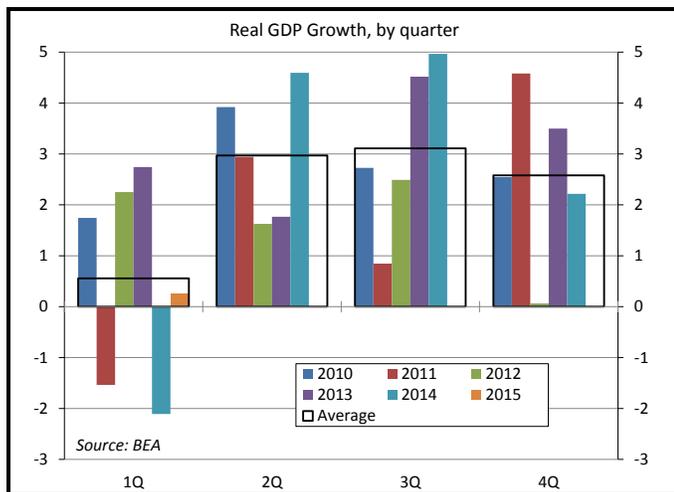


Weekly Economic Monitor

Fun with GDP

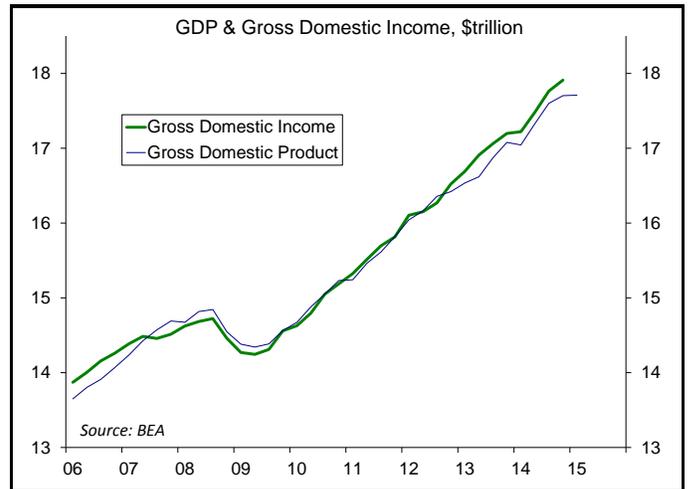
The current economic expansion is rapidly approaching its six-year anniversary. Contrary to popular belief, the likelihood of entering a recession does not depend on the age of the expansion. However, there are other issues. In this recovery, average growth in the first quarter of the year has been well below the average of the other three quarters, leading to some doubts about the quality of the seasonal adjustment. Looking ahead, the government will introduce two new gauges with the annual benchmark revisions in late July.

Economic activity has strong seasonal patterns related to the weather, the school year, and holiday shopping. Estimates of Gross Domestic Product are adjusted for seasonal differences, or rather, their components are adjusted (usually by the agency providing the source data). By design, seasonally adjusted data should not display signs of seasonal variation (that is, there should be no residual seasonality).

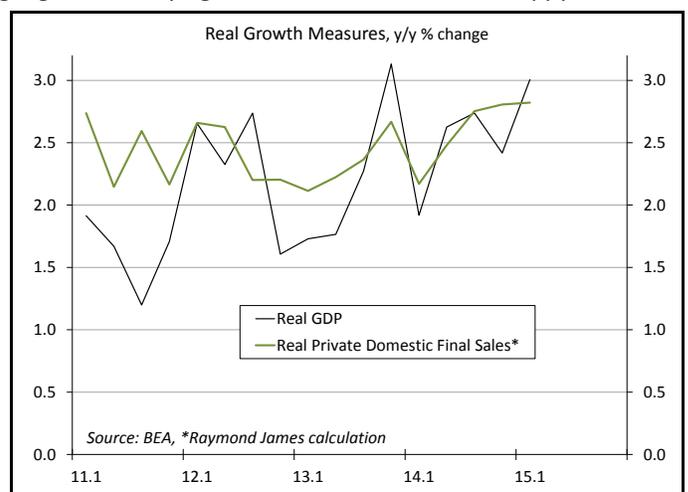


Clearly, first quarter GDP growth in recent years has been lower, but is that truly significant? [Economists](#) at the Fed’s Board of Governors say no. [Economists](#) at the San Francisco Fed say yes, and properly adjusted, GDP growth for 1Q15 would have been 1.8%, rather than the 0.2% reported in the advance estimate. Yet, any statistician can tell you, five observations are not enough on which to base any meaningful analysis. In other words, nobody knows. Post-recession seasonal patterns may have changed. The housing collapse and mortgage debt overhang could have led to permanent changes in spending habits. Financial deleveraging may have led to longer-term distortions in the credit system. We won’t know for sure until a lot more time has passed. The government does alter the seasonal adjustment over time. However, seasonal adjustment problems will balance out over the course of the year. One can simply look at year-over-year changes.

