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

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Weekly Economic Monitor

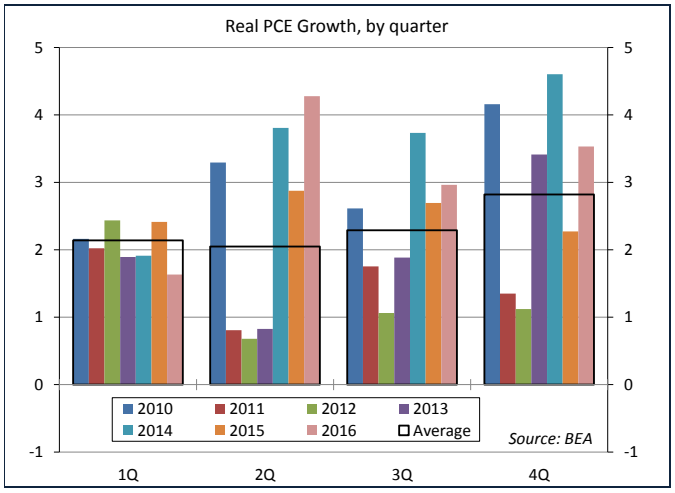
"Soft" vs. "Hard" Data and 1Q17 GDP Growth

The Bureau of Economic Analysis reports its advance estimate of first quarter economic growth on Friday. In recent years, the National Income and Product Accounts have exhibited what's called "residual seasonality" in 1Q growth. That is, first quarter growth has tended to be below that of the rest of the year. Investors may be willing to dismiss a soft first quarter. There are other reasons to be skeptical of soft 1Q data, but the ongoing difference between various sentiment survey results and the hard economic data add to the view that labor market constraints will limit the pace of growth in the quarters ahead.

There are regular seasonal patterns in the economy. The holiday shopping season, the school year, and the summer travel season are the most notable examples. Most economic data are seasonally adjusted. Since the Great Recession, on average, 1Q GDP growth (+1.1%) has been less than half of the 2Q-4Q pace (+2.5%). It's possible that the severity of the recession generated a permanent change in the seasonal pattern, but if so, the government's seasonal adjustment will adapt over time – and we may find that this residual seasonality disappears in future revisions to the national accounts.

The advance estimate of 1Q17 GDP growth is expected to be held down by a sluggish pace of consumer spending growth. Consumer spending accounts for 69% of GDP. Interestingly, there is no evidence of residual seasonality in first quarter consumer spending growth (although fourth quarter figures have tended to be above the average of the rest of the year).

Still, there are other reasons to take soft 1Q17 consumer spending numbers in stride. Notably, at a 3.5% annual rate, 4Q16 consumer spending growth was strong and it's not unusual to see a strong quarter followed by a soft quarter. Job and wage growth should continue to provide support for consumer spending growth in the second quarter.



Consumer and business attitude surveys have improved sharply since the November election. By themselves, consumer confidence figures generally reflect the strength of the overall economy. They fall in recessions and rise in recoveries. However, consumers don't spend confidence. Spending is largely a function of income growth, but it also depends partly on wealth and the ability to borrow. Inflation-adjusted income should pick up. Consumer credit has begun to tighten, not terribly, but that will bear watching in the months ahead.

In contrast to the household sector, business sentiment plays a significant part in capital spending. Orders and shipments of nondefense capital goods began to pick up last summer, partly reflecting a bottoming out in energy extraction and some improvement in the global economy – and they picked up further following the November election. However, business sentiment may fall back. Washington's inability to advance the Trump agenda, especially on tax reform, may be a factor. However, to remain optimistic, firms must eventually see increased demand for the goods and services they produce.

For economists, the divergence we're seeing between the soft and hard data isn't unusual. The soft data are useful, but you wouldn't want to bet the ranch on them. The hard data also have limitations (statistical noise, sampling uncertainty, difficulties in the seasonal adjustment), which is one reason to look to the anecdotal information. Note that you can tie yourself in knots relying on the word-of-mouth assessments. In practice, look at everything (especially if you're a Fed official).

