RAYMOND JAMES

Economic Research
Published by Raymond James & Associates

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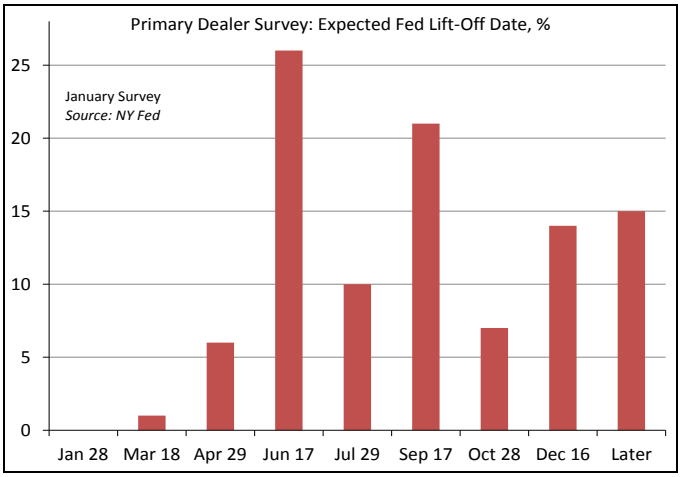
February 23 - 27, 2015

Weekly Economic Outlook

Yellen's Trip to the Hill, a Preview…

Fed Chair Janet Yellen will testify on monetary policy on Tuesday and Wednesday. These appearances are less traumatic for the financial markets than they used to be. The Fed releases minutes of the policy meetings on a timelier basis and the Fed chair holds press conferences after every other meeting. Hence, it's unlikely that we'll see Yellen signal a major change in the policy outlook. Still, the financial markets will pay attention.

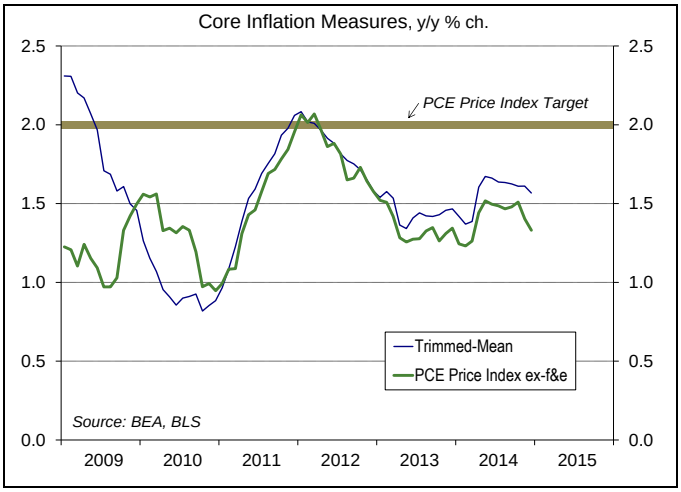
The minutes of the January 27-28 policy meeting helped to clarify the outlook for monetary policy. Officials continued to prepare for policy normalization, as they worked on the technical details. The financial markets are more concerned about the timing of the lift-off – that is, when the Fed will begin to raise short-term interest rates. However, policymakers were briefed not just on possibilities for the timing, but also on the pace of rate increases. The minutes did not go into details on what the Fed staff presented or what conclusions may have been drawn, if any. Note that in her press conference in mid-December, Yellen cautioned against assuming that the Fed would raise rates at *"a measured pace"* (that is, 25 basis points per meeting) once tightening begins. She also emphasized that the FOMC could decide to begin raising rates at any meeting, not just the ones that have a post-meeting press conferences. So, the Fed could wait longer and raise rates more rapidly once it starts, or make larger moves on an irregular basis. Indeed, Yellen previously emphasized optimal control theory, which *"calls for a later lift-off"* of policy tightening.



Prior to each FOMC meeting, the Fed surveys the primary dealers, asking questions about the timing of policy firming and about the outlook for the economy and financial markets. In January, responses on the timing were all over the place, but with more than half between June and September. This is roughly consistent with the range of forecasts of the year-end federal funds rate made by senior Fed officials in December.

The FOMC minutes provided a concise picture of the Fed's timing debate. *"Several"* Fed officials feared that waiting too long could lead to higher inflation. However, *"many"* participants (which is more than *"several"* in Fed lingo) worried that moving too soon could *"damp the apparent solid recovery in real activity and labor market conditions."* An earlier lift-off would also leave the Fed with limited options should the economy slow (as it remains close to the zero lower bound). Many Fed officials wanted to see a pickup in wages growth or evidence that the recovery remained on solid footing, with inflation moving back toward the 2% goal *"after the transitory effects of lower energy prices and other factors dissipate."*

The low inflation does not mean that the Fed won't hike. Yellen indicated that the Fed could still raise rates as long as there is a strong expectation that inflation will move toward the 2% goal. The Fed has described the impact of lower energy prices as *"transitory."* However, lower energy prices are likely to help push core inflation down in the near term.



