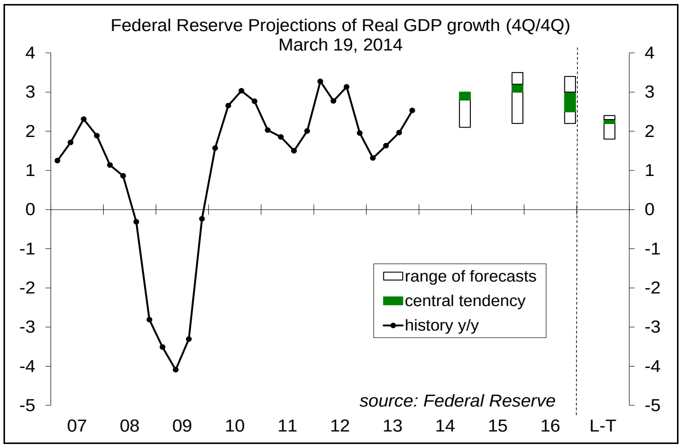
Scott J. Brown, Ph.D., (727) 567-2603, Scott.J.Brown@RaymondJames.com **March 26, 2014**

Monthly Economic Outlook

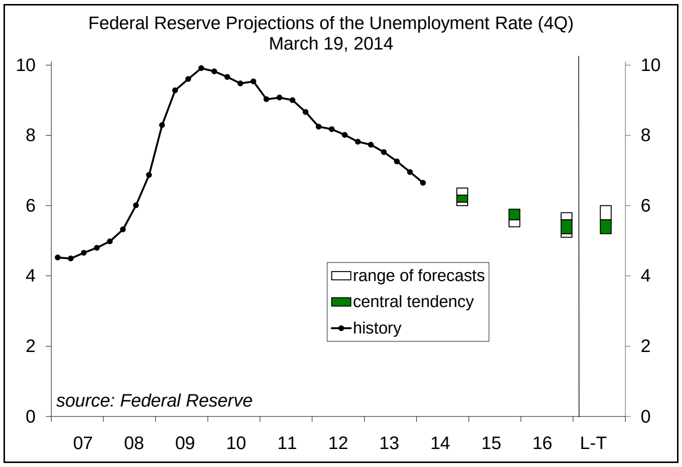
Still an Optimistic Outlook

- *Adverse weather has had a negative impact on growth in early 2014, but the underlying trend is likely to have been a bit lackluster regardless. Data reports for the spring and early summer should show a rebound from poor weather, making the economy appear stronger than the underlying trend.*
- *Federal Reserve policymakers have continued along the expected taper path. The language in the forward guidance (on short-term interest rates) has changed, but the monetary policy outlook is essentially the same as it was at the end of 2013.*
- *Concerns about emerging economies have not gone away. Fallout from Russia's annexation of Crimea and continued uncertainties about the Chinese economy bear watching.*

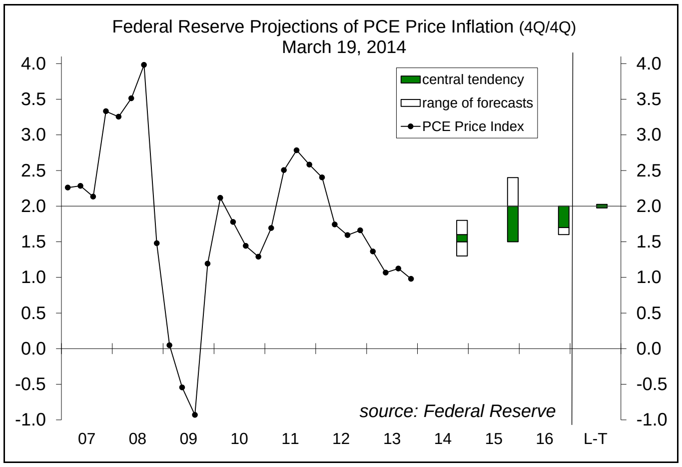
Real GDP rose at a 2.4% annual rate in the 2nd estimate for 4Q13 (down from 3.2% in the advance estimate). Growth in the first quarter is expected to be well below that, but the outlook for the year as a whole is little changed relative to that of a few months ago. This is largely a story of diminished headwinds (relative to the last few years) and continued support from monetary policy. Weather-related slowing in economic activity is often associated with a sharp rebound in the months that follow, but prolonged weakness may contribute to a softer trend in personal income. A mild winter tends to pull forward growth that would have otherwise occurred in the spring and early summer. In contrast, a bad winter will push some growth out to later months, but a portion (such as restaurant sales) will be lost forever.



