ECONOMIC PREVIEW

REGIONS

Week of August 4, 2014

Indicator/Action Economics Survey: | Last Actual: | Regions' View:

Fed Funds Rate
(after the FOMC meeting on September 16-17)
Range: 0.00 to 0.25 percent
Median: 0.125 percent (mid-point of target range)

Last Actual: 0.00% to 0.25%

On the whole, the July employment report was "Fed-friendly" in the sense that job growth topped the 200,000 mark for a sixth consecutive month, the longest such streak since 1997, but at the same time there is further evidence of a still elevated degree of slack that buys the Fed time to be more deliberate as they flesh out the path of monetary policy normalization. And, the fact that the July employment is Fed-friendly means it is also market-friendly, which may come as a relief to some following last week's market turmoil sparked, at least to some degree, over fears the FOMC may have to act sooner rather than later. Well, at least until the next piece of data suggesting faster growth.

One data set that is clearly on the Fed's radar screen, or their dashboard anyway, is productivity growth and unit labor costs, for which we will get a preliminary report for Q2 on Friday (see below). While productivity growth rebounded along with GDP growth in Q2, the longer running trend remains concerning. Why this matters, for openers, is an economy's "speed limit" (or, the rate at which it can grow without igniting inflation pressures) is largely governed by the rate of growth of the labor force and the rate of worker productivity growth, with the sum being a good proxy for the speed limit on real GDP growth. Using longer-term averages over recent years (a far more meaningful measure than using only a current quarter measure) puts the economy's speed limit below 2.0 percent, as both labor force growth and productivity growth have been notably weak. While we do expect labor force growth to improve over coming quarters, it is likely to remain below its historical norm. Whether and to what extent productivity growth will do the same remains very much an open question, but barring a 1990s style revival in productivity growth, the economy's speed limit is unlikely to push much over 2.25 percent. This has clear, and potentially uncomfortable, implications for the path of monetary policy. Another reason productivity growth matters is, at least historically, a sustained period of healthy productivity growth is a precursor to meaningful and sustained growth in labor earnings. In the current cycle, we are not yet at or even near that point, which is an often overlooked factor in what is considerable discussion of the lack of wage growth.

June Factory Orders — Tuesday, 8/5
Range: 0.3 to 1.0 percent
Median: 0.6 percent

Last Actual: May = -0.5%

Up by 0.6 percent. Orders for durable goods are reported to have risen by 0.7 percent, and we look for a slightly smaller gain in orders for nondurable goods, leaving total orders up 0.6 percent. The encouraging element of June orders is the healthy increase in orders for core capital goods.

June Trade Balance — Wednesday, 8/6
Range: -$46.7 to -$42.0 billion
Median: -$44.5 billion

Last Actual: May = -$44.4 bil

Widening to $45.1 billion as we look for a slight dip in exports of U.S. goods while imports rise modestly.

Q2 Nonfarm Productivity — Friday, 8/8
Range: -1.2 to 2.2 percent
Median: 1.3 percent SAAR

Last Actual: Q1 = -3.2%

Up at an annualized rate of 1.6 percent. First, look for a sizeable downward revision to the Q1 number. Based on revised data on nonfarm business output (included in the GDP data), we think productivity will be reported to have declined at an annual rate of around 4.8 percent in Q1. As for Q2, real nonfarm business output rose at an annual rate of 5.2 percent which, after accounting for the gain in aggregate private sector hours worked, will yield a healthy rebound in productivity growth. One wild card is how the decline in aggregate hours worked by the self-employed will impact the data, as it is not always clear to us (well, okay, frankly, it is never clear) how this segment of the private sector work force is incorporated into measured productivity. As noted above, however, what is more relevant than the Q2 number is the longer running trend rate of productivity growth which will remain troublingly weak even with our anticipated Q2 growth.

Q2 Unit Labor Costs — Friday, 8/8
Range: 0.0 to 2.6 percent
Median: 1.2 percent SAAR

Last Actual: Q1 = +5.7%

Up by 0.4 percent. Quarter-to-quarter changes in unit labor costs tend to reflect the flip side of the quarterly changes in productivity growth. So, just as Q1 productivity growth will likely be revised down, growth in Q1 unit labor costs will be revised even higher while the improvement in productivity will hold down growth in unit labor costs in Q2. Clearly, though, labor costs are rising neither as rapidly as reported for Q1 nor as slowly as will be reported for Q2, and once again the relevant measure is the longer-term trend. On this basis, growth in unit labor costs is still running below 2.0 percent, which is supportive of Fed Chair Yellen's contention that there remains significant slack in the labor market.

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