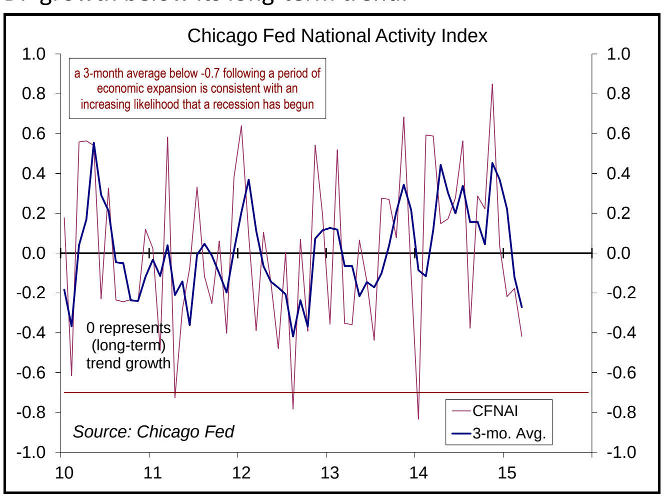
Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com **April 24, 2015**

Monthly Economic Outlook

Still Optimistic, but Some Uncertainties

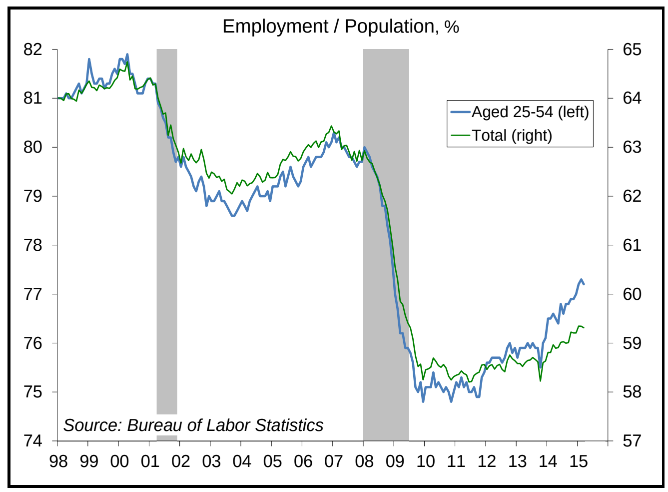
- *Growth slowed in the first quarter, reflecting bad weather, West Coast port issues, a contraction in energy exploration, and the impact of a strong dollar, but is widely expected to pick up.*
- *Senior Fed officials continue to suggest that conditions are likely to warrant an initial increase in short-term interest rates this year. However, they also believe that the more important question is the pace of tightening after the first hike, and they suggest that that pace is likely to be very gradual.*
- *Financial market participants face uncertainty regarding the pace of economic growth here and abroad, as well as Fed policy changes, geopolitical worries, and other issues.*

Economic data reports have been mixed in recent weeks, consistent with a slowing in the pace of economic growth in 1Q15. Weather was certainly a factor. Although not as severe as last year, this winter was worse than normal, restraining retail sales in January and February. Poor weather often dampens manufacturing activity, although West Coast port delays and the strong dollar were also factors in the first quarter. Orders for core capital goods have continued to trend lower, falling for the seventh consecutive month in March. The Chicago Fed National Activity Index, a composite of 85 economic indicators, has dipped below zero, consistent with GDP growth below its long-term trend.

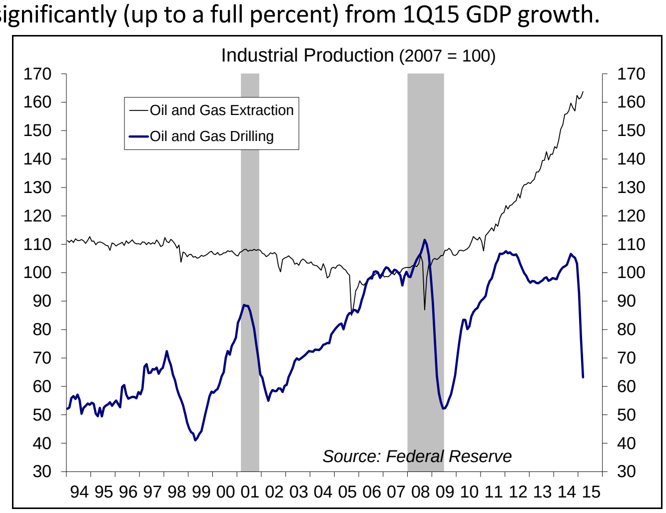


Nonfarm payrolls rose by 126,000 in the initial estimate for March, but averaged a 198,000 monthly pace in 1Q15. That is not exactly "slow," but it is well below the blistering pace of the fourth quarter (+317,000). That downshift may reflect seasonal adjustment issues or it could be statistical noise. Job destruction remains low. Hiring by small and medium-sized businesses remained strong through March, but hiring at large firms has slowed. The broad range of data suggests that the labor market continues to improve, but a lot of slack remains.

