



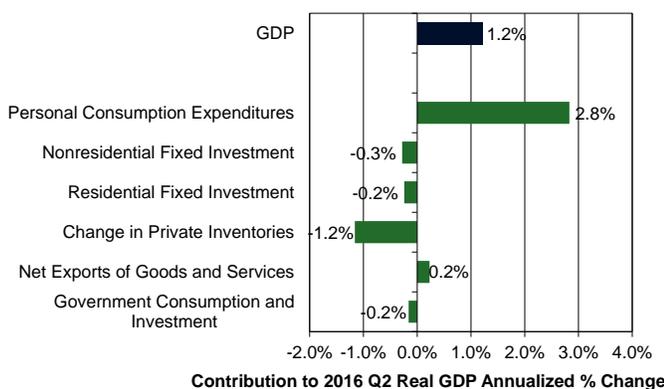
Weekly Note – July 29, 2016

Economics: The One Percent Economy

This week's data featured the first glimpse of Q2 2016 GDP growth, and it wasn't a pretty sight. With a slight downward revision to Q1 growth, growth averaged just 1.0 percent annualized during the first half of the year. While real consumer spending growth came in at 4.2 percent annualized in Q2 as we predicted, and contributed 2.8 percentage points to overall economic growth, the rest of the GDP components largely disappointed. Residential, nonresidential, and inventory investment, as well as government spending, were drags on growth, with net exports the only other main category besides consumer spending adding to growth. Real residential investment fell 6.1 percent annualized, subtracting 0.2 percentage points from growth, marking the first time housing dragged on growth since Q1 2014. The biggest drag to growth in Q2 was inventories, which declined for the first time since Q3 2011. The surprise weakness in inventory investment is a potential positive for near-term growth, however, as it implies more of an increase in inventories in the second half of the year. In contrast to consumers, businesses struggled, with investment in both equipment and structures falling. Notably, the drop in business investment in equipment extended the string of declines to three consecutive quarters. The durable goods orders report points to another lackluster showing in Q3, as core capital goods orders, a forward-looking indicator for equipment investment, remain weak in June. For Q2 as a whole, core orders fell at a 6.6 percent annualized rate, the third straight quarterly drop. Measures of consumer sentiment were mixed in July, with the Conference Board index little changed and the University of Michigan index falling to a three-month low. On the labor market front, the Employer Cost Index showed no meaningful pickup in labor compensation in Q2, as the gain matched the prior quarter's increase. As expected, the July Federal Open Market Committee was uneventful. The Fed expressed concerns regarding business investment, but noted that near-term downside risks to the outlook have receded, which suggests a rate increase this year remains on the table. However, we believe this week's economic news supports our expectation of no rate hike this year.

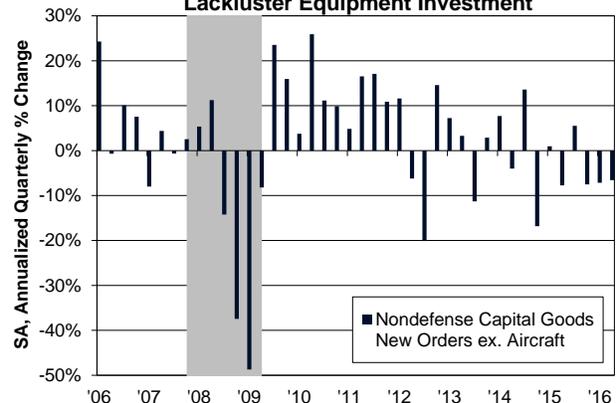
- **Gross domestic product (GDP)**, adjusted for inflation, rose 1.2 percent annualized in Q2 2016, according to the advance estimate from the Bureau of Economic Analysis. The core personal consumption expenditures price index rose 1.7 percent annualized in Q2 and 1.6 percent from one year ago. The report included annual revisions back to 2013 showing no meaningful changes in overall growth, but a shift in growth to Q1 from Q2 of each year.
- **The University of Michigan Consumer Sentiment Index** fell 3.5 points to 90 in the final July reading. Current economic conditions dropped 1.8 points while expectations fell 4.6 points. **The Conference Board Consumer Confidence Index** edged down 0.1 point to 97.3 in July. The present situation index improved to its highest level since last September while the expectations component fell.
- **Durable goods orders** fell 4.0 percent in June, according to the Census Bureau. The weakness was driven by defense and nondefense aircrafts. Core capital goods orders (nondefense capital goods ex-aircraft), a proxy for future business investment, edged up 0.2 percent, but May core orders were revised down to a 0.5 percent drop from an initially reported 0.4 percent decline.
- **The Employment Cost Index (ECI)**, a measure of labor compensation, rose 0.6 percent in Q2 2016, according to the Bureau of Labor Statistics. Wages and salaries for all workers rose 0.6 percent, while benefits increased 0.5 percent.
- **Initial claims for unemployment insurance** increased 14,000 to 266,000 in the week ending July 23, according to the Department of Labor. The four-week moving average decreased by 1,000 to 256,500.

