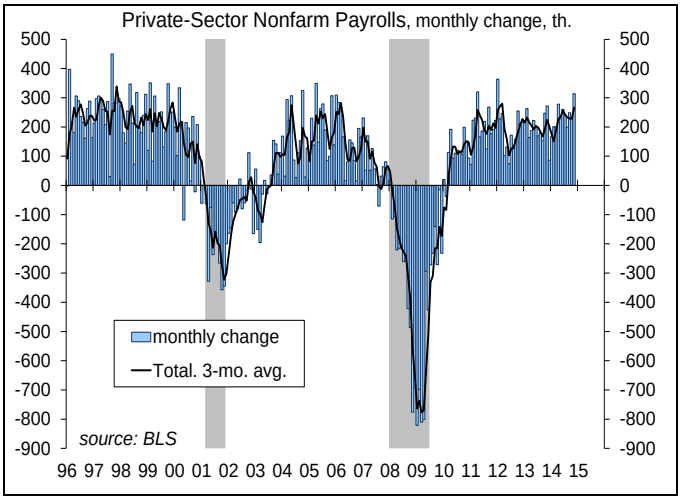
FOMC Minutes (December 16-17) – Fed Chair Janet Yellen's post-meeting press conference gave us a good look into what went on at this meeting. The Fed's decision on when to start raising rates will be data-dependent and the Fed can afford to be "patient" in deciding when to hike. However, some Fed officials are clearly more patient than others. There are hawks at the Fed and the financial markets may be rattled by their opinions, but there are more doves on the FOMC.

Thursday

Jobless Claims (week ending January 3) – There is a strong spike in claims at the start of the year, but that spike has moderated in recent years. Seasonal adjustment is tricky and we often see increased volatility in the adjusted figures (the noise should settle down in late February). Take any large moves with a grain of salt. The underlying trend should remain low.

Friday

Employment Report (December) – On a seasonal basis, we can expect to lose a lot of construction and education jobs each December, but we also gain holiday-related jobs (retail, package delivery). Some holiday job gains may have been pulled forward this year (making the November payroll figure look a lot better), but that would wash out over time. The unemployment rate should trend lower, but the pace of decline can be expected to slow in 2015 as an improved job market outlook leads to an increase in labor force participation. Average hourly earnings picked up in November, but these figures are often uneven.



Next Week …

Lower gasoline prices will have a mixed impact on retail sales figures for December (lower gasoline sales, but increased spending on everything else). The Consumer Price Index should be driven down by the drop in gasoline prices, with a sharp decline in the year-over-year pace.

Coming Events and Data Releases

January 19	MLK Holiday (markets closed)
January 22	ECB Policy Meeting
January 28	FOMC Policy Decision (no press conference)
January 30	Real GDP (4Q14, advance estimate)
February 1	Super Bowl XLIX
February 6	Employment Report (January)
March 18	FOMC Policy Decision, Yellen press conference
April 29	FOMC Policy Decision (no press conference)
June 17	FOMC Policy Decision, Yellen press conference