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Weekly Economic Monitor

Fed Policy Outlook – In *Retrograde?

The question of whether the Fed would abandon the *"patient"* language should have not been an issue, but the financial press always tries to generate some level of tension. However, while the Federal Open Market Committee appeared to move closer to tightening monetary policy, it indirectly signaled that it would likely be much less aggressive.

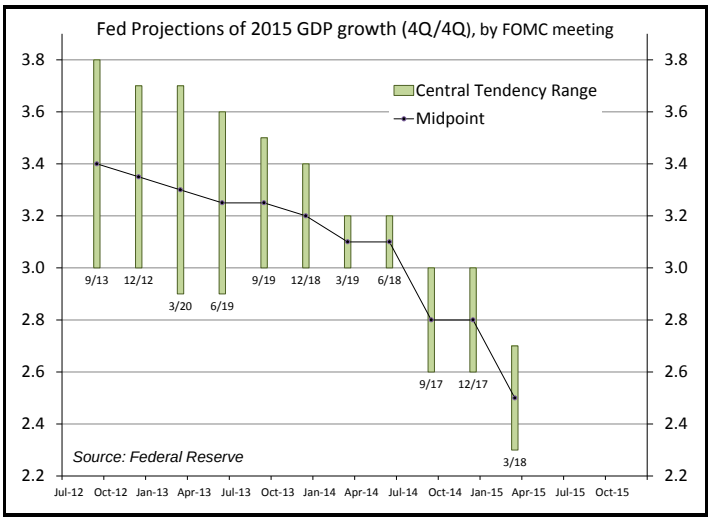
In its policy statement, the FOMC noted that economic growth has *"moderated somewhat."* In her press briefing, Chair Yellen cited slower growth in household spending, weaker export growth, and a subdued recovery in housing. The Fed's outlook is *"not a weak forecast,"* said Yellen. The Fed is still expecting above-trend growth. However, the outlook is less optimistic than it was three months ago.

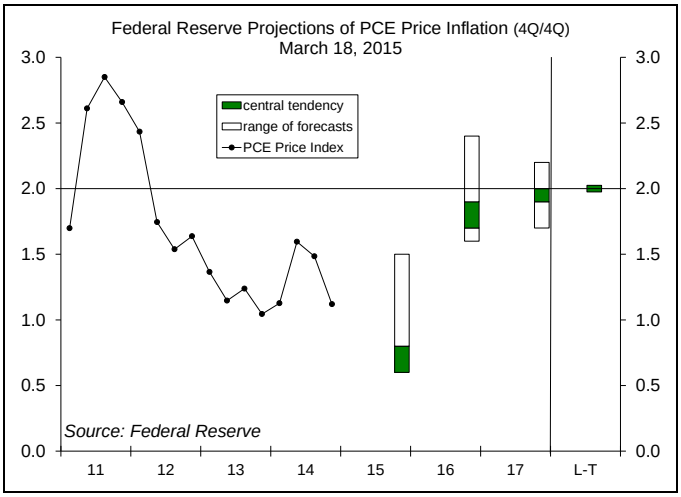
Federal Reserve's Summary of Economic Projections:

	2015	2016	2017	long run
Real GDP (4Q/4Q)	**2.3-2.7%**	**2.3-2.6%**	**2.0-2.4%**	**2.0-2.3%**
Dec Projections	*2.6-3.0%*	*2.5-3.0%*	*2.3-2.5%*	*2.0-2.3%*
Unemp. Rate (4Q)	**5.0-5.2%**	**4.9-5.1%**	**4.8-5.1%**	**5.0-5.2%**
Dec Projections	*5.2-5.3%*	*5.0-5.2%*	*4.9-5.3%*	*5.2-5.5%*
PCE Price Inf. (4Q/4Q)	**0.6-0.8%**	**1.7-1.9%**	**1.9-2.0%**	**2.0%**
Dec Projections	*1.0-1.6%*	*1.7-2.0%*	*1.8-2.0%*	*2.0%*
Core PCE Infl. (4Q/4Q)	**1.3-1.4%**	**1.5-1.9%**	**1.8-2.0%**	
Dec Projections	*1.5-1.8%*	*1.7-2.0%*	*1.8-2.0%*	

*These are central tendency forecasts, which exclude the three lowest and three highest forecasts of the Fed governors and 12 district bank presidents.

