U.S. Flash

Beige Book Points To Expansion On A Broad Scale

- **Modest to moderate improvement in a majority of districts**
- **Construction industry continues to provide growth for affiliated sectors**
- **Higher gas prices and payroll tax increase restrain some consumer activity**

The Federal Reserve Beige Book released for April points toward moderate to modest growth throughout the 12 districts due to an expansion in construction activity and durable goods production. While the New York and Dallas regions reported the slowest pace of improvement, all 12 districts continue to benefit as revived industries fuel growth. Manufacturing and construction remain some of the best performing sectors. However, some districts noted a fall in demand for construction-related activity tied to defense contracts which have been reduced due to government spending cuts. Nonfinancial services also performed well with a majority of the districts again touting rising home prices as positive additions to their local economies. Oil and natural gas production were also picking up in the Dallas, Kansas City and Cleveland districts while coal production remains on the decline. Employment, a watched indicator especially after the March payroll growth, was either stable or improving throughout the districts with hiring coming from manufacturing, residential construction, information technology and professional services.

The overall outlook remains optimistic although there is some uncertainty regarding fiscal policy and healthcare reform as both begin their long implementation. Looking first at manufacturing, most districts reported stable or improved conditions while the Chicago and Richmond areas noted a slowdown compared to earlier in the year. There were a couple of districts, primarily Kansas, which reported weaker durable goods production, in line with expectations for the March period. However, the bulk of manufacturing growth came from construction and affiliated industries as several districts reported increased construction activity which spurred production of related supplies. The energy industry, specifically natural gas, was also cited as a catalyst for increased manufacturing activity along with the electronic equipment manufacturers who supply both the energy and high-tech industries. The main concern of most districts was the effect of spending cuts on defense-based manufacturing. Chicago, Philadelphia and Cleveland all experienced some sort of cost cutting or demand reduction from metal producers as fears of a slowdown forced some manufacturers to begin laying off or at least implementing furloughs.

Sales activity across the districts remained moderately positive, although the Richmond and Chicago districts reported a decline in pace. Sales of housing related items like furniture and appliances were boosters while high-tech equipment continued to expand in the San Francisco area, the high-tech hub. Auto sales continued to grow as well with new dealerships popping up and used car sales continuing their climb. However, there was some restrained growth throughout the districts which some areas blamed on higher gas prices and unexpected weather conditions. Some districts did point out that higher gas prices, inclement weather conditions, and the payroll tax as factors that may have restrained some retail expansion over the period. Employment remained unchanged or improved slightly according to the districts while the aforementioned bright spots in construction and some retail areas proved to benefit their respective labor markets. Loan conditions from the banking perspective have improved slightly as districts report better credit conditions but credit is still hard to come by as standards remain tight.

Overall, the Beige Book suggests that conditions are improving across most sectors although consumers appear to be still feeling the effects of higher energy prices and the payroll tax rise. Fears of spending cuts from the public sector are also feeding into the skepticism that growth will jump much higher but optimism remains strong that the economy is making progress toward sustainable expansion. In general, the comments are supportive of a slow but steady recovery and do not change our outlook for growth in the first half of 2013.

Kim Fraser
kim.fraser@bbvacompass.com
+1 713 831 7342

Alejandro Vargas
alejandro.vargas@bbvacompass.com
+1 713 831 7348

| 2001 Kirby Drive, Suite 310, Houston, TX 77019 USA | www.bbvaresearch.com