

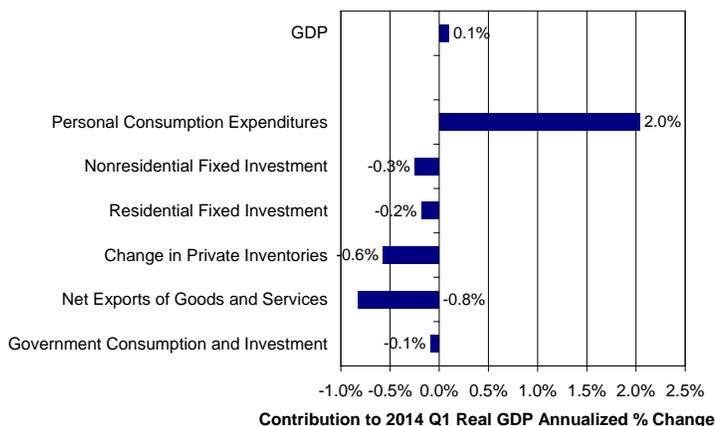
Economics: Gloomy Picture in the Rearview Mirror; Positive Near-term Outlook

The economy ground to a halt in Q1 2014. However, this week's indicators corroborate recent data suggesting that the economy is picking up momentum heading into spring. Data for March—a jump in consumer spending and an upward revision in core capital goods orders—set up a good trajectory for the current quarter. April data also were positive, with the exception of consumer confidence, which edged down. Hiring picked up to the strongest pace in more than two years and a gauge of manufacturing activity showed faster expansion. While auto sales declined modestly, the back-to-back pace of at least 16 million annualized units was the first since 2007. The FOMC meeting was uneventful as the Fed reduced the monthly pace of asset purchases another \$10 billion to \$45 billion as expected, with no change to forward guidance. Despite the sharp drop in the unemployment rate, we believe that the first rate hike is still at least a year away.

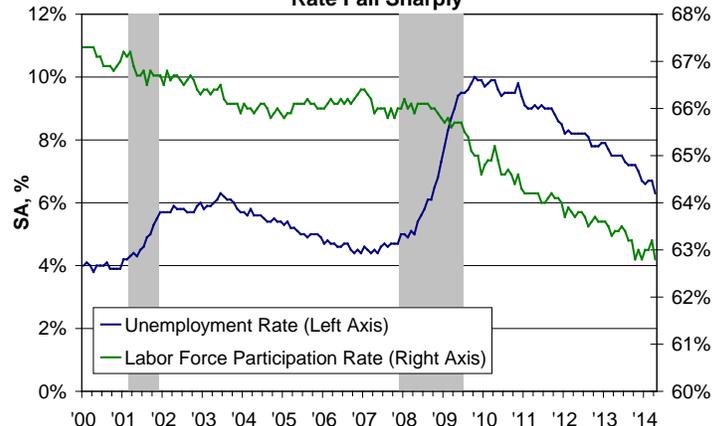
➤ **Nonfarm payrolls** rose 288K coupled with upward revisions of 36K jobs for March and February, pushing the average monthly gain for the past three months to 238K—a substantial pickup from the 167K average gain during the prior three month period. Other details were soft, including flat hourly earnings and average weekly hours worked. The separate household survey showed a 0.4 percentage point drop in the unemployment rate to 6.3%—the lowest rate since 2008. However, the drop was due to a 0.4 percentage point decline in the labor force participation rate to 62.8%.

➤ **Gross Domestic Product (GDP)** edged up 0.1% annualized in Q1 2014, after adjusting for inflation. Consumer spending was the only major component that contributed to GDP. The solid 3.0% gain in real consumer spending was driven by a weather-related gain in spending on utilities and on health care associated with the Affordable Care Act. The latter contributed 1.1 percentage points to economic growth, the biggest on record.

GDP Growth Slows Markedly in Q1



The Unemployment Rate and the Participation Rate Fall Sharply



Source: Bureau of Economic Analysis, Bureau of Labor Statistics

➤ **Personal consumer spending (PCE)** increased 0.7% in March, after adjusting for inflation. Services spending rose 0.4% while real spending on goods posted a 1.4% gain—the strongest in four years. Real personal income rose 0.4%. With spending growth outpacing income growth, the saving rate fell to 3.8%, the second lowest reading in the expansion. The PCE price index increased 0.2% from February and 1.1% from a year ago, well below the Fed's 2% target.

➤ **The Conference Board consumer confidence index** slipped 1.6 points in April to 82.3, pulled back by deteriorating consumer assessments of current economic conditions—including labor market and business conditions—and essentially flat expectations. The share of consumers planning to buy a home edged up to 5.6% from 5.3% in March.

➤ **The Institute for Supply Management (ISM) manufacturing index** rose 1.2 points to 54.9 in April, corroborating other factory-related reports suggesting that manufacturing output will accelerate in the current quarter.

➤ **Factory orders** rose 1.1% in March after a 1.5% gain in February. Revisions to core capital goods data—a leading indicator of business investment—were strong, showing a 3.5% jump in orders versus the previously reported 2.2% gain.

➤ **Vehicle sales** edged down to 16.0 million annualized units from 16.3 million but remained solid following a three month stretch during which sales likely were held down by unseasonably harsh winter weather.

Housing: Light at the End of the Tunnel

After a dismal few weeks of housing data, the uptick in pending home sales—which typically lead existing sales by one to two months—provides a glimmer of hope for an April rebound in home sales activity from lows unmatched in nearly two years. Furthermore, continued improvement in construction employment, particularly in the residential sector, suggests a potential pickup in homebuilding after the recent winter lull. The Q1 GDP report (discussed above) included sobering evidence that the housing sector has exerted sizable downward pressure on headline economic growth over the past two quarters, a headwind expected to reverse in coming quarters a result of home sales picking up and construction activity improving. Remarkably, despite a substantial setback this winter in housing activity, home prices, while showing early signs of moderating, are still posting robust year-over-year gains.

- **The National Association of REALTORS® pending home sales index** edged up in March for the first time in nine months, rising 3.4% to a four-month high. The index, which records contract signings (rather than closings) of existing home sales, was 7.9% below the March 2013 reading.
- **The S&P/Case-Shiller composite 20-city home price index** was unchanged in February on a non-seasonally adjusted basis. Over the past 12 months, prices are up 12.9%, ranging from 23.1% in Las Vegas to 3.0% in Cleveland. The headline index is up a cumulative 23% from the January 2012 trough, but still remains 18% below the April 2006 peak.
- **The Housing Vacancy Survey (HVS)** showed a 0.1% decline in the seasonally adjusted homeownership rate to 65.0% in Q1, the lowest rate since 1995. Vacancy rates were mixed, with the rental vacancy rate ticking up one tenth to 8.3% while the homeowner vacancy rate edged down one tenth to 2.0%.
- **Residential fixed investment**, a component of the business fixed investment category used to estimate U.S. GDP, contracted at a 5.8% seasonally adjusted annual rate in Q1, the second consecutive decline after 12 straight quarters of growth. The sector acted as a 0.2 percentage point drag to headline GDP growth of just 0.1%.
- **Construction spending** increased 0.2% in March and 8.4% over the past 12 months, boosted by the private residential sector, which rose 0.8% during the month amid a sharp gain in multifamily construction spending.
- **Construction payroll employment** increased by 32K in April and 189K over the past year. Residential construction employment, which includes construction workers and specialty trade contractors in the residential sector and accounts for approximately 38% of total construction employment, rose 13K during the month and 108K over the past year.



Source: Census Bureau, Bureau of Economic Analysis

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