Looking past the large upward revision to November 2014 nonfarm payrolls, you might have noticed that the U.S. economy has entered, in the words of the Federal Reserve’s version of Chance, the Gardener, Alan Greenspan, a “soft patch”. In recent months, labor conditions have weakened, manufacturing activity has hit a wall, consumer spending has waned and residential real estate demand has sunk. This “soft patch” is illustrated in Charts 1, 2, 3 and 4, which contain representative data that will not be revised radically, if at all.
I believe this *current* weakening in the pace of U.S. economic activity is primarily the result of the *past* sharp deceleration in the growth of thin-air credit, thin-air credit being defined here as the sum of commercial bank credit and reserves of depository institutions held at the Federal Reserve. As I have argued *ad nauseam*, there is a positive correlation between lagged values of thin-air credit growth and the growth of economic activity. Chart 5 shows the behavior of thin-air credit in the 12 months ended January 2015 in terms of its three-month annualized growth and its month over year-ago month percent change. There was a noticeable deceleration in the growth of thin-air credit in October, November and December 2014, followed by a sharp re-acceleration in January 2015.
Chart 6 shows the behavior of the two components of thin-air credit in terms of their three-month annualized percent changes.

With the cessation of Fed QE securities purchases in October 2014, the Federal Reserve component of thin-air credit, depository institution reserves held at the Fed, has entered an outright contractionary phase.
But at the same time that the Fed’s contribution to thin-air credit has been diminishing, commercial banks’ contribution has been increasing. The acceleration in commercial bank credit in the three months ended January 2015 has largely been responsible for the re-acceleration in year-over-year and three-month annualized growth in total thin-air credit in January 2015.

Barring a sharp deceleration in commercial bank credit in the next several months, a re-acceleration in total thin-air credit growth should be sufficient to extricate the U.S. economy from its current “soft patch”. So, to paraphrase Chance, the Gardener: “Yes, there will be stronger growth in the U.S. economy in the spring.” The current economic-activity “soft patch” likely has the FOMC leaning toward making no monetary policy changes at its June 16-17 meeting. If the pace of economic activity picks up in the second quarter, as I expect, the lag in the reporting of economic data might still stay the FOMC’s hand in June. If I am right about a spring pick-up in the pace of economic activity, however, look for some overt FOMC tightening action at the July 28-29 meeting.

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