Low inflation is also a consequence of a soft global economy. Yet, lower energy prices should help the rest of the world to eventually recover. However, the timing isn't clear. Estimates of European growth have picked up a bit recently, due to the drop in energy prices, but there are a lot more issues in the global economic outlook besides energy.

Note that the Fed does consider the impact of a stronger dollar on growth and inflation. However, the exchange rate of the dollar is not the Fed's responsibility (that's the Treasury's call). The Fed is not going to refrain from raising short-term interest rates to weaken the dollar.

Does it really matter when the Fed begins to tighten? The timing has some minor implications for longer-term Treasury yields, but it's much more important for the middle of the curve. Forecasting the pace of policy normalization ought to be just as important as getting the start date right.

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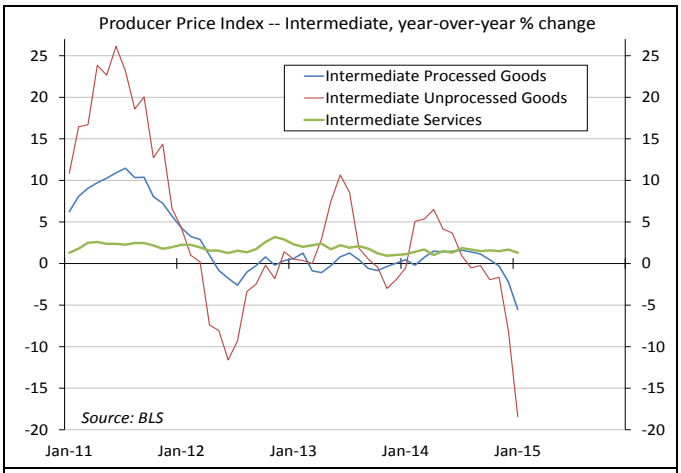
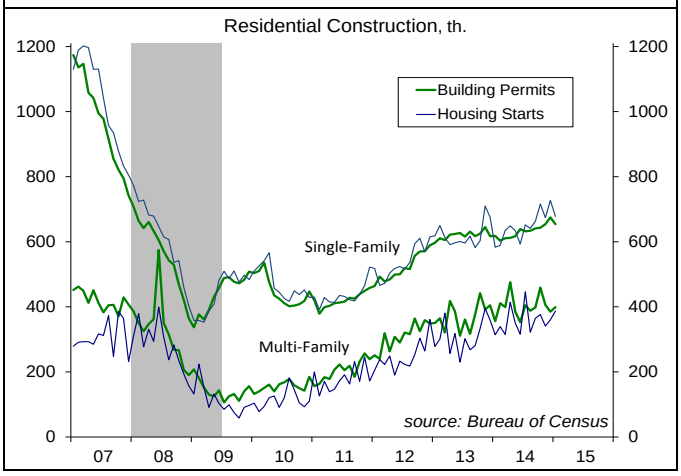
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
1/23/15	0.03	0.07	0.17	0.51	0.84	1.28	1.77	2.33	1.128	1.502	117.80	1.240	4757.88	2051.82	17672.60
2/13/15	0.01	0.07	0.23	0.66	1.03	1.53	2.02	2.63	1.141	1.539	118.70	1.245	4893.84	2096.99	18019.35
2/20/15	0.02	0.07	0.21	0.64	1.06	1.60	2.12	2.72	1.138	1.539	119.07	1.254	4955.97	2110.30	18140.70

Recent Economic Data and Outlook

Greece's latest proposal to extend its debt was rejected by Germany, but there were hopes that other Eurogroup finance ministers would be more agreeable. In the end, the issue was kicked down the road once more. The Fed policy meeting minutes showed that officials are continuing to plan policy normalization. Views were mixed, but officials mostly seemed to be in no hurry to raise short-term interest rates. The economic data were mixed. The PPI surprised to the downside and details suggests more downward price pressures in the pipeline.





