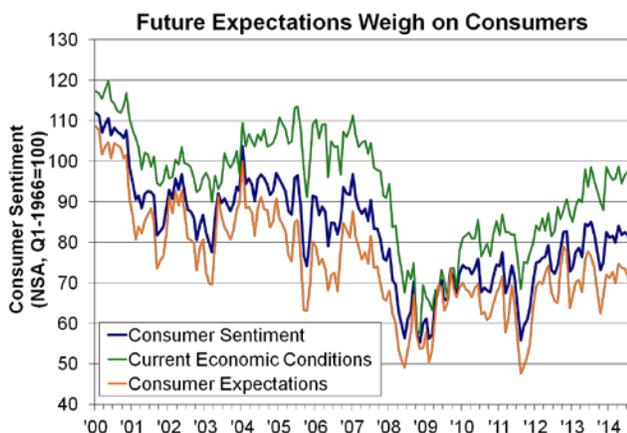


Economics: Consumers Nervous, Employers Hiring

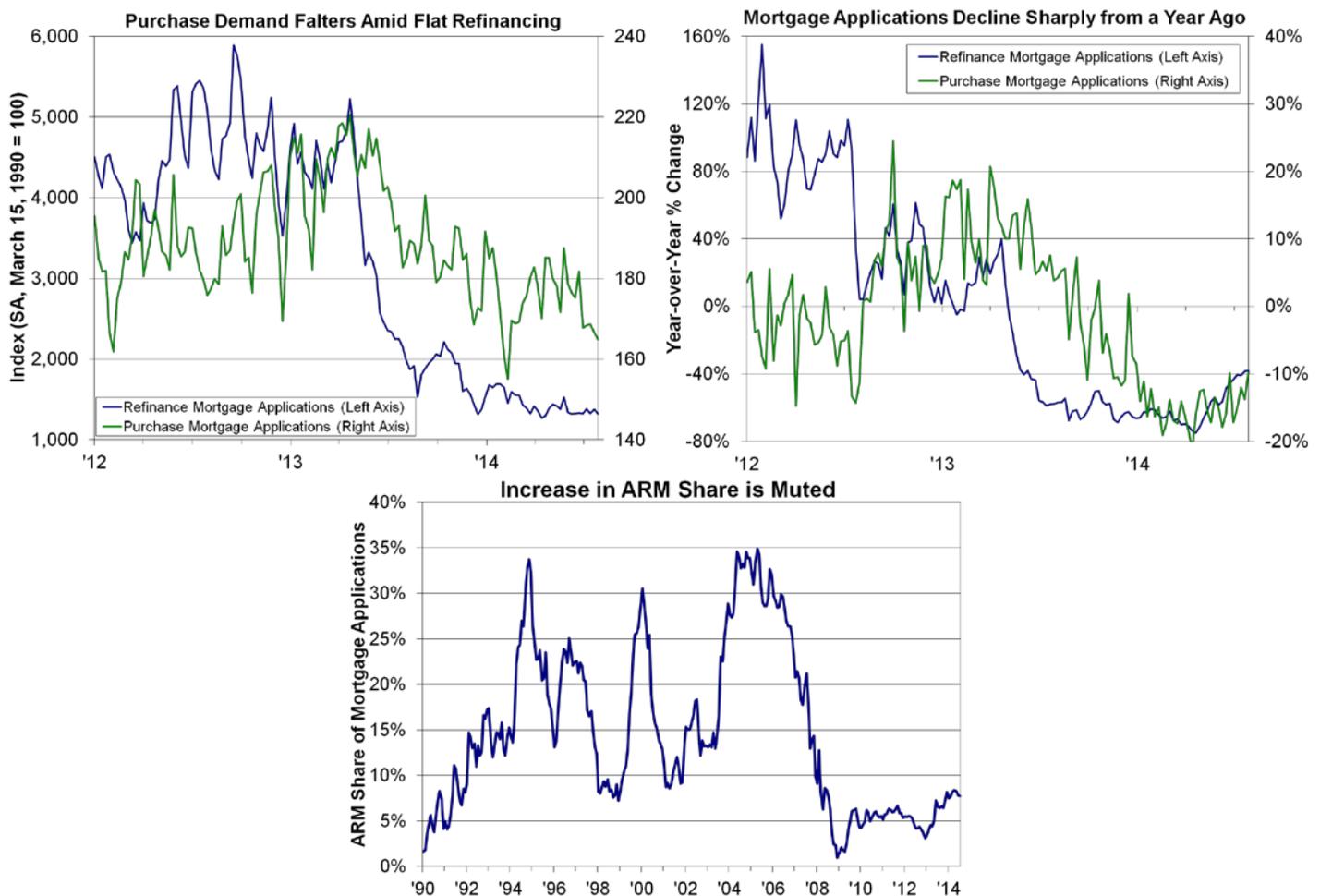
Economic data released this week were mixed, but generally supportive of a healthy trend in economic growth in the second half of this year. Consumer-related reports were soft, with retail sales weighed down by a dip in auto sales in July, while an early gauge of August consumer sentiment showed that although consumers' view of current economic conditions were the strongest recorded in the current expansion, expectations of the future were downbeat, potentially due to current geopolitical events in the Middle East. Markets shared this concern as a flight to quality pushed the 10-year Treasury yield down to 2.33 percent at the time of this writing—the lowest in more than a year. Labor market indicators, however, continued to impress, including a 58 percent annualized quarterly gain in job openings in Q2—by far a record since the inception of the series in late 2000. Though jobless claims picked up last week, the four-week moving average remains near an eight-year low. Presaged by strength in the manufacturing purchasing managers index, industrial production gained momentum in July and sat just one tenth below the December 2007 reading.

