Lavery Consulting Group

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The Recovery Defies Its Cynics

The week of April 19 began with an upbeat economic tone. The Index of Leading Economic Indicators (LEI) soared 1.4% in March, atop an upwardly revised February gain of 0.4%. The LEI March increase was the largest m/m gain since May 2009 (also 1.4%). The LEI strength in March brought its y/y gain to 11.7%, up from the February y/y advance of 10%. The March m/m result beat our expectation of 1.3%, and was well above the market consensus call of a gain of 1.0%.

The six month annualized % change in the March LEI was 10.6%, above the 9.9% comparable advance for the six month period ending February. That the six month annualized gain in the LEI of 10.6% is, however, below the 11.7% y/y rise, suggests a somewhat slower forward momentum in the economy in the months ahead. The ratio of coincident to lagging indicators remained at 92.9 in March, unchanged from both February and January. This ratio is often considered a better leading indicator than the LEI itself. The ratio also portends slower forward momentum in the economy in the months ahead.

Other good news is the fact that initial unemployment claims dropped 24,000 for the week ending April 17 to 456,000, a level still elevated by administrative problems in New York and California. As detailed in the "week ahead" indicators section of this report, we expect initial claims to decline further to 435K in the report on April 29 (for the week ending April 24). The April 23 release of "Mass Layoffs" showed improvement in March, and are dramatically lower in the manufacturing sector. The labor market continues to mend.

The Business Roundtable's 1Q:'10 CEO Economic Survey was released on April 7. It's composed of expectations of sales, capital spending, and employment. The CEO Survey revealed a sequential rise to 88.9 in the first quarter from 71.5 in 4Q:'09. The 1Q:'10 survey was the strongest since 2Q:'06, and continues the improvement from a cyclical low of -5.0 in 1Q:'09.

Manufacturing continues to strengthen. The April 23 release of March durable goods orders showed a misleading drop of 1.3% m/m, below consensus. The entire decline in March orders was in the highly volatile civilian aircraft component, which fell 67% m/m. Excluding the transportation category, orders rose 2.8%, above the consensus expectation of a gain of 0.7%. On a y/y basis, the momentum of overall durable goods orders continues intact, up 11.9% in March, after rising 11.4% in February, and 10.9% in January.

Machinery orders surged 8.6% in March from February. Electrical equipment orders rose 4.9% in March, while primary metals orders increased 3.5%, and computers and electronic parts rose 3.4%. The measure of core non-defense durable goods orders, excluding aircraft, rose 3% in March. With a 1.2% gain in durable goods shipments in March, core non-defense capital goods shipments, excluding aircraft, rose 2.2%, 3% if one includes the upward revision to February. This gauge of core non-defense capital goods shipments, excluding aircraft, is used directly by the Bureau of Economic Analysis (BEA) in calculating the business investment piece (capital spending) of real GDP.

In its April 22 release, March existing home sales (single-family and multi- family) increased 6.8% in March to 5.35 million annualized, from the February revised pace of 5.02 million. Sales of single-family existing homes increased 7.3% to 4.68 million units annualized, while multi-family starts rose 3.1%. March existing home sales were the highest since December 2009 (5.44 mln). The stronger numbers in March are due to the April 30 expiration of the previously extended and expanded homebuyer tax credit as well as better weather vs. February. Existing homes sales are up 16.1% y/y, the median selling price was $170,700, up 0.4% y/y, and the number of months supply fell to 8.0 from 8.5. This is how long it would take, at the Mach 2010 selling rate, to absorb the entire inventory of unsold existing homes.

In its April 23 release, March new single-family home sales increased 26.9% to 411,000 annualized, atop February's revised level of 324K units sold. This was previously reported at 308K annualized. Even with the upward revision, the February selling rate was the lowest in the history of comparable data dating back to January 1963. March new single-family home sales were up 23.8% y/y. The March supply of new homes on the market declined to 6.7 months in March from 8.6 months in February and 11.3 months in March 2009. The median price of new homes sold in March was $214,000, rising 4.3% y/y, with the mean price $258,600, down 0.5% y/y.

On April 22, the Federal Housing Finance Agency (FHFA) reported its purchase only Home Price Index (HPI) fell 0.2% in February, following a 0.6% decline in January. In February, the HPI dropped 3.4% y/y, worse than January' 3.2% y/y decline. Since September 2007, the only y/y increase in the HPI was a November 2009 gain of 0.1%.

In the March producer price index (PPI) released April 22, the headline finished goods index rose 0.7%, following a 0.6% decline in January. The core PPI, excluding food and energy, rose 0.1% in March following a 0.1% gain in February. The finished goods PPI is now up 6.0% y/y, due primarily to energy, while the core is up 0.9%.

The equity market continues to climb a wall of worry. We remain of the belief the greatest risk to the recovery is an increase in long-term interest rates, due to non-U.S. investors having as many dollar-denominated assets as they want. Enhanced foreign capital inflows will occur, but it will, at some point, require an increase in the interest rates the U.S. Treasury will have to pay.