The **FOMC Minutes** from the January 27-28 policy meeting showed the Fed preparing to raise short-term interest rates, but also illustrated differences of opinion about the risks of departing too late or too soon from the current low level of short-term interest rates. While *"several"* Fed officials feared that waiting too long would risk higher inflation, *"many"* (which in Fedspeak, is more than *"several"*) worried that a premature increase could dampen the economic recovery and leave the Fed with limited options to correct course. Many wanted to see signs that the economic recovery remained well-grounded after the transitory effects of lower gasoline prices and other factors dissipate. Several wanted to see a pickup in labor compensation. There remained a lot of anxiety regarding possible changes to the language (the *"patient"* phrase), with worries that the financial markets might overreact.

The **Producer Price Index** fell 0.8% in January (+0.0% y/y), held down by a 10.3% drop in energy prices). Food fell 1.1% (+2.5% y/y). Ex-food & energy, the PPI slipped 0.1% (+1.6% y/y). Ex-food, energy, and trade services, the PPI fell 0.3% (+0.9% y/y). Pipeline gauges reflected significant disinflation pressures.

Industrial Production rose 0.2% in January, held back by a 1.0% drop in mining (drilling oil and gas wells down 10.0%). Manufacturing output rose 0.2% +6.0% y/y), with autos down 0.6% (+13.3% y/y). Ex-autos, factory output rose 0.2% (+5.1% y/y). Results were mixed but mostly positive across industries.

Building Permits fell 0.7% in January, to a 1.053 million seasonally adjusted annual rate (+8.1% y/y). Single-family permits fell 3.1% (+5.8% y/y) – down in all four regions (-2.0% in the Northeast, -2.0% in the Midwest, -2.1% in the South, and -6.7% in the West). **Housing Starts** fell 2.0%, to a 1.065 million pace (+18.7% y/y), with single-family starts down 6.7% (+16.3% y/y).

Homebuilder Sentiment slipped to 55 in February, vs. 57 in January and 58 in December.

The **Index of Leading Economic Indicators** rose 0.2% in January, while figures for November and December were revised a bit lower. Components were mixed. Positive contributions were led by the yield curve, credit conditions, and consumer expectations. Building permits and the stock market subtracted. The Conference Board noted that the LEI, combined with the index of coincident indicators, "suggests that the expansion in economic activity should continue in the near-term."

Economic Outlook (1Q15): Real GDP growth of 2.5-3.0%.

Employment: Job growth is strong. Small firms are hiring.

Consumers: Strong job growth and lower gasoline prices should support spending growth in 1H15. Confidence is trending higher, but we'll eventually need to see a pickup in wages.

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 remains well below the Fed's 2% goal – and the core rate is moving in the wrong direction. Pipeline pressures are mild. Wage pressures are limited. Inflation expectations remain well-anchored, but may decline.

Interest Rates: With low inflation and a still-high elevated level of slack in the economy, the Fed can be patient in deciding when to begin raising short-term interest rates. Global financial conditions are also a consideration (along with the outlooks for inflation and the job market). The hard part for the Fed will be managing financial market expectations.

