JUN 06.19.2015

ECONOMICS: US PERSPECTIVES

# SUBDUED EXPECTATIONS? THE FOMC AND THE ECONOMIC OUTLOOK

+ Joseph G. Carson, US Economist and Director—Global Economic Research, joe.carson@abglobal.com

This week, the Fed lowered its economic growth forecast to roughly 2% for 2015 and painted a slow-growth picture (in the low to mid-2% range) for the next two years. The subdued growth expectations led policymakers to promise a more gradual and shallow rise in official rates over the next few years. We think they are too pessimistic on US growth.

### Cautious Fed Projections and Perspectives...

Following the June Federal Open Market Committee (FOMC) meeting, policymakers acknowledged that US economic growth had rebounded in the second quarter after having hit a soft patch in the first quarter. But that progress—and prospects for continued growth in 2015—appears insufficient in the eyes of policymakers to achieve their previous growth projections. So the Fed lowered its growth projection to a little below 2.0% for the year, down from its previous estimate of 2.5%.

Policymakers left their growth estimates for 2016 and 2017 virtually unchanged at 2.6% and 2.3%, respectively. They also maintained their projections for unemployment to decline toward a 5% rate during the course of 2016 and 2017, and they expected a gradual climb in headline inflation to 1.8% in 2016 and 2.0% in 2017.

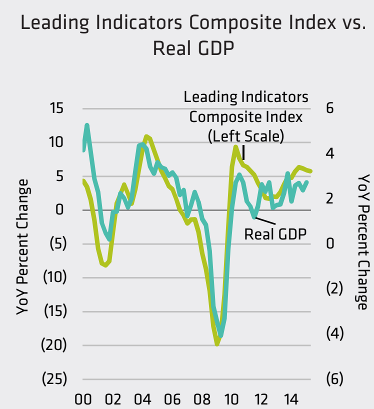
The slower growth pattern, along with a very steady but slow rise in inflation, resulted in policymakers anticipating a more gradual normalization of official rates, according to the median projections among FOMC members. At the end of 2015, official rates will likely rise to roughly 0.625%—up 50 basis points from today's level. Projections further indicate a rise in official rates to 1.625% by the end of 2016 and 2.875% by year-end 2017. These latest Fed projections represent a reduction of 25 basis points relative to the proposed rate pattern in March. The longer-run neutral fed funds target of 3.75% remained unchanged.

### ...but We See a Better Growth Rebound

In our view, policymakers appear too conservative in their growth projections—not only for the rest of 2015 but for the longer run. At face value, the FOMC's revised 2% growth number for 2015 implies an average quarterly rate of 2.6% annualized for the remaining quarters.

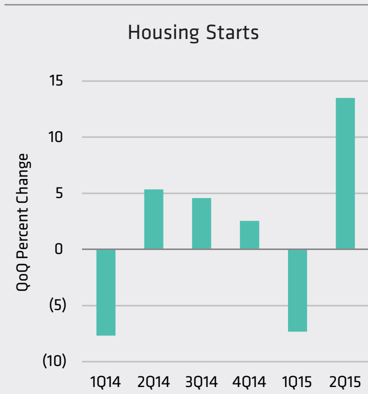
However, we believe that incoming survey-based and hard data for the second quarter indicate a stronger rebound—nearly as strong as what happened last year, when real GDP growth jumped to 4.6%. For example, payroll job gains of 217,000 for the first 5 months of 2015 are running only slightly behind the 230,000 of 2014. But the 2Q:2015 rebound in consumption growth is likely to be faster than the 2.5% gain of last year

Display 1
Brighter Growth Outlook Implied in Leading Indicators




Through June 1, 2015
Source: Bureau of Economic Analysis, The Conference Board and Haver Analytics

Display 2
Strong Rebound in Residential Construction




Through June 1, 2015
Source: Census Bureau and Haver Analytics

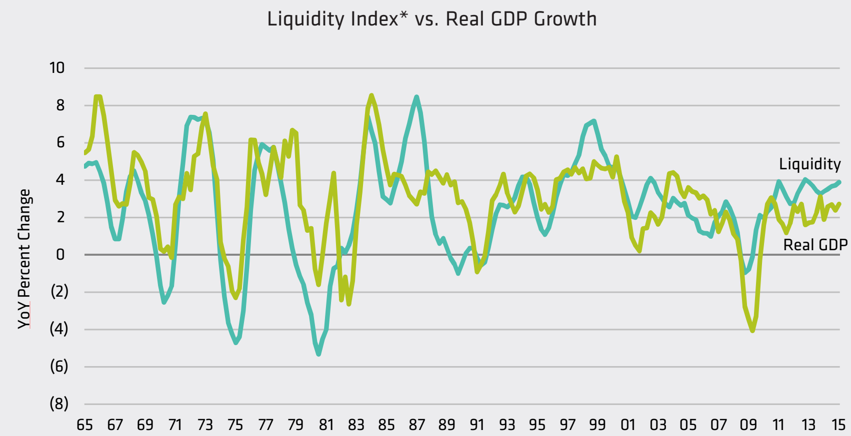
thanks to strong real wage gains, increased credit growth and the impressive rebound in spending on services. At this point, we see real 2Q consumer spending in the 3.0% to 3.5% range.

