

Economics: Hitting a Speed Bump on the Road to Growth

The economy shrank in Q1 2014 for the first time in four years, driven by reduced inventory investment and severe weather. Although core capital spending by businesses ticked down in April 2014, the previous month's gain was significantly upgraded. Following a jump in March, consumer spending started Q2 on a weak note, presaged by disappointing retail sales reported earlier, and consumer confidence was mixed in May. Despite some softness in this week's reports, incoming data during the past several weeks have been positive overall, continuing to support our view that the setback in Q1 2014 should be short-lived and that economic growth is poised to rebound to above 3.0 percent on an annualized basis in Q2 2014.

➤ **Gross domestic product (GDP)**, adjusted for inflation, fell by 0.98 percent annualized in Q1 2014 after advancing at a 2.6 percent pace in Q4 2013. Although consumer spending added 2.09 percentage points to growth in Q1 2014, all other categories subtracted from growth, outweighing consumer spending's positive effect. The largest drag on GDP growth came from inventory investment, which subtracted 1.6 percentage points from growth.

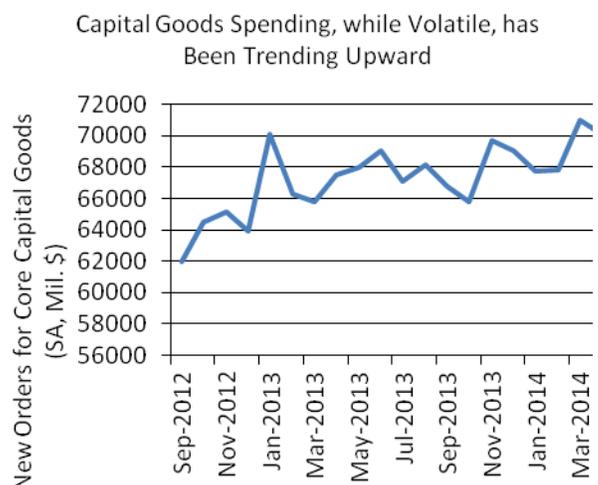
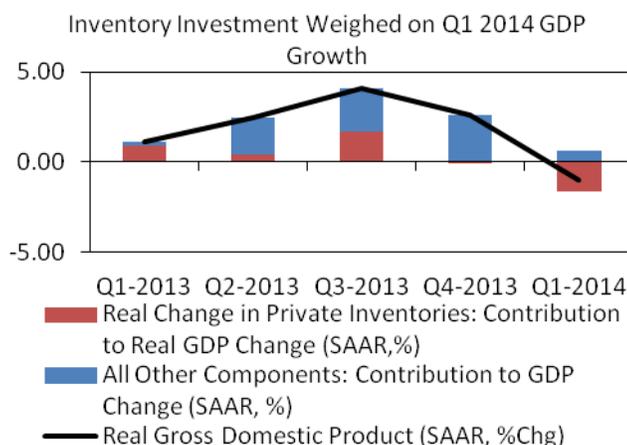
➤ **Durable goods orders** rose 0.8 percent in April 2014, marking the third consecutive month of growth. A large jump in defense aircraft orders drove the headline number, masking weak underlying details. Core capital goods orders (excluding defense capital goods and aircraft orders)—a leading indicator of business capital spending—fell 1.2 percent in April. However, the prior month's gain was revised higher from 2.2 percent to 4.7 percent, continuing to support our view that business capital spending will rebound in the current quarter after declining in Q1 2014 for the first time since Q3 2012.

➤ **The Conference Board Consumer Confidence Index** rose 1.3 points to 83 in May 2014, driven by gains in both the present conditions and future expectations components. Improved labor market assessments helped boost the overall gain.

➤ **The University of Michigan Consumer Sentiment Index** final May reading came in at 81.9, down 2.2 points from April. Consumer sentiment toward both present conditions and future expectations dropped in May, with the former sliding to the lowest reading in six months.

➤ **Initial claims for unemployment insurance** dropped 27,000 to 300,000 for the week ending May 24, 2014. Their four-week moving average fell from 322,750 to 311,500, marking the fourth straight week of declines.

➤ **Personal Income** growth slowed in April 2014, rising 0.3 percent after increasing 0.5 percent in March. Disposable income rose 0.3 percent while wage growth advanced 0.2 percent. Adjusted for inflation, personal income rose 0.1 percent in April while consumer spending fell 0.3 percent. The personal consumption expenditure price index, the Fed's preferred measure of inflation, advanced 0.2 percent in April and was up 1.6 percent compared to April 2013, the highest 12-month growth rate since October 2012. The savings rate rose from 3.6 percent in March to 4.0 percent in April.



