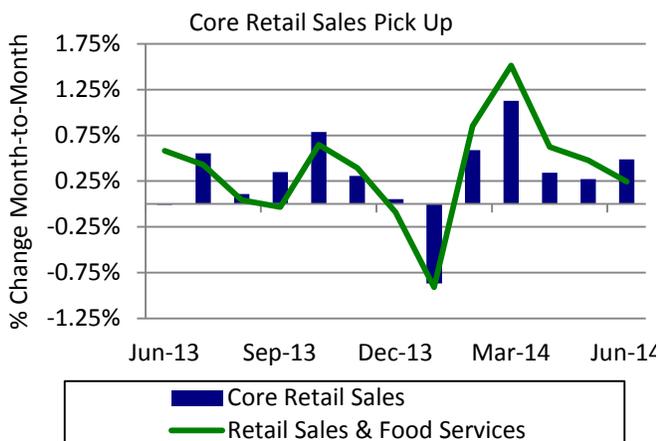


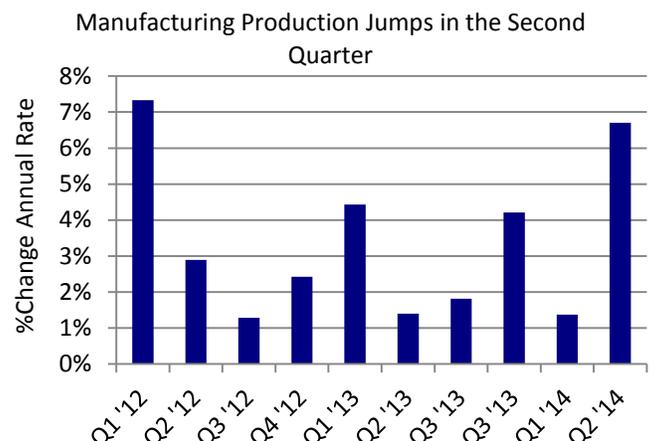
Economics: Climbing Back from a Deep Hole

Recent reports support the view that economic growth was essentially flat in the first half of 2014, as the economy likely grew in the second quarter at a pace that could offset the 2.9 percent annualized decline in the first quarter. News on the consumer front is mixed. The lackluster headline on June retail sales masks an encouraging detail: the impact of core retail sales. Strength in core retail sales—an input used to estimate consumer spending—suggests that real consumer spending may not be as weak as feared after declining in both April and May. However, there is a great deal of uncertainty surrounding spending on services given government statisticians’ difficulty in determining health care expenditures in Q1 2014. Consumer sentiment dipped in early July, as rising gasoline prices likely weighed on consumers. The jump in gasoline prices pushed wholesale and import prices higher in June, but outside of energy prices, gains were muted. While manufacturing output rose only modestly at the end of the second quarter, solid gains earlier in the quarter made it the best quarterly performance in more than two years. This week’s two upbeat regional Federal Reserve manufacturing surveys (New York and Philadelphia) suggest a bright prospect for manufacturing activity in the second half of 2014.

- **Retail Sales** rose 0.2 percent in June. Core sales (excluding autos, building supplies, and gasoline station sales) rose a solid 0.5 percent, and the previous months’ data were revised higher.
- **Import Prices** edged up 0.1 percent in June, boosted by rising fuel prices. Nonfuel prices fell modestly. From a year ago, import prices are up 1.2 percent, the biggest increase since in March 2012.
- **The Producer Price Index** for final demand increased 0.4 percent in June, driven by a jump in gasoline prices. The year-over-year gain moderated to 1.9 percent from 2.0 percent in the prior month. Core prices (excluding food and energy items) rose just 0.1 percent from May and 1.4 percent from a year ago.
- **Business Inventories** rose 0.5 percent in May following April’s 0.6 percent gain. After subtracting 1.7 percentage points from economic growth in Q1 2014, we believe inventory investment likely added nearly one percentage point to growth in Q2.
- **Industrial production**—a gauge of output in the manufacturing, mining, and utility industries—advanced 0.2 percent in June, as a 0.1 percent gain in manufacturing output and a 0.8 percent increase in mining output more than offset a 0.3 percent drop in utilities output. For Q2 2014, manufacturing output increased 6.7 percent annualized, the best showing since Q1 2012.
- **The Reuters/University of Michigan Consumer Sentiment Index** slipped 1.2 points to 82.5 in July’s preliminary report, as the decline in the expectations component outweighed the small gain in the current conditions component.
- **The Conference Board Index of Leading Indicators** rose 0.3 percent in June, following a 0.7 percent increase in May and a 0.3 percent gain in April. Favorable financial and labor market conditions and improving outlook for new orders in manufacturing helped offset the weakness in housing permits. Recent trends in the index are consistent with strengthening growth in the second half of this year.