In Econ 1, students learn the aggregate economic activity can be measured as output or income. While most people are familiar with GDP, many are unaware of GDI. These two measures often differ from quarter to quarter and each has its advocates. In July, the Bureau of Economic Analysis will introduce a new measure, which is simply the average of the two.



Financial market participants place way too much emphasis on the headline GDP growth figure. Consumer spending and business fixed investment are key, accounting for more than 80% of GDP. However, net exports, the change in inventories, and defense spending account for more than their fair share of volatility and can whip the headline GDP growth figure around from quarter to quarter. In July, the BEA will introduce Final Sales to Private Domestic Purchases, which will be a better gauge of underlying demand and be a lot less choppy than GDP.



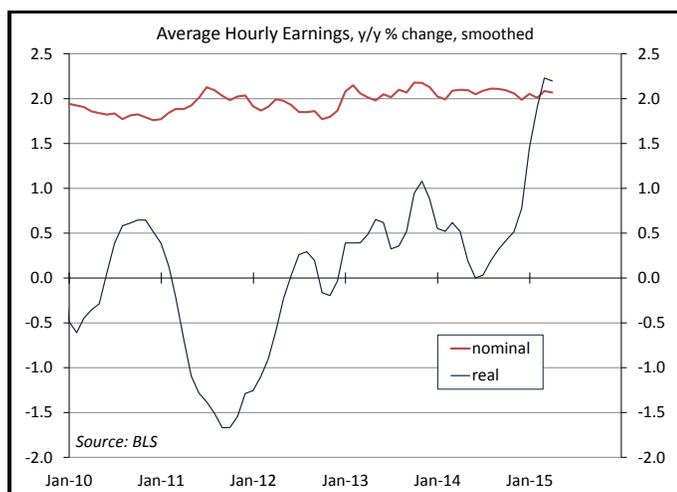
Questions about the seasonality of GDP growth help highlight the fact that investors should consider the broad range of economic data, not just one figure.

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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/\$	NASDAQ	SPX	DJIA	
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	
3/15/15	0.02	0.09	0.23	0.55	0.90	1.46	2.14	2.93	1.143	1.577	119.36	1.201	5048.29	2122.73	18272.56	
3/22/15	0.02	0.08	0.20	0.62	1.00	1.56	2.21	2.99	1.101	1.547	121.53	1.230	5089.36	2126.12	18232.08	

## Recent Economic Data and Outlook

The economic data reports were mixed, consistent with moderate growth in the near term. April residential construction figures surprised to the upside, largely reflecting the normal volatility one sees in the multi-family sector. Existing home sales fell short of expectations. Core inflation was slightly higher than expected. The FOMC minutes showed that a few officials thought that conditions might warrant an initial rate hike in June. However, that was a minority opinion and subsequent data have made a June liftoff extremely unlikely. On Friday, after many market participants had left for a long weekend, Fed Chair Yellen indicated that the Fed will likely “*proceed cautiously*” once it begins to tighten and that it will likely be “*several years*” before the federal funds target rates returned to normal.



**Fed Chair Janet Yellen**, speaking for herself and not the FOMC, noted that the recovery has been impeded by a number of headwinds, which are fading. The first quarter slowdown was due to “*transitory*” restraints and possibly statistical noise. If growth picks up, as expected, it should be appropriate for the Fed to begin raising rates later this year (but there was no hint about the precise time of tightening). Importantly, she said that “*if conditions develop as my colleagues and I expect, then the FOMC’s objectives of maximum employment and price stability would best be achieved by **proceeding cautiously**, which I expect would mean that **it will be several years before the federal funds rate would be back to its normal, longer-run level.***”

The **FOMC Minutes** from the April 28-29 policy meeting held no surprises and offered no clues as to the timing of the Fed’s initial increase in short-term interest rates. The minutes showed that Fed officials were concerned about the functioning of the bond market and a possible over-reaction to the initial rate hike. They requested that the staff provide more frequent updates on the financial markets for some time after the initial tightening.

The **Consumer Price Index** rose 0.1% in April (-0.2% y/y). Ex-food & energy, the CPI rose 0.3% (+0.256% before rounding, +1.8% y/y). Hospital services jumped 1.9% (+4.8% y/y).

