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Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com

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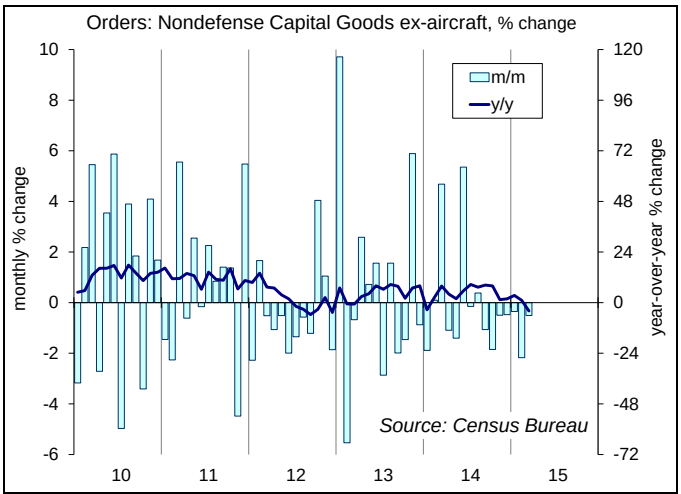
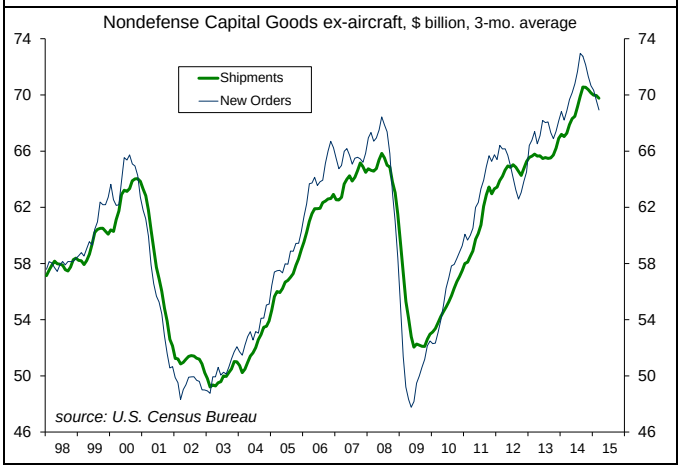
Weekly Economic Monitor

The Pause in Capital Spending

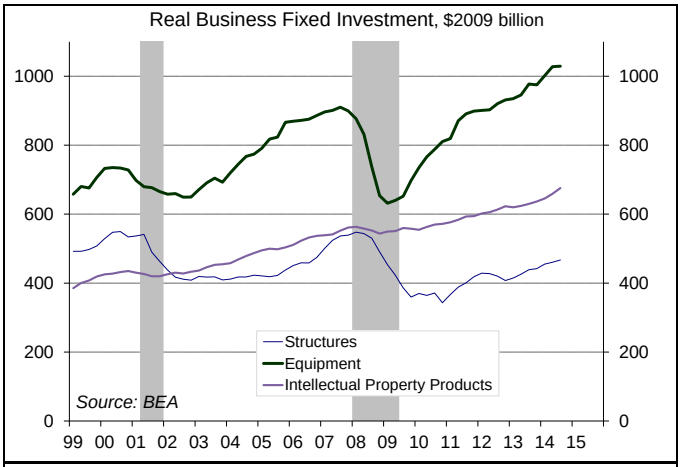
The Bureau of Economic Analysis will report its initial estimate of first quarter growth on April 29. There's always a lot of uncertainty in the advance estimate, but that's especially true for 1Q15. Of the key components of GDP, consumer spending is expected to have slowed to a more moderate pace – nothing terrible. However, business fixed investment should be soft. For business investment, as with manufacturing activity in general, it's often difficult to distinguish a short-term slowdown from the beginning of a more significant downturn.

