The U.S. Economy Stands to Gain from Actions of Central Banks

May 10, 2013

by Team

of Northern Trust

Recent central bank meetings have resulted in a reiteration of accommodative monetary policy from the Federal Reserve and new initiatives from its counterparts overseas.

President Mario Draghi of the ECB sent a strong message that he “stands ready to act” in addition to the ECB lowering the policy rate last week. The Reserve Bank of India eased monetary policy to lift growth as inflation numbers turned favorable, while the Reserve Bank of Australia took preemptive action to prevent a weakening of economic activity. All of this comes on top of the Bank of Japan’s charge to fight its persistent deflationary trend and promote growth.

The bottom line is that major central banks have acted independently to reduce the downside risk of soft global economic momentum in the months ahead. The foreign central bank actions also help to reduce downside risks to growth in the United States. The U.S. economy is projected to experience a small deceleration in growth during the second quarter, largely a result of sequestration, only to be followed by a pickup in the latter half of the year.

U.S. Economic Outlook

	2012				2013				Q4 to Q4 change			Annual change		
	12:1a	12:2a	12:3a	12:4a	13:1a	13:2f	13:3f	13:4f	2011a	2012a	2013f	2011a	2012a	2013f
Real Gross Domestic Product (% change, SAAR)	2.0	1.3	3.1	0.4	2.5	1.8	2.1	2.3	2.0	1.7	2.2	1.8	2.2	1.9
Consumer Price Index (% change, year-over-year)	2.8	1.9	1.7	1.9	1.7	1.8	1.7	1.7	3.3	1.9	1.7	3.1	2.1	1.7
Civilian Unemployment Rate (%, average)	8.3	8.2	8.0	7.8	7.7	7.5	7.4	7.3				8.9*	8.1*	7.5*
Federal Funds rate	0.10	0.15	0.14	0.16	0.14	0.15	0.15	0.15				0.10*	0.14*	0.15*
2-yr. Treasury Note	0.29	0.29	0.26	0.27	0.27	0.30	0.30	0.45				0.45*	0.28*	0.33*
10-yr. Treasury Note	2.04	1.82	1.64	1.71	1.95	1.81	1.90	2.05				2.79*	1.80*	1.93*

a= actual
f=forecast
*= annual average

Key elements of our forecast:

- Service sector expenditures led the 3.2% jump in consumer spending during the first quarter, but a moderation of these outlays is expected during the second quarter. Auto sales slipped in April to an annual rate of 14.9 million units from 15.3 million in March. A conservative pickup in sales during May and June will translate into only a modest contribution to the goods component of consumer spending.

- Fewer permits issued for construction of new homes suggest that the pace of construction should be less robust than the first quarter’s 17.6% increase in residential investment expenditures. The latest Senior Loan Officer’s Survey results show an improved mortgage lending environment. This, combined with the strength in the April employment report and lean inventory of unsold homes, are positive signals favoring continued growth in home construction and sales.

- Business spending posted a disappointing 3.0% gain in the first quarter, after a strong increase in the final three months of 2012. A slightly higher pace of activity is expected in the rest of the year. Only a mild increase in inventory accumulation is likely in the second quarter, following an outsized gain in the prior quarter.

- The small but surprising gain in exports in the first quarter will probably stage a repeat in the months ahead. The dollar’s recent strength and weak economic conditions abroad are the major factors preventing a stronger performance from exports.

- Federal government spending has declined in seven of the last nine quarters. There is little reason to project a turnaround, given that cuts in spending are underway. State and local government outlays are projected to show a gentle declining trend.
- The 1.0% and 1.1% year-to-year gains, respectively, in the personal consumption expenditure (PCE) price index and the core PCE price gauge, which excludes food and energy, led to the Fed's new position to raise or cut asset purchases depending on the labor market and inflation outlooks. Market-based measures of inflation expectations remain well contained around the 2.0% range.
- April employment data brought a sense of relief after the soft numbers of March. The 7.5% unemployment rate and a 165,000 gain in payrolls put to rest concern about slowing economic conditions. The participation rate, which held steady in April, is projected to climb gradually in the near future and trim improvements in the unemployment rate.
- A string of mixed economic reports prior to the April employment report and the BoJ's actions led to a decline in Treasury securities yields, which reversed course after the April employment report. The fundamentals of the U.S. economy point to higher Treasury note yields by year-end, but sharp jumps are not on the horizon.
- Although the Fed has put in place symmetric forward guidance for asset purchases, the weight of most recent economic evidence – a bullish employment report, rising equity prices and an upward trend in home prices – points to the possibility of tapering asset purchases rather than an expansion of the program by year-end or early next year.

www.northerntrust.com