**Real Hourly Earnings** were flat for the second consecutive month, little changed since January, but still up 2.3% y/y.

**Building Permits** jumped 10.1% in April, to a 1.143 million seasonally adjusted annual rate (+6.4% y/y). Single-family permits rose 3.7% (+7.1% y/y). **Housing Starts** jumped 20.3%, to a 1.135 million pace (+9.2% y/y), with single-family permits up 16.7% y/y (+14.7% y/y).

**Homebuilder Sentiment** fell to 54 in May, vs. 56 in April.

**Existing Home Sales** fell 3.3% in April, to a 5.04 million seasonally adjusted annual rate (+5.1% y/y). Results were mixed across regions. The National Association of Realtors noted elevated buyer interest, but cited tight supplies as a constraint.

The Index of **Leading Economic Indicators** jumped 0.7% in April, partly reflecting the sharp rebound in building permits. The Index of Coincident Economic Indicators rose 0.2%, vs. -0.1% in March. The Conference Board noted that “*taken together, the current behavior of the composite indexes and their components suggest that the expansion in economic activity should continue, but the pace of growth is not likely to significantly strengthen in the months ahead.*”

The **Chicago Fed National Activity Index** rose to -0.15 in April, from -0.36 in March. At -0.23, the three-month average was consistent with growth slightly below the long-term trend.

**Economic Outlook (2Q15):** Around a 1.0% to 1.5% annual rate.

**Employment:** The pace of job growth has slowed, 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 boosted consumer purchasing power, but the pickup in spending has been less than anticipated.

**Manufacturing:** The strong 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 (which is likely to be gradual).

This Week:				<i>forecast</i>	last	last -1	comments
Monday	5/25	Memorial Day Holiday					markets closed
Tuesday	5/26	8:30 <b>Durable Goods Orders ex-transportation</b>	Apr	<b>-2.6%</b> <b>+0.4%</b>	+4.4% +0.4%	-1.4% -1.3%	volatility in aircraft likely to improve
		nondef cap gds ex-aircraft		<b>+0.3%</b>	+0.1%	-2.0%	turning the corner?
		9:00 Case-Shiller Home Prices year-over-year	Mar	<b>+0.5%</b> <b>+4.6%</b>	+0.4% +4.2%	+0.5% +4.4%	still rising moderate y/y
		10:00 <b>New Home Sales, th.</b> % change	Apr	<b>530</b> <b>+10.2</b>	481 -11.4	543 +5.6	seen higher, but these data are erratic watch for revisions
		10:00 <b>Consumer Confidence</b>	May	<b>97.0</b>	95.2	101.4	likely to bounce (watch for revisions)
		1:00 Treasury Note Auction					\$26 billion in 2-year notes
		2:30 <b>Fed VC Fischer Speaks</b>					the Federal Reserve & the global economy
Wednesday	5/27	9:00 BOC Policy Decision					no change in rates or in inflation target
		11:30 Treasury FRN Auction					\$13 billion in re-opened 2-year FRNs
		1:00 Treasury Note Auction					\$35 billion in 5-year notes
Thursday	5/28	8:30 Jobless Claims, th.	5/23	<b>272</b>	274	264	a low trend
		10:00 Pending Home Sales	Apr	<b>+1.5%</b>	+1.1%	+3.6%	trending higher
		1:00 Treasury Note Auction					\$29 billion in 7-year notes
Friday	5/29	8:30 <b>Real GDP (2<sup>nd</sup> estimate)</b>	1Q15	<b>-0.2%</b>	+2.2%	+5.0%	+0.2% in the advance estimate
		9:45 Chicago PM Index	May	<b>53.0</b>	52.3	46.3	rebounding from first quarter slump
		10:00 UM Consumer Sentiment	May	<b>92.2</b>	95.9	93.0	88.6 at mid-month
Next Week:							
Monday	6/01	8:30 Personal Income	Apr	<b>+0.4%</b>	0.0%	+0.4%	rebounding from a soft March
		Personal Spending		<b>+0.2%</b>	+0.4%	+0.2%	a lackluster gain
		PCE Price Index ex-f&e		<b>+0.2%</b>	+0.1%	+0.1%	the core CPI rose 0.256%
		9:45 Markit US Manf PMI (final)	May	<b>NF</b>	54.1	55.7	53.8 in the flash estimate
		10:00 Construction Spending	Apr	<b>+1.2%</b>	-0.6%	+0.0%	some rebound from weather effects
		10:00 <b>ISM Manf. Index</b>	May	<b>51.8</b>	51.5	51.5	not especially strong
Tuesday	6/02	10:00 Factory Orders	Apr	<b>NF</b>	+2.1%	-0.1%	most of the volatility is in durable goods
		tbd Motor Vehicle Sales, mln	May	<b>16.7</b>	16.5	17.1	the trend appears to be leveling off
		domestically built		<b>13.1</b>	12.9	13.3	seen higher
Wednesday	6/03	7:45 ECB Policy Decision					no change
		8:15 <b>ADP Payroll Estimate, th.</b>	May	<b>+170</b>	+169	+175	watch the mix (large vs. small)
		8:30 <b>Trade Balance, \$bln goods only</b>	Apr	<b>-47.0</b> <b>-66.2</b>	-51.4 -70.6	-35.9 -55.7	seen narrower but watch for possible revisions
		10:00 <b>ISM Non-Manf. Index</b>	May	<b>57.0</b>	57.8	56.5	moderate
		2:00 <b>Fed Beige Book</b>					still a mixed bag (modest to moderate)
Thursday	6/04	8:30 Jobless Claims, th.	5/30	<b>273</b>	<b>272</b>	274	holiday adjustments may add noise
Friday	6/05	8:30 <b>Nonfarm Payrolls, th.</b> private-sector	May	<b>+170</b> <b>+175</b>	+223 +213	+85 +94	uneven, but a slower trend in 2Q15 watch for possible revisions
		<b>Unemployment Rate</b>		<b>5.4%</b>	5.4%	5.5%	flat or slightly lower
		employment/population		<b>59.4%</b>	59.3%	59.3%	a very gradual trend of improvement
		Avg. Weekly Hours		<b>34.5</b>	34.5	34.5	seen steady
		Avg. Hourly Earnings		<b>+0.2%</b>	+0.1%	+0.2%	modest wage pressures

