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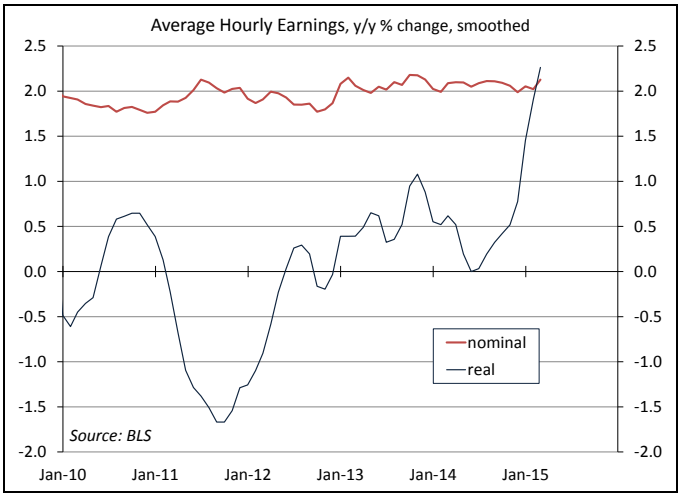
Weekly Economic Monitor

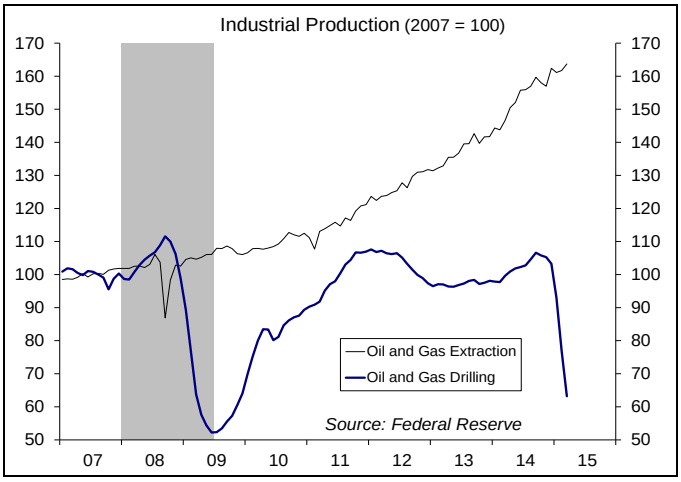
Uncertainty

We live in an uncertain world. Policymakers have to sift through a wide range of data, much of which is subject to statistical error and measurement difficulties. Financial market participants deal with much of the same data, but also have to account for the uncertainty in how policymakers will interpret the data and respond. There are longer-term questions, which won't be resolved anytime soon. So where do we stand now?



On April 29, Federal Reserve officials will meet again to set monetary policy. That morning, the Bureau of Economic Analysis will release its initial estimate of 1Q15 GDP growth. There's always a lot of uncertainty in the advance GDP estimate. The BEA does not have a complete picture of the component data – and as we've seen over the last several quarters, subsequent revisions can be very large. Rather than focus on the headline GDP figure, investors would do better to consider the key details. Consumer spending accounts for 70% of GDP. Job growth has been supportive, but wage growth has been relatively lackluster over the last several quarters. The drop in gasoline prices has pushed consumer price inflation close to zero (the CPI fell 0.1% over the 12 months ending in March), resulting in a sharp rise in real wages. That should help drive consumer spending in the near term. Spending was soft in December, January, and February. Inflation-adjusted spending appears to be on track for about a 2.0% annual rate in 1Q15, down from a 4.4% pace in 4Q14 (reflecting unusual strength in October and November). Spending in 2Q15 should pick up.

The sharp drop in energy prices has led to a significant contraction in oil and gas exploration. While locally severe, the loss of jobs should be small on a national level. The bigger impact on GDP will come through the drop in business structures. That decline will be magnified in the GDP calculation. Growth is reported at an annual rate. So a sharp decline in a single quarter will appear much larger. It's hard to put a precise number on it, but the decline in business structures is likely to help push the headline GDP figure close to zero (or a bit negative) in the first quarter. Note that while energy exploration has contracted, energy extraction is still going strong, helping to keep energy prices low.