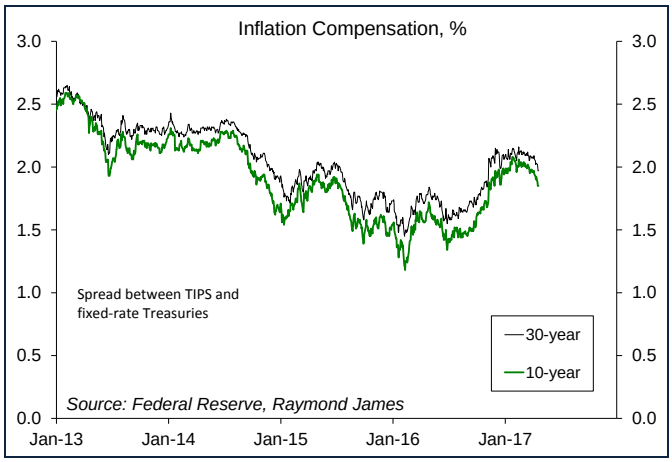
The hard data / soft data divide points back to the key underlying story. That is, there are limits in the labor market which will restrain economic growth in the quarters and years ahead. Unless we see a sharp rise in productivity growth, slower labor force growth means slower economic growth. That's not necessarily bad, but you might want to curb your enthusiasm.

International Headquarters: The Raymond James Financial Center | 880 Carillon Parkway | St. Petersburg, Florida 33716 | 800-248-8863

	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
3/24/17	0.78	0.89	1.00	1.26	1.52	1.93	2.40	3.00	1.081	1.249	111.03	1.337	5828.74	2343.98	20596.72
4/14/17	0.81	0.94	1.03	1.21	1.40	1.77	2.24	2.89	1.063	1.253	108.63	1.332	5805.15	2328.95	20453.25
4/21/17	0.78	0.92	0.98	1.18	1.39	1.76	2.23	2.90	1.070	1.280	109.08	1.350	5914.28	2348.70	20546.76

Recent Economic Data and Outlook

Stock market participants came back from the Easter weekend in a somewhat better mood (as tensions with North Korea subsided). There were some concerns about the French election, but also some optimism that Congress might be able to advance the Trump agenda when it returns from its two-week recess. The economic data reports were largely inconsequential for the financial markets, but that will change soon enough.



The Fed's **Beige Book** reported that the economy continued to expand through the end of March, *"with the pace of expansion equally split between modest and moderate."* Regarding the labor market, *"a larger number of firms mentioned higher turnover rates and more difficulty retaining workers."* A couple of Fed districts reported that *"worker shortages and increased labor costs were restraining growth in some sectors, including manufacturing, transportation, and construction."* Businesses generally expected labor demand to increase moderately in the next six months, and looked for modest wage growth. *"Retail prices rose moderately, on the whole."*

Industrial Production rose 0.5% in March (+1.5% y/y), reflecting an 8.6% rebound in the output of utilities (more normal temperatures). Manufacturing output fell 0.4% (+1.0% y/y), reflecting a 3.0% drop in motor vehicles (+1.3% y/y). Ex-autos, factory output edged down 0.2% (+0.8% y/y). Oil and gas well drilling rose 7.7% (+77% since May, but -56% since late 2014).

Building Permits rose 3.6% in March, to a 1.26 million seasonally adjusted annual rate (+17.0% y/y). Single-family permits, the key figure in the report, fell 1.1% (+13.5% y/y). Results varied by region (0.0% in the Northeast, -5.9% in the Midwest, +1.3% in the South, and -3.6% in the West). **Housing Starts** sank 6.8% (+9.2% y/y), with single-family down 6.2% (+9.2% y/y), likely reflecting a return to more normal weather.

Homebuilder Sentiment fell to 68 in April, vs. 71 in March and 65 in February. Results varied by region.

Existing Home Sales jumped 4.4% in March (+5.9% y/y), likely reflecting February's mild weather (existing home sales measure closings). Results varied by region (Northeast +10.1%, Midwest 9.2%, South +8.5%, West -1.6%).

The New York Fed's **Empire State Manufacturing Index** fell to 5.2 in April, vs. 16.4 in March and 18.7 in February. The **Philadelphia Fed Index** slipped to 22.0 in April, vs. 32.8 in March and 43.3 in February. Both reports showed somewhat slower growth in new orders, but better growth in jobs.

The Index of **Leading Economic Indicators** rose 0.4% in March. Most components made positive contributions (especially, ISM new orders, the yield curve, and consumer expectations). A shorter factory workweek and a pickup in jobless claims were the only negative (both likely temporary).