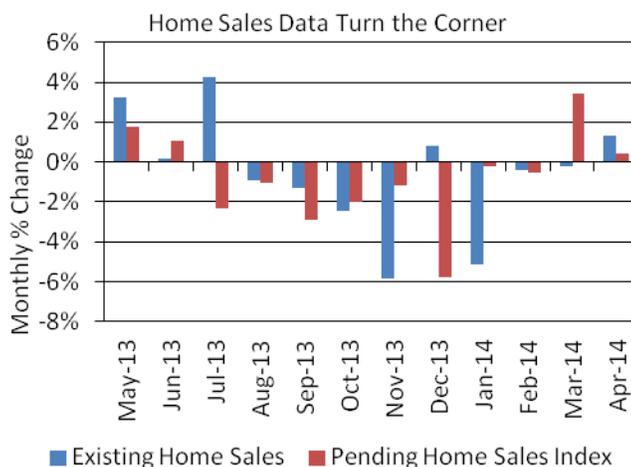
Source: Bureau of Economic Analysis

Source: Census Bureau

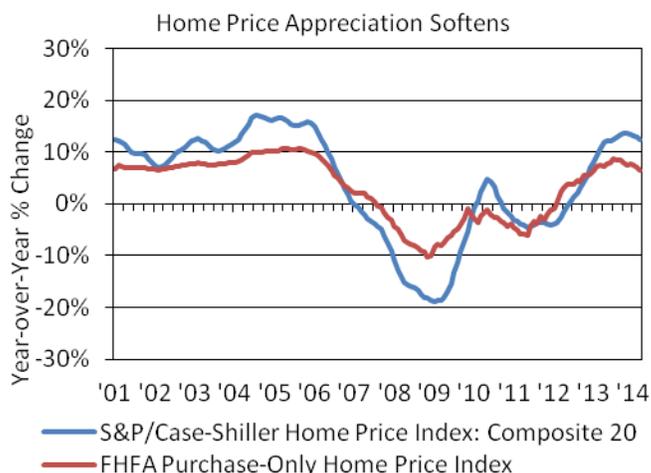
Housing: Soft Rebound Gives Reason for Cautious Optimism

We expect that the nearly one-year-old slowdown in home sales activity may be over as the spring selling season gets under way, though our expectation is for a modest recovery rather than a sharp rebound. After last week's April 2014 existing home sales report showed the first increase this year, pending home sales—which typically lead existing sales by one to two months—rose in April for a second consecutive month. The gain was anemic, however, and we continue to expect existing sales to decline roughly 2.0 percent this year. The second estimate of Q1 2014 GDP showed residential fixed investment declined slightly less than previously reported. Following two consecutive quarterly drops, we expect residential investment to reverse in the current quarter, in line with improvement in residential homebuilding and rebounding broker commissions. Year-over-year home price growth remains strong on a national basis, though the data show early signs of a moderating trend—a trend we expect to continue through this year. Meanwhile, the average interest rate for 30-year fixed mortgages has declined for five consecutive weeks to 4.12 percent this week according to Freddie Mac, commensurate with the recent bond rally, which could help boost consumer confidence in the housing market.

- **Pending home sales** increased 0.4 percent in April on a seasonally adjusted annualized basis according to the National Association of REALTORS® index. The modest April gain follows a 3.4 percent jump in March that stemmed from a streak of eight consecutive declines. The index is down 9.2 percent from a year ago, and has declined in all four Census Regions on an annual basis.
- **Real residential fixed investment**, a component of the business fixed investment category used to calculate U.S. GDP, contracted at a 5.1 percent seasonally adjusted annualized rate in Q1 2014, according to the Bureau of Economic Analysis' second estimate. The revised figure was slightly better than the 5.8 percent decline reported in the initial estimate. This was the second consecutive decline, following a 12-quarter streak of gains. The sector, which is composed largely of new residential completions, home improvements, and brokers' commissions, subtracted 0.2 percentage points from headline GDP growth.
- **The S&P/Case-Shiller composite 20-city home price index** jumped 0.9 percent in the three months ending in March 2014 on a non-seasonally adjusted basis. Over the past 12 months, prices are up 12.4 percent, off slightly from the recent peak of 13.7 percent year-over-year appreciation reported in November. On a regional basis, annual price appreciation ranged from 21.2 percent in Las Vegas to 3.9 percent in Cleveland. The headline index is up a cumulative 24.0 percent from the January 2012 trough, but still remains 19.0 percent below the April 2006 peak. The S&P/Case-Shiller national home price index edged up 0.2 percent in Q1 2014 and 10.3 percent over the past year.
- **The FHFA purchase-only home price**, a repeat-transactions index, rose 0.7 percent in March 2014 on a seasonally adjusted basis. Prices are up 6.5 percent over the past 12 months. The quarterly index increased 1.3 percent on a seasonally adjusted basis in Q1 2014, and 6.6 percent over the past four quarters.



Source: National Association of REALTORS®



Source: S&P/Case-Shiller, Federal Housing Finance Agency

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