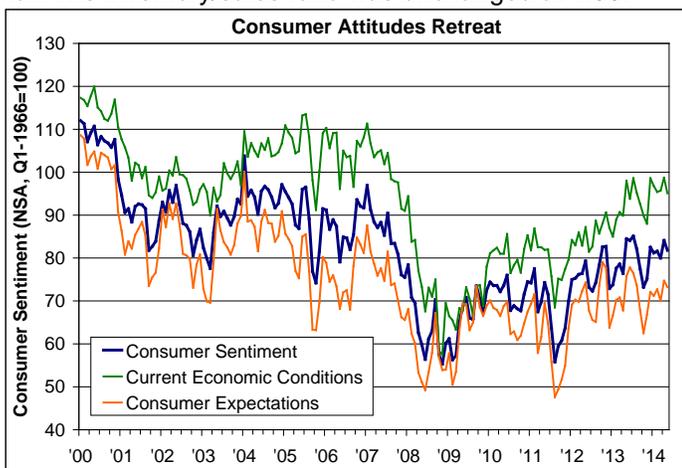


## Economics: A Soft Patch of Data Clouds the Spring Rebound

We continue to expect a sizable pickup in economic growth in the current quarter after anemic growth to start the year, but this week's economic indicators gave little cause for optimism. Retail sales firmed at the end of Q1 2014, but started Q2 2014 with a thud. The moving Easter holiday may have impacted the seasonal adjustment factors, but the data point was nonetheless disappointing, especially considering the pullback in consumer sentiment in early May, which doesn't bode well for May retail sales. Industrial production retreated in April, though we expect that to reverse in coming months. Furthermore, inflation pressure has picked up recently, driven in large part by higher gasoline and food prices. On a positive note, small business confidence marched ahead with details supporting continued improvement in small business hiring. Markets took note of the soft data, as a flight to quality pushed the 10-year Treasury yield down to 2.5% by Friday.

- **Retail sales** rose just 0.1% in April, though revisions showed significantly more strength in the final two months of Q1 2014 than previously reported. Over the past 12 months, retail sales are up 4.0%, down from a post-recession peak of roughly 8% in 2011, but above the 1.6% annual gain recorded in February. Core retail sales, which exclude auto, building supplies, and gasoline station sales, fell modestly in April following two months of healthy gains. Clothing and department store sales led growth while sales at appliance and electronic stores declined.
- **Consumer sentiment** edged lower in early May according to the preliminary Reuters/University of Michigan consumer sentiment survey. The headline index pulled back 2.3 points early in May following a 4.1 point jump in April. Both the current conditions and consumer expectations components retreated while inflation expectations held relatively steady.
- **Small business confidence** in April reached its highest level since October 2007 according to the National Federation of Independent Business (NFIB) small business optimism index. The headline index built on a 2.0 point gain in March, rising 1.8 points in April to 95.2. Details were encouraging, especially regarding the labor market, as more firms reported job openings and more indicated plans to increase employment. Though still a minority, more firms expect the economy to improve and to report higher earnings this quarter.
- **Industrial production** pulled back in April, falling 0.6% after 1.1% and 0.9% gains in February and March, respectively. Manufacturing, which accounts for approximately 75% of all industrial output, fell 0.4% in April after solid gains in the final two months of Q1 2014. Utilities production plunged 5.3% as more normal weather returned in April after an unusually cold March. Mining production maintained its strength, rising 1.4% after a 2.0% jump in March.
- **The consumer price index (CPI)** increased 0.3% in April—the largest monthly gain since last June—boosted by higher petroleum and food prices. Excluding food and energy, core CPI increased by a more modest 0.2%. Over the past 12 months, CPI and core CPI are up 2.0% and 1.8%, respectively—higher than in recent months but still relatively modest inflation. **The producer price index (PPI)** jumped 0.6% in April and 2.1% year-over-year, while **import prices** declined 0.4% in April and 0.3% over the past year.
- **Business inventories** rose 0.4% in March while revisions improved the February gain to 0.5%. Strength in manufacturing and wholesale inventory growth pushed overall business inventories higher, while retail inventories were flat. The inventory/sales ratio was unchanged at 1.30.