The unemployment rate held steady at 5.5% in March, a level once seen as "full employment." However, the figure has been distorted in recent years by a decrease in labor force participation. Some of that decline is due to the demographics, the aging of the population. However, a large number of individuals have moved to the sidelines, not officially counted as "unemployed" but who would take a good job if one were available. The degree of underemployment (people working part-time due to economic reasons), still-high rates of unemployment for teenagers and young adults, and the lackluster pace of growth in average hourly earnings also suggest that the job market has a long way to go for a full recovery. Judging the amount of slack and how rapidly that slack is being taken up are key issues for the Fed policy outlook.



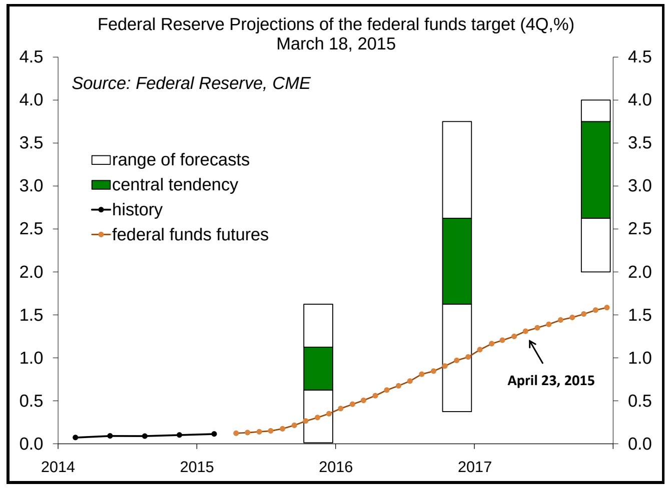
The collapse in energy prices has led to a contraction in oil and gas exploration. Associated job losses, while perhaps locally severe, are small on a national scale (-30,000 in 1Q15). However, a related drop in business structures is expected to subtract significantly (up to a full percent) from 1Q15 GDP growth.



While energy exploration has fallen off, extraction is still going strong, and is likely to prevent a rapid rebound in energy prices. Lower energy prices have pushed consumer price inflation to around 0% year-over-year, but that won't last forever. Fed officials expect inflation (as measured by the PCE Price Index) to move back toward the 2% goal. However, they need to be "reasonably confident" of that before tightening.

The Fed generated some confusion in March, when officials suggested that they would begin debating an increase in short-term interest rates at the June 16-17 policy meeting. That doesn't mean that the Fed *will* raise rates at that time. Rather, this is simply a return to "business as usual." Policymakers will debate interest rate changes at each meeting and rely less on the forward guidance (the conditional commitment to keep rates low for an extended period, which in Fed parlance is "an extraordinary measure").

Financial market participants have spent considerable time and effort in trying to determine the timing of the Fed's liftoff. Fed governors, including Chair Yellen and Vice-Chair Fischer, have indicated that conditions are likely to warrant an initial rate hike by the end of the year, but they don't seem to be in any hurry. Fed officials have stressed that the more important question is the pace of tightening after the initial hike. It's likely that rate hikes will be very gradual – perhaps a 25-basis-point rise at every other policy meeting or slower. The Fed funds futures market has priced in a more gradual pace of tightening than Fed officials were projecting in March. One concern for the Fed is possible adverse reactions in the global financial markets. Recall that the talk of the Fed tapering the monthly pace of asset purchases back in 2013 pushed bond yields sharply higher and generated turmoil in emerging markets. Fed officials will consider the outlooks for the job market and inflation, but also financial stability.



While growth in nominal (current-dollar) earnings has been lackluster, low inflation has resulted in a sharp rise in real (constant-dollar) earnings. That should help propel consumer spending in the second quarter and beyond. Motor vehicle sales and retail sales picked up in March. Consumer spending accounts for 70% of Gross Domestic Product and should drive overall economic growth over the next few quarters.

Economic growth has tended to be softer in the first quarter, which suggests that the seasonal pattern may be changing. Given the amount of slack in the economy, growth can be above-trend for some time before putting significant upward pressure on inflation. Longer term, there are important questions about whether the economy's potential growth is permanently slowing at home and abroad. The debate on "secular stagnation" is unlikely to be resolved definitively over the next few years. If true, interest rates should be on a lower trajectory and financial markets seem to be factoring in some likelihood that this is the case.