The negative impact of lower energy prices should be more front-loaded, while the benefits (to the consumer) are likely to build over time. In the advance GDP estimate, there is also the usual uncertainty surrounding inventories and net exports.

The Fed generated some confusion by saying it would begin debating rate increases in June. That doesn't mean that the Fed will begin to raise rates at that time. Rather, it's simply a return to business as usual for the Fed (less reliance on the forward guidance). While officials have continued to indicate that conditions are likely to warrant a rate hike by the end of the year, they have also suggested that the pace of increases (after the first) will be much more important, and likely very gradual.

U.S. investors are not the only ones interested in the Fed policy outlook. We saw significant global reactions in the "taper tantrum" of 2013. The reaction in emerging market economies to the initial Fed rate hike could be just as severe or greater.

Greece has been a reoccurring worry for investors here and abroad. We've been through this a number of times, and it usually ends with the can kicked down the road. However, the length of these "kicks" has gotten shorter and the calls for a Greek exit from the euro have grown louder. Both sides have been reported to be preparing plans for a Grexit, but there will be enormous challenges for policymakers if that happens.

The financial markets appear to be searching for a direction. Stocks often climb a wall of worry, but a lot of good news (a 2Q15 rebound in GDP growth, a Federal Reserve not in any hurry to tighten policy) is already factored in.

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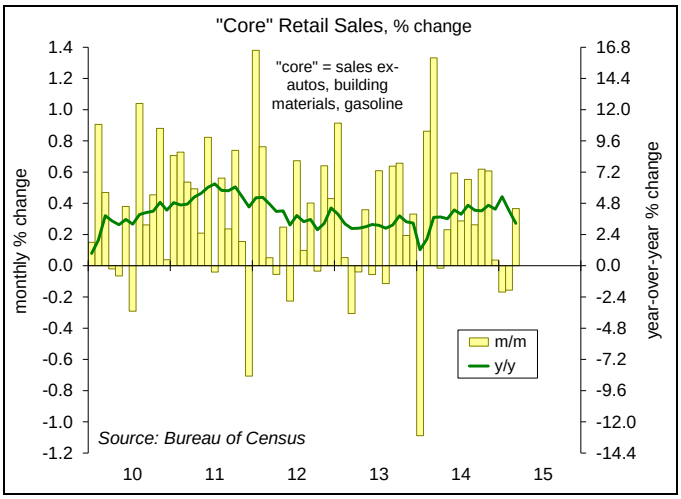
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
3/20/15	0.01	0.11	0.24	0.60	0.95	1.42	1.93	2.50	1.079	1.492	120.28	1.259	5026.42	2108.10	18127.65
4/10/15	0.02	0.09	0.24	0.57	0.91	1.41	1.96	2.58	1.060	1.465	120.29	1.260	4995.98	2102.06	18057.65
4/17/15	0.02	0.08	0.20	0.51	0.84	1.31	1.86	2.52	1.082	1.496	118.82	1.222	4931.81	2081.08	17826.17

Recent Economic Data and Outlook

The economic data reports were mixed, consistent with relatively soft growth in the first few months of 2015, but pointing toward a pickup in the second quarter. Financial markets appeared to struggle for direction. Worries about Greece returned on Friday following rumors of a possible exit from the euro.



Retail Sales rose 0.9% in March (+1.3% y/y), up 0.4% excluding autos. Ex-autos, building materials, and gasoline, sales rose 0.4% (+3.3% y/y). It was the first increase in three months.

Business Inventories rose 0.3% in February, up 3.3% y/y. Business sales were flat, down 1.2% y/y. The inventory-to-sales ratio was 1.36, vs. 1.30 a year ago (a poor sign).

The **Consumer Price Index** rose 0.2% in March (-0.1% y/y), up 0.2% ex-food & energy (+1.8% y/y).