## This Week...

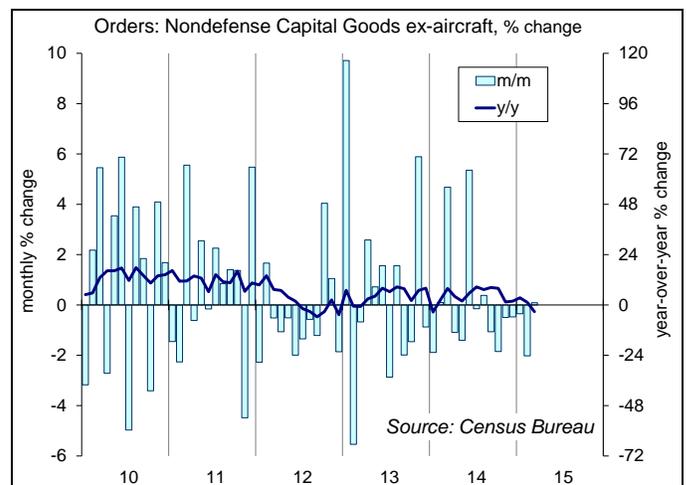
The holiday-shortened week will be bookended by some important economic reports. On Tuesday, the focus will be on durable goods orders and consumer confidence. On Friday, the government will release revised GDP growth estimate for the first quarter (note: figures will be revised again next month and annual benchmark revisions are due at the end of July).

## Monday

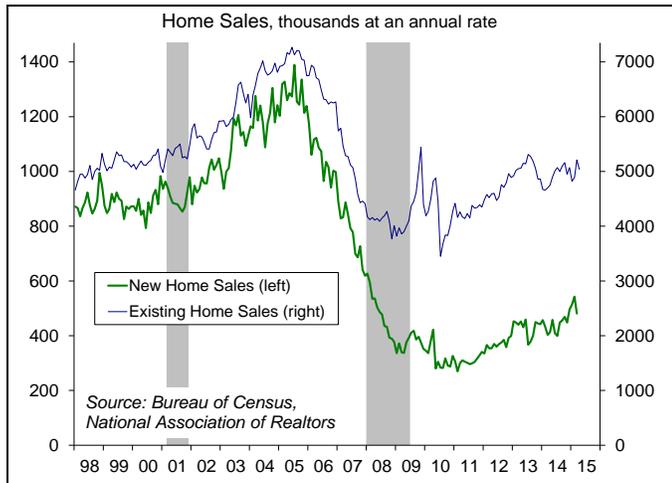
**Memorial Day Holiday** – Markets closed.

## Tuesday

**Durable Goods Orders (April)** – Monthly changes in orders can be erratic, but the weak trend in capital goods orders (reflecting the strong dollar's impact) is a concern. Aircraft orders are likely to reverse. The ex-transportation figure should rise moderately.