Downward revisions to the growth outlook are nothing new. Expectations have typically been revised down in recent years.





The Fed also revised lower its inflation outlook. The drop in oil prices has had a huge impact on headline inflation driving the year-over-year pace to around 0%. Lower oil prices also feed through indirectly to core inflation over time. The strong dollar has led to declines in import prices, which have restrained inflation, Yellen noted, *"and will likely continue to do so in the months ahead."* At the same time, officials see these impacts as *"transitory."* Yellen repeated that, before raising short-term interest rates, Fed officials want to see further improvement in the job market and be *"reasonably confident"* that inflation will move back to the 2% goal. That should happen as the job market strengthens and transitory inflation impacts fade, but Yellen indicated that there was no precise definition of *"reasonably confident."* Fed officials will remain focused on the job market, wages, and inflation expectations.

While the dots in the dot plot continued to suggest no clear consensus on the timing and pace of rate hikes, they did generally move down, implying that most Fed officials expect the initial rate hike to arrive after the June policy meeting and further rate increases are expected to arrive more slowly.

In recent weeks, the Fed funds futures market had priced in a slower policy outlook than most Fed officials. However, while Fed officials have now revised their policy outlooks down, so too has the market, which still expects rate hikes to come much more slowly than even the most dovish Fed officials. The fixed income and currency markets were encouraged by the less aggressive Fed policy outlook, but the Fed is still moving toward raising rates at some point. Short-term interest rates will still have to rise at some point. The data will dictate when.

*When the Earth laps Mars (which is on an outer orbit around the Sun), it appears to travel backward in the night sky. In a much better analogy, the *Financial Times* described the Fed's action (appearing to move toward tightening while actually expecting to be less aggressive) as "moonwalking."

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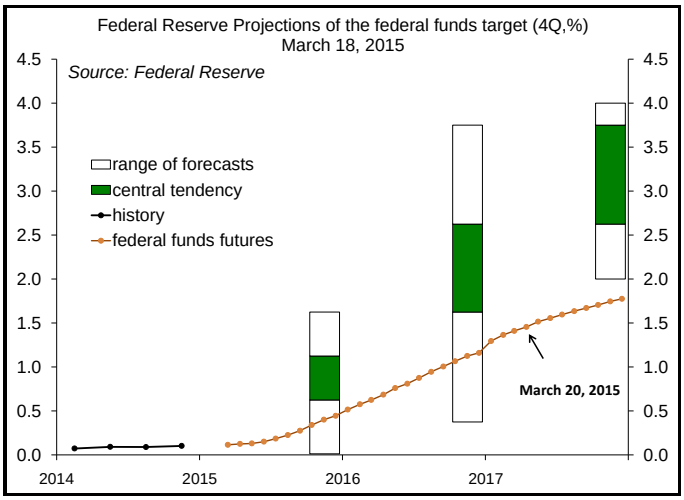
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
2/20/15	0.02	0.07	0.23	0.67	1.07	1.61	2.13	2.73	1.137	1.539	118.68	1.250	4955.97	2110.30	18140.44
3/13/15	0.03	0.11	0.24	0.68	1.07	1.60	2.13	2.70	1.052	1.476	121.17	1.280	4871.76	2053.40	17749.31
3/20/15	0.03	0.11	0.24	0.60	0.95	1.42	1.93	2.50	1.082	1.495	120.00	1.256	5026.42	2108.06	18127.65

Recent Economic Data and Outlook

The focus on the FOMC's "patient" was misplaced. Officials were less optimistic about growth, saw lower inflation, and generally expected a less aggressive path of short-term rate hikes.