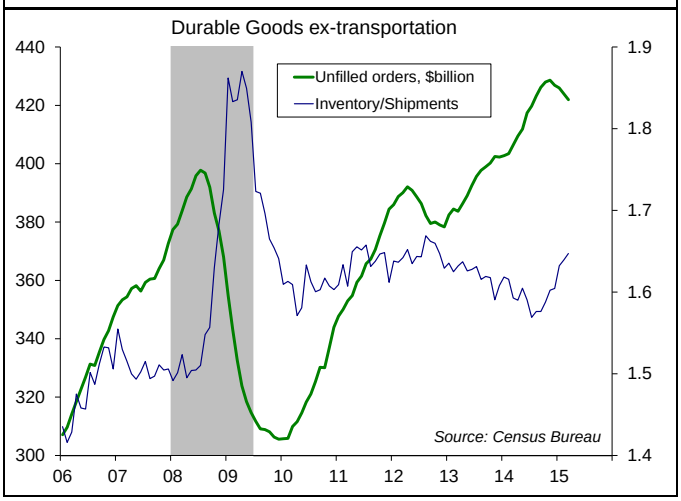




Orders for core capital goods (nondefense and excluding aircraft) have fallen for seven months in a row. This decline could be a "correction" from unusual strength in 2Q14 and 3Q14. More likely, it's a reflection of the stronger dollar. The dollar has had a negative impact on corporate profits, which are a key driver of capital investment. The dollar has stabilized in recent weeks. If that continues, the currency impact on earnings should fade over time. There's nothing to suggest a sharp decline in business investment similar to recent recessions.

There's a reason that it's called "the business cycle." Business fixed investment accounts for about 13% of GDP, but it swings sharply in recessions and recoveries. Business fixed investment includes structures, equipment, and (since 2013) intellectual property products. Structures and equipment are the more cyclical components. In recent quarters, energy exploration and extraction accounted for about 6.8% of business fixed investment (some equipment, but mostly structures) or about 0.9% of Gross Domestic Product.





Durable goods orders and shipments provide some insights into the manufacturing sector, but some gauges will tend to lead (although not always). Unfilled orders, a favorite of former Fed Chair Alan Greenspan, are an early indicator of trouble when falling. The inventory-to-shipments ratio can be used to gauge imbalances. However, the increased use of computers and scanners in inventory management and the off-shoring of inventories make the U.S. economy less susceptible to inventory cycles (compared to a few decades ago). These gauges are not yet at "danger" levels, but they bear watching.

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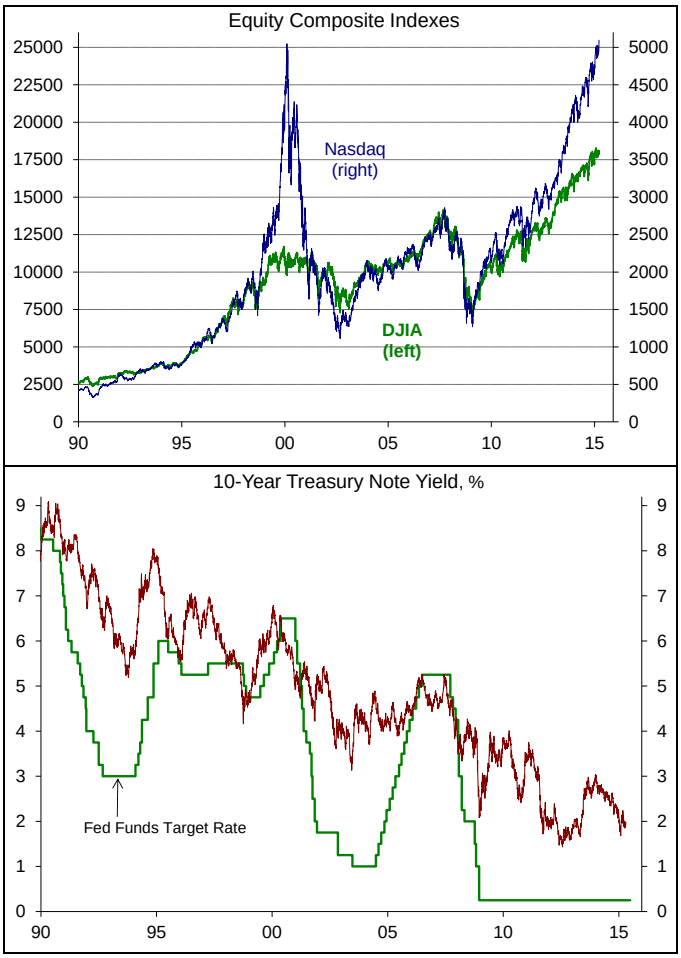
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
3/27/15	0.04	0.12	0.27	0.58	0.92	1.42	1.95	2.53	1.089	1.488	119.15	1.258	4891.22	2061.02	17712.66
4/17/15	0.01	0.08	0.23	0.51	0.84	1.31	1.87	2.51	1.078	1.494	119.02	1.223	4931.81	2081.18	17826.30
4/24/15	0.02	0.09	0.22	0.51	0.84	1.32	1.91	2.61	1.086	1.517	118.88	1.217	5092.09	2117.71	18080.21