Source: Reuters/University of Michigan

Source: Federal Reserve Board

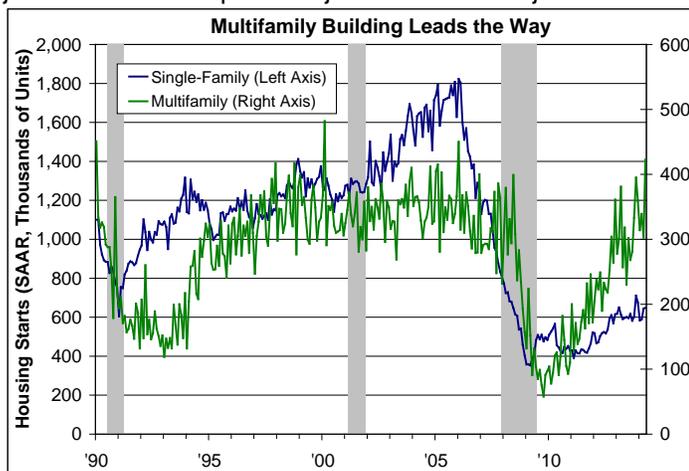
## Housing: Multifamily Momentum

The rebound in total housing starts was an encouraging sign that homebuilding will accelerate this spring following a sluggish winter. However, persistent weakness in the single-family sector is worrisome. Robust increases in multifamily housing starts and permits put multifamily building activity on par with levels reached at the height of 2001-2007 economic expansion. Single-family housing starts by comparison have been much slower to recover. Meanwhile, the continued weakness in homebuilder confidence suggests more tepid improvement in the near term. Despite the stall in housing market activity to start the year, mortgage credit continued to improve as nearly all stages of mortgage delinquency eased in Q1 2014. Shadow inventory, or properties backed by defaulting mortgages likely to enter the market at some point, remains elevated, but the bulk of the inventory is concentrated in judicial foreclosure states that have markedly slower foreclosure timelines than non-judicial states, preventing a large influx of distressed properties from entering the market in a short period of time, and supporting continued home price appreciation.

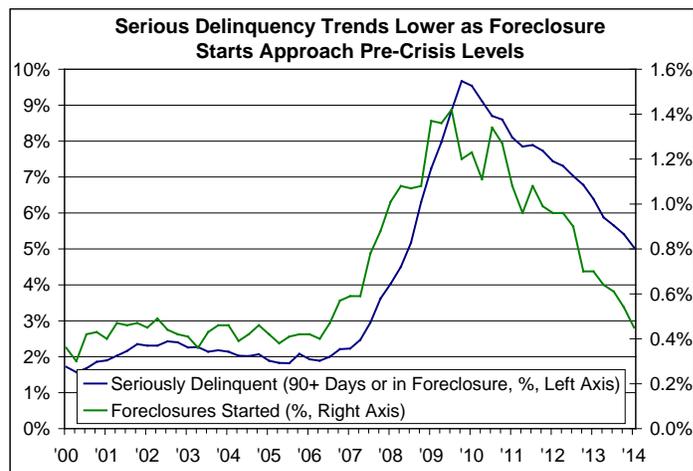
➤ **Housing starts** surged 13.2% in April to a seasonally adjusted annual rate of 1.07 million units, the fastest pace in five months and the third consecutive monthly gain. A remarkable 39.6% jump in multifamily starts to a new recovery-high of 423,000 units in April pushed total starts higher, while a much more modest 0.8% rise in single-family housing starts to 649,000 was more lackluster. Year-to-date housing starts for the first 4 months of the year are up just 1.7% for the single-family sector compared to a robust 14.1% jump in the multifamily sector compared to last year. **Building permits** jumped 8.0% in April, boosted by a 19.5% rise in multifamily permits, compared to an anemic 0.3% gain in single-family permits.

➤ **Builder confidence** sank one point to a 12-month low in May according to the National Association of Homebuilders/Wells Fargo housing market index. Despite an uptick in single-family sales expectations over the next six months and a modest rise in buyer traffic (still at a very depressed level), builders' view of current sales activity pulled back and dragged the headline reading down. The headline index has remained below 50 for four consecutive months, indicating more builders view the market as poor than good.

➤ **Mortgage delinquency** continued to trend down in Q1 2014 according to the Mortgage Bankers Association (MBA) National Delinquency Survey. The share of total mortgages past due fell 28 basis points to 6.11% on a seasonally adjusted basis, the lowest since Q4 2007. Short-term delinquency, or mortgages 30-59 days past due, fell to 2.70%, in line with lows witnessed during the prior two economic expansions. Seriously delinquent mortgages, which are not seasonally adjusted and include mortgages 90 days or more past due in addition to the share of mortgages currently in the foreclosure process, fell to 5.04% of all mortgages, the lowest since Q2 2008. Though still high by historical standards, the measure has trended down steadily since peaking at 9.67% in Q4 2009. The disparity between judicial and non-judicial foreclosure states remained evident in Q1 2014, with an average share of mortgages in foreclosure of 4.6% in judicial states compared to just 1.4% for non-judicial states.



Source: Census Bureau



Source: Mortgage Bankers Association

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