As expected, the **Federal Open Market Committee** removed the "patient" language from the policy statement, but also indicated that *"an increase in the target range for the federal funds rate remains unlikely at the April FOMC meeting."* The FOMC noted that *"economic growth has moderated somewhat"* (vs. January's *"expanding at a solid pace"*), adding that *"export growth has weakened."* It also indicated that the change in the forward guidance *"does not indicate that the Committee has decided on the timing of the initial increase in the target range."*

In its **Summary of Economic Projections**, Fed officials lowered their forecasts for GDP growth and inflation. Forecasts of the employment rate edged down, but so did assessments of the sustainable long-term level. The dots in the dot plot (expectations of the appropriate year-end level of the federal funds rate) generally moved lower, implying a lower expected path of interest rates in the months ahead.

In her post-meeting press conference, **Fed Chair Yellen** indicated that the FOMC will begin to consider rate increases on a meeting-by-meeting basis beginning in June, but that does not mean that the Fed will move at that time. Future policy decisions will be data-dependent. Officials expect falling import prices to continue to restrain inflation in the months ahead, but these factors are viewed as *"transitory."* She repeated that the Fed wants to see further improvement in the job market and be "reasonably confident" that inflation will move back toward the 2% target. She could not give a definition of reasonable confident, but said that the Fed will be watching job market conditions, wages, and inflation expectations.

Industrial Production rose 0.1% in February, as the impact of cold weather offset a decrease in energy exploration. The output of utilities jumped 7.3%. Mining output fell 2.5% (oil and gas extraction up 0.2%, oil and gas well drilling down 17.3% following -10.0% in January). Manufacturing output slipped 0.2%, vs. -0.3% in January and -0.1% in December (+3.7% y/y). Auto output fell 3.0% (weather?). Non-auto output was flat.

Building Permits rose 3.0% in February, to a 1.092 million seasonally adjusted annual rate +7.7% y/y), reflecting the usual volatility in the multi-family sector. Single-family permits, the key figure in the report, fell 6.2% +2.8% y/y), with mixed results across regions (-30.6% in the Northeast, -11.8% in the Midwest, -6.0% in the South, and +5.6% in the West). **Housing Starts** sank 17.0%, to an 897,000 annual rate (-3.3% y/y), reflecting a weather impact. Single-family starts fell 14.9% (+0.7% y/y).

Homebuilder Sentiment edged down to 53 in March, vs. 55 in February and 57 in January. Weaker traffic of prospective buyers accounts for most of the recent decline.

The **Current Account Deficit** widened to $113.4 billion in 4Q14, or 2.6% of GDP, vs. $98.9 billion in 3Q14 (2.2% of GDP).

The Index of **Leading Economic Indicators** rose 0.2% in February, reflecting mixed components (with some drag from adverse weather). The Conference Board said that the recent behavior of the leading and coincident indices suggests that "the expansion in economic activity should continue, but the pace is not likely to pick up considerably in the months to come."

Economic Outlook (1Q15): Real GDP growth of 1.0-1.5%, reflecting softer consumer spending growth, the dollar's drag on exports, and a reduction in capital spending in energy.

Employment: The pace of job growth has been very strong in recent months and should remain strong in the near term.

Consumers: Strong job growth and lower gasoline prices should support spending growth in 1H15. Real wages have popped, but we'll eventually need to see a pickup in nominal wage growth.

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. Anecdotal evidence suggests strength. Look for the March and April data to confirm that.

Prices: The PCE Price Index is about flat year-over-year – and the core inflation rate has moved lower in recent months. Pipeline pressures are mild. Wage pressures are limited. Inflation expectations remain well-anchored.

Interest Rates: With low inflation and a still-elevated level of slack in the economy, the Fed does not have to hit the brakes, but it does need to consider when to take the foot off the gas. The Fed needs to see further improvement in the job market and has to be "reasonably confident" that inflation will move back toward the official 2% goal.