The IMF's **World Economic Outlook** was a bit brighter. "Global economic activity is picking up with a long-awaited cyclical recovery in investment, manufacturing, and trade." However, the IMF cautioned that "these positive developments should not distract from binding structural impediments to a stronger recovery and a balance of risks that remain tilted to the downside, especially over the medium term."

Economic Outlook (2Q17): 2.0-2.5% GDP growth, following around 1.0% growth in 1Q17.

Employment: Job growth has remained relatively strong, although the pace should slow as the job market tightens.

Consumers: Job gains and wage growth are supportive, but purchasing power has decreased (gasoline prices). Debt levels are manageable, with few signs of strain in the aggregate.

Manufacturing: Improving in the near term, reflecting good weather, strengthening capital goods orders, and an improved global economic outlook.

Housing/Construction: Job growth has remained supportive, but higher home prices and higher mortgage rates are a restraint for first-time buyers. Tax cuts are expected to help fuel the demand for vacation homes and second homes.

Prices: Ex-food & energy, the PCE Price Index has continued to trend below the Fed's 2% target, but not by a lot. There is little inflation in consumer goods. Inflation in services has been boosted by higher rents. Wage gains are moderate, but rising.

Interest Rates: The Fed remains in tightening mode, and is expected to be more aggressive in raising rates in 2017 than in 2016 and 2015, but policy will remain data-dependent.

This Week:					*forecast*	last	last –1	comments
Monday	4/24		no significant data					Hubble Space Telescope launched (1990)
Tuesday	4/25	10:00	**New Home Sales, th.**	Mar	***575***	592	558	reported with huge uncertainty
			% change		***-2.9***	+6.1	+5.3	watch for revisions
		10:00	**CB Consumer Confidence**	Apr	***123.8***	125.6	116.1	some moderation seen
		1:00	Treasury Note Auction					$26 billion in 2-year notes
Wednesday	4/26	11:30	FRN Auction					$15 billion in 2-year Floating Rate Notes
		1:00	Treasury Note Auction					$34 billion in 5-year notes
Thursday	4/27	7:45	ECB Policy Decision					no change
		8:30	Jobless Claims, th.	4/22	***242***	244	234	still a low trend
		8:30	**Durable Goods Orders**	Mar	***+0.8%***	+1.8%	+2.4%	aircraft orders should be higher
			ex-transportation		***+0.5%***	+0.5%	+0.3%	moderate otherwise
			nondef cap gds ex-aircraft		***+0.4%***	-0.1%	+0.2%	soft in Jan and Feb
		8:30	Advance Econ Indicators	Mar				fine-tuning GDP estimates
			Wholesale Inventories		***NF***	+0.4%	-0.2%	slower in 1Q17
			Retail Inventories		***NF***	+0.4%	+0.9%	faster in 1Q17
			Merch. Trade Balance, $bln		***NF***	-64.8	-68.8	choppy in Jan and Feb
		10:00	Pending Home Sales Index	Mar	***NF***	+5.5%	-2.8%	choppy, but a moderately strong trend
		1:00	Treasury Note Auction					$28 billion in 7-year notes
Friday	4/28	8:30	**Employment Cost Index**	1Q17	***+0.6%***	+0.5%	+0.6%	moderate wage pressures
			year-over-year		***+2.3%***	+2.2%	+2.3%	still moderate
		8:30	**Real GDP (advance est.)**	1Q17	***+1.0%***	+2.1%	+3.5%	soft consumer spending
			Priv. Dom. Final Purch.		***+1.8%***	+3.4%	+2.4%	follows a strong 4Q
		9:45	Chicago Business Barometer	Apr	***57.2***	57.7	57.4	moderately strong
		10:00	UM Consumer Sentiment	Apr	***97.8***	96.9	96.3	98.0 at mid-month
Next Week:								
Monday	5/01	8:30	Personal Income	Mar	***+0.3%***	+0.4%	+0.5%	quarterly data included in the GDP report
			Personal Spending		***+0.2%***	+0.1%	+0.2%	mixed, but lackluster
			PCE Price Index ex-f&e		***+0.0%***	+0.2%	+0.3%	the core CPI fell 0.122%
		10:00	Construction Spending	Mar	***NF***	+0.8%	-0.4%	choppy, subject to large revisions
		10:00	**ISM Manufacturing Index**	Apr	***56.5***	57.2	57.7	moderately strong
Tuesday	5/02	tbd	Motor Vehicle Sales, mln	Apr	***17.1***	16.5	17.5	likely to rebound
			domestically-built		***13.4***	13.0	13.6	spurred by further discounts
Wednesday	5/03	8:15	**ADP Payroll Estimate, th.**	Apr	***+170***	+263	+245	watch for revisions
		10:00	**ISM Non-Manf. Index**	Apr	***56.3***	55.2	57.6	consistent with moderate growth
		2:00	**FOMC Policy Decision**					no change, no Yellen press conference
Thursday	5/04	8:30	Jobless Claims, th.	4/29	***240***	***242***	244	still a low trend
		8:30	Trade Balance, $bln	Mar	***NF***	-43.6	-48.2	likely steady
			goods only		***NF***	-65.0	-69.5	choppy in Jan/Feb
		8:30	NF Productivity (prelim.)	1Q17	***NF***	+1.3%	+3.3%	a lackluster increase
			Unit Labor Costs		***NF***	+1.7%	+0.7%	moderate inflation pressure
		10:00	Factory Orders	Mar	***NF***	+1.0%	+1.5%	trending moderately higher
Friday	5/05	8:30	**Nonfarm Payrolls, th.**	Apr	***+175***	+98	+219	Easter adjustment adds uncertainty
			private-sector		***+170***	+89	+221	moderately strong
			Unemployment Rate		***4.6%***	4.5%	4.7%	seen a bit higher, trend is lower
			employment/population		***60.1%***	60.1%	60.0%	a modest trend higher
			Avg. Weekly Hours		***34.4***	34.3	34.3	should be a little higher
			Avg. Hourly Earnings		***+0.3%***	+0.2%	+0.3%	moderate wage pressure

