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Economic Research
Published by Raymond James & Associates

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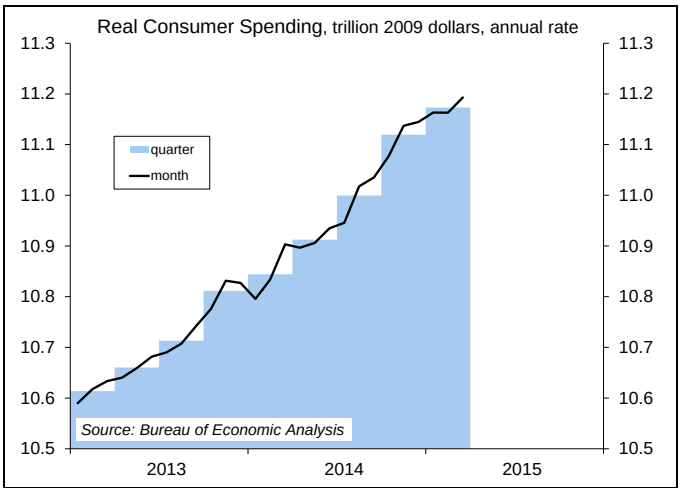
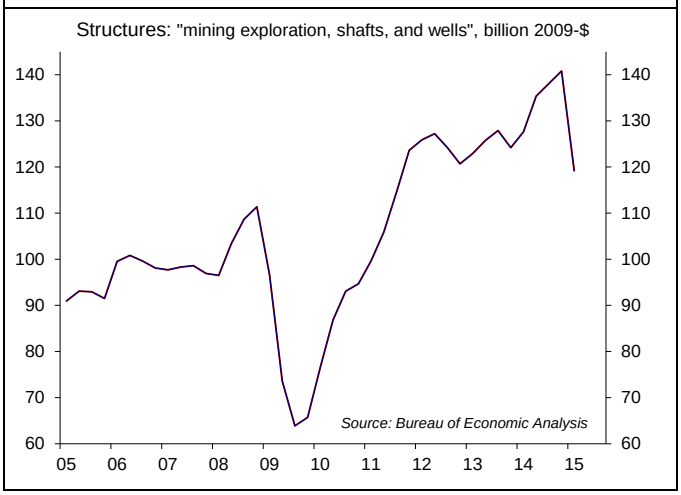
May 4 - 8, 2015

Weekly Economic Monitor

Waiting on the Turn

The economy slowed in the first quarter, reflecting a variety of restraints. Most of these should give way, leading to stronger growth in the second quarter. However, Federal Reserve officials and financial market participants will want to see proof.