Real Hourly Earnings edged up 0.1% in March, vs. -0.1% in February and +1.2% in January (+2.2% y/y).

The **Producer Price Index** rose 0.2% in March (-0.8% y/y), up 0.2% ex-food, energy, and trade services (+0.8% y/y).

Industrial Production fell 0.6% in March (+2.0% y/y), reflecting a 17.7% plunge in oil & gas drilling and a 5.9% drop in the output of utilities (more normal temperatures). Manufacturing output edged up 0.1% (+2.7% y/y), mixed across industries.

Building Permits fell 5.7% (±2.0%) in March, to a 1.039 million seasonally adjusted annual rate, up 2.9% (±0.9%) y/y. Single-family permits, the key figure in the report, rose 2.1% (±0.9%), up 4.1% (±1.0%) from a year earlier. **Housing Starts** rose 2.0%, to a 926,000 pace (±13.0%), down 2.5% (±11.5%) y/y. Single-family starts rose 4.4% (±12.3%) down 2.7% (±8.9%) y/y.

Homebuilder Sentiment rose to 56 in April, vs. 52 in March (revised from 53). Evaluations of current sales conditions improved and builders were more optimistic about the next six months. Foot-traffic of potential buyers improved. Results were mixed across regions.

The Fed's **Beige Book** summary: *"Reports from the twelve Federal Reserve Districts indicate that the economy continued to expand across most regions from mid-February through the end of March. Activity in the Richmond, Chicago, Minneapolis, Dallas, and San Francisco Districts grew at a moderate pace, while New York, Philadelphia, and St. Louis cited modest growth. Boston reported that business activity continues to expand, while Cleveland cited a slight pace of growth. Atlanta and Kansas City described economic conditions as steady... Labor markets remained stable or continued to improve modestly. Layoffs related to the decline in oil and gas prices were reported in multiple Districts. Difficulty finding skilled workers was frequently reported. Districts noted modest upward pressure on wages and overall prices."*

The Index of **Leading Economic Indicators** rose 0.2% in March.

The Index of **Small Business Optimism** fell to 95.2 in March, vs. 98.0 in February. The earnings trend stayed weak. Respondents were negative on the general business outlook. Sales expectations were moderate. Hiring plans remained moderate. Job openings were more moderate, but still relatively brisk.

In its revised World Economic Outlook, **IMF** projections of global growth were little changed from January, but with a lower outlook for the U.S. (3.1% in 2015, vs. a 3.6% forecast in January) and a rosier outlook for the euro area and Japan.

Economic Outlook (2Q15): About a 3.0% annual rate, following around 0.5% in the first quarter.

Employment: The pace of job growth slowed in 1Q15, but from an unusually strong pace in 4Q14. Job losses remain very limited. New hiring appears to have remained strong for small and medium-sized firms, but has slowed for larger firms.

Consumers: The drop in gasoline prices from last summer has sharply boosted consumer purchasing power and we should see a pickup in spending in the spring and early summer.

Manufacturing: The stronger dollar is a constraint. A decline in corporate profits has contributed to a softening trend in capital spending. Domestic demand should be picking up.

Housing/Construction: The spring is a critical time for home sales and residential construction activity. Will this be the year housing takes off? We should see good improvement in the near term, but we're still years away from a full recovery.

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 pedal. 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.

