ESR Economic and Housing Weekly Note ***March 4, 2016***

Economics: Job Creation Remains Strong, Calming Recession Fears

Economic data released this week were generally encouraging. The February jobs report, which showed strong payroll gains and upward revisions to the prior two months, was in line with recent improving economic data and financial market conditions and should continue to calm recession fears. Another positive from the report was the third consecutive rise in the labor force participation rate—a welcome trend unseen since late 2006. Even as improving labor market conditions attracted people back into the labor market, the headline unemployment rate maintained its lowest level in eight years, and the broadest measure of labor underutilization, which includes part-timers who prefer full-time jobs and persons marginally attached to the labor force, fell to a new expansion low. The main disappointment from the report was continued lackluster nominal wage growth, as average hourly earnings declined on the month and the year-over-year gain fell back into the narrow band from the past few years after recently showing signs of breaking out. Data on manufacturing hinted that perhaps the worst is over and the sector may be finding its footing. Factory orders rose in January, ending two months of decline. While the previously released data on core capital goods orders—a leading indicator of business investment in equipment—were revised lower to show a smaller increase, the gain was still the largest since June 2014. A survey of purchasing managers suggested that manufacturing activity improved in February but remained in contraction territory for the fifth consecutive month, the longest stretch since the first half of 2009. Other economic news from the week was mixed. Productivity in Q4 2015 was revised higher, but still posted a large drop; February vehicle sales remained elevated after a small fall; and the January trade deficit widened. Financial markets have generally reacted positively to the news this week, and the flight-to-safety receded somewhat. At the time of this writing, the Dow Jones Industrial Average is about 3.0 percent higher than Monday's weekly low, and the 10-year Treasury yield is up 20 basis points from Monday as well.

- **Nonfarm payroll employment** expanded by 242,000 jobs in February, according to the Bureau of Labor Statistics. The unemployment rate was unchanged at 4.9 percent, as the labor force participation rate increased two-tenths to 62.9 percent. Average hourly earnings fell three cents during the month, but increased 2.2 percent from a year ago. The average workweek decreased two-tenths to 34.4 hours. The broadest measure of the unemployment rate (U-6) fell two-tenths to 9.7 percent, the lowest level since May 2008.

- **Nonfarm business productivity** decreased 2.2 percent in Q4 2015, according to the Bureau of Labor Statistics, an upward revision of eight-tenths of a percentage point from the initial estimate. From a year ago, growth in productivity was meager, at 0.5 percent. With compensation per hour increasing just 0.9 percent, unit labor costs rose 3.3 percent.

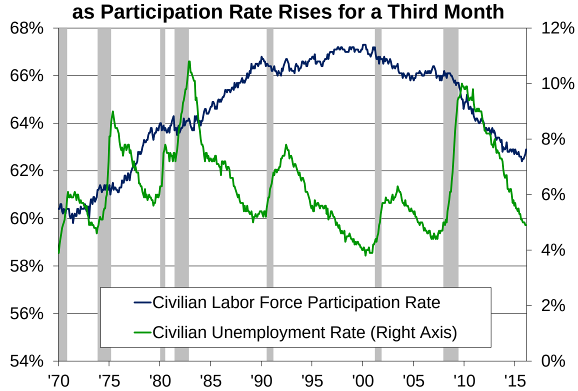
- **The Institute for Supply Management (ISM) Manufacturing Index** rose 1.3 points to 49.5 points in February (any reading above 50 indicates expansion). **The ISM Nonmanufacturing Index**, a gauge of service sector activity, edged down one-tenth of a point to 53.4 in February.

- **Light vehicle sales** slipped 0.2 percent in February to a 17.5 million annualized rate, according to Autodata.

- **The U.S. trade deficit** widened by $979 million to $45.7 billion in January, according to the Census Bureau. Both imports and exports declined, falling 1.3 percent and 2.1 percent, respectively. The inflation-adjusted goods deficit, used in the calculation of net exports in the GDP estimate, widened by $1.9 billion to $62 billion.

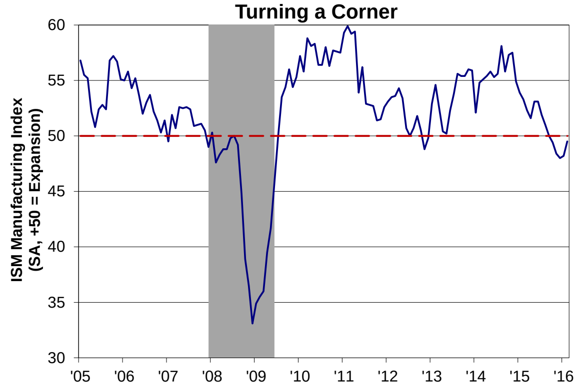
- **Factory orders** increased 1.6 percent in January, according to the Census Bureau. Non-durable goods, the new piece of data in the report, fell for the seventh consecutive month, dropping 1.4 percent. Growth in core capital goods orders (non-defense orders excluding aircraft) was revised down by one-half of a percentage point to 3.4 percent.