Recent Economic Data and Outlook

The stock market was uneven, but the NASDAQ composite managed to hit a new high, finally eclipsing the dot-com bubble high (valuations may be debated, but the fundamentals appear to be more solid this time). The economic calendar was thin. The details on durable goods orders were bad.

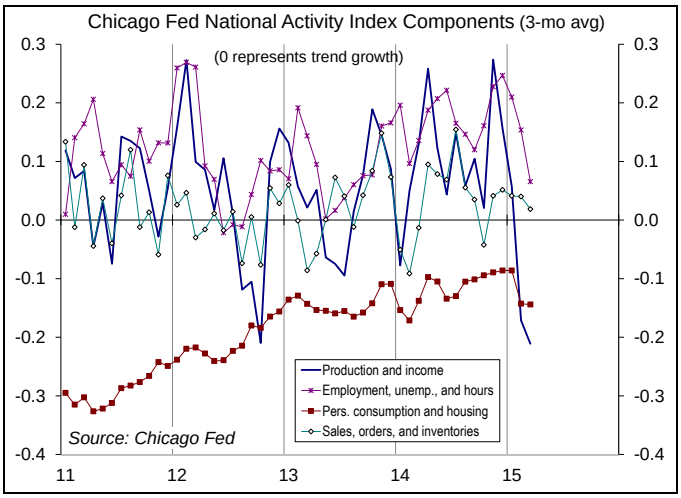


Durable Goods Orders jumped 4.0% in March, reflecting a surge in transportation orders (motor vehicles +5.4%, civilian aircraft +30.6%, defense aircraft +112.8%). Ex-transportation, orders fell 0.2%, the sixth consecutive monthly decline. Orders for core capital goods (nondefense and excluding aircraft) fell 0.5%, the seventh consecutive decline. Shipments for this category, a rough proxy for business fixed investment, fell 0.4% (a -2.2% annual rate in 1Q14, vs. -2.3% in 4Q14 and +12.7% in 3Q14).

New Home Sales sank 11.4% (±18.6%) in March to a 481,000 seasonally adjusted annual rate, +19.4% (±21.8%) y/y. Figures for the three previous months were revised higher. Results were mixed across regions in March (Northeast -33.3%, Midwest +5.9%, South -15.8%, West -3.4%).

Existing Home Sales rose 6.1% in March, to a 5.19 million seasonally adjusted annual rate (+10.4% y/y). Results were strong across regions (Northeast +6.9%, Midwest +10.1%, South +3.8%, West +6.3%).

The **Chicago Fed National Activity Index** fell to -0.42 in March. The three-month average dropped to -0.27%, consistent with growth below its long-term trend.



Economic Outlook (2Q15): About a 3.0% annual rate.

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: Sales appeared mixed at the start of the spring selling season. Rising prices and relatively tight credit appear to be constraining the lower end of the market.

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: Senior Fed officials have signaled that conditions are likely to warrant an initial increase in short-term rates this year. Officials need to see further improvement in the labor market and be "reasonably confident that inflation will move back toward the 2% target. Officials have suggested that the more important question is the pace of tightening after the initial hike, but they have signaled that will likely be gradual.

