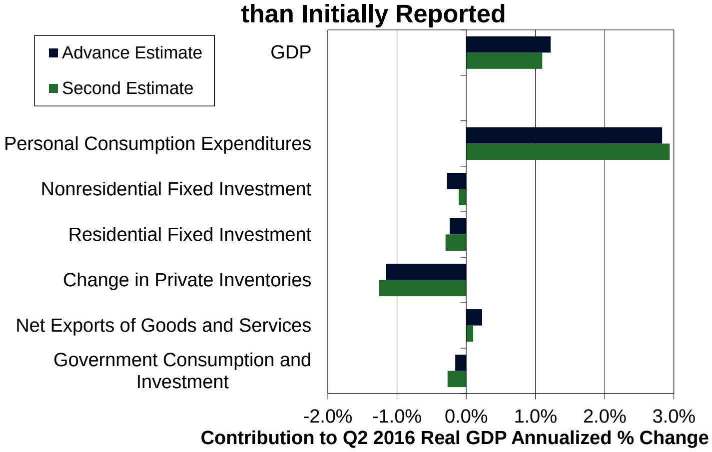
Weekly Note – August 26, 2016

Economics: On Second Thought, Q2 Growth Still Stinks

Second quarter economic growth from the second estimate of GDP remained sluggish, and was even a bit worse than initially thought. The economy has averaged 0.9 percent annualized growth over the last three quarters, marking the first three-quarter stretch of under 1.0 percent growth since 2012. The revisions in the second estimate were marginal and confirmed the storyline from the initial estimate. The good news is consumer spending contributed to growth slightly more than first thought. However, the drags from inventory drawdown, residential investment, and government spending were worse than initially reported, and upward revisions in imports lowered net exports. Corporate profits, the new piece of data in the second estimate, fell in the second quarter after rebounding in the first quarter, resuming the trend from 2015, when profits fell every quarter. The decline in profits contributed to the decline in business fixed investment over the past three quarters. However, the July durable goods orders report was encouraging, as new orders increased by the most since last October. Notably, core capital goods orders, a leading indicator of business fixed investment in equipment, posted back-to-back gains for the first time this year, pointing to an improving outlook for business investment later in the year. Another positive for the outlook is that inventories among manufacturers rose in July for the first time this year, a good first step towards reversing the inventory drawdown from the second quarter. Consumers appear to be increasingly unsettled. The University of Michigan sentiment index fell in August, as consumers' view of current economic conditions dipped to a four-month low. The index has fallen every month this year except for the jump in May. Lastly, Federal Reserve Chair Yellen's remarks at Jackson Hole were in line with other recent speeches from Fed officials supporting a rate hike this year as she noted that "the case for an increase in the fed funds rate has strengthened in recent months."

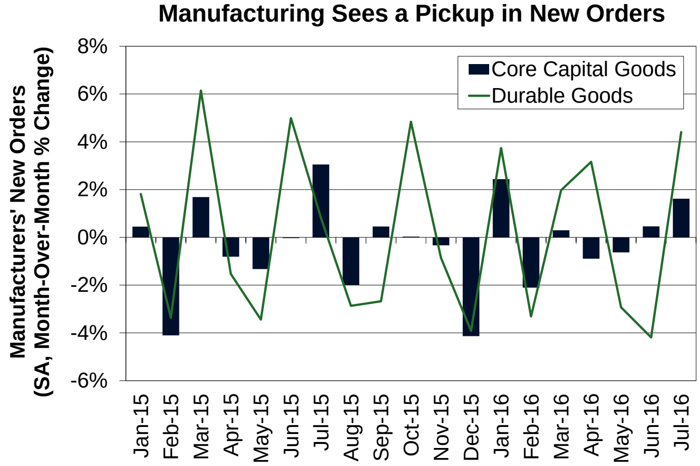
- **Gross domestic product (GDP)**, adjusted for inflation, grew 1.1 percent at an annual rate in Q2 2016, according to the second estimate from the Bureau of Economic Analysis. The one-tenth downward revision primarily reflected downward revisions to state and local government spending and private inventory investment, and an upward revision to imports. These changes were partly offset by upward revisions to non-residential fixed investment and to consumer spending. Corporate profits fell 1.2 percent in the second quarter, marking the fifth drop in the past six quarters. Profits also declined year-over-year for the fifth straight time, falling 4.9 percent.
- **The University of Michigan Consumer Sentiment Index** slipped slightly by 0.2 points from August to 89.8 in the final August reading. The two point drop in the current economic conditions component outweighed the 0.9 point increase in the consumer expectations component, which ended two months of declines.
- **Durable goods orders** rose 4.4 percent in July, according to the Census Bureau. The volatile non-defense aircraft orders component jumped 89.9 percent, but there was also widespread improvement amongst the other sectors. Orders for motor vehicles and parts were flat during the month, however. Core capital goods orders (non-defense capital goods orders excluding aircraft) rose for the second straight month, improving 1.6 percent. Core shipments, on the other hand, fell for the third straight month.
- **Initial claims for unemployment insurance** decreased slightly by 1,000 to 261,000 in the week ending August 20, according to the Department of Labor. The four-week moving average also decreased, falling by 1,250 to 264,000.