This Week:					*forecast*	last	last –1	comments
Monday	3/23	10:00	**Existing Home Sales, mln**	Feb	***4.95***	4.82	5.07	more reflective of January weather
			% change		***+2.7***	-4.9	+2.4	some chance for a surprise
		12:20	**Fed Gov Fischer Speaks**					*"Mon. Policy Lessons and the Way Ahead"*
Tuesday	3/24	8:30	**Consumer Price Index**	Feb	***+0.3%***	-0.7%	-0.3%	gasoline prices bounced
			year-over-year		***+0.1%***	-0.1%	+0.8%	still roughly flat y/y
			ex-food & energy		***+0.1%***	+0.2%	+0.1%	core inflation likely to remain low
			year-over-year		***+1.6%***	+1.6%	+1.6%	steady, but a low trend
		8:30	Real Earnings	Feb	***-0.2%***	+1.2%	+0.1%	nominal earnings rose 0.1%
		9:45	Markit US Manf. PMI (flash)	Mar	***NF***	55.1	53.9	mixed across industries, moderate overall
		10:00	**New Home Sales, th.**	Feb	***465***	481	482	expecting some weather impact
			% change		***-3.3***	-0.2	+8.1	but these figures aren't accurate
		11:30	FRN Auction					2-year notes
		1:00	Treasury Note Auction					2-year notes
Wednesday	3/25	8:30	**Durable Goods Orders**	Feb	***+0.1%***	+2.8%	-3.7%	aircraft figures are squirrelly
			ex-transportation		***+0.4%***	0.0%	-0.8%	a lackluster trend
			nondef cap gds ex-aircraft		***+0.2%***	+0.5%	-0.5%	mixed, w/ perhaps some weather effects
		1:00	Treasury Note Auction					5-year notes
Thursday	3/26	8:30	Jobless Claims, th.	3/21	***290***	291	290	a low trend
		1:00	Treasury Auction					7-year notes
Friday	3/27	6:30	Fed Gov Fischer Speaks					on the non-bank financial sector
		8:30	**Real GDP (3rd estimate)**	4Q14	***+2.4%***	+5.0	+4.6	+2.2% in the 2nd estimate
		9:55	UM Consumer Sentiment	Mar	***92.2***	95.4	98.1	91.2 in the mid-month assessment
		3:45	**Fed Chair Yellen Speaks**					*"Monetary Policy"*
Next Week:								
Monday	3/30	8:30	Personal Income	Feb	***+0.3%***	+0.3%	+0.3%	moderate
			Personal Spending		***+0.2%***	-0.2%	-0.3%	soft retail sales, but more heating
			PCE Price Index ex-f&e		***+0.1%***	+0.1%	0.0%	mild core inflation
		10:00	Pending Home Sales Index	Feb	***+1.2%***	+1.7%	-1.5%	should pick up
Tuesday	3/31	9:00	Case Shiller Home Prices	Jan	***+0.7%***	+0.7%	+0.8%	a faster pace in recent months
			year-over-year		***+4.6%***	+4.6%	+4.7%	a double-edged sword
		9:45	Chicago PM Index	Mar	***51.0***	45.8	59.4	rebounding from weather, port issues?
		10:00	**Consumer Confidence**	Mar	***97.5***	96.4	103.8	may see a bounce
Wednesday	4/01	8:15	ADP Payroll Estimate, th.	Mar	***+220***	+212	+250	moderate
		9:45	Markit US Manf Index (final)	Mar	***NF***	55.1	53.9	not market-moving
		10:00	Construction Spending	Feb	***-1.0%***	-1.1%	+0.8%	some weakness in energy
		10:00	**ISM Manf. Index**	Mar	***52.2***	52.9	53.5	mixed across industries, lackluster overall
		tbd	Motor Vehicle Sales, mln	Mar	***16.5***	16.2	16.6	likely to rebound from bad weather
			domestically built		***13.2***	12.9	13.3	but trend may be flattening otherwise
Thursday	4/02	8:30	Jobless Claims, th.	3/28	***290***	***290***	291	still low
		8:30	**Trade Balance, $bln**	Feb	***-43.0***	-41.8	-45.6	seen a bit wider (oil price rebound)
			goods only		***-62.6***	-61.6	-65.0	port issue may have been a factor
		10:00	Factory Orders	Feb	***NF***	-0.2%	-3.5%	nondurables likely to bounce
Friday	4/03		Good Friday Holiday					stock market close, half-day for bonds
		8:30	**Nonfarm Payrolls, th.**	Mar	***230***	295	239	a moderate pace
			private-sector		***220***	288	237	watch for revisions
			Unemployment Rate		***5.5%***	5.5%	5.7%	seen steady, but trending lower
			employment/population		***59.4%***	59.3%	59.3%	a gradual trend higher
			Avg. Weekly Hours		***34.6***	34.6	34.6	steady
			Avg. Hourly Earnings		***+0.2%***	+0.1%	+0.5%	mild wage pressures

