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Breakout or Breakdown?

Is the economic "party" ramping up or about to close down? If measured by the headlines, the U.S. economy is finally firing on all cylinders and picking up momentum. The final reading on 3Q2014 GDP pegged growth at a sizzling 5.0%; 2014 saw 2.95 million jobs created while unemployment dropped to 5.6%. The stock market rose to new all-time nominal highs. Inflation remained subdued, and mortgage rates were near historic lows.

Yet, beneath the headlines, the story takes on a different hue. GDP growth in 3Q2014 was strongly influenced by a surge in healthcare-related spending; $12.1 billion of the $18.6 billion of additional GDP from consumer spending in the final 3Q revision can be traced back to health care (mainly insurance premiums). Despite employment gains, real wages remain stagnant and record numbers of working-age persons are *not* in the labor force. Housing starts and sales were sputtering at year's end amid the low mortgage rates. And while the stock market indexes posted records, trading volume has been relatively light. So, the party continues, but is it really heating up or starting to close down? Perhaps the following will help readers make up their own minds:

• ***Manufacturing*** – Industrial production (IP) decreased 0.1% in December. Although lower than November's +1.3%, manufacturing posted a gain of 0.3% (its fourth consecutive monthly increase). Monthly opinion surveys conducted by both Markit and the Institute for Supply Management confirmed the deceleration in manufacturing IP growth. Meanwhile, Wood Products output retreated by 1.2%; Paper rose 0.1%.

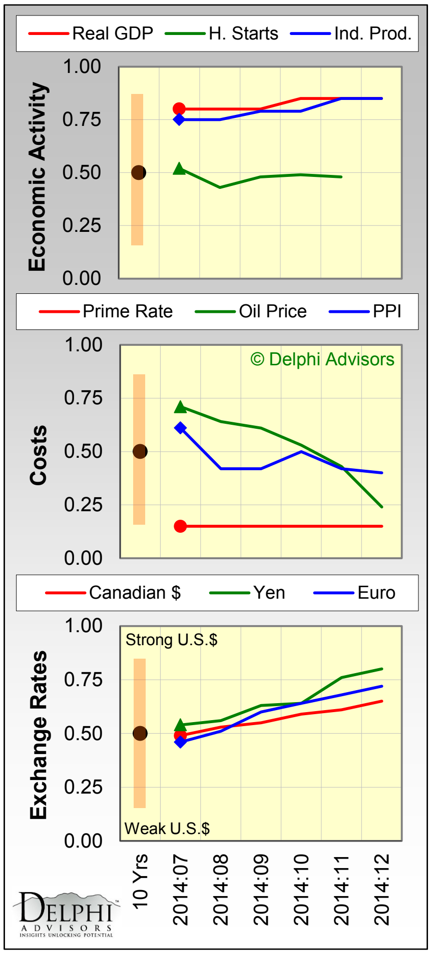
• ***International trade*** – The U.S. goods and services deficit declined by $3.2 billion in November, to $39.0 billion. Oil imports were down 35 million barrels from last month, and down 24 million barrels from a year earlier. On an inflation-adjusted basis, however, the ex-oil trade deficit was near recent records.

Softwood lumber exports decreased by 21.2% in November (-23.8% year-over-year) while imports fell by 15.3% (-0.2% YoY). Net exports of pulp, paper and paperboard edged up 0.2% (+2.7% YoY), to their highest level since January 2014.

• ***Oil*** – The monthly average U.S.-dollar price of West Texas Intermediate crude oil extended its retreat for a sixth month, plummeting by $15.95 to $59.84/barrel – the lowest price since May 2009. Bad global economic news, coupled with excess oil production, were given as reasons for the continuing price slump. One analyst estimated that roughly 40% of oil's recent price drop may be attributable to weakness in the global economy. Because the short-term supply and demand curves for oil are very steep, even small changes in the quantity supplied or demanded can have outsized impacts on price.

• ***Exchange rates*** – In December the monthly average value of the U.S. dollar once again appreciated against all three major currencies we track: 1.8% against Canada's loonie, 1.2% relative to the euro, and 2.6% against the yen. On a trade-weighted index basis, the dollar strengthened by 2.4% against a basket of 26 currencies. Canadian GDP growth of nearly 3.7% (annualized) in October was not enough to overcome the adverse impacts (especially for exports) of falling oil prices on the loonie. The euro's drop reflected moribund Eurozone activity and continued speculation the European Central Bank will soon expand its stimulus programs aimed at spurring growth and avoiding deflation. The yen continued to weaken thanks to previous monetary policy decisions.

This report is a compilation of articles posted on our website; those articles relate recent economic developments to the U.S. forest products sector in much greater detail. ■



Previous six month's behavior of macroeconomic variables indexed relative to their historical 10-year min, max and average (lower and upper ends of the orange bars, and black dots, respectively)