Homebuilding and construction spending (outside of oil and gas) should also post a relatively strong gain in 2Q, as good as if not better than 2Q:2014. At present, second-quarter housing starts are running 13% (not annualized) over the first-quarter average (*Display 2, previous page*). The gain in housing starts in 2Q:2014 was 5.3%. Other segments of the construction market, such as nonresidential buildings and public construction, are also showing robust gains in the mid-teens range versus a gain of 9% last year.

Business surveys also support our view for a stronger second quarter. For example, the April and May average of the Institute for Supply Management composite indexes for manufacturing and nonmanufacturing stands at 56.2 versus 55.8 for 2Q:2014. Also, the second-quarter reading for the National Association of Homebuilders index stands at 56—sharply above the reading of 47 for 2Q:2014.

Two areas that may somewhat hold back second-quarter growth are the continued retrenchment in oil and gas capital spending, and smaller contributions from other business spending on capital equipment and software. Still, the sum of all sectors suggests real 2Q GDP growth in the 3.0% to 4.0% range when all of the final data are in.

Display 3
Liquidity Flows Indicate Stronger Growth Through Mid-2016




Through March 31, 2015
*Liquidity index is a weighted average of real money growth, growth in business and consumer credit, and growth in short-term liquid assets.
Source: Haver Analytics and AB

## Growth Outlook for Second Half of 2015

Looking beyond the current quarter, the 5.7% year-on-year growth in The Conference Board's Leading Economic Index through May not only matches the reading from last year at that time, but indicates a much brighter growth picture for the remainder of 2015 than what appears embedded in the FOMC growth forecast (*Display 1, previous page*).

The more robust outlook on growth is also supported by our proprietary liquidity index (*Display 3*). It's based on a weighted average of broad money growth, the change in liquid assets, and business and consumer credit, and it has a fairly accurate track record on foreshadowing real GDP growth over the next six to 12 months. The most recent reading of nearly 4% represents one of the strongest growth signals of the current economic cycle. As such, it indicates that the pace of growth through early 2016 should be well above the FOMC forecast.

## Rate Outlook for Now and Next Year

In our view, a faster growth pattern through the end of 2015 should not alter the pace of official rate hikes for 2015 (i.e., two rate hikes of 25 basis points) as offered by the FOMC in June. However, this faster growth might trigger a change in the pace of rate hikes for next year, especially if policymakers see an acceleration in the path toward their 2% inflation target. ■

The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed herein may change at any time after the date of this publication. This document is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates.

Note to Canadian Readers: AllianceBernstein provides its investment management services in Canada through its affiliates Sanford C. Bernstein & Co., LLC and AllianceBernstein Canada, Inc.

Note to European Readers: This information is issued by AllianceBernstein Limited, 50 Berkeley Street, London W1J 8HA. Registered in England, No. 2551144. AllianceBernstein Limited is authorised and regulated in the UK by the Financial Conduct Authority (FCA).

Note to Austrian and German Readers: This information is issued in Germany and Austria by AB Europe GmbH. Local paying and information agents: Austria—UniCredit Bank, Austria AG, Schottengasse 6-8, 1010 Vienna; Germany:—BHF-Bank Aktiengesellschaft, Bockenheimer Landstrasse 10, 60323 Frankfurt am Main.

Note to Swiss Readers: This document is issued by AllianceBernstein Schweiz AG, Zurich, a company registered in Switzerland under company number CHE-306.220.501. AllianceBernstein Schweiz AG is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority (FINMA) as a distributor of collective investment schemes. This document is directed at Qualified Investors only. Swiss Representative & Swiss Paying Agent: BNP Paribas Securities Services, Paris, Succursale de Zürich. Registered office: Selnaustrasse 16, 8002 Zürich, Switzerland, which is also the place of performance and the place of jurisdiction for any litigation in relation to the distribution of shares in Switzerland.

Note to Australian Readers: This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is only intended for persons that qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia), and should not be construed as advice.

Note to New Zealand Readers: This document has been issued by AllianceBernstein New Zealand Limited (AK 980088, FSP17141). Information in this document is only intended for persons who qualify as "wholesale clients," as defined by the Financial Advisers Act 2008 (New Zealand), and should not be construed as advice.

Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia, China, Taiwan and India: This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries.

Note to Readers in Malaysia: Nothing in this document should be construed as an invitation or offer to subscribe to or purchase any securities, nor is it an offering of fund management services, advice, analysis or a report concerning securities. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in Malaysia. Without prejudice to the generality of the foregoing, AllianceBernstein does not hold a capital markets services license under the Capital Markets & Services Act 2007 of Malaysia, and does not, nor does it purport to, deal in securities, trade in futures contracts, manage funds, offer corporate finance or investment advice, or provide financial planning services in Malaysia.

Note to Singapore Readers: This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSL", Company Registration No. 199703364C). ABSL is a holder of a Capital Markets Services Licence issued by the Monetary Authority of Singapore to conduct regulated activity in fund management and dealing in securities. AllianceBernstein (Luxembourg) S.à r.l. is the management company of the portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative.

Note to Taiwan Readers: AllianceBernstein L.P. does not provide investment advice or portfolio-management services or deal in securities in Taiwan. The products/services illustrated here may not be available to Taiwan residents. Before proceeding with your investment decision, please consult your investment advisor.

Note to Hong Kong Readers: This document is issued in Hong Kong by AllianceBernstein Hong Kong Limited (聯博香港有限公司), a licensed entity regulated by the Hong Kong Securities and Futures Commission. This document has not been reviewed by the Hong Kong Securities and Futures Commission.