This Week…

The economic data could contain a few surprises. The February CPI data are expected to reflect a bounce in gasoline prices, but a continued low trend in core inflation. Monetary policy will remain a focus, with speeches by the Fed chair and vice chair.

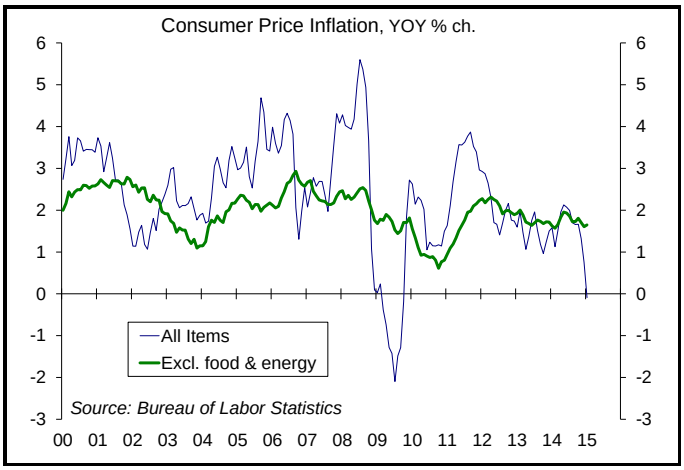
Monday

Existing Home Sales (February) – Weather may have been a factor, but the underlying pace is likely to have remained relatively strong. Remember, these data measure closings. The Pending Home Sales Index rose in January.

Fed Vice Chair Fischer Speaks – Stanley Fischer (not to be confused with recently retired Dallas Fed President Richard Fisher) has an impressive resume (former governor of the Bank of Israel, chief economist at the World Bank, professor at MIT). He is a central banker's central banker. At MIT, he taught former Fed Chair Ben Bernanke, ECP President Mario Draghi, former Treasury Secretary Larry Summers, and former Bush CEA Chair Greg Mankiw. So when he speaks, people should listen. This speech, at the Economic Club of New York, will focus on monetary policy, where it's been and where it's going.