Unemployment Rate Remains at an 8-Year Low as Participation Rate Rises for a Third Month



Source: Bureau of Labor Statistics

Manufacturing Sector Shows Signs of Turning a Corner



Source: Institute for Supply Management

Housing: Activity Cools as Prices Heat Up

This week's reports showed a general weakening in housing and mortgage activity, with the exception of home prices. Pending home sales (contract signings of existing homes), which typically lead existing home sales (closings) by one to two months, posted the biggest drop since the end of 2013, falling to the lowest level in a year. The National Association of REALTORS® noted that the recent pickup in home prices and "minimal" inventory are primary culprits holding back sales. Recent trends in purchase mortgage demand also suggest some cooling in near-term existing home sales, with last week's purchase applications dropping for the second time over the last three weeks. After recording the best showing since April 2010 in December, the average monthly reading dropped in January and declined further in February. Recent home price trends also point to lean inventories. The CoreLogic National Home Price Index posted the biggest year-over-year gain since June 2014. Regionally, only two states — Louisiana and Mississippi — showed annual home price declines. Two oil-producing states, Oklahoma and Texas, saw slowdowns in annual price gains. Notably, in Midland, Texas, which has the highest concentration of oil employment of all metropolitan areas, the year-over-year home price increase moderated to 4.3 percent in January 2016, less than half the pace of the gain in January 2015. Single-family homebuilding activity was lackluster in January. Presaged by an earlier report of a drop in unit single-family housing starts in January, construction spending on new single-family homes fell during the month. However, spending on multifamily units rose, roughly offsetting the drops in new single-family construction and home improvement spending. Despite the December Fed rate hike, mortgage rates have trended down in response to global financial market turmoil, helping to temper the decline in housing affordability stemming from strong home price appreciation. However, financial conditions have improved and the flight-to-quality has receded, sending long-term Treasury yields higher. The average 30-year fixed mortgage rate in the Freddie Mac survey rose this week for the first time this year, edging up two basis points from a one-year low in the prior week to 3.64 percent.

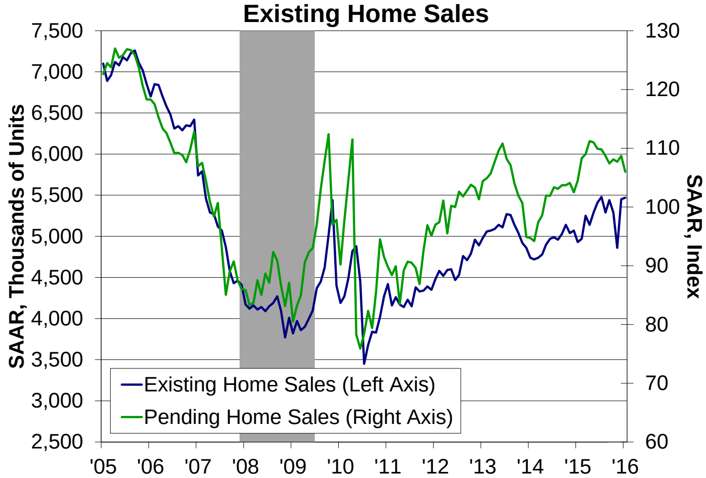
- **The National Association of REALTORS® Pending Home Sales Index** fell 2.5 percent in January. This marks the fourth drop over the last six months. Sales declined in every region but the South, which registered a small gain.

- **The CoreLogic National Home Price Index** (not seasonally adjusted) rose 1.3 percent in January. From one year ago, the index was up 6.9 percent. Nationally, nominal home prices remain 7.0 percent below their April 2006 peak, but prices reached new highs in nine states: Colorado, Hawaii, North Carolina, Nebraska, New York, Oregon, Tennessee, Texas and Wyoming.

- **Private residential construction spending** was flat in January, according to the Census Bureau. Spending on new single-family homes fell 0.2 percent, compared with a 2.6 percent gain for multifamily units. Spending on home improvement fell 0.7 percent. From one year ago, single-family and multifamily construction spending rose 6.9 percent and 29.6 percent, respectively.

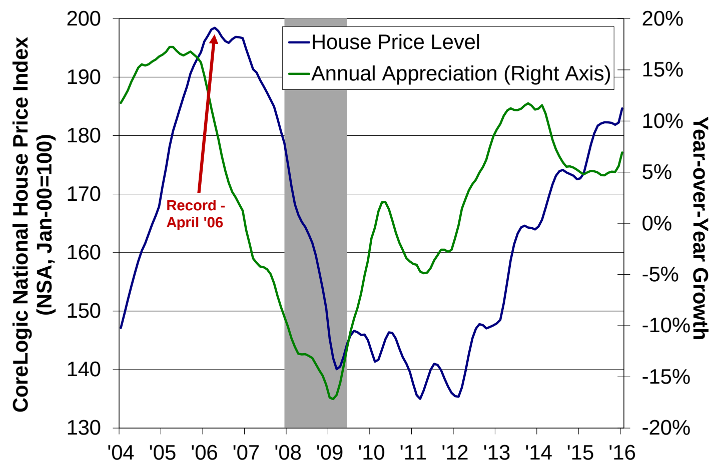
- **Mortgage applications** dropped 4.8 percent for the week ending February 26, according to the Mortgage Bankers Association. Purchase applications edged down 0.6 percent following a 2.2 percent gain in the prior week. Refinance applications dropped 7.2 percent, similar to the percentage decline in the prior week. The average 30-year fixed mortgage rate in the survey slipped two basis points to 3.83 percent.

Pending Home Sales Point to Softening Existing Home Sales



Source: The National Association of REALTORS®

Home Prices Continue to Firm



Source: CoreLogic

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