ESR Economic and Housing Weekly Note *March 25, 2016*

Economics: Business Capital Spending Slump Continues

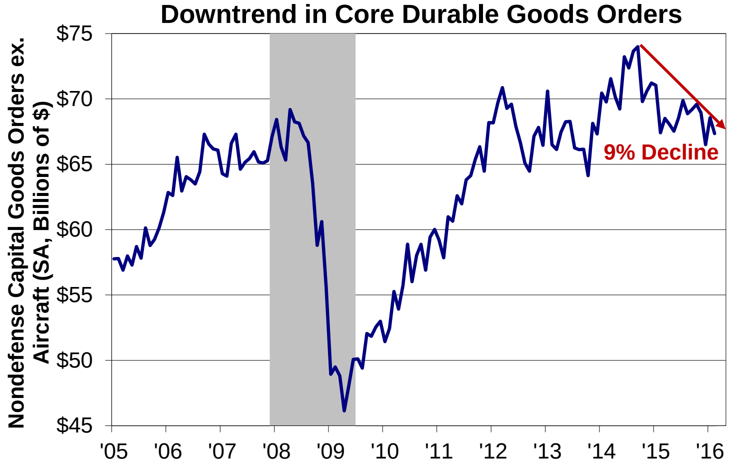
This week's sparse economic reports have a downbeat implication for current quarter economic growth. February durable goods data were bearish in both the headline and the details. Core capital goods shipments—a key source of data used to estimate business equipment spending — and their leading indicator, core capital goods orders, fell on the heels of downward revisions in January. Core shipments declined in five of the past seven months while core orders fell for the third time over the past four months. The weakness in core shipments and orders suggest that, after contracting in Q4 2015 for the first time in a year, business equipment spending will likely decline again this quarter, which would mark the first back-to-back drops since mid-2013. Since reaching the expansion high in September 2014, when crude oil prices began their descent and the dollar started to surge, core capital goods orders have moved lower by 9.0 percent, sending a gloomy signal regarding the outlook for business capital spending. News on the labor market front remains upbeat, however. Despite the increase in initial jobless claims in the latest week, annual revisions showed a more positive picture of recent trends. Lastly, the third estimate of gross domestic product for Q4 2015 showed a modest upgrade in economic growth to 1.4 percent annualized. The composition of the revisions was also positive, as growth in real final sales to domestic purchasers, a gauge of the underlying health in domestic demand, was revised higher 0.3 percentage points to 1.7 percent. However, the report showed that corporate profits fell sharply for the second consecutive quarter, driven by a sharp decline in profits from domestic industries. Profits fell for all of 2015, the first full-year decline since 2008. Overall, this week's economic data suggest downside risks to our forecast of first quarter growth of 2.0 percent annualized.

- **Gross domestic product (GDP)**, adjusted for inflation, rose 1.4 percent annualized in Q4 2015, according to the Bureau of Economic Analysis's third estimate, compared with a 1.0 percent increase in the prior estimate. Consumer spending, residential investment, and exports were revised higher. Real consumer spending grew 2.4 percent, compared with 2.0 percent in the prior estimate, accounting for 0.28 percentage points of the 0.4 point upward revision. A larger than previously estimated drag from inventory investment partially offset upward revisions in the other components of growth. Corporate profits fell 7.8 percent (not annualized), the largest quarterly drop since early 2011, after falling 1.6 percent in the prior quarter. Profits from domestic industries declined much more sharply than the prior quarter.

- **Durable goods orders** dropped 2.8 percent in February, according to the Census Bureau. A 27.1 percent drop in volatile non-defense aircraft orders and a 25.6 percent fall in defense orders drove the decline. Core capital goods (non-defense capital goods excluding aircraft) shipments fell 1.1 percent in February, and the January data were revised down from a decline of 0.4 percent to a decrease of 1.3 percent. Core capital goods orders dropped 1.8 percent, and the January increase was revised lower from 3.4 percent to 3.1 percent.

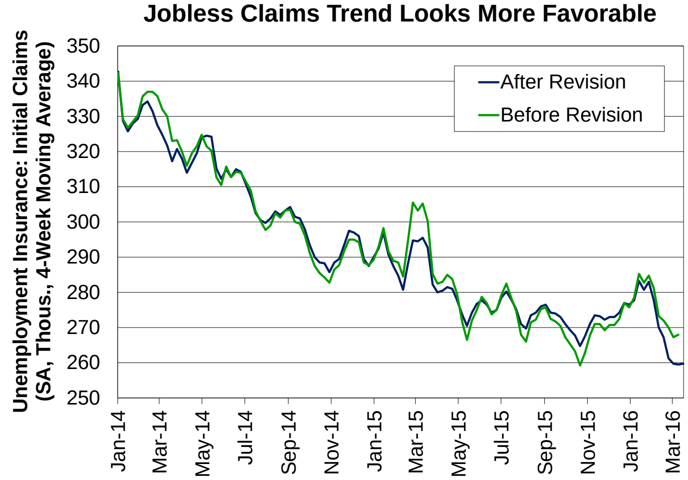
- **Initial claims for unemployment insurance** increased 6,000 to 265,000 in the week ending March 19, according to the Department of Labor. The four-week moving average edged up slightly to 259,750. The report contained annual revisions that made the recent trend in claims more favorable than previously reported. The four-week moving average for claims has essentially held steady at approximately 260,000 for the third consecutive week, the best showing in the expansion to date and an improvement from the trend prior to the revision.

