Economic Forecast

A stronger dollar, falling interest rates and perhaps a growth in wages.

The U.S. dollar has appreciated sharply since the end of 2013, gaining 15 percent against the Euro, 13 percent against the Japanese yen and 11 percent against the Canadian dollar.

Driving the U.S. dollar's appreciation are dissimilar polices taken by central banks and divergent paths of economic growth.

The Federal Reserve (Fed) ended its quantitative easing policy and is signaling a rise in interest rates in 2015. Meanwhile, the European Central Bank (ECB) is initiating a bond buying program; the Bank of Japan (BOJ) has already engaged in massive monetary expansion; and the Bank of Canada lowered interest rates amid the oil slump.

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Lower interest rates abroad make the U.S. dollar stronger. Both the ECB and BOJ are fighting deflationary pressures that remain acute as economic momentum has slowed. The U.S. remains a bastion of economic strength amid the uneasy world economy. The World Bank and IMF recently downgraded economic growth in developed economies, except for the U.S.

A stronger dollar has positive and negative implications for the U.S. economy. On the positive side, imports will be less costly — the cost of European and Japanese products goes down, travel abroad is less expensive, and energy and raw material cost less. On the other hand, exports are more expensive as prices rise for American goods abroad and travel to U.S. from Europe will be more expensive.

The dollar's appreciation is bad news for GM's Cadillac sales in the U.S. The German luxury manufacturers (BMW, Mercedes and Audi) are exporting more vehicles to the U.S., offering sales incentives and making once optional features standard to take advantage of the dollar's appreciation against the Euro. Expect GM to increase incentives on the Cadillac to offset that advantage or to make further price cuts.

Canadian shoppers may make fewer trips to Metro Detroit due to higher U.S. prices. Incentives will be necessary to draw them back to U.S. stores.

Fall In Long-Term Interest Rates

In economic circles, the consensus in 2014 was that improved U.S. growth and reduced monetary stimulus would result in higher interest rates. Growth did accelerate and the Fed ended quantitative easing. However, interest rates decreased. The 30- and 10-year Treasury rates declined respectively to 2.49 percent and 1.92 percent on Jan. 12, 2015, from 3.96 percent and 3.04 percent on Dec. 31, 2014.

The decline in U.S. interest rates is due to robust demand globally for safe securities in a destabilized geopolitical world and the fall in inflationary expectations. As inflationary expectations decline, investors accept lower nominal interest rates because the purchasing power of money will not be eroding as rapidly.

Lower oil and commodity prices will lead to lower inflation in 2015, and investors seem to think that lower inflation will persist. The five-year forward inflation expectation (2019-2024) has fallen to 1.98 percent from 2.81 percent. Historically low long-term interest rates may be here for many more years.

Lower interest rates will boost the residential real estate market by making housing more affordable and will also continue to fuel automobile sales. Whirlpool, Masco, General Motors, Ford and Chrysler are Michigan businesses that benefit from lower interest rates. For homeowners considering a mortgage refinance, now may be the time to do so.

Lower inflationary expectations and declining long-term interest rates create a dilemma for the Fed. If global growth continues to be challenging, inflation slows and wage growth is muted, the beginning of interest rate hikes by the Fed for 2015 would likely be deferred.

Looking ahead, I expect the U.S. dollar and interest rates to stabilize by the second quarter of 2015, and that wage growth will begin. I suspect the Fed may increase interest rates beginning in June.

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