- **Retail sales** were flat in July following a 5.3 percent annualized gain in Q2. Auto sales declined as expected given the drop in unit sales reported two weeks ago, while non-auto sales ticked up just 0.1 percent. Core sales (excluding autos, building supplies, and gasoline station sales) edged up 0.1 percent following a healthy 0.5 percent gain in June. From a year ago, total retail sales are up 3.7 percent, the slowest annual growth since February.
- **Industrial production**—a gauge of output in the manufacturing, mining, and utility industries—jumped 0.4 percent in July for the second consecutive month (after upward revisions to June data), boosted by a 1.0 percent gain in manufacturing production. Mining production rose 0.3 percent while utilities production slid 3.4 percent and has not posted a monthly increase since January 2014.
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** rose 0.7 points in July, but failed to recover from the 1.7 point drop in June. Details were positive, particularly on the employment side. Though the share of firms with job openings ticked down two percentage points to 24, it was from a seven-year high. Meanwhile, 13 percent of firms indicated they are planning to increase employment, the highest share reported since September 2007.
- **The University of Michigan/Reuters Consumer Sentiment Index** dipped 2.6 points in early August after a 0.7 point drop in July. The decline was due to a sharp drop in consumer expectations, while the current economic conditions component edged up to a seven-year high.
- **The Job Openings and Labor Turnover Survey (JOLTS)** showed that the number of job openings increased 2.1 percent in June to 4.67 million—the highest since February 2001. Hires also increased, rising 1.9 percent to a six-year high of 4.83 million. Over the past 12 months, job openings and job hires are up 17.6 and 9.3 percent, respectively.
- **Initial claims for unemployment insurance** increased 21,000 to 311,000 in the week ending August 9. The four-week moving average (a better gauge of the underlying trend) ticked up 2,000 to 295,750 from its recovery-low.
- **The Producer Price Index (PPI)** ticked up 0.1 percent in July after a 0.7 percent gain in June. Over the past 12 months, producer prices are up 2.9 percent, though core PPI, which excludes food and energy components, is up a more modest 1.9 percent. **Import prices** fell 0.2 percent in July and increased just 0.8 percent over the past year.



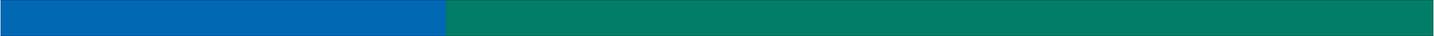
Housing: Purchase Demand Can't Save the Mortgage Market

No major housing data were released this week, though a closer look into mortgage applications provided a window into current mortgage demand (or lack thereof). [Last week](#) we lamented the lack of consumer demand for mortgages, and the Mortgage Bankers Association mortgage applications survey for the week ending August 8 showed further deterioration. Total mortgage applications slipped 2.7 percent leaving the volume index only marginally above a 13-year low. Mortgage applications for refinance dropped 4.0 percent—more than erasing the prior week's 3.8 percent gain—and have largely moved sideways since reaching a five-year low in April. More concerning is the weak trend in purchase mortgage applications. After reaching their lowest level since 1995 in February of this year, purchase applications had risen in the three consecutive months ending in May 2014 as existing home sales rebounded from the sharp contraction of activity in the second half of 2013. Unfortunately, that momentum has faded over the past nine weeks, leaving purchase mortgage demand at its lowest level since the February 2014 trough. Additionally, we've [previously discussed](#), the inability of consumers to improve housing affordability by using adjustable rate mortgage (ARM) products as more stringent underwriting standards have constrained potential borrowers. This is reflected in the modest increase in the ARM share of mortgage applications during the period when mortgage rates spiked by approximately 120 basis points last year relative to prior periods of rising mortgage rates. We have long anticipated the imminent transition from one of the largest refi-booms in American history to a more purchase dominated market. However, our expectation at the start of the year that the 2014 purchase market would improve from 2013 and partially offset the sharp decline in refinance volumes appears to have been too optimistic. Besides the jump in mortgage rates, housing activity has been hindered by stagnant real income growth amid large increases in real home prices, and changing consumer preferences, including, but not limited to, delaying marriage and childbearing typically associated with first-time home buying. The elevated share of cash sales also restrains purchase mortgage demand. Yet the recent strength in the labor market provides hope that this slide may halt, but only if improvement in job gains is matched by improving real incomes.



Source: Mortgage Bankers Association

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