Oil Price Collapse and Rising Dollar Trigger Downtrend in Core Durable Goods Orders



Source: Census Bureau

Jobless Claims Trend Looks More Favorable



Source: Department of Labor

Housing: A Topsy-Turvy Month for Home Sales

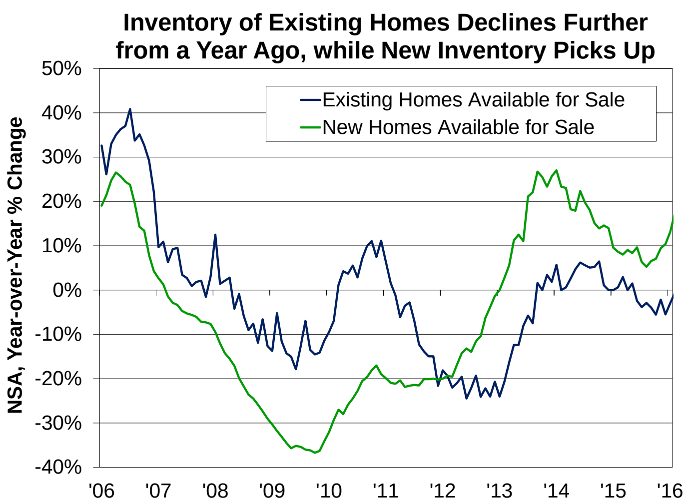
Home sales were the focus this week, with the releases of February new and existing home sales data. Existing homes sales disappointed, falling sharply from the strong December and January paces. The weakness was nationwide, as sales declined in all four regions. Sales in the Northeast, in particular, saw the biggest decline in over five and half years. The main issue remains supply and affordability, as it has become common in some markets for lower-priced homes to receive multiple bids and go under contract quickly, according to the National Association of REALTORS®. The number of existing homes available for sale (reported on a non-seasonally adjusted basis) has fallen year-over-year for nine consecutive months. New home sales, on the other hand, offered a brighter picture, rising in February for the fourth time in the past five months. However, sales rose in only one region, the West, which saw a sharp rebound from a sizable drop in January. In contrast to existing homes, the number of new homes for sale (reported on a seasonally adjusted basis) increased for the seventh straight month and posted the largest annual gain since August 2014. Inventory still remains well below historical levels, however. The persistent supply constraints continue to put upward pressure on home prices, as the annual gain in the FHFA purchase-only index accelerated in January, showing the biggest increase since last October. Mortgage applications continued their recent downward trend last week, driven by another fall in refinance applications, even as mortgage rates ended a three-week rise. The average 30-year fixed mortgage rate fell two basis points this week to 3.71 percent, according to Freddie Mac's survey.

- **New single-family home sales** rose 2.0 percent to 512,000 annualized units in February, according to the Census Bureau. Through the first two months of the year, sales are down 2.4 percent from the same period in 2015. The number of homes available for sale increased 1.7 percent from January 2016 and 17.4 percent from February 2015. The months' supply (inventory-to-sales ratio) remained flat during February at 5.6 months. The median sales price of new homes, which is not adjusted for the composition of sales, rose 2.6 percent from one year ago, ending the first back-to-back declines in annual price growth since January 2012.

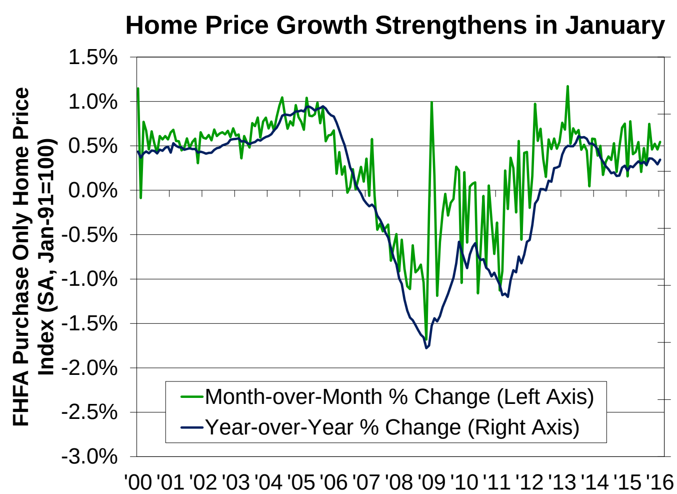
- **Existing home sales** declined 7.1 percent in February to 5.08 million annualized units, according to the National Association of REALTORS®. On a year-to-date basis, sales are up 6.9 percent from one year ago. The number of homes for sale fell 1.1 percent from one year ago. The months' supply rose four-tenths to 4.4 months, marking the second consecutive rise from a near decade-low reached in December. The median sales price of existing homes rose 4.4 percent from one year ago, down from an 8.1 percent gain in January.

- **The FHFA Purchase-Only House Price Index,** reported on a seasonally adjusted basis, increased 0.5 percent in January for the fourth consecutive month. From one year ago, the index rose 6.0 percent, compared with 5.6 percent in December.

- **Mortgage applications** fell 3.3 percent again in the week ending March 18, marking the fourth fall in the past five weeks, according to the Mortgage Bankers Association. Refinance applications dropped for the fifth consecutive week, falling 4.9 percent, even though the average 30-year fixed mortgage rate ended a four-week run of increases, edging down one basis point to 3.93 percent. Purchase applications fell for the first time in three weeks, declining 1.0 percent.



Source: Census Bureau, National Association of REALTORS®



Source: Federal Housing Finance Agency

Frank Shaw and Orawin T. Velz
Economic and Strategic Research Group
March 25, 2016