2015 REMAINS FILLED WITH PROMISE

After a disappointing start, 2015 still holds potential for record-breaking growth.

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Coming into 2015, many economists were forecasting above 3 percent growth. Some still are. Tailwinds, such as a booming stock market, lower fuel prices, rapid job growth, and early evidence of sharper wage gains, led forecasters to believe that 2015 was shaping up to be the best year for the economy since 2005, the last year the U.S. economy expanded more than 3 percent over the course of a calendar year (at 3.4 percent).

The construction industry was primed to lead the charge. 2014 saw the highest level of construction spending since 2008, according to the U.S. Census Bureau. Construction employment surged during the fourth quarter of 2014, and the industry's labor force dynamics were showing signs of improvement. All signs pointed toward a glowing start to 2015 for the construction industry.

The year, however, has gotten off to a disappointing start. Certain headwinds were at least partially foreseeable. Winter comes once a year and with it comes snow. Ice storms impacted many southern communities for days on end. Once again, the frigid temperatures cut into construction activity. A stronger U.S. dollar predictably frustrated export growth. West Coast ports had been chaotic for months, and supply chain interruptions were inevitable.

The real source of disappointment, however, came in the form of consumer spending. Given recent job creation and wage growth as well as lower fuel prices, retail sales were expected to be stronger. Every dollar saved at the gas pump should have helped to boost retail segments. Economists estimate that every penny reduction in the price of gasoline translates into a billion dollars of additional spending power. To date, consumers have been spending less of their fuel savings than anticipated. According to the Census Bureau, sales from the nation's retail and food sectors dropped 0.8 and 0.6

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percent in January and February, respectively. Consumers will have to pick things up considerably if the economy hopes to hit the 3 percent growth mark this year.

The authors believe that consumers will pick up the pace. Although it is true that certain fuel prices have edged higher recently (the retail price of gasoline increased by 15 percent between January and March), prices remain more than 30 percent lower than during the summer of 2014. Despite a weak job report in March, the nation has still managed to add more than 3 million net new jobs over the past year. Many are in economic segments associated with middle-level wages or better, including construction, manufacturing, local government, and finance. Wages and salaries are rising at their highest levels in roughly six years, and industries like construction and distribution have begun to experience the lull of worker shortages in various parts of the nation.

Although the impact of low fuel prices is largely positive, it is not exclusively so. Moreover, the negative impacts of the oil price swoon are more likely to be felt immediately while benefits are likely to be experienced over the course of many months. Negative impacts are already apparent in key oil-producing states like Texas and North Dakota. For many months, North Dakota led the nation in percentage job growth. That is no longer the case.

ONCE A LIGHTWEIGHT, THE U.S. DOLLAR HAS BECOME A HEAVYWEIGHT.

The impact on Texas has been even starker. In March, the Longhorn state lost jobs on a monthly basis for the first time in 53 months, with total non-farm employment rates falling by two-tenths of a percentage point. The mining and logging sector, which encompasses many of the state's oil-related jobs, has shed workers during each of the year's initial three months. Since December 2014, mining employment in Texas has slipped by nearly 3.5 percent after registering employment expansions during each of the prior 62 months.

For a time, there was hope that the displaced workers would help to soften the impact of Texas' long-feared construction worker shortage. Although it is true that some fraction of workers from the oil patch have reentered construction occupations, overall demand for construction workers has also slipped. The state's construction industry experienced diminished employment in January and March for the first time in over two years. An analyst from JPMorgan Chase predicts that declines in energy-related capital expenditures will subtract 2.7 percent from first quarter gross state product.

The greenback goes back up

For those states that do not produce oil in significant quantities, the more significant headwinds are likely to be associated with a stronger U.S. dollar. Once a lightweight, the U.S. dollar has become a heavyweight. According to Citibank, the dollar's recent rise in the rankings has represented its strongest growth in value in 40 years. With the Federal Reserve poised to begin increasing interest rates later this year and with Europe in the midst of the early stages of its version of quantitative easing, further gains in the greenback are possible. U.S. economic performance also continues to be superior to performance in Europe or Japan, which is also consistent with the notion that the value of the dollar could continue to rise against the euro and yen.

That said, while the Eurozone's economy continues to struggle, recent news has been better. The European Central Bank recently increased its growth outlook for the Eurozone to 1.5 percent for the current year, up from 1 percent previously. The Eurozone is expected to achieve 2 percent growth by 2017. For years, investors have tended to reduce their emphasis on European holdings given sovereign and bank debt crises. While Europe continues to make news along these dimensions, shifting monetary policy coupled with emerging economic momentum strongly suggest that investors would be wise to reconsider their theories of action regarding Europe. Such logic suggests that at some point, money may begin to leave more expensive U.S. equity markets for relative bargains overseas. Although that would not be positive for stock prices, it would result in a weaker dollar, which would help rejuvenate America's flagging manufacturing and export sectors.

Although it would be easy to lose oneself in the sea of negative economic considerations emerging from both the global and domestic economies, there are more things about which to be excited. Both consumer and business confidence remain near multi-year highs. Corporate earnings continue to impress despite erratic economic performance. The nation's housing market continues to heal, supported in part by 30-year fixed-rate mortgage rates below 4 percent and 15-year fixed mortgage rates below 3 percent.