This Week…

The focus is expected to be on the GDP report. As usual, there is a lot of uncertainty in the advance estimate. Figures will be revised next month (and the month after that). Consumer spending accounts for 69% of GDP, and figures for January and February (which are subject to revision) point to a sharp slowing in the first quarter. That follows a strong showing in 4Q16 – so one soft quarter is not too worrisome. Congress is back in session and the current Continuing Resolution (which authorizes spending) runs through Friday. It should be easy enough to kick the can down the road (that is, to come up with another CR) – no government shutdown. The debt ceiling became binding in mid-March (Treasury can employ extraordinary measures, as a workaround, to fund the government until autumn), but we may see an extension of the limit folded into the CR.

Sunday

French Election (first round) – Okay, so it's only the future of the European Union that's at stake. Voters always make good choices (sarcasm). If, as expected, no candidate wins a majority, there will be a run-off election of the two leading candidates on May 7. Most likely, this will be Macron (a centralist) and Le Pen (who wants to leave the EU *and* the monetary union).

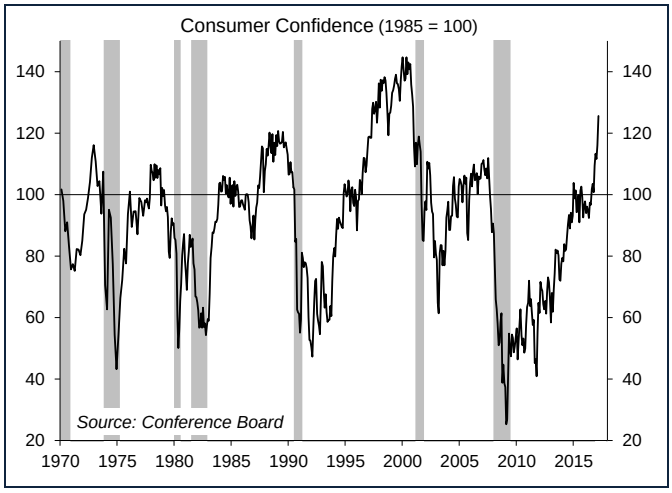
Monday

No significant economic data.

Tuesday

New Home Sales (March) – Monthly sales figures are reported with a gigantic amount of statistical uncertainty (February sales were reported as "+6.1% ±17.3%"). The underlying trend is higher, but the mix is tilted away from the low end.

CB Consumer Confidence (April) – Like many other sentiment gauges, the Conference Board's Consumer Confidence Index rose sharply following the election, boosted partly by improved labor market perceptions (which lag actual improvement). Still, consumers don't spend confidence. Income growth is the biggest driver, along with wealth and the ability to borrow.