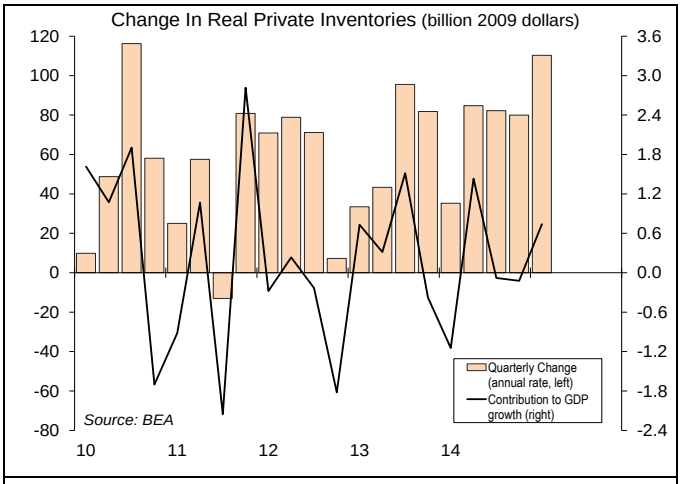


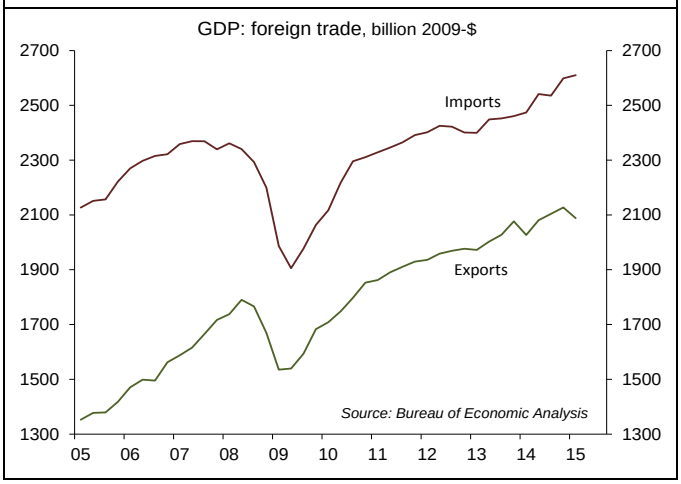


Inflation-adjusted consumer spending, which accounts for 70% of Gross Domestic Product, rose at a 1.9% annual rate in the advance estimate for 1Q15, not bad considering that the 4Q14 pace was +4.4%. Personal income was flat in March, but inflation-adjusted disposable income rose sharply in the quarter, which should provide support for spending in 2Q15.

The contraction in oil and gas drilling pushed investment in business structures lower. These figures will be revised, but they currently suggest more to come in the second quarter.

Inventories rose more than expected in 1Q15. While the total may be revised lower, the inventory-to-sale ratio is relatively high and suggests that we may see a correction in production for the second quarter (and a moderate drag on GDP growth).





The stronger dollar had a negative impact on foreign trade in 1Q15. However, West Coast port delays (the impact of which continues to be reported) make it difficult to say how much of the wider trade deficit was due to the dollar, how much was weak growth abroad, and how much was port issues (in addition, the monthly figures are normally choppy). The port delays likely had a bigger impact on imports, which have a negative sign in the GDP calculation.

Putting the pieces together, the data suggest a pickup in consumer spending in 2Q15, but further restraint in business fixed investment, a moderate inventory correction, and a further drag from foreign trade. GDP forecasts for the second quarter ought to be coming down (from early forecasts of 3%+).

In its monetary policy statement, the Federal Open Market Committee recognized the first quarter slowdown, but pinned that on "transitory factors." That still leaves the Fed on track to begin raising rates later this year. However, officials will want to see evidence of a second quarter pickup in growth and, more importantly, further improvement in labor market conditions.

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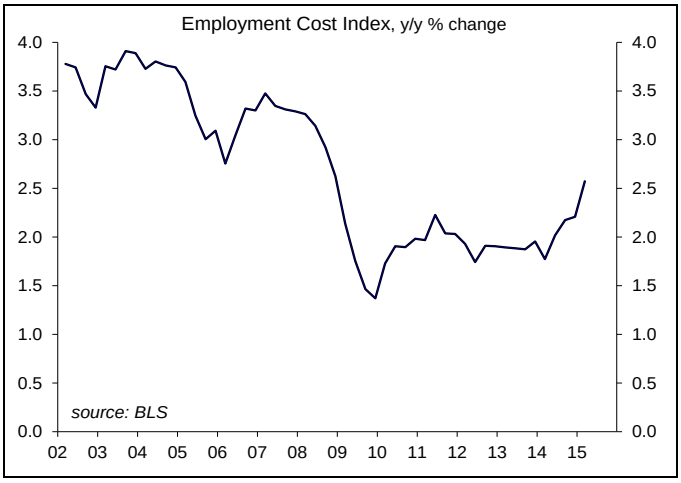
	Treasury Yields								Dollar				Equities		
	13-wk	26-wk	52-wk	2-yr	3-yr	5-yr	10-yr	30-yr	$/Euro	$/BP	JY/$	CD/$	NASD	SPX	DJIA
4/03/15	0.02	0.10	0.21	0.49	0.80	1.26	1.85	2.49	1.099	1.492	118.96	1.247	4886.94	2066.96	17676.00
4/24/15	0.03	0.10	0.24	0.54	0.84	1.34	1.93	2.62	1.088	1.518	118.98	1.217	5092.09	2117.69	18080.14
5/01/15	0.01	0.04	0.23	0.60	0.95	1.50	2.11	2.82	1.121	1.515	120.17	1.216	5005.39	2108.23	18023.66

Recent Economic Data and Outlook

The economic data were mixed, but remained consistent with restrained growth in the first quarter (likely to be followed by better growth in the second). Fed policymakers suggested that the recent slowdown will prove to be "transitory." Stock market volatility remained high. Higher bond yields in Europe appeared to put upward pressure on U.S. Treasury yields.