**New Home Sales (April)** – These figures are notoriously erratic, with large monthly swings, and are subject to sizable revisions. Sales fell sharply in March (possibly reflecting a weather impact) – hence, can be expected to snap back in April.



**Conference Board Consumer Confidence Index (May)** – If you already know personal income, wealth, and the consumers' ability to borrow, then confidence gauges don't really help to explain much about spending. What people say and what they do are separate things. However, they can present a convenient summary view of the overall situation. The Conference Board's survey includes a current labor market assessment, which may help the Fed to judge the amount of remaining slack.

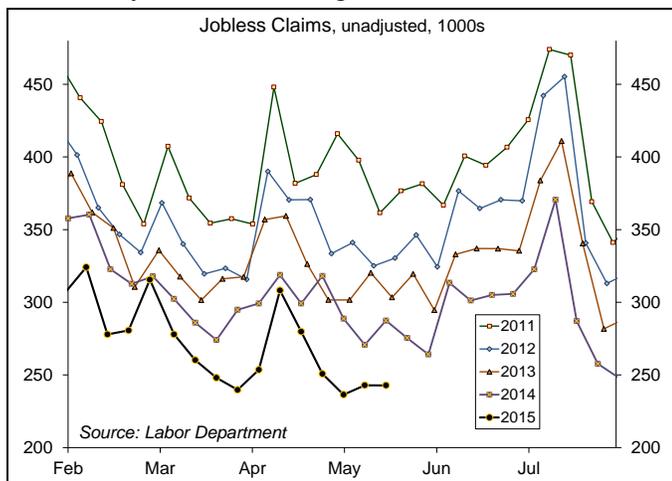
**Fed Vice Chair Fischer Speaks** – Fischer's recent speech, on the history of the euro area, did not address much about the current situation. However, given the title of this speech ("The Federal Reserve and the Global Economy"), we're likely to hear more about the 2013 taper tantrum and policymakers' concerns about adverse market reactions to possible Fed tightening.

## Wednesday

No significant data.

## Thursday

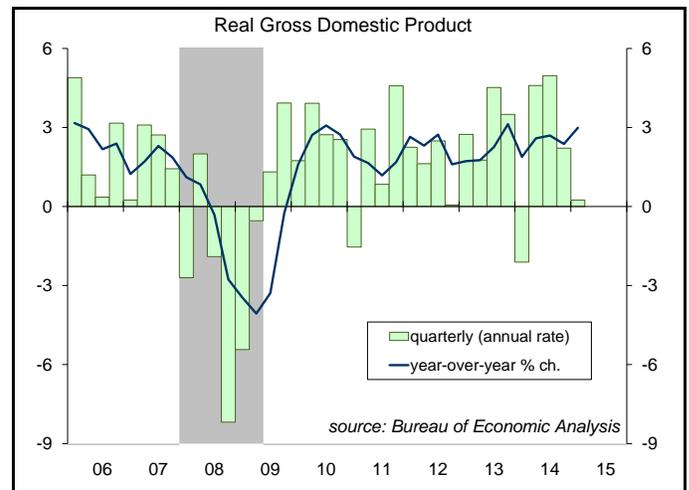
**Jobless Claims (week ending May 23)** – The trend in May has been remarkably low, but job destruction really hasn't been an issue for the job market in a long time.



**Pending Home Sales Index (April)** – The PHSI does tend to lead existing home sales, but the relationship isn't perfect. Some improvement is likely for April.

## Friday

**Real GDP (1Q15, 2<sup>nd</sup> estimate)** – The trade deficit was wider than assumed in the advance estimate, while inventories appear to have risen more slowly. Hence, the first quarter growth GDP figure was widely expected to be revised lower.



**Chicago Purchasing Managers Index (May)** – The harsh winter took a toll on Chicago-area manufacturing. Activity recovered a bit in April and we should see further improvement in May.

**UM Consumer Sentiment Index (May)** – The headline figure stumbled in the mid-month assessment, but we should see some rebound in the full-month reading

## Next Week ...

The focus is likely to be on the May employment figures. Note that the private sector can be expected to add about a million jobs in May – that is, prior to seasonal adjustment. We may lose about 300,000 education jobs (public and private), with much larger declines expected for June and July. The unemployment rate should hold about steady, with the employment/population ratio trending only gradually higher.

## Coming Events and Data Releases

June 11	Retail Sales (May)
June 15	Industrial Production (May)
June 16	Building Permits, Housing Starts (May)
June 17	FOMC Policy Decision, Yellen press conference
July 2	Employment Report (June)
July 3	Independence Day Holiday (observed)
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