Source: Census Bureau



Source: Federal Reserve Board

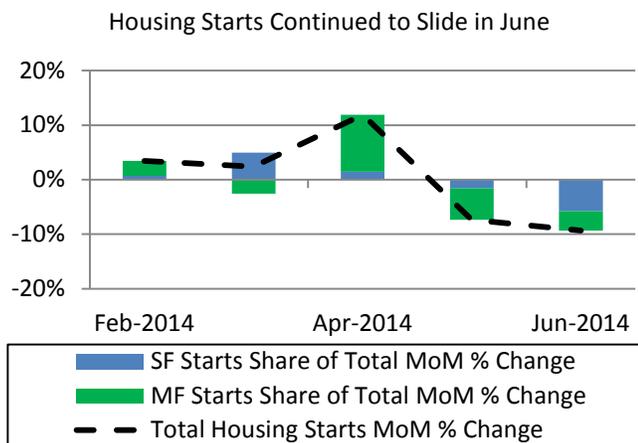
Housing: Construction Slows yet Homebuilders Remain Optimistic

This week's mixed reports called into question the state of the homebuilding recovery as disappointing results in June residential construction contrasted sharply with increased homebuilder optimism in July. The June National Association of Home Builders survey, which included special questions regarding the availability of employment, may help to explain some of the marked slowdown we have seen in homebuilding over the last two months. Many of those surveyed remarked that a shortage of skilled laborers, particularly in the carpentry and framing trades, are resulting in higher prices and delays. We expect that homebuilder optimism will translate to increased activity as single-family permits continue to pick up, but decreased demand for purchase mortgages continues to weigh on the outlook.

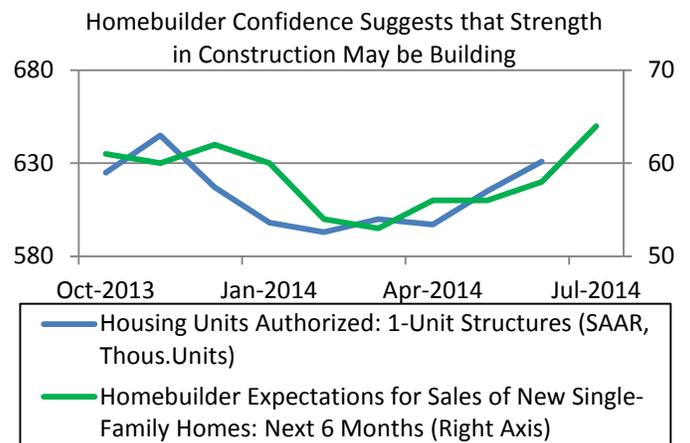
➤ The **National Association of Home Builders Housing Market Index** rose from 49 to 53 in July, marking the highest level since January. Sentiment was up across all four regions and the future expectations component of the index jumped from 58 to 64. July is the first month since January in which the index has been above 50, which indicates that a majority of those surveyed view the market positively.

➤ **Housing starts** plummeted in June, dropping 9.3 percent to a seasonally adjusted annual rate of 893,000 units. Single-family housing starts dropped 9 percent from May while multifamily starts slid 10 percent. The decline was due to a record drop of 30 percent in the pace of homebuilding in the largest region, the South. All other regions saw gains, as the Northeast, Midwest, and West saw increases of 14, 28, and 3 percent, respectively. Housing starts remained positive year-over-year, increasing by 7.5 percent from June 2013, but single-family starts turned negative year-over-year for the first time in four months, shedding 4.3 percent from the June 2013 pace. Single-family permits increased for the second straight month, gaining 2.6 percent, while multifamily permits continued to head in the opposite direction, decreasing 14.9 percent, the second straight month of double-digit declines. Single-family permits were up 0.6 percent from June 2013, while multifamily permits were up 6.8 percent year-over-year.

➤ The **Mortgage Bankers Association's Mortgage Applications Survey** showed that mortgage application activity contracted by 3.6 percent last week, led lower by a sharp 7.6 percent drop in the purchase index, the fourth decline over the last five weeks, and a more moderate 0.1 percent drop in the refinance index. Year-over-year, the purchase and refinance indices were down 17 and 44 percent, respectively.



Source: Census Bureau



Sources: National Association of Home Builders, Census Bureau

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