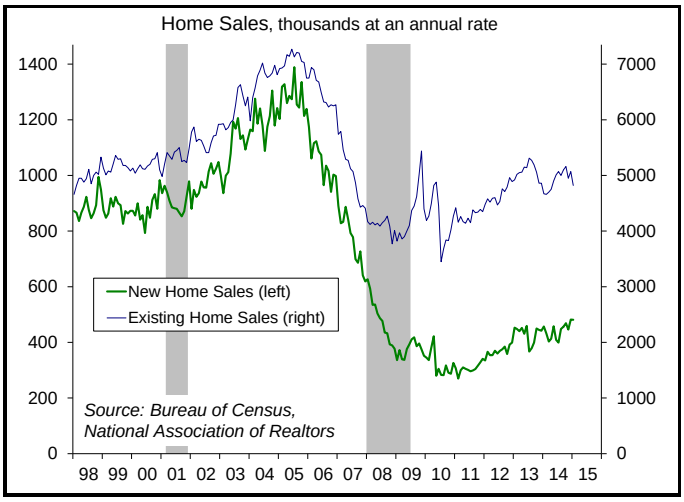
Tuesday

Consumer Price Index (February) – Retail gasoline prices rose about 11% from January, while the seasonal adjustment anticipated an increase of 2.9%, yielding about a 0.4 percentage point boost to the headline figure. Core inflation is expected to remain low, reflecting the secondary impact of lower energy costs. The low trend should keep the Fed on hold, but not forever (the Fed sees disinflationary pressures as "transitive").



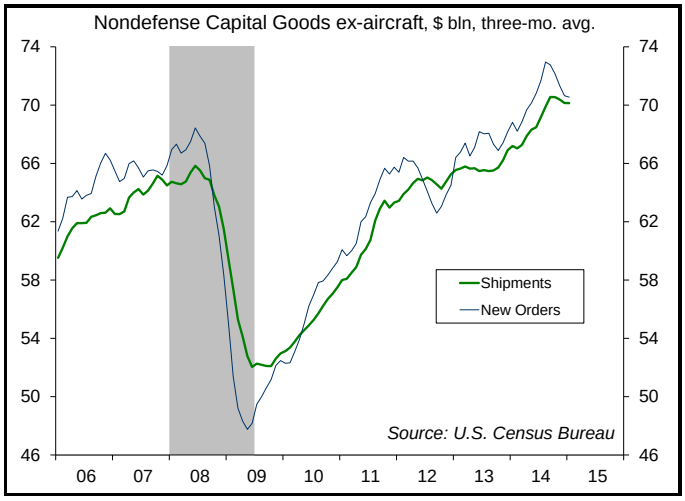
Real Earnings (March) – Inflation-adjusted earnings have risen meagerly in recent years, but popped higher in the last few months (reflecting the drop in gasoline prices). Nominal (current-dollar) average hourly earnings rose just 0.1% in March, less than (expected) increase in the CPI. However, that's only a minor setback. The year-over-year gain should remain strong.

New Home Sales (February) – These figures measure initial transactions (a signed contract or deposit), but are reported with a huge amount of statistical uncertainty. Monthly changes tend to be choppy and figures are subject to large revisions. Weather was likely a factor in February, but we should see a gradual trend of improvement in the near term.



Wednesday

Durable Goods Orders (February) – Monthly change in orders tend to be choppy and there is sometimes a large mismatch between the civilian aircraft data and figures reported by Boeing. Of greater concern is the recent softness in capital goods orders and shipments. Some of that may reflect the impact of a stronger dollar. Some of it may be a natural moderation following exceptional stronger in the middle of last year. February is not a critical month, but it will be worrisome if the trend doesn't pick up soon.



Thursday

Jobless Claims (week ending March 21) – With seasonal noise fading, claims are likely to settle into a low trend.

Friday

Real GDP (4Q14, 3rd estimate) – The estimate of further quarter growth is likely to be somewhat higher, reflecting stronger-than-expected consumer spending on services.

Fed Chair Yellen Speak – Yellen returns to the San Francisco Fed, where she served a president for several years. The topic ("monetary policy") is timely, but (with 15 minutes left in the trading session) there will be only a brief opportunity for the stock market to react. Most likely, she will simply repeat what she said in her March 18 press conference.

Next Week …

The situation with Greece is still ticking and may finally blow. Otherwise the focus will be on the March employment data, which arrives on Good Friday, when the stock market is closed (the bond market will be open for a half-session).

Coming Events and Data Releases

April 8	FOMC Minutes (March 17-18)
April 14	Retail Sales (March)
April 16-17	G20 Finance Ministers Meeting (Washington)
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