	1Q14	2Q14	3Q14	4Q14	***1Q15***	***2Q15***	***3Q15***	***4Q15***	***1Q16***	***2Q16***	2014	**2015**	**2016**
GDP (↓ *contributions*)	-2.1	4.6	5.0	2.2	***0.2***	***3.0***	***3.1***	***2.7***	***2.6***	***2.6***	2.4	***2.5***	***2.7***
consumer durables	*0.2*	1.0	0.7	*0.5*	***0.1***	***0.5***	***0.4***	***0.4***	***0.4***	***0.4***	*0.5*	***0.4***	***0.4***
nondurables & services	*0.6*	0.8	1.5	*2.5*	***1.3***	***1.8***	***1.5***	***1.4***	***1.4***	***1.4***	*1.2*	***1.6***	***1.4***
bus. fixed investment	*-0.1*	1.2	1.1	*0.6*	***-0.4***	***0.7***	***0.8***	***0.6***	***0.6***	***0.6***	*0.6*	***0.5***	***0.7***
residential investment	*-0.2*	0.3	0.1	*0.1*	***0.1***	***0.5***	***0.3***	***0.3***	***0.2***	***0.2***	*0.1*	***0.2***	***0.2***
government	*-0.2*	0.3	0.8	*-0.4*	***0.0***	***0.3***	***0.3***	***0.2***	***0.2***	***0.2***	*0.0*	***0.2***	***0.2***
Domestic Final Sales	0.7	3.4	4.1	3.3	***1.2***	***3.9***	***3.4***	***2.9***	***2.8***	***2.7***	2.3	***3.0***	***2.9***
exports	*-1.3*	1.4	0.6	*0.6*	***-0.6***	***0.1***	***0.3***	***0.4***	***0.4***	***0.4***	*0.4*	***0.1***	***0.4***
imports	*-0.4*	-1.8	0.2	*-1.6*	***-0.2***	***-0.7***	***-0.7***	***-0.6***	***-0.6***	***-0.6***	*-0.6*	***-0.6***	***-0.6***
Final Sales	-1.0	3.2	5.0	2.3	***0.3***	***3.2***	***3.0***	***2.6***	***2.6***	***2.6***	2.2	***2.9***	***2.7***
ch. in bus. inventories	*-1.2*	1.4	0.0	*-0.1*	***-0.1***	***-0.2***	***0.1***	***0.0***	***0.0***	***0.0***	*0.1*	***0.0***	***0.0***
Unemployment, %	6.7	6.2	6.1	5.8	5.6	***5.3***	***5.1***	***4.9***	***4.8***	***4.7***	6.2	***5.2***	***4.7***
NF Payrolls, monthly, th.	193	284	237	324	197	***240***	***220***	***210***	***200***	***190***	260	***217***	***189***
Cons. Price Index (q/q)	2.1	3.0	1.2	-0.9	-3.1	***2.1***	***1.8***	***1.8***	***1.9***	***1.9***	1.6	***0.1***	***1.9***
excl. food & energy	1.8	2.4	1.4	1.5	1.7	***1.9***	***1.8***	***1.8***	***1.8***	***1.9***	1.7	***1.7***	***1.8***
PCE Price Index (q/q)	1.4	2.3	1.2	-0.4	***-1.9***	***1.7***	***1.6***	***1.6***	***1.7***	***1.7***	1.3	***0.4***	***1.7***
excl. food & energy	1.2	2.0	1.4	1.1	***1.0***	***1.6***	***1.6***	***1.6***	***1.7***	***1.7***	1.4	***1.4***	***1.7***
Fed Funds Rate, %	0.07	0.09	0.09	0.10	0.11	***0.13***	***0.17***	***0.38***	***0.42***	***0.65***	0.09	***0.20***	***0.79***
3-month T-Bill, (bond-eq.)	0.1	0.0	0.0	0.0	0.0	***0.0***	***0.1***	***0.3***	***0.4***	***0.7***	0.0	***0.1***	***0.8***
2-year Treasury Note	0.4	0.4	0.5	0.5	0.6	***0.6***	***1.2***	***1.6***	***2.2***	***2.4***	0.5	***1.0***	***2.5***
10-year Treasury Note	2.8	2.6	2.5	2.3	2.0	***2.0***	***2.3***	***2.6***	***2.9***	***3.0***	2.5	***2.2***	***3.1***