Economics: The Case Strengthens for Above-Trend Second-Half

Another week of generally upbeat economic data releases further bolster our forecast for above-trend growth in the second half of 2014 of about 3.0 percent. A survey of purchasing managers in the service sector showed broad-based growth in activity including the new orders index which registered three consecutive monthly readings above 60 for the first time since 2005. Orders for manufactured goods posted a healthy gain in June with upward revisions to core capital goods orders—a leading indicator of business fixed investment in equipment. The sharp gain in the purchasing manager survey of manufacturing activity for July released last week hints that this trend may continue. June trade data suggest potential for an upward revision to the 4.0 percent advance estimate of Q2 GDP growth, though the sluggish trend in exports is a bit concerning. Though credit card debt growth slowed in June, its year-over-year gain of 2.5 percent was a recovery high and the lowest four week moving average of initial jobless claims since February 2006 will support consumer confidence. The 10-year Treasury yield edged down to below 2.4 percent at the time of this writing as geopolitical concerns amid deteriorating growth prospects in Europe weighed on markets—a trend that bears watching.

- **The Institute for Supply Management (ISM) nonmanufacturing index** jumped 2.7 points in July to 58.7—the highest reading in nearly nine years (any reading above 50 indicates expansion in the sector). Strength was broad-based among sub-indices, with a 4.9 point surge in the coincidental business activity index, a 3.7 point increase in the forward-looking new orders index, and healthy gains in the employment and supplier deliveries components.

- **Initial claims for unemployment insurance** declined in the week ending August 2, falling 14,000 from the previous week to 289,000. The four week moving average (a better gauge of the underlying trend) declined 4,000 to a fresh recovery low.

- **Consumer (nonmortgage) credit outstanding** increased at a 6.5 percent annual rate in June—the 34th consecutive month of growth. Non-revolving credit outstanding (composed primarily of auto and student loans and other financed big box purchases) increased 8.4 percent, while revolving credit outstanding (mostly credit card debt) edged up a more modest 1.3 percent.

- **The U.S. trade deficit** narrowed $3.1 billion to $41.5 billion in June—the smallest deficit since January—due to a decline in imports of foreign goods and services amid a small increase in exports. The real goods deficit, used to estimate the trade sector of real GDP, followed a similar trend, shrinking $3.3 billion to $48.8 billion as real imports contracted and real exports expanded for the fourth consecutive month.

- **Factory orders** increased 1.1 percent in June and have risen in four of the past five months. The previously released durable goods orders data were revised up from a 0.7 percent rise to a 1.7 percent gain, while orders for nondurable goods increased by 0.6 percent. Core capital goods orders (nondefense durable goods orders excluding aircraft) jumped 3.3 percent in June to a new nominal high since record keeping began in 1992.

- **Wholesale inventories** increased 0.3 percent in June and 7.9 percent from a year ago. Durable goods inventories rose 0.7 percent, overcoming a 0.2 percent decline in nondurable inventories.
Housing: Mortgages Anyone?

Housing data released this week provided mixed evidence on the status of mortgage activity at the outset of the second half of 2014 and an early look at the trend in home price gains at the end of Q2, which have moderated in line with our expectations. A Federal Reserve survey of bank loan officers in July showed the largest net share of banks loosened lending standards for residential mortgages in years. The survey also found a substantial pickup in demand for mortgages following three consecutive quarters of retrenchment. These results are broadly consistent with the Q2 Fannie Mae Mortgage Lender Sentiment Survey. However, recent mortgage applications data suggest that activity may slow in coming months. We believe that accelerating mortgage activity will require commensurate increases in consumer incomes in addition to ongoing strength in job growth allowing first time homebuyers to step into the void that investors have vacated. A bright spot was the continued improving trend in mortgage performance. Short-term delinquency is near a 40 year low, while serious delinquency continues to decline gradually amid sluggish improvement in judicial foreclosure states.

- The Federal Reserve Board Senior Loan Officer Opinion Survey showed a general loosening of lending standards for business and consumer loans in July amid strengthening demand. Specific to the mortgage market, a net share of 18.3 percent of banks indicated loosening standards for prime residential mortgages following two consecutive quarters of net tightening. Demand for prime residential mortgages also improved with a net share of 45.1 percent of banks indicating stronger demand—the first net increase in demand in a year.

- Mortgage applications ticked up in the week ending August 1 as a measured gain in refinance applications outweighed a decline in purchase applications to the lowest level since mid-February, according to the Mortgage Bankers Association (MBA). Despite the increase in refinance activity last week, the index sits nearly 40 percent below its year-ago level and nearly 70 percent below the May 2013 peak reached prior to the sharp rise in mortgage rates. After showing some life in Q2 following a dismal start to the year, purchase demand has retreated in the first five weeks of Q3, down roughly 5 percent from the end of June, and about 14 percent from a year ago.

- Mortgage delinquency continued its downtrend in Q2 according to the MBA National Delinquency Survey. The seasonally adjusted share of mortgages past due declined 7 basis points to 6.04 percent during the quarter. Short-term delinquency, or mortgages 30-59 days past due, declined 4 basis points to 2.66 percent—the lowest since 2006. Seriously delinquent mortgages, which are not seasonally adjusted and include mortgages 90 days past due or in the process of foreclosure, declined for the 11th consecutive quarter, falling 24 basis points to a six year low 4.80 percent.

- The CoreLogic Home Price Index, a repeat-sales measure, increased 1.0 percent in June on a non-seasonally adjusted basis, down from the 1.2 percent gain in May. Annual home price appreciation has moderated to 7.5 percent in June, down from the recent peak of 11.9 percent reached in February and the smallest gain since October 2012. Despite 28 consecutive months of annual price appreciation, the index remains 12.9 percent below its April 2006 peak.

![Mortgage Lending Standards Ease](source)

![Short-Term Delinquency Near 40 Year Low](source)

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