Consumers Carry the Economy



Source: The Bureau of Economic Analysis

Core Capital Goods Orders Point to Continued Lackluster Equipment Investment



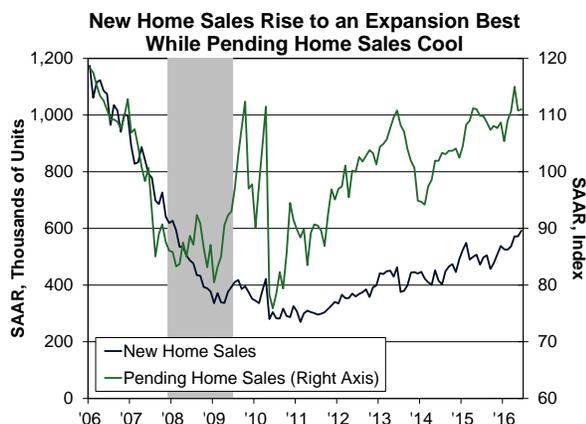
Source: Census Bureau



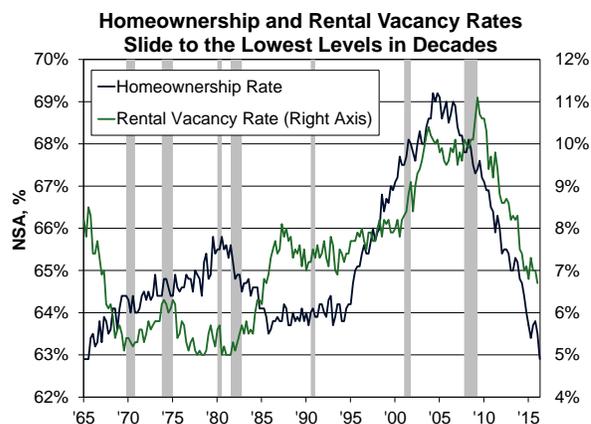
Housing: Mixed News at Halftime

This week's reports were quite a mixed bag. New home sales rose in June to an expansion high, but pending home sales were little changed during the month after a sizable drop in May. Another near-term leading indicator of home sales — purchase mortgage applications — rose 2.8 percent in June; however, they fell last week, failing to post an increase for the third consecutive week. The annual gain in the Case-Shiller House Price Index held steady in May at 5.0 percent, slightly lower than the gains seen in other measures. Lastly, the Q2 2016 Housing Vacancy Survey (HVS) points to a bearish picture of the owner-occupied segment. Annual household growth reached nearly one million following volatile movements over the past couple of years. With all of the net increase coming from renter households, the homeownership rate fell sharply from one year ago, reaching the lowest level since the HVS began reporting the quarterly homeownership rate in 1965. Meanwhile, the demand for rental properties pushed the rental vacancy rate down to the lowest reading since 1985. The trends in the homeownership and the rental vacancy rates underscore the stellar performance of the rental market at the expense of the owner-occupied market despite historically low mortgage rates. Freddie Mac's survey showed that the average 30-year fixed mortgage rate rose for the third consecutive week, increasing three basis points to 3.48 percent. Despite recent increases, the average fixed mortgage rate remains 50 basis points below the level one year ago.

- **New single-family home sales** rose 3.5 percent in June to 592,000 units (seasonally adjusted annualized rate), according to the Census Bureau. Unlike existing home sales, new home sales record contract signings rather than closings. Sales rose in the Midwest and the West and fell in the Northeast and the South. May sales were revised higher from 551,000 to 572,000, though April sales were revised lower to 572,000 from 586,000. New homes for sale were up 1.2 percent from May and 13 percent from June 2015. The months' supply (inventory-to-sales ratio) fell two-tenths during the month to 4.9 months. The median sales price, which is unadjusted for the mix of sales, was up 6.1 percent from last June. Year-to-date sales were 10.8 percent more than during the same period in 2015.
- **The National Association of REALTORS® pending home sales index**, which records contract signings on existing homes and typically leads closings by one to two months, edged up 0.2 percent in June following a 3.7 percent drop in May. The Northeast and Midwest posted gains while the South and West experienced declines.
- **The Housing Vacancy Survey (HVS)** for Q2 2016 (not seasonally adjusted) showed that the homeownership rate declined to 62.9 percent, the lowest level since 1965 and 0.5 percentage points below the rate in Q2 2015, according to the Census Bureau. Meanwhile, the rental vacancy rate fell to 6.7 percent, the lowest reading since 1985.
- **The S&P/Case-Shiller National Home Price Index** (not seasonally adjusted) in the three months ending in May was up 5.0 percent from one year ago, moderating from a 5.4 percent gain at the start of the year.
- **Mortgage applications** fell 11.2 percent for the week ending July 22, according to the Mortgage Bankers Association. Purchase and refinance applications both dropped for the second consecutive week as mortgage rates rose for the second straight week. Purchase applications fell 3.3 percent to the lowest level since February 2016, while refinance applications declined 15.1 percent. Mortgage demand has increased significantly over the past year, however, with purchase and refinance applications up 12.1 percent and 71.8 percent, respectively, from one year ago. The average 30-year fixed mortgage rate rose four basis points to 3.69 percent.



Source: Census Bureau, the National Association of REALTORS®



Source: Census Bureau

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