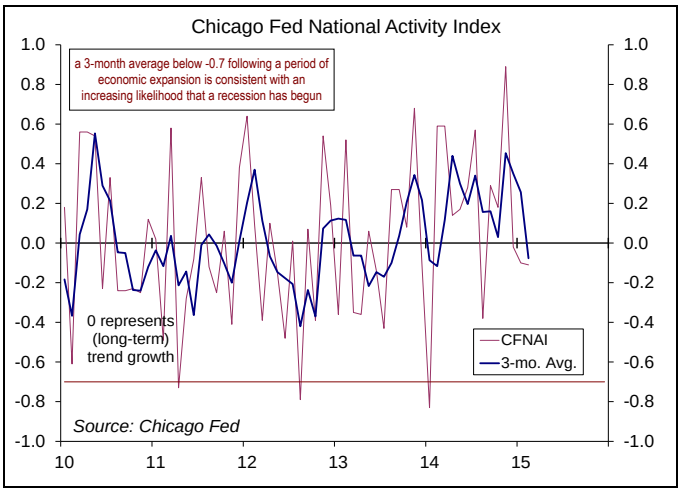
This Week:					*forecast*	last	last –1	comments
Monday	4/20		Chicago Fed Nat Act Index	Mar	***NF***	-0.11	-0.10	growth slightly below trend in Jan and Feb
Tuesday	4/21		no significant data					Happy Birthday Queen Elizabeth II
Wednesday	4/22	10:00	**Existing Home Sales, mln**	Mar	***4.96***	4.88	4.82	should pick up
			% change		***+1.6***	+1.2	-4.9	but may be limited by low inventories
Thursday	4/23	8:30	Jobless Claims, th.	4/18	***285***	294	282	still subject to seasonal noise
		9:45	Markit US Manf PMI (flash)	Mar	***NF***	55.7	55.1	a moderately strong trend
		10:00	**New Home Sales, th.**	Mar	***540***	539	500	noisy data, but a stronger trend
			% change		***+0.2***	+7.8	+4.4	watch for revisions
		1:00	TIPS Auction					$18 billion in 5-year TIPS
Friday	4/24	8:30	**Durable Goods Orders**	Mar	***+0.5%***	-1.4%	+1.9%	lower aircraft orders, mixed otherwise
			ex-transportation		***+1.1%***	-0.6%	-0.9%	looking for a spring bounce
			core capital goods		***+0.3%***	-1.1%	-0.3%	down 6 months in a row
Next Week:								
Monday	4/27	1:00	Treasury Note Auction					2-year notes
Tuesday	4/28	9:00	Case-Shiller Home Prices	Feb	***+0.7%***	+0.6%	+0.7%	seen higher
			year-over-year		***+4.7%***	+4.5%	+4.6%	creating some affordability problems
			Consumer Confidence	Apr	***103.0***	101.3	98.8	likely higher
		1:00	Treasury Note Auction					5-year notes
Wednesday	4/29	8:30	**Real GDP (advance)**	1Q15	***+0.5%***	+2.2%	+5.0%	not so good (but a lot of uncertainty)
		10:00	Pending Home Sales Index	Mar	***+2.0%***	+3.1%	+1.2%	improving
		11:30	Treasury FRN Auction					2-year FRNs
		1:00	Treasury Note Auction					7-year notes
		2:00	**FOMC Policy Statement**					no change (no press conference)
Thursday	4/30	8:30	Jobless Claims, th.	4/18	***282***	***285***	294	a low trend
		8:30	Employment Cost Index	1Q15	***+0.7%***	+0.6%	+0.7%	some pickup
		8:30	Personal Income	Mar	***+0.3%***	+0.4%	+0.4%	more moderate wage growth
			Personal Spending		***+0.5%***	+0.1%	-0.2%	retail sales rebounded sharply
			PCE Price Index ex-f&e		***+0.2%***	+0.1%	+0.1%	core CPI reported at +0.227%
		10:00	Chicago PM Index	Apr	***51.5***	46.3	45.8	rebounding from weather and port issues
Friday	5/01	9:45	Markit US Manf. PMI (final)		***NF***	55.7	55.1	not market-moving
		10:00	Construction Spending	Mar	***NF***	-0.1%	-1.7%	likely mixed
		10:00	**ISM Manf Index**	Apr	***52.6***	51.5	52.9	mixed, but likely stronger
		10:00	UM Consumer Sentiment	Apr	***96.2***	93.0	91.2	95.9 in the mid-month reading
		tba	Motor Vehicle Sales, mln	Apr	***NF***	17.1	16.2	still strong
			domestically built		***NF***	13.4	12.8	but pace may be flattening

This Week…

The economic calendar is relatively light, but home sales and durable goods data are volatile and could surprise.