Economic Indicators in the Week Ahead:

Tuesday, April 27 9:00a.m. February Case-Shiller Home Price Index
The Case-Shiller Home Price Index for the 20 largest metropolitan areas is likely to show a February advance of 1.0% over February 2009. This would be the first y/y increase for the Case-Shiller Home Price Index (HPI) since 2006. The consensus sees a 1.1% y/y rise in February. The January HPI was down 0.7% y/y, while December's HPI was off 3.1% y/y. The non-seasonally adjusted m/m number likely fell 0.4% in February. The m/m numbers have been declining since October 2009, a reflection of the distressed sales, foreclosures, and inventory of unsold homes that are restraining home prices.

Tuesday, April 27 10:00a.m. April Consumer Confidence Index
The Conference Board Consumer Confidence Index rebounded in March to 52.5, following a large February decline to 46.4. The April reading likely rose to 55.0. Equity prices provide an upside probability, but the ABC News Consumer Comfort index is averaging -47 so far in April, worse than -45 in March. The consensus, at this writing, sees consumer confidence rising to 54.0.

Wednesday, April 28 (P.M.) FOMC Post-Meeting Statement
The Federal Open Market Committee meets on April 27-28. The FOMC statement released after the meeting will likely continue to articulate the need to keep the federal funds rate in the 0%-.25% range. The recovery endures, but has many weak spots (e.g., commercial real estate, and the fiscal difficulties of the state and local government sector). In addition, tighter credit by banks and a labor market recovery that is just underway prevents undue optimism. This FOMC meeting will come forth with some direction on asset sales by the Federal Reserve. But, the Fed will be cautious about being too specific. The Fed's balance sheet has in excess of $1 trillion of mortgage-backed securities. The Fed needs to determine how and when to sell these securities without disrupting the markets, i.e., without inducing upward pressure on long-term interest rates.

Thursday, April 29 8:30a.m. Jobless Claims, Wk. Ending April 24
In the week ending April 17, initial jobless claims fell 24,000 to a still elevated 456,000. Continuing claims, which are reported with a one-week lag, declined 40,000 in the week ending April 10 to 4.646 million. We see initial jobless claims receding again in the week ending April 24 to 435,000. The administrative problems, which the Labor Department said had elevated the claims data, have apparently been

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centered in California and New York. The consensus sees initial jobless claims falling to 442K. The number of workers collecting unemployment benefits via the extended federal benefits program was 5.347 million for the week ending April 3. President Obama signed on April 15, 2010 a continuing extension through June 2 of the EUC (Emergency Unemployment Compensation).

Friday, April 30 8:30a.m. 1Q:'10 Real GDP (A), GDP Deflator

We estimate the advance report from the BEA will show that real GDP in 1Q:'10 grew 3.5% at an annual rate. While slower than the 5.6% growth rate reported for 4Q:'09, the recovery is broadening. Much of 4Q:'09 growth was due largely to a reduced rate of inventory liquidation. Real final demand only grew 1.7% annualized in the fourth quarter. In contrast, the first quarter of 2010 will likely deliver 2.6% annualized growth in real final sales. We see real personal consumption spending growing at a 3.6% pace in 1Q:'10. Slight inventory building is probable in 1Q:'10. On a momentum basis, growth is improving. 4Q:'10 real GDP was only 0.1% above its year earlier level. First quarter 2010 real GDP will likely come in as up 2.9% y/y. Inflation remains tame. The GDP deflator likely advanced roundly 1.0% at an annual rate in 1Q:'10. The market consensus, at this writing, expects 3.4% annualized real growth in real GDP in 1Q:'10, with the GDP deflator rising 0.9% annualized.

Friday, April 30 8:30a.m. 1Q:'10 Employment Cost Index (ECI)

Reflective of sluggish increases in both wages and salaries and in benefits, we expect the first quarter to show a 0.4% change from the prior quarter. The consensus expectation sees a 0.5% growth in the ECI. If we're correct on a 0.4% sequential rise, the ECI would be up only 1.6% y/y.

Friday, April 30 9:45a.m. April Chicago PMI

We believe the Chicago Purchasing Managers Index (PMI) rose from 58.8 in March to 61.0 in April. The new orders and production components likely rose to 62.6 and 61.2, respectively, in April from 61.8 and 60.5 in March. The consensus has the overall PMI coming in at 59.6 from 58.8 in March and 62.6 in February. The Beige Book said that economic activity improved in the Seventh District in March, and that consumer and business confidence were increasing. Higher steel and auto production likely boosted the PMI and initial claims fell in the Seventh District.

Friday, April 30 9:55a.m. April Consumer Sentiment Index (F)

The preliminary April Reuters/University of Michigan Consumer Sentiment Index slipped to 69.5 from a final March level 72.5. We see an upward revision to 74.5 in the final April reading, boosted by higher stock prices, and implied by improved daily sentiment readings from Rasmussen. Our 74.5 forecast is above consensus expectations of 71.8.

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