Mind the gap: hard vs soft data

- Since the elections, household and business confidence has improved
- However, the hard data has not caught up with this optimism
- In the past, consumer surveys have shown a limited correlation with hard data, such as retail sales, a proxy for consumption…
- ...while business surveys are a better tracker of the hard data
- We see the weakness in economic data in the first quarter as temporary
- Strong fundamentals, looser financial conditions, and a rebound of the global economy, should narrow the gap between hard and soft data

Introduction
President Trump’s first 100 days in office were characterised by a widening gap between soft data (surveys) and hard data (such as retail spending). Soft data, which was already trending up, rebounded after the US presidential elections. Consumer confidence, manufacturing and services surveys, as well as confidence indicators for small businesses and homebuilders, have shown a considerable improvement. However, much of the hard data has not yet caught up with this optimism. This divergence is leading to some scepticism among investors about the force of the rebound in economic momentum. It’s also worth noting that this divergence between hard and soft data is a global phenomenon. This is the case of the eurozone, where we expect stronger growth in the second quarter, in line with the more positive soft data. In this research note we assess whether it’s the soft or hard data that is currently the better indicator of the state of the US economy.

Not unusual: weak economic data in the first quarter
Before looking at the details it’s important to put the weaker hard data in perspective. There is a pattern of recurrent weakness in the data that feeds into first-quarter GDP growth. This appears to be partly attributable to methodological distortions in the seasonal adjustment process. In fact, first-quarter US GDP growth from 2010 to 2016 averaged 1% compared to an average of 2.5% in the other three quarters. Details on first-quarter growth suggest that this pattern of weaker growth can be found in categories such as construction, federal and local government expenditures, defence spending and exports. If this residual seasonality were absent, GDP growth would be much higher. On top of this,
extreme weather also has had some negative impact on activity data in the first quarters. Overall, it looks like we are heading for a weak first quarter. For instance, the Federal Reserve Bank of Atlanta’s GDPNow is forecasting 0.5% GDP growth in the first quarter. We are forecasting below-trend growth of slightly more than 1% in this first quarter, but we expect a rebound in the second quarter.

**The gap between hard and soft data, more related to consumption**

Historical data suggests that consumer surveys have a limited correlation with hard data, such as retail sales, a proxy for consumption. In general, retail sales growth is quite volatile even when consumer confidence surveys are improving. However, manufacturing and business surveys generally do track hard data well, though they tend to be coincident rather than leading. This time has been no different as hard data, such as manufacturing-related indicators and the growth of capital goods orders have been picking up. Weakness in consumer spending rather than in manufacturing and exports have been a big driver of the weak Q1.

**Fundamentals remain strong**

The question is whether hard or soft data is the better indicator of the economy. The US economy was been showing signs of improvement, starting with the labour market. In 2016, average monthly job gains were a bit lower, landing at 182K. In the first two months of this year, job gains were 217K. The unemployment rate has dropped to 4.5% in March 2017 from 6.6% at the beginning of 2014. We think consumers are better off than they were in years. Household net worth amounts to nearly 6.5 times disposable income. That said, the savings rate remains high. This contrasts slightly with the strong optimism displayed by consumers. As for business investment growth and export growth, these have been subdued for quite some time. However, with the impact of a stronger dollar and lower oil prices dissipating, a gradual recovery in business investment growth has been taking shape and stronger export growth should also start to materialise. The housing market has been moving in the right direction, albeit with its characteristic volatility. The last two quarters of 2016 already showed above-trend GDP growth of 3.5% and 2.1%, respectively. As mentioned it seems that weaker consumption growth will weigh in this first quarter.
Underlying household data positive for consumption

Capital goods orders trending upwards

Other factors supporting the hard data
There are other factors that could lead to an acceleration of hard data: i) looser financial conditions, ii) a rebound of the global economy and iii) possibility of fiscal stimulus although later than expected. Financial conditions have been loosening, as a result of the weaker US dollar and strong equity markets, albeit at a very modest pace. Finally, the rebound in the global economy is expected to support US export growth. There are already signs from Asia that foreign demand is surging. With respect to Trump’s policies, fiscal and infrastructure plans are important elements for the US economic outlook. Although the direct effect of these measures will take time to materialise, the impact on future growth could trigger stronger consumer spending. This all makes it unlikely that economic activity will slow down in the near term.