This Week:					*forecast*	last	last –1	comments
Monday	2/23	10:00	**Existing Home Sales, mln**	Jan	***5.10***	5.04	4.92	likely to improve
			% change		***+1.2***	+2.4	-6.3	but spring activity will be more important
Tuesday	2/24	9:00	C-S Home Prices (national)	Dec	***+0.6%***	+0.8%	+0.7%	trending higher
			year-over-year		***+4.6%***	+4.7%	+4.6%	roughly steady
		10:00	CB Consumer Confidence	Feb	***103.2***	102.9	93.1	follows strong gain in January (revisions?)
		10:00	**Yellen Mon Pol Testimony**	Feb				Senate, tentatively scheduled
		1:00	Treasury Note Auction					2-year notes
Wednesday	2/25	10:00	**New Home Sales, th.**	Jan	***485***	481	431	anecdotal reports of solid strength…
			% change		***+0.8***	+11.6	-6.7	but these figures are erratic
		10:00	**Yellen Mon Pol Testimony**	Feb				House, tentatively scheduled
		11:30	FRN auction					re-opened 2-year Floating Rate Notes
		1:00	Treasury Note Auction					5-year notes
Thursday	2/26	8:30	Jobless Claims, th.	2/21	***290***	283	304	choppiness should begin to settle
		8:30	**Consumer Price Index**	Jan	***-0.6%***	-0.3%	-0.3%	lower gasoline prices
			year-over-year		***-0.1%***	+0.7%	+1.3%	roughly flat vs. a year ago
			ex-food & energy		***+0.1%***	+0.1%	+0.1%	low core inflation
			year-over-year		***+1.5%***	+1.6%	+1.7%	edging lower
		8:30	Real Weekly Earnings	Jan	***+1.0%***	+0.2%	+0.8%	nominal earnings rose 0.5%
		8:30	**Durable Goods Orders**	Jan	***-0.2%***	-3.3%	-2.2%	seasonal adjustment may complicate
			ex-transportation		***-0.4%***	-0.8%	-1.2%	mixed across sectors, but a poor trend
			nondef cap gds ex-aircraft		***-0.6%***	-0.1%	-0.5%	weakness in energy and exports
		1:00	Treasury Note Auction					7-year notes
Friday	2/27	8:30	**Real GDP (2nd estimate)**	4Q14	***+2.2%***	+5.0%	+4.6%	+2.6% in adv. est., mixed revisions
		9:45	Chicago PMI	Feb	***58.5***	59.4	58.8	moderately strong
		9:55	UM Consumer Sentiment		***94.2***	98.1	93.6	93.6 at mid-month
		10:00	Pending Home Sales Index	Jan	***+1.6%***	-3.7%	+0.6%	likely to rebound
Next Week:								
Monday	3/02	8:30	Personal Income	Jan	***+0.5%***	+0.3%	+0.3%	better growth in labor income
			Personal Spending		***-0.2%***	-0.3%	+0.5%	lower gasoline prices
			PCE Price Index ex-f&e		***+0.1%***	0.0%	0.0%	trending well below the Fed's 2% goal
		9:45	Markit US Manf PMI (final)	Feb	***NF***	53.9	53.9	54.3 in the flash estimate
		10:00	**ISM Manf Index**	Feb	***53.4***	53.5	55.1	mixed, but moderate on balance
		10:00	Construction Spending	Jan	***+0.3%***	+0.4%	-0.2%	mixed, watch for revisions
Tuesday	3/03	tba	Motor Vehicle Sales, mln	Feb	***NF***	16.6	16.8	weather may have been a factor
			domestically built		***NF***	13.3	13.4	still a strong trend
Wednesday	3/04	8:15	**ADP Payroll Estimate, th.**	Feb	***+190***	+213	+253	weather? (benchmark revisions due)
		10:00	**ISM Non-Manf. Index**	Feb	***56.2***	56.7	56.5	moderate
		10:00	BOC Policy Decision					no change (after surprise cut last time)
		2:00	**Fed Beige Book**					growth still "modest to moderate"?
Thursday	3/05	7:00	BOE Policy Decision					no change
		7:45	ECB Policy Decision					more details on QE launch
		8:30	Jobless Claims, th.	2/28	***290***	***290***	283	a low trend
		10:00	Factory Orders	Jan	***NF***	-3.4%	-1.7%	a poor trend
Friday	3/06	8:30	**Nonfarm Payrolls, th.**	Feb	***+180***	+257	+329	bad weather
			private sector		***+190***	+267	+320	trend is still strong
			Average Weekly Hours		***34.5***	34.6	34.6	weather
			Average Hourly Earnings		***+0.2%***	+0.5%	-0.2%	a moderate trend
			Unemployment Rate		***5.6%***	5.7%	5.6%	trending lower
			employment/population		***59.4%***	59.3%	59.2%	trending gradually higher
		8:30	Trade Balance, $bln	Jan	***-42.0***	-46.6	-39.8	choppy, watch for revisions
			goods only		***-61.5***	-66.0	-59.2	lower petroleum prices

This Week…

U.S. financial markets may react to the news on Greece. The economic data calendar is heavy, but focus is expected to be on Janet Yellen's monetary policy testimony. Speaking on behalf of senior officials (not just herself) the Fed chair is likely to rehash the range of opinions seen in the recent FOMC minutes. The CPI should be about flat year-over-year. The estimate of 4Q14 GDP is expected to be revised lower.

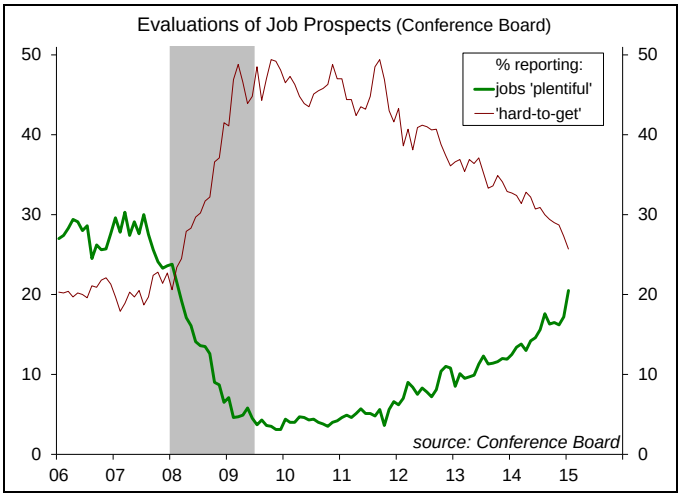
Monday

Existing Home Sales (January) – Weather may have been a factor, but one shouldn't put much weight on January housing data.