Wednesday

No significant economic data.

Thursday

ECB Policy Decision – No change. There will likely be some internal pressure (at least from the Germans) to unwind accommodation in the months ahead.

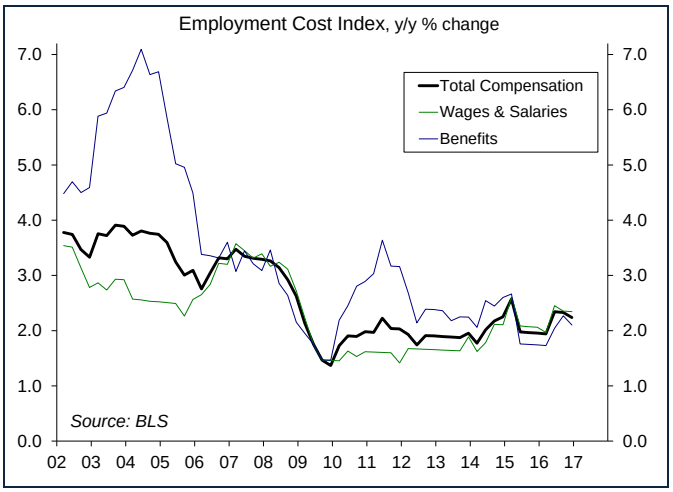
Jobless Claims (week ending April 22) – Figures will remain subject to Easter noise, but the underlying trend remains low.

Durable Goods Orders (March) – Monthly changes are notoriously volatile, largely reflecting the choppiness in aircraft orders. Ex-transportation, orders are likely to have risen moderately. Orders for nondefense capital goods ex-aircraft, a proxy for business fixed investment, may run out of steam.

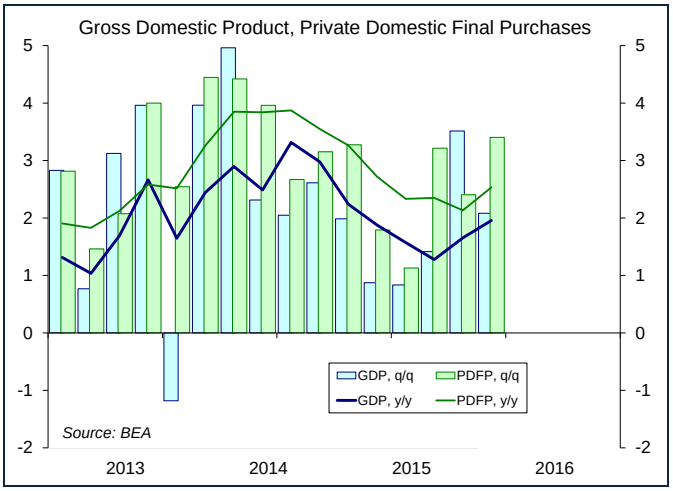
Advance Economic Indicators (March) – Foreign trade and inventory figures (along with durable goods shipments) may lead to last minute adjustments to forecasts of 1Q17 GDP growth.

Friday

Employment Cost Index (1Q17) – The ECI, which includes benefit costs, is a better, more balanced, measure of labor cost pressure than average hourly earnings. It is expected to have risen moderately in the three months ending in March, no major threat to the inflation outlook, but still consistent with a gradual normalization of monetary policy.



Real GDP (1Q17, advance estimate) – Net exports and inventories are likely to subtract (but there's a lot of uncertainty in the initial numbers). Private Domestic Final Purchases (GDP less inventories and net exports) should be moderately strong, despite a soft quarter for consumer spending growth. Business fixed investment is likely to have risen moderately. Trade



Next Week …

The monthly ISM surveys have market-moving potential, but the focus is expected to be on the April Employment Report.

Coming Events and Data Releases

May 12	Consumer Price Index (April) Retail Sales (April)
May 16	Building Permits, Housing Starts (April) Industrial Production (April)
May 29	Memorial Day (markets closed)
June 14	FOMC Policy Decision, Yellen press conf.
July 26	FOMC Policy Decision (no press conf.)
September 20	FOMC Policy Decision, Yellen press conf.
November 1	FOMC Policy Decision (no press conf.)
December 13	FOMC Policy Decision, Yellen press conf.