As expected, the **Federal Open Market Committee** left monetary policy unchanged and provided no additional guidance on the timing of rate increases. The FOMC noted that *"economic growth slowed during the winter months, in part reflecting transitory factors."* While recognizing that *"growth in output and employment slowed"* in 1Q15, the FOMC said that it *"continues to expect that, with appropriate policy accommodation, economic activity will expand at a moderate pace, with labor market indicators continuing to move toward levels the Committee judges consistent with its dual mandate."*

Real GDP rose at a 0.2% annual rate in the advance estimate for 1Q15 (+3.0% y/y). Consumer spending rose at a 1.9% pace (vs. 4.4% in 4Q14). Business fixed investment fell at a 3.4% pace, reflecting a 23.1% annual rate of decline in structures ("mining exploration, shafts, and wells" fell at a 48.7% annual rate). Residential construction and government were little changed relative to the fourth quarter. Inventory growth picked up, adding 0.7 percentage point to GDP growth. Net exports subtracted 1.3 percentage points. Real Domestic Final Sales (GDP less inventories and net exports) rose at a 0.7% annual rate (+2.9% y/y). The GDP Price Index fell at a 0.1% annual rate, up 0.4% ex-food & energy. The PCE Price Index fell at a 2.0% pace (+0.3% y/y), up 0.9% ex-food & energy (+1.3% y/y).

Personal Income was flat in March (+3.8% y/y), with wages and salaries up 0.2% +3.8%). Adjusted for inflation, disposable income fell 0.2%, but still rose at a 6.2% annual rate in the quarter. **Personal Spending** rose 0.4% (+3.0% y/y), up 0.3% adjusting for inflation (+2.7% y/y). The **PCE Price Index** rose 0.2% (+0.171% before rounding, +0.3% y/y), up 0.1% ex-food & energy (+0.148% before rounding, +1.3% y/y).

Motor Vehicle Sales slowed to a 16.5 million seasonally adjusted annual rate in April, vs. 17.1 million in March.

The **ISM Manufacturing Index** was unchanged at 5.15 in April. New orders improved and production advanced, but employment fell below the breakeven level. Export orders rose modestly. Input price pressures continued to retreat. Comments from supply managers were mostly upbeat, with some further reference to West Coast port delays.

The **Chicago Purchasing Managers Index** rose to 52.3 in April, vs. 46.3 in March and 45.8 in February, reflecting a rebound from adverse weather and West Coast port delays.

The Conference Board's **Consumer Confidence Index** fell unexpectedly to 95.2 in the initial estimate for April, vs. 101.4 in March. Evaluations of current job conditions deteriorated.

The University of Michigan's **Consumer Sentiment Index** edged up to 95.9 in April (unchanged from the mid-month estimate), vs. 93.0 in March.

The **Employment Cost Index** rose 0.7% for the three months ending in March, up 2.6% y/y (vs. +1.8% for the 12 months ending March 2014). Wages & salaries rose 0.7% (+2.6% y/y), while benefit costs rose 0.6% (+2.7% y/y).

Construction Spending fell 0.6% in March, but figures for January and February were revised higher, leaving the quarterly total somewhat higher than was assumed in the advance GDP report (implying, all else equal, a small upward revision to the first quarter growth estimate). For the first three months of the year, single-family construction spending rose 10.2% relative to last year, while nonresidential rose 6.4%.

Economic Outlook (2Q15): Around a 2.0% 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, but indicate that the more important question is the pace of tightening after the initial hike (likely to be gradual).