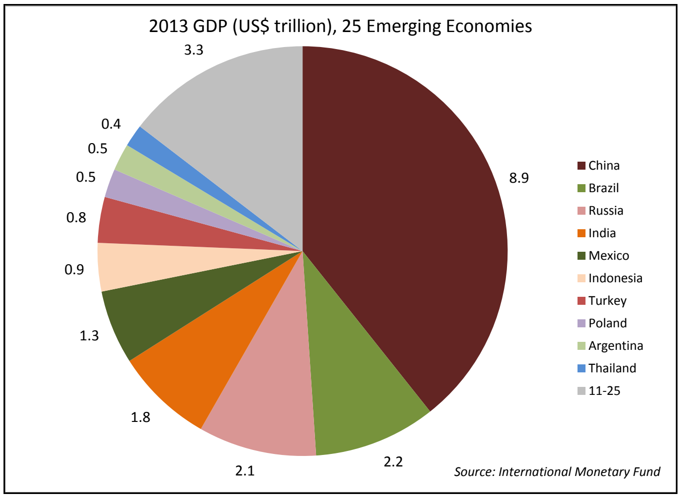
Between the December and March policy meetings, there was little revision in the growth projections of senior Federal Reserve officials. Forecasts of the unemployment rate did come down a bit, although the sense is that the labor market has not grown tighter than anticipated. Labor force participation, which has been trending lower since the recession began, should begin to level out at some point, as some individuals, currently on the sidelines, can be expected to return to the workforce as the job outlook improves.



The Fed continued to taper its monthly rate of asset purchases ($55 billion in April) and, barring a significant change in the outlook, is expected to further reduce asset purchases *"in measured steps"* ($10 billion per Fed policy meeting). At the March policy meeting, Fed policymakers abandoned the 6.5% unemployment rate threshold in their forward guidance on the overnight lending rate. Asked about how long it would be between the end of QE3 and the first hike in short-term interest rates, Fed Chair Janet Yellen gave a nuanced answer that amounted to *"it depends"* – the Fed will take into account economic developments, the inflation outlook, and financial conditions. However, if the economy continues to evolve as anticipated, that might be around six months, according to Yellen. Financial markets took the "six months" phrase out of context. Yellen stressed that there had been no change in the Fed policy outlook. Moreover, the federal funds target rate is expected to remain well below normal at the end of 2016, even as employment and inflation near the Fed's long-term goals.



The Fed expects inflation (as measured by the PCE Price Index) to remain below its 2% goal this year and at or below target in 2015 and 2016. A continued low trend in inflation (closer to 1% than 2%) could create some difficulties for the economy, and would likely lead to less tapering of the Fed's monthly rate of asset purchases and a delay in the timing of the first increase in short-term interest rates. Low inflation is expected to be an issue for many countries this year.



The 25 emerging economies (as defined by the IMF) are about 1.4 times the size of the U.S. economy (the top six, China, Brazil, Russia, India, Mexico, and Indonesia, are roughly the same size as the U.S.). More importantly, these economies are expected to grow twice as fast as the U.S. over the next four or five years. Fed tapering has led to some pullback in the carry trade (borrowing cheaply in the U.S. and investing in higher-returning assets abroad) and reduced capital inflows (or increased outflows). At this point, the impact on the U.S. economy is expected to be small, but conditions could worsen.

Sanctions against Russia (following its annexation of Crimea) will have a major effect on the country's economy (which had been struggling before the incursion), but this could help boost other emerging economies (reflecting capital shifts). Of course, a lot depends on whether Putin is willing to stop at Crimea.

China is a lot different – it is by far the largest of the emerging economies and is less dependent on capital inflows. However, China faces significant challenges. Its economy is highly imbalanced, overly dependent on exports and business investment. Consumption accounts for 35% of GDP, half of the U.S. share. Signs of a housing bubble, a large shadow banking system, and excess capacity have added to concerns. Yet, China is likely to be successful in transforming itself into an advanced economy. Its leaders have proposed significant institutional and political reforms, including a transformation from a system of administrative governance (asking authorities for approval) to a more modern rule of law (allowing companies to do only what's not explicitly forbidden). However, China's transition, which is consistent with a slower trend rate of growth (6-8%, vs. 10-12%), is likely to be bumpy.

Despite a clear negative impact from adverse weather, the 2014 U.S. economic outlook remains optimistic. This is essentially a story of diminished headwinds (less fiscal drag, an improving housing sector) and continued support from the Federal Reserve. Developments in emerging economies and the near-term trend in inflation bear watching closely.