NONRESIDENTIAL CONSTRUCTION CONTINUES TO RECOVER AND WILL REPRESENT ONE OF THE ECONOMY'S MOST IMPORTANT ADJUNCTS TO AN OTHERWISE CONSUMER-LED RECOVERY.

Despite several years of rapid growth in oil production, America remains a net importer of oil. This means that all things being equal, America is a net beneficiary of cheaper fuel prices. Lost in the focus on oil prices has been an almost equally remarkable decline in natural gas prices. All of this inures to the benefit of the U.S. consumer sector, which represents two-thirds of aggregate demand and which stands to power the U.S. economy forward in 2015. Despite an uninspiring first quarter performance, the International Monetary Fund continues to predict that the U.S. economy will expand by more than 3 percent this year.

Lingering skepticism regarding economic performance this year is hardly surprising given that the economy recently experienced a six-month soft patch. According to final estimates from the Bureau of Economic Analysis, real gross domestic product (GDP) increased at an annualized 2.2 percent rate during 2014's final quarter. At the time of this writing, the Bureau of Economic Analysis has yet to supply statistics regarding first-quarter GDP, but the Federal Reserve Bank of Atlanta recently reported that its forecast for first-quarter GDP is around 0.2 percent on an annualized basis. Although that may prove a bit too pessimistic, other estimates indicate that for a second consecutive year, first-quarter performance fell well short of expectations. J.P. Morgan Chase economists estimate 0.6 percent growth for the first quarter while Morgan Stanley economists anticipate a reading of 0.9 percent.

Some of this weakness will extend into the second quarter. Because consumers have not spent as aggressively as many had predicted, manufacturing inventories have expanded. These inventories will need to be worked off during the second quarter, which implies that the second quarter is unlikely to produce a massive rate of growth. The quarter will be better, however, in part because this spring residential selling season will be one of the finest experienced over the past decade.

The logic of 2015 rests with the consumer. Consumers have increased outlays in recent years despite lower levels of job creation, slower wage growth, and higher fuel prices than exist presently.

Last year provided a reminder of how impactful consumer spending can be. After being shut out of malls and street-level stores by powerful weather events during the first quarter of 2014, GDP expanded 4.6 percent on an annualized basis during the second quarter and 5 percent during the third. While the middle six months of the current year may not be quite as impressive, the economy still has a puncher's chance of achieving 3 percent expansion this year as consumption surges with average temperatures. Some of the consumer's potency was on display in March: Retail sales that month expanded 0.9 percent on a seasonally adjusted basis — the strongest monthly gain since the same time one year prior.

That same month, the Conference Board's Consumer Confidence Index recovered to a reading of 103.1, a seven-year high. The Expectations Index rose to 96 from 90, indicating that the outlook among consumers was improving even before the weather did.

Nonresidential construction continues to recover and will represent one of the economy's most important adjuncts to an otherwise consumer-led recovery. Nonresidential construction spending was up 4.6 percent in February on a year-over-year basis, although on a monthly basis, performance was not as impressive. Just seven of 16 nonresidential construction subsectors posted monthly gains in spending in February, including manufacturing (6.8 percent), conservation and development-related construction (11 percent), and lodging-related construction (5 percent). Despite the end of quantitative easing, most construction firms report that financing conditions continue to ease. Profit margins have also been expanding recently, which provides construction firms with greater ability to invest in new hires, technology, equipment, marketing, and training.

According to the U.S. Bureau of Labor Statistics, the U.S. construction industry lost 1,000 jobs in March. However, nonresidential segments still managed to add 5,000 new jobs for the month. Nonresidential specialty trade contractors led the way, adding 4,400 new jobs for the month.

For the most part, the nonresidential construction recovery has been attached to segments driven by private sector activity. Manufacturing-related construction has expanded impressively in the wake of several years of strong industrial production growth. Construction related to amusement and recreation segments, which encompasses much of the nation's gaming industry, has also been surging. Construction of retail space and fulfillment centers has also ticked higher due to past and expected growth in consumer outlays. A bustling leisure and hospitality industry has produced higher hotel occupancy rates, which in turn has translated into more construction put-in-place. Recent readings of the Architecture Billings Index remain consistent with the notion that nonresidential construction spending will rise around 6 percent this year despite a lack of aggressive public sector participation.

Looking ahead

The U.S. economy will continue to expand in 2015. In fact, this could easily turn out to be the best year of economic recovery since the Great Recession ended in June 2009. Along with consumer spending, nonresidential construction in private sectors not related to oil production will continue to rally. State and local government spending has also been recovering, though capital spending remains suppressed as governments continue to wrestle with rising Medicaid expenditures and the need to shore up underfunded pensions.

Key interest rates are likely to remain low despite the broadly shared expectation that short-term rates controlled by the Federal Reserve will begin to rise later this year. With European and Japanese interest rates remaining low, U.S. rates are not likely to arc higher anytime soon. Not only does this support diminished borrowing costs, it supports elevated stock market valuations, which in turn helps drive economic activity through wealth effects.

The leading threat to the U.S. economy arguably takes the form of a stronger U.S. dollar. The U.S. dollar has become far stronger over the past several quarters against the euro, yen, and Canadian dollar. Although this is wonderful for consumers who purchase imports or travel abroad, the stronger dollar has rendered it much more difficult for exporters to penetrate foreign markets. Given the headwinds coming from the stronger greenback and the unplanned inventory accumulation that transpired during the year's first quarter, the U.S. economy does not appear poised for breakaway growth in the very near term. ■