This Week:					*forecast*	last	last –1	comments
Monday	4/27	1:00	Treasury Note Auction					$26 billion in 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					$35 billion in 5-year notes
Wednesday	4/29	8:30	**Real GDP (advance)**	1Q15	***+0.2%***	+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					$15 billion in 2-year FRNs
		1:00	Treasury Note Auction					$29 billion in 7-year notes
		2:00	**FOMC Policy Statement**					no change (no press conference)
Thursday	4/30	8:30	Jobless Claims, th.	4/25	***285***	295	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	54.2 in the flash estimate
		10:00	Construction Spending	Mar	***NF***	-0.1%	-1.7%	likely mixed
		10:00	**ISM Manf Index**	Apr	***52.2***	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	***17.0***	17.1	16.2	still strong
			domestically built		***13.5***	13.4	12.8	but pace may be flattening
Next Week:								
Monday	5/04	10:00	Factory Orders	Mar	***+1.8%***	+0.1%	-0.7%	durable goods reported at +4.0%
Tuesday	5/05	8:30	**Trade Balance, $bln**	Mar	***-39.4***	-35.4	-42.7	seen wider
			goods only		***-59.2***	-55.2	-62.5	rebounding from port impact
		10:00	**ISM Non-Manf. Index**	Apr	***56.4***	56.5	56.9	moderate
Wednesday	5/06	8:15	**ADP Payroll Estimate, th.**	Apr	***+175***	+189	+214	moderately strong
		8:30	NF Productivity (prelim.)	1Q15	***NF***	-2.2%	+3.9%	another weak quarter
			Unit Labor Costs		***NF***	+4.1%	-1.0%	seen higher
		9:00	Quarterly Refunding Annc.					size of 3-, 10-, and 30-yr auctions
Thursday	5/07	8:30	Jobless Claims, th.	5/02	***282***	***285***	295	a low trend
Friday	5/08	8:30	**Nonfarm Payrolls, th.**	Apr	***+175***	+126	+264	rebounding from March weather
			private-sector		***+175***	+129	+264	a more moderate trend
			Unemployment Rate		***5.4%***	5.5%	5.5%	trending lower
			employment/population		***59.4%***	59.3%	59.3%	likely to edge higher
			Avg. Weekly Hours		***34.6***	34.5	34.6	rebound from weather
			Avg. Hourly Earnings		***+0.2%***	+0.3%	+0.1%	modest wage pressures

This Week…

The focus is likely to be on the GDP report. Investors often put far too much weight on the headline figure, but they may be more willing to dismiss a bad figure this time (amid expectations of near-term improvement and following a similar pattern last year). The Fed policy meeting should be a non-event. There will be no post-meeting press conference. The ISM manufacturing data are likely to be soft, but not horrible.

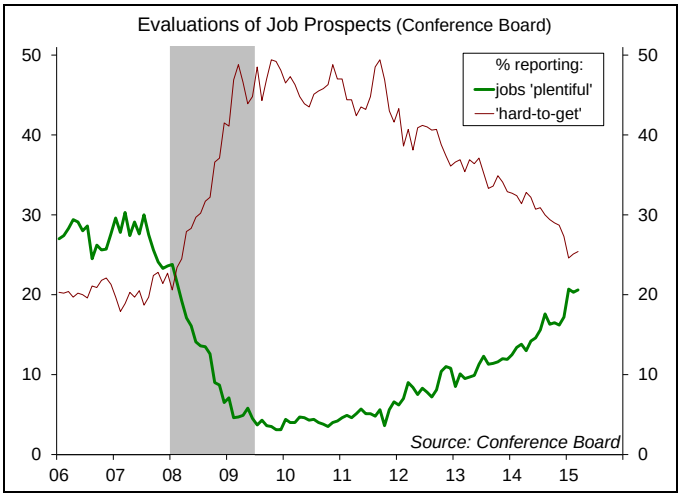
Monday

No significant data.

