

Greg Valliere Monthly Commentary

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GREG VALLIERE: Well, hello, everyone. It's Greg Valliere at the Potomac Research Group recording on February 18th, at the end of what has been an interminable winter in the Northeast, as most all of you know and have experienced. And, actually, I'm going to refer to the weather in this month's call, because I think it's playing a real role in where the economy is, and actually may play an indirect roll in this fall's elections.

Let me start by saying that most economists who I respect are now revising downward their estimates for first quarter growth. Many people are at or below 2%. That's on the heels of a very strong second half as you all know. And I think this is starting to make people ask a fundamental question: Is the slowdown in the economy, this air pocket for the last couple of months, strictly a factor of the weather, or is it a sign that, once again, the economy may be sputtering after high hopes at the beginning of the year? It seems like this happens with disturbing regularity almost every year, with the recovery just not taking off. I think the jury is still very much out on that, but I think for the next several weeks the pressure on numbers will be downward pressure for numbers to disappoint. And, obviously, weather has played a factor; you can't deny that. So I think there are three big policy issues to look at when confronting an economy that, at least so far this year, has been a disappointment.

The first is whether anything can happen on fiscal policy. And I think the answer, basically, is no. I don't see any new stimulus. I don't think Congress will increase the minimum wage. That's really a state issue. And even an increase or an extension of unemployment benefits looks increasingly unlikely because Congress can't figure out how to pay for it. So I don't see any stimulus. I don't see anything on the fiscal front that could help an economy that looks kind of soft right now.

Secondly, and more intriguingly, could this softness have an impact at the Federal Reserve? They meet again on March 18th and 19th. And I'd have to say if we get a continuation of lousy economic numbers, especially the unemployment number on March 7th, if that one looks soft, I think on the table at this upcoming FOMC meeting in mid-March could be the possibility of slowing down the tapering, maybe only tapering by \$5 billion a month, not 10, maybe even delaying tapering, stopping it for one meeting. I think that it's still too early to flat-out predict that that will happen, but, again, if the economic numbers, especially the next unemployment report show continued weakness, I think the Fed has to consider a change in policy. As many

of you have heard me say over the last year or two, this is the most dovish Fed in our lifetime, a Fed that is determined to get the economy up and running strongly, and I think it wouldn't take much more in terms of bad economic numbers to make them think about slowing down the tapering of asset purchases.

The third angle on this story is perhaps the most intriguing. I think the only hope for the Democrats to do well this fall, because they are facing a drubbing, the only hope would be for the economy to take off. For GDP to be growing by you know, 3– 3 ½% by summer and with unemployment continuing to fall. And perhaps just as importantly, for basic attitudes for Americans' opinions changing and acknowledging, finally, that the economy is growing nicely. So there is really only about four or five months to go before we get to mid-summer to see if the economy does start to take off, and if it doesn't, and if the public doesn't perceive an improvement, I increasingly think this is going to be a really nasty election for the Democrats because they would have the twin whammy of a very mediocre economy and, of course, the great albatross that is Obamacare that is continuing to hound Democrats seeking reelection around the country.

So, for now, I think the safe call is that the House unquestionably stays in the control of the Republicans. Seventeen is the magic number, and I'm beginning to think the Republicans might actually add seats to their majority there. The more intriguing story has for the last few months been the Senate, where the Republicans' prospects have improved greatly. The magic number there is six. I think they have a very good chance to get four or five, and I think six is now within shouting distance. As I look at polls in a lot of crucial states, like North Carolina, New Hampshire, Louisiana, with Mary Landrieu just barely ahead, I see a shift in virtually every state in the polls toward the Republicans. So I think the bottom line in this upcoming election increasingly is that both houses may get more conservative, and I think that means this mood of fiscal restraint will persist for quite a while.

Well, it's a cliché to say as I conclude that a month is lifetime in politics and a lot can change, but I'd say unless this economy starts to really pick up, and there aren't many signs of that right now, I think this is going to be a very ugly election for the Democrats, and I think it may have the Fed scratching its head wondering if maybe it should slow down on its tapering.

So that is it for this month. I look forward to talking to you again soon.

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