Consumer Spending Drives Growth Even More than Initially Reported



Source: Bureau of Economic Analysis

Manufacturing Sees a Pickup in New Orders

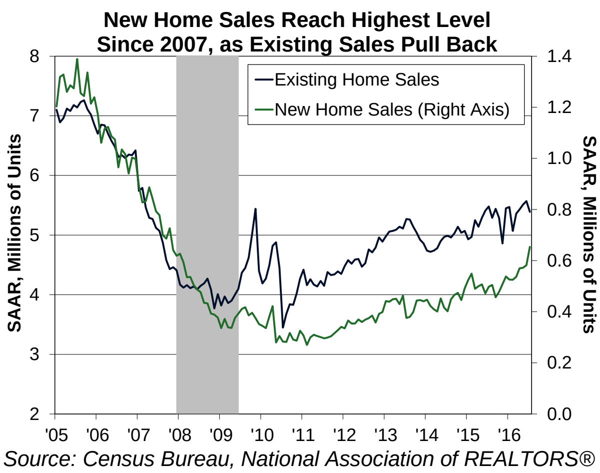


Source: Census Bureau

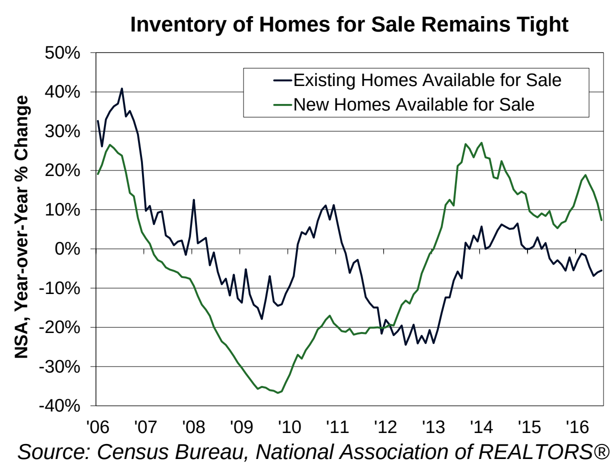
Housing: Existing Sales Cool While New Sales March On

This week's housing news was largely soft. Existing home sales ended a streak of gains in July, declining from their nine-year high and marking the first monthly drop in five months. Sales also fell below the level of last July, the first annual decrease since November 2014. Both single-family and condo/co-op sales retreated, with the latter posting the biggest drop in six years. There is no supply relief in sight, as the inventory of homes for sale remained about 6.0 percent below its level one year ago for the third consecutive month and extended its annual drop to 14 consecutive months. New home sales jumped in July, advancing for the fifth straight month to the best showing since October 2007. The share of new homes sold but not yet started or under construction rose to 70.2 percent, the highest level since March 2014, which is a positive for future single-family starts, which have been lackluster since hitting an expansion high in February. We caution against placing too much emphasis on new home sales data, however, as they are derived from a very small sample, with substantial month-over-month volatility and revisions. The FHFA home price index showed a weakening annual price gain in June, but the pace of increase remained strong. Mortgage applications fell last week for the fifth time in six weeks amid the first increase in mortgage rates in four weeks. Freddie Mac's survey showed the average 30-year fixed mortgage rate held steady at 3.43 percent this week, the ninth consecutive week that the rate remained below 3.5 percent.

- **Existing home sales** fell 3.2 percent to a seasonally adjusted annualized rate (SAAR) of 5.39 million in July, according to the National Association of REALTORS®. Sales dropped in every region but the West. Single-family sales fell 2.0 percent while condo/co-op sales declined 12.3 percent. Year-to-date existing home sales were 2.6 percent higher than sales during the same period last year. The inventory of homes for sale (not seasonally adjusted) was down 5.8 percent from one year ago. The months' supply ticked down two-tenths from last July to 4.7 months. The median price, which is not adjusted for the mix of sales, increased 5.3 percent on a year-over-year basis.
- **Single-family new home sales** jumped 12.4 percent to 654,000 (SAAR) in July, according to the Census Bureau. Sales in the prior three months were revised lower by 12,000. Through the first seven months of the year, new home sales were 12.8 percent higher than last year. Sales rose in every region but the West, with the South accounting for the largest gain. The inventory of homes for sale fell 2.9 percent in July to the lowest reading since last November. The strong sales pace and the decline in inventory pushed the months' supply down from 4.9 months to 4.3 months, the lowest level since June 2013. The median sales price fell 0.5 percent from last July, marking the first year-over-year drop since January. The rise in sales came from an increase in the sales of homes priced at $299,000 and below, which contributed to the lower median price.
- **The FHFA purchase-only house price index**, reported on a seasonally adjusted basis, rose 0.2 percentage points for the third consecutive month in June. From one year ago, prices rose 5.6 percent, moderating from 5.7 percent in the prior month and marking the smallest gain since last August. Price gains were strongest in the Pacific and Mountain divisions, followed closely by the South Atlantic. Rates of appreciation were well below the national average in the Middle Atlantic and New England.
- **Mortgage applications** fell 2.1 percent for the week ending August 19, according to the Mortgage Bankers Association. Purchase applications edged down 0.3 percent, compared with a 3.2 percent drop for refinance applications. The average 30-year mortgage rate rose three basis points to 3.67 percent.



Source: Census Bureau, National Association of REALTORS®



Source: Census Bureau, National Association of REALTORS®

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