This Week:					*forecast*	last	last –1	comments
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	***-45.2***	-35.4	-42.7	assumed a lot wider in GDP estimate
			goods only		***-64.6***	-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	***-2.4%***	-2.2%	+3.9%	another weak quarter
			Unit Labor Costs		***+5.1%***	+4.1%	-1.0%	seen higher
		9:00	Quarterly Refunding Annc.					size of 3-, 10-, and 30-yr auctions
		9:15	Fed Chair Yellen speaks					*"Finance and Society"*
Thursday	5/07	8:30	Jobless Claims, th.	5/02	***282***	262	296	a bit choppy, but a low trend
			UK Election					a new coalition?
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
Next Week:								
Monday	5/11	7:00	BOE Policy Decision					no change
Tuesday	5/12	9:00	Small Business Optimism	Apr	***NF***	95.2	98.0	likely to rebound
		10:00	JOLTS: hiring rate		***NF***	3.5%	3.5%	a gradual trend, but below normal
			JOLTS: quit rate		***NF***	1.9%	2.0%	expecting gradual improvement
		1:00	Treasury Note Auction					3-year notes
		2:00	Treasury Budget, $bln	Apr	***NF***	106.9	112.9	April is a surplus month
Wednesday	5/13	8:30	Import Prices	Apr	***NF***	-0.3%	+0.2%	no pressure
			ex-food & fuels		***NF***	-0.4%	-0.2%	a declining trend
		8:30	**Retail Sales**	Apr	***+0.3%***	+0.9%	-0.5%	moderate
			ex-autos		***+0.5%***	+0.4%	0.0%	moderate
			ex-autos, bld mat, gasoline		***+0.6%***	+0.4%	-0.2%	core sales picking up
		10:00	Business Inventories	Mar	***+0.3%***	+0.3%	-0.0%	assumed up 0.3% in advance GDP est.
		1:00	Treasury Note Auction					10-year notes
Thursday	5/14	8:30	Jobless Claims, th.	5/09	***280***	***282***	262	a low trend
		8:30	**Producer Price Index**	Apr	***+0.0%***	+0.2%	-0.5%	seen about flat
			ex-food & energy		***+0.1%***	+0.2%	-0.5%	modest
			ex-f, e, trade services		***+0.1%***	+0.2%	0.0%	a low trend in new core
		1:00	Treasury Bond Auction					30-year bonds
Friday	5/15	8:30	Empire St. Manf. Index	May	***+6.2***	-1.2	+6.9	erratic, but likely to rebound
		9:15	**Industrial Production**	Apr	***NF***	-0.6%	+0.1%	a lackluster trend
			manufacturing output		***NF***	+0.1%	-0.2%	seen higher, but mixed across industries
			Capacity Utilization		***NF***	78.4%	79.0%	no threat to the inflation outlook
			manufacturing		***NF***	77.9%	78.0%	still plenty of excess capacity
		10:00	UM Consumer Sentiment	m-May	***97.0***	95.9	93.0	should pick up a bit

This Week…

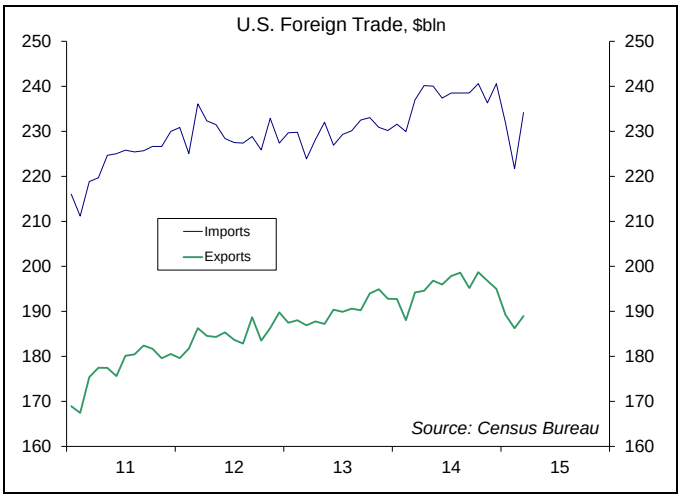
The focus is expected to be on Friday's employment data. There's a fair amount of statistical noise in the payroll figures, but we're likely to see a rebound from weather effects (weather was worse than normal during the March survey week). Of course, the financial markets may be buffeted by other factors, including developments in Europe.

Monday

Factory Orders (March) – Orders for durable goods (subject to revision in this report) were reported to have risen 4.0%, reflecting a spike in aircraft orders and lackluster results otherwise (ex-transportation, a sixth consecutive monthly decline). Orders for nondurable are likely to be dominated by petroleum prices. Keep an eye on unfilled orders and the inventory-to-sales ratio, but trending in the wrong direction.

Tuesday

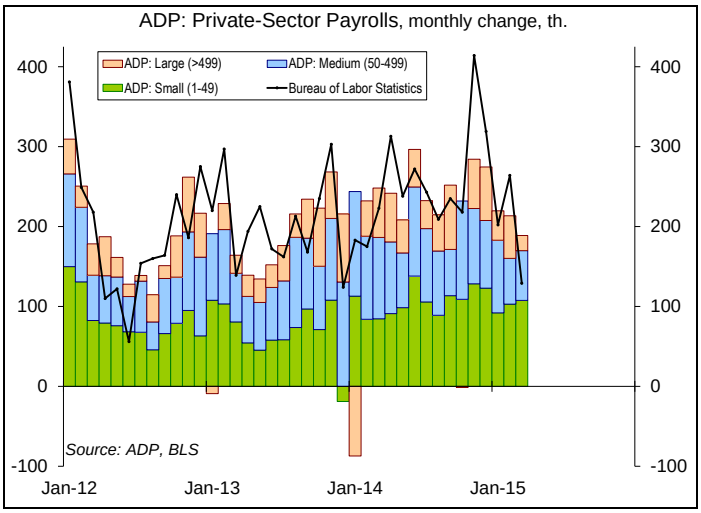
Trade Balance (March) – It was a difficult quarter. Net exports subtracted 1.3 percentage points from first quarter GDP growth (according to the advance estimate). The strong dollar appears to have been a major factor, boosting imports and reducing exports. West Coast port delays (we're still hearing anecdotal reports of a lingering impact into April) added noise to the data, making it difficult to gauge the magnitude of the dollar's impact. In the advance GDP report, the BEA assumed a substantial widening of the trade deficit in March. The March figures, reflecting a rebound from port delays, aren't going to give us a good picture, but these data will have some implications for revisions to the first quarter GDP growth estimate. Note that, with currency markets stabilizing (or at least turning range-bound), the dollar impact on growth should be transitional.