While inflation has been low, real wage growth has been anemic. Real average hourly earnings rose 1.1% over the 12 months ending in February (real average weekly earnings rose 0.2% y/y, reflecting a decrease in hours from a year ago). Limited gains in real income mean limited gains in consumer spending growth in the near term, and limited strength in the recovery.

	1Q13	2Q13	3Q13	4Q13	**1Q14**	***2Q14***	***3Q14***	***4Q14***	***1Q15***	***2Q15***	2013	**2014**	**2015**
GDP (↓ *contributions*)	1.1	2.5	4.1	2.4	***1.7***	***2.8***	***3.1***	***3.1***	***3.1***	***3.1***	1.9	***2.9***	***3.1***
consumer durables	*0.4*	*0.5*	*0.6*	*0.2*	***0.2***	***0.5***	***0.4***	***0.4***	***0.4***	***0.4***	*0.5*	***0.4***	***0.5***
nondurables & services	*1.1*	*0.8*	*0.8*	*1.5*	***1.4***	***1.4***	***1.5***	***1.5***	***1.5***	***1.5***	*0.8*	***1.4***	***1.5***
bus. fixed investment	*-0.6*	*0.6*	*0.6*	*0.9*	***0.3***	***0.6***	***0.7***	***0.7***	***0.7***	***0.7***	*0.3*	***0.5***	***0.7***
residential investment	*0.3*	*0.4*	*0.3*	*-0.3*	***-0.1***	***0.6***	***0.4***	***0.3***	***0.3***	***0.3***	*0.3*	***0.2***	***0.3***
government	*-0.8*	*-0.1*	*0.1*	*-1.1*	***0.5***	***0.1***	***0.1***	***0.1***	***0.1***	***0.1***	*-0.4*	***0.0***	***0.1***
Domestic Final Sales	0.5	2.1	2.3	1.2	***2.4***	***3.3***	***3.0***	***3.0***	***3.0***	***3.0***	1.6	***2.5***	***3.0***
exports	*-0.2*	*1.0*	*0.5*	*1.2*	***0.4***	***0.6***	***0.6***	***0.6***	***0.6***	***0.6***	*0.4*	***0.8***	***0.6***
imports	*-0.1*	*-1.1*	*-0.4*	*-0.2*	***-0.4***	***-0.5***	***-0.5***	***-0.6***	***-0.6***	***-0.6***	*-0.2*	***-0.4***	***-0.5***
Final Sales	0.2	2.1	2.5	2.3	***2.4***	***3.4***	***3.1***	***3.1***	***3.1***	***3.0***	1.5	***2.5***	***3.1***
ch. in bus. inventories	*0.9*	*0.4*	*1.7*	*0.1*	***-0.6***	***-0.6***	***0.0***	***0.0***	***0.0***	***0.0***	*0.2*	***0.0***	***0.0***
Unemployment, %	7.7	7.5	7.3	7.0	***6.5***	***6.3***	***6.1***	***6.0***	***5.9***	***5.8***	7.4	***6.3***	***5.7***
NF Payrolls, monthly, th.	207	182	167	172	***185***	***205***	***205***	***210***	***210***	***200***	182	***201***	***196***
Cons. Price Index (q/q)	1.2	0.4	2.2	1.1	***1.9***	***1.6***	***1.7***	***1.8***	***1.9***	***1.9***	1.5	***1.6***	***1.9***
excl. food & energy	2.0	1.4	1.8	1.6	***1.6***	***1.7***	***1.8***	***1.9***	***1.9***	***2.0***	1.8	***1.6***	***1.9***
PCE Price Index (q/q)	1.1	-0.1	1.9	1.0	***1.4***	***1.5***	***1.6***	***1.7***	***1.8***	***1.8***	1.1	***1.4***	***1.7***
excl. food & energy	1.4	0.6	1.4	1.3	***1.2***	***1.5***	***1.6***	***1.7***	***1.8***	***1.8***	1.2	***1.4***	***1.8***
Fed Funds Rate, %	0.14	0.12	0.09	0.09	***0.08***	***0.11***	***0.15***	***0.20***	***0.24***	***0.28***	0.11	***0.14***	***0.62***
3-month T-Bill, (bond-eq.)	0.1	0.1	0.0	0.1	***0.1***	***0.1***	***0.1***	***0.2***	***0.2***	***0.3***	0.1	***0.1***	***0.6***
2-year Treasury Note	0.3	0.3	0.4	0.3	***0.4***	***0.5***	***0.7***	***1.0***	***1.3***	***1.7***	0.3	***0.6***	***1.9***
10-year Treasury Note	2.0	2.0	2.7	2.7	***2.8***	***2.9***	***3.2***	***3.4***	***3.6***	***3.7***	2.4	***3.1***	***3.8***