Northern Trust

U.S. ECONOMIC & INTEREST RATE OUTLOOK

March 2015

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

Carl R. Tannenbaum
Chief Economist
312.557.8820
ct92@ntrs.com

Asha G. Bangalore
Economist
312.444.4146
agb3@ntrs.com

• The Expansion Settles, but Its Foundation Is Strong

Growth in the U.S. economy tapered a bit in the fourth quarter, but the outlook ahead remains very positive. Real gross domestic product (GDP) grew 2.2% in the fourth quarter after a 5.0% increase in the third quarter, but some special factors were at play that should ease as the first quarter of 2015 winds down.

Inflation readings are becoming increasingly important as the Federal Reserve considers interest rate increases and as investors try to assess yields in the bond market. The price level appears depressed at the moment, but a rebound is expected later this year.

Key Economic Indicators

	2014				2015				Q4 to Q4 change			Annual change		
	14:1a	14:2a	14:3a	14:4a	15:1f	15:2f	15:3f	15:4f	2013a	2014a	2015f	2013a	2014a	2015f
Real Gross Domestic Product (% change, SAAR)	-2.1	4.6	5.0	2.2	3.1	3.2	3.1	2.9	3.1	2.4	3.1	2.2	2.4	3.3
Consumer Price Index (% change, annualized)	1.9	2.6	0.5	-2.3	-1.8	1.9	1.9	2.0	1.2	1.2	0.5	1.5	1.6	-0.1
Civilian Unemployment Rate (%, average)	6.6	6.2	6.1	5.7	5.6	5.5	5.4	5.3				7.4*	6.1*	5.4*
Federal Funds rate	0.07	0.09	0.09	0.10	0.10	0.10	0.20	0.50				0.11*	0.09*	0.23*
2-yr. Treasury Note	0.37	0.42	0.52	0.54	0.61	0.80	1.03	1.43				0.31*	0.46*	0.97*
10-yr. Treasury Note	2.76	2.62	2.50	2.28	2.00	2.30	2.60	3.00				2.35*	2.54*	2.48*

a=actual
f=forecast
*=annual average

Key Elements of Forecast:

- Consumer spending increased at an annual rate of 4.2% in the fourth quarter. A recent dip in auto sales is expected to trim consumer spending from the robust level of the previous quarter. Auto sales averaged an annualized 16.5 million units in the January-February period, down from 16.9 million units in the fourth quarter. Bad weather likely caused some of the decline in auto sales, and a pickup is possible as weather improves.

- Business equipment spending barely increased in the fourth quarter following two quarters of double-digit gains. Shipments of non-defense capital goods excluding aircraft (which is an input for capital spending in the GDP report) increased in January. Business surveys point to expectations of higher capital spending in the months ahead. Consistent with this information, we predict moderate growth in business capital spending.

- The California dockworkers' strike led to a sharp drop in imports and exports, with the former declining more than the latter. Consequently, it resulted in a narrowing of the trade deficit in January, but this is very much a transitory situation. Going forward, we expect the trade deficit to continue to expand as a result of relative economic resiliency in the United States and the consequent strength of the U.S. dollar.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

- Payroll employment rose 295,000 in February, putting the three-month moving average at 288,000. The unemployment rate declined to 5.5%, down an entire percentage point from a year ago. Robust wage growth is the missing piece in the labor market picture. The nature of jobs created (low- versus high-paying) and accumulated pent-up wage cuts helped keep wages down.

  At 2.0%, the quit rate in January is the highest in the expansion and it is approaching the 2.3% peak of the prior cycle, which suggests that an acceleration of wage growth should become visible soon. Also, reports of Wal-Mart and Aetna raising compensation of their lowest-paid employees support expectations of a pickup in labor compensation.

- Inflation readings continue on a benign path. The Consumer Price Index (CPI) fell 0.7% in January, mostly due to lower energy prices. Crude oil prices appear to have stabilized, and gasoline prices increased in February. Inflation data should stabilize in the months ahead, but arithmetic leaves the annual CPI change for 2015 on the soft side.

  The Fed prefers inflation measures from the GDP report. The personal consumption expenditure (PCE) price index rose only 0.2% from a year ago in January, mostly due to lower oil prices. The core PCE price index, which excludes food and energy, increased 1.3%. Service-sector inflation is holding at 2.0%, partly due to higher rents. This, combined with a stable energy price outlook, suggests that inflation readings should move toward the Fed's 2.0% inflation target.

  The 5-year forward inflation expectations readings reflect a change in market expectations. As of March 9, this inflation expectations gauge had moved up 12 basis points from the 1.93% low seen in late January. This suggests that market participants are becoming more comfortable that the global disinflationary trend will not take deep root in the United States.

- The 10-year Treasury note yield trading at 2.13% as of this writing is up 45 basis points in five weeks, reflecting the bond market's re-evaluation of the fundamental strength of the U.S. economy.

- The European Central Bank has embarked on its full-scale quantitative easing program, which raises the probability of more stable economic conditions in a key global market. Geopolitical issues continue to stay on the radar screen as risk factors for the U.S. economy and U.S. markets.

- In our opinion, employment compensation and inflation data are too low for the Fed to feel compelled to act. The Fed would prefer to be confident before commencing the rate-hike cycle. Therefore, we continue to project the first rate increase at the September Federal Open Market Committee meeting.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.