Tuesday

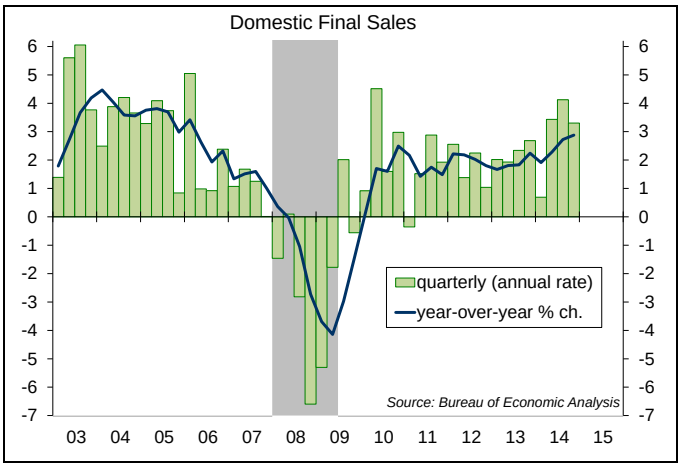
Case-Shiller Home Prices (February) – Home prices have picked up again. That's helpful for existing home owners (greater wealth effect), but it also reduces affordability for potential buyers (which explains the continued softness at the low end).

Consumer Confidence (April) – The Conference Board's measure is likely to improve further in the advance estimate for April (watch for possible revisions to March). Job market perceptions have generally improved (especially toward the end of last year), which should help support consumer spending growth in the near term. However, figures are likely to remain consistent with a high degree of labor market slack.



Wednesday

Real GDP (1Q15, advance) – There's always a lot of uncertainty in the initial GDP growth estimate. The Bureau of Economic Analysis doesn't have a complete picture and will have to make assumptions about inventories, foreign trade, and other components. The financial markets typically zero in on the headline figure, but rarely delve much into the details. To date, consumer spending (70% of GDP) appears to be on track for about a 2.0% annual rate (vs. 4.4% in 4Q14). Business fixed investment is likely to have contracted, reflecting weakness in capital goods shipments and the contraction in energy exploration. The drop in oil and gas drilling should lead a drop in business structures. Remember, GDP is reported at an annual rate, so a short, sharp drop will be magnified. Net exports are tougher to figure out. The strong dollar has had an impact and West Coast port delays generated some noise (in addition, monthly changes tend to be choppy under normal conditions). Inventories are likely to have slowed a bit, subtracting from overall growth. These figures will be revised (and revised). Note that Domestic Final Sales (GDP less inventories and net exports) tend to be less noisy and are a better representation of the strength of underlying domestic demand.



Pending Home Sales Index (March) – The PHSI should point the way toward further improvement in existing home sales, However, there's a fair amount of noise in the monthly figures.

Federal Open Market Committee Meeting – Fed officials have signaled that no policy changes are going to come out in April. Chair Yellen has said that the June 16-17 meeting will be "live." Officials will debate the possibility of raising rates at that meeting (but it's unlikely that they *will* hike). In the policy statement, the FOMC should recognize the recent slowdown, but officials are likely to remain optimistic. The FOMC is still working on the details of its exit strategy. We ought to get more debate on that, but any conclusions (and communications to the public) will likely be delayed until June or later.

Thursday

Jobless Claims (week ending April 25) – Unadjusted figures typically pop a bit higher after Easter, but we should see the underlying trend remain low. Job destruction hasn't been an issue for the labor market for some time.

Employment Cost Index (1Q15) – The ECI has trended at a low level, consistent with a high degree of labor market slack. Fed officials will be watching for signs that the trend is picking up.

Personal Income and Spending (March) – Quarterly figures are part of the GDP report, so there shouldn't be much suspense.

Chicago PMI (April) – Figures were depressed in February and March by bad weather and West Coast port disruptions. We should see a rebound in the figures for April.

Friday

ISM Manufacturing Index (April) – Manufacturing activity appears to be mixed across industries, but generally soft.

Motor Vehicle Sales (April) – The pace is back to about where it was before the recession. The fundamentals are better now (less reliance on home equity extraction) and replacement needs and readily available credit should provide support. However, vehicle sales are still likely to flatten out in the quarters ahead, providing less support for consumer spending.

Next Week …

The Employment Report arrives on the third Friday following the week that contains the 12th of the month (in this case, April 8). Weather was a factor in March. The recovery from the weather will likely compete with a moderating trend and the usual statistical noise (hence, it's a bit of Bond Market Bingo). Still, the payroll figures will drive the near-term economic view and the outlook for Federal Reserve policy.

Coming Events and Data Releases

May 13	Retail Sales (April)
May 19	Building Permits, Housing Starts (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