Monday

Chicago Fed National Activity Index (March) – The CFNAI has been signaling economic growth slightly below trend.

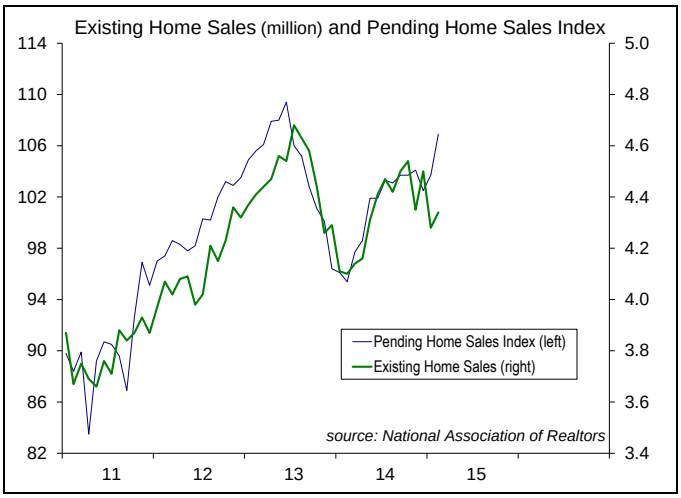


Tuesday

No significant economic data.

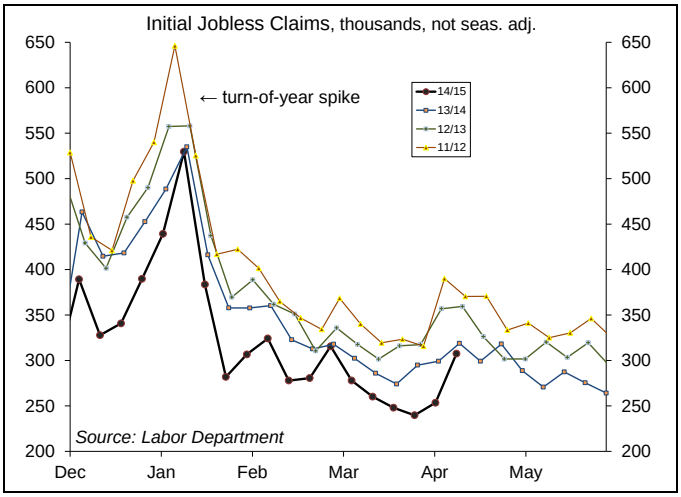
Wednesday

Existing Home Sales – Sales should pick up, although the pace may be limited by lean inventories of homes for sale.

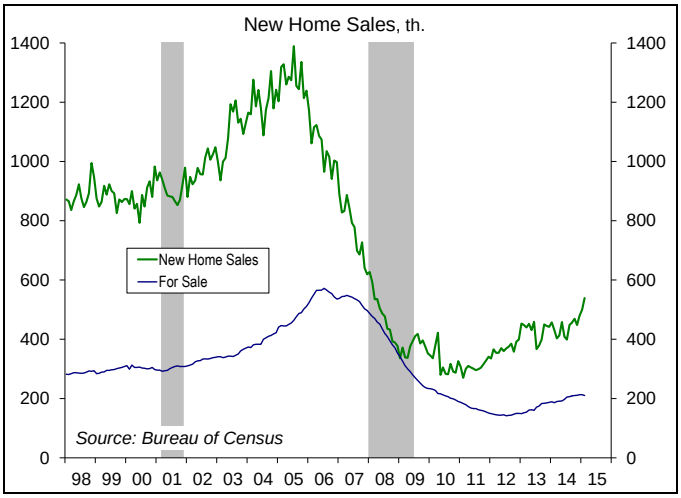


Thursday

Jobless Claims (week ending April 18) – Seasonal adjustment around Easter can be tricky, but the underlying trend should remain relatively low in the near term.

