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WHAT'S GOING ON? – JUNE 13, 2014

Is the U.S. economy entering a period of more rapid growth? Many observers expect that, after a dismal weather related first quarter, overall economic activity will rebound in the second quarter – and beyond. What happened to the first quarter, of course, was that real GDP fell at a yearly rate of 1%, marking the first quarter quarterly decline in three years. While there is no doubt that harsh winter weather contributed to the first quarter's negative rate of GDP growth, there is also a possibility that the economy may have lost momentum during the early months of 2014. To be sure, the first quarter's economic performance could well be followed in the second quarter by real GDP growth at a yearly rate of close to 3.5%. Be that as it may, we seriously doubt that, at long last, real GDP growth in the U.S. is breaking out from the 2-2.5% range recorded over the past 4 years.

While the economy continues to add jobs in a brisk pace – monthly gains between March and May of this year have averaged a robust 234,000 – many of the new additions have been in relatively low-paying industries. For example, of the past three months – March to May – employment gains in two categories, education & health care and leisure & hospitality, have averaged close to 40,000 jobs a month as compared to only 6,000 and 18,000 in manufacturing and construction, respectively. Then too, the employment-to-population ratio in May is less than 59%%, down from the 63% recorded before the recession. In other words, the employment-to-population ratio has still not recovered from the recession that ended 5 years ago. And the percentage of the unemployed who have been out of work for 27 weeks or longer currently stands at 35%, more than double the 16% reported before the recession.

Meanwhile, there is very little evidence of a resurgence of consumer spending following the slowdown associated with the bad winter weather. True, cars sales in May were at a yearly rate of 16.8 million, the highest monthly figure since July of 2006 and marking the continuance of a vigorous recovery from the 2008-2009 downturn. The boom in car sales, however, has been accompanied by generally weak gains in spending for non-automobile sales. Over the past three months – March through May – retail sales (ex autos) posted a lackluster gain of 2.6%, which, after adjusting for price increases, indicates a slender increase of about 1% in real volume. It might also be noted that, since February, there has been little or no increase in non-automobile retail sales.

One reason for the generally lackluster pace of consumer spending is the lack of growth in household incomes. In April – the latest month for which income data is available – real after-tax income was less than 2% above a year earlier, and was less than 5% higher than the figure reported three years ago. Arguably, the near-stagnant pattern of income growth will not support anything much better than a modest increase in outlays over the balance of 2014.

Even though the fundaments of the housing market - including gains in household formations, a rising trend of employment and improved household balance sheets - still look positive, the recovery in the single family market appears to have run out of steam. During the first four months of this year, the number of building permits issued for single family house construction was down some 1% from a year earlier. In contrast, permits for apartment construction were up 20% over this same period of time, which, on the face of it, suggests a shift toward multi-family construction. That said, the housing market is not fulfilling its traditional function of leading the recovery out of recession.

So far as the business investment is concerned, the outlook calls for slow, as opposed to vigorous, expansion. Over the January-April period, orders of non-defense capital goods (ex aircraft) – which are a leading indication of spending for new business equipment - were up just 3% from the comparable period of 2013. And in real terms, the gains were probably in the neighborhood of 1% or even less. While there is still a need to replace outdated plants and equipment, there is, from all reports, an elevated level of uncertainty which is holding back spending. Likewise, the trend of outlays for non-residential construction has not advanced since the fourth quarter of 2012. Thus, outlays during the first four months of 2014 averaged $309 billion, which was essentially the same as the number reported in the September-December period of 2012. Uncertainty about the long-term outlook, combined with a sizable overhang of unrented and unsold properties, are acting as a constraint in investments in non-residential structures, notable office buildings, shopping centers and the like.

Finally, the U.S. international trade balance for the first 4 months of 2014 shows a deficit of $174 billion, up from $161 billion in the same period of last year. As matters now stand, the net export deficit in 2014 will likely be slightly larger than it was last year. Looked at another way, foreign trade will likely make a small negative contribution to this year's growth in real GDP.

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