Tuesday

Case-Shiller Home Prices (December) – After slipping in the first half of last year, home prices are generally on the rise again. This could resurrect affordability issues, restraining sales ahead.

Consumer Confidence (February) – The Conference Board's measures jumped sharply in the advance estimate for January. While that surge (watch for possible revisions) may have indirectly reflected lower gasoline prices, the detailed data have shown improvement in labor market conditions.



Yellen Monetary Policy Testimony (Senate Banking Committee) – The Fed chair is required to appear before Congress twice a year. With the release of the January 27-28 minutes last week, there's not a lot of suspense. The minutes showed that the Fed is preparing to raise short-term interest rates. There is some debate about the risks of moving too early or too late, but most Fed officials appear to be leaning toward later rather than sooner. Communications are a key issue and it will be interesting to hear Yellen expound on the "patient" language. She should also come out swinging against the horrible Fed "audit" bill. The Fed is already audited, but this bill would allow Congress to influence monetary policy – a very bad idea.

Wednesday

New Home Sales (January) – These figures are erratic, especially during the winter months (when weather effects can be magnified by the seasonal adjustment). Take with a grain of salt.

Yellen Monetary Policy Testimony (House Financial Services) – The Fed chair will repeat her written testimony, but there's some chance that something new might come up in the Q&A.

Thursday

Jobless Claims (week ending February 21) – It's not unusual to see the weekly figures bounce around in the first couple of months of the year, but the underlying trend has remained low.

Consumer Confidence Index (January) – Retail gasoline prices fell further last month and the drop will be boosted a bit by the seasonal adjustment (which anticipates an increase). Simple math suggests that gasoline will subtract 0.6 percentage point from the overall monthly change in the PPI. The year-over-year change should be about flat, but not for long (gasoline prices have risen somewhat in February). Food prices fell sharply in the PPI, but we may not see that feed through much to the CPI. Core inflation has been trending low and lower gasoline prices may help push core inflation a little lower in the near term.

Real Earnings (January) – Average hourly earnings and average weekly earnings each rose 0.5% in January (after falling 0.2% in December). The drop in the CPI will result in a strong gain in real earnings. That's helpful for consumer spending, but we need to see a pickup in nominal wage growth at some point.

Durable Goods Orders (January) – Monthly changes in orders are notoriously choppy, but the underlying trend has been disturbingly weak in recent months. We may be due for a rebound, but it's hard to get excited about figures for January.

Friday

Real GDP (4Q14, 2nd estimate) – Component revisions were a bit mixed, but mostly lower. That's not necessarily bad. The trade deficit was a lot wider than assumed in the advance estimate (increased imports are a sign of strength in the domestic economy, but imports have a negative sign in the GDP calculation). Inventories appear to have risen more slowly. Try to focus on domestic final sales (GDP less net exports and the change in inventories), which is likely to remain relatively strong (and about at the same pace as in 3Q14).

Chicago Purchasing Managers Index (February) – Subject to some noise from the weather, the Chicago PMI should continue to suggest relative strength in Midwest manufacturing activity.

UM Consumer Sentiment (February) – The headline figure fell unexpectedly in the mid-month assessment, possibly reflecting the pickup in gasoline prices.

Pending Home Sales (January) – There's a fair amount of noise in these figures, but we should see a moderate trend of improvement over the next few months.

Next Week …

The economic data calendar remains relatively heavy, with some fresh figures for February (ISM surveys, auto sales, jobs). The focus is expected to be on the Employment Report, which may show some impact from the weather. The Fed's Beige Book is likely to reflect further improvement in the economy, but wage and price pressures should remain benign.

Coming Events and Data Releases

March 12	Retail Sales (February)
March 15	Debt ceiling back in effect (but not yet binding)
March 18	FOMC Policy Decision, Yellen press conference
April 3	Good Friday Holiday (markets closed) Employment Report (March)
April 29	FOMC Policy Decision (no press conference)
June 17	FOMC Policy Decision, Yellen press conference
July 29	FOMC Policy Decision (no press conference)
September 17	FOMC Policy Decision, Yellen press conference
October 28	FOMC Policy Decision (no press conference)
December 16	FOMC Policy Decision, Yellen press conference