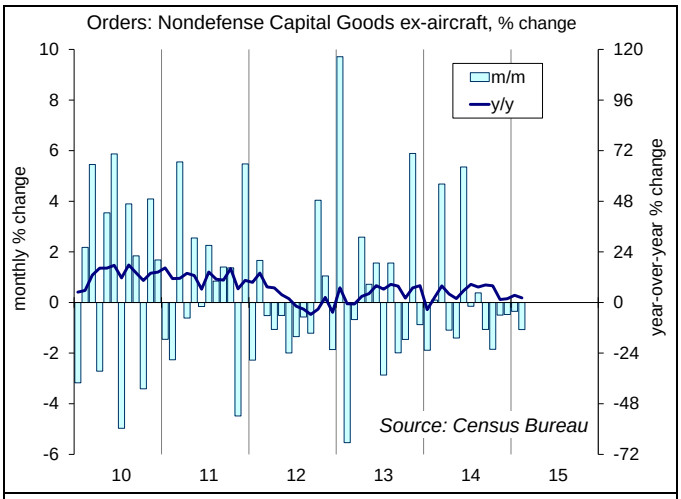


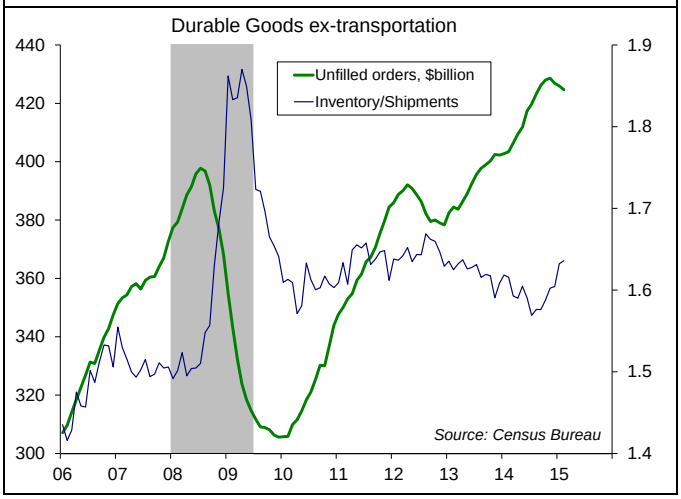
New Home Sales (March) – These figures can be very erratic, with large monthly swings and sizable revisions. That said, the pace should improve in the near term, supported by low mortgage rates and strong job growth over the last year. Tight credit has been a restraint at the low end of the scale, but should gradually loosen up over time.



Friday

Durable Goods Orders (March) – Monthly changes in orders tend to be choppy, making it difficult to discern a change in trend. Through February, orders for core capital goods (nondefense excluding aircraft) have fallen six months in a row. It's difficult to say how much of this soft patch may be a statistical moderation and how much is genuine weakness. The strong dollar, weather, and West Coast port issues have been factors. Unfilled orders have started to trend down and the inventory-to-shipments ratio is rising. Both bear watching, but neither is at a level considered to be dangerous. Note that these gauges lagged in the recession, missing the turn, but moving sharply as conditions worsened. Orders at Boeing were reported lower in March, but we ought to see a bounce ex-transportation.





Next Week …

The economic calendar picks up again. There should be little suspense surrounding the Fed policy meeting (no change in policy, no Yellen press conference). Officials will begin to debate raising rates in June. The advance GDP estimate is always an adventure given the incomplete picture of the quarter. Real consumer spending is likely to have been close to a moderate 2.0% annual rate. The bigger concern is the sharp drop in oil and gas drilling, which will be magnified by the GDP arithmetic (it's quarterly data, but reported at an annual rate). A plunge in business structures could push the headline GDP figure close to zero (or even a bit negative).

Coming Events and Data Releases

May 8	Employment Report (April)
May 13	Retail Sales (April)
May 25	Memorial Day (markets closed)
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