ISM Non-Manufacturing Index (April) – The April report should be consistent with moderate growth in the overall economy. Watch the figures on new orders and employment.

Wednesday

ADP Payroll Estimate (April) – The ADP is not known as a good predictor of the official BLS data, but a surprise (relative to the median forecast) could move the markets. Note that the March report suggested a slowdown in hiring at large firms, but continued strength at small and medium-sized firms.



Nonfarm Productivity (1Q15, preliminary) – Ugly. The nonfarm business portion of GDP fell at a 0.2% annual rate. Aggregate private-sector hours rose at a 2.2% pace. That should leave productivity growth down again in 1Q15. The Employment Cost Index rose at a 2.6% annual rate. That should leave Unit Labor Costs (the labor expense per unit of output) up sharply. These figures can bounce around a lot from quarter to quarter – so take the news with a grain of salt – but it's a troublesome picture when taken at face value. Faster growth in Unit Labor Costs could lead to higher inflation, if firms can pass those increases along, or could eat into corporate profits, which is often a catalyst for weaker job growth in the months ahead.

Yellen Speaks ("Finance and Society") – The Fed chair, along with Senator Elizabeth Warren and IMF Managing Director Christine Lagarde, will speak at a conference sponsored by the Institute for New Economic Thinking. Not likely to be market-moving.

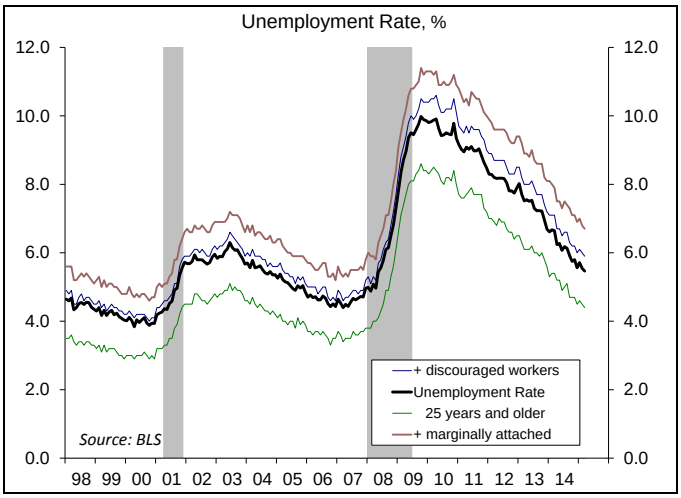
Thursday

Jobless Claims (week ending May 2) – Figures have been a bit choppy recently, but the underlying trend has remained low.

UK Election – One thing to admire about the British, their election campaigns are a lot shorter (in the U.S., we still have 18 months to go). While the outcome is uncertain, it's likely to be another hung parliament (no clear majority for a single party), which means a coalition will be necessary to govern.

Friday

Employment Report (April) – There's a fair amount of statistical noise in the payroll data (figures are reported accurate to ±105,000), but we're likely to see some rebound from bad weather in March. The unemployment rate (reported accurate to ±0.2%) is expected to edge lower. However, broader measures suggest that significant slack remains.



Next Week …

The focus is likely to be on the retail sales report, where investors will be looking for signs of a second quarter pickup.

Coming Events and Data Releases

May 19	Building Permits, Housing Starts (April)
May 20	FOMC Minutes (April 28-29)
May 25	Memorial Day (markets closed)
May 26	Durable Goods Orders (April) Consumer Confidence (May)
May 29	Real GDP (1Q15, 2nd estimate)
June 5	Employment Report (May)
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