ESR Economic and Housing Weekly Note ***May 29, 2015***

Economics: Worse but Not Unexpected, GDP Contracts in the First Quarter

As feared, the economy contracted in the first quarter of 2015 according to the government's second estimate released this morning, marking the third time that real gross domestic product shrank at the start of the year so far during this expansion. The strong dollar continued to wreak havoc, as the trade deficit widened even further after revision. Two measures of consumer confidence were mixed in May but both stood below their expansion highs reached during Q1 2015. Yet as the economic landscape darkened for the first quarter, there are hints of a brighter second quarter. Core capital goods orders, a leading indicator of business spending on equipment, rose for the second consecutive month in April, suggesting a possible turnaround for business capital expenditures. State employment data for April gave further evidence that March's employment weakness was likely a temporary blip, as 40 out of the 50 states posted gains, more than double the number recorded for March. In addition, Texas employment, a primary concern with the fall in oil prices over the past year, steadied after declining in March for the first time since September 2010.

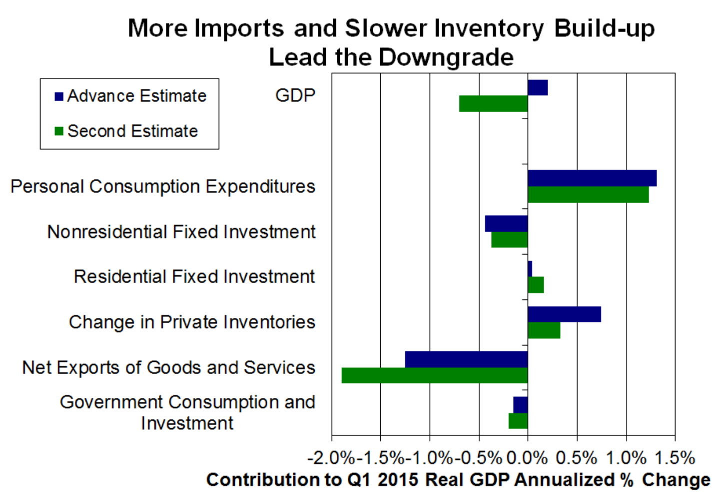
➢ **Gross Domestic Product (GDP)**, adjusted for inflation, decreased 0.7 percent annualized in Q1 2015 according to second estimate by the Bureau of Economic Analysis—a downgrade from the 0.2 percent growth in the first estimate. The main source of the downward revision came from a wider trade deficit than previously thought as imports were revised higher, and a slower pace of inventory investment than initially estimated. Residential fixed investment was the only main component with an upward revision, contributing 0.2 percentage points to GDP compared with a previously reported neutral contribution. Personal consumption spending continued to be the main driver of growth, although its contribution to GDP was revised down by 0.1 percentage points to 1.2 percentage points.

➢ **Durable goods orders** fell 0.5 percent in April, according to the Census Bureau, as transportation orders fell back from a sizable increase in March (nondefense aircraft orders fell 4.0 percent after a 40.7 percent surge in March). However, the details were more upbeat as orders excluding transportation rose for the second consecutive month following five consecutive months of decline. In addition, core capital goods shipments, which exclude defense and aircraft items and are an input to estimate business equipment investment in GDP, rose for a second month in a row, increasing 0.8 percent. Core capital goods orders also advanced again in April, rising 1.0 percent, but fell 1.4 percent from a year ago.

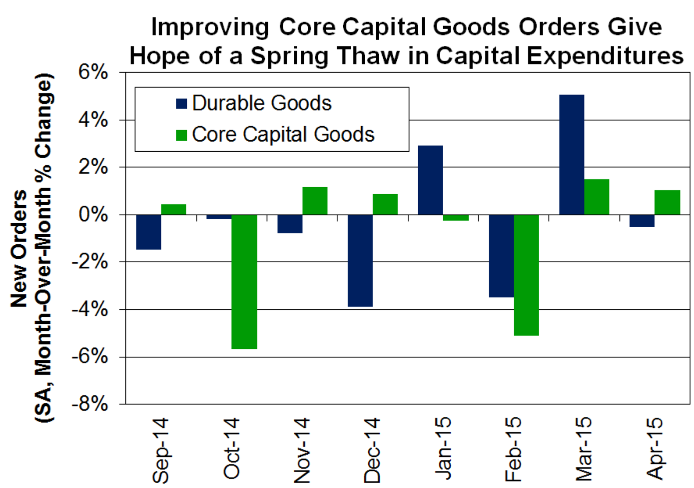
➢ **The Conference Board Consumer Confidence Index** rose 1.1 points to 95.4 in May, but remains below the quarterly average in Q1 2015 of 101.3 points, an expansion high. A 3.0 point gain in the present situation component outweighed a fall in future expectations.

➢ **The Reuters/University of Michigan Consumer Sentiment Index** fell 5.2 points to a six-month low of 90.7 in the final May reading. Both the present conditions and expectation components dropped in May after rising in April.

➢ **Initial claims for unemployment insurance** increased by 7,000 to 282,000 in the week ending May 23, according to the Department of Labor. The four-week moving average increased by 5,000 to 271,500, ending four weeks of decline.



Source: Bureau of Economic Analysis



Source: Census Bureau

Housing: Outlook for Home Sales Improves, with Reasons for Caution

The home sales picture for the current quarter and beyond brightened this week following last week's report of a pullback in April existing home sales. New home sales partially rebounded in April from a double-digit decline in March, while pending home sales—which tend to lead existing home sales by one to two months—surged during the month to a nine-year high, suggesting a rebound in May existing home sales. In addition, purchase mortgage applications bounced back in the third week of May after edging lower in the first half of the month, and remain near highs witnessed in mid-2013. An oft-cited constraint on sales volumes is a dearth of moderately priced homes on the market. Lean inventories continue to help support home price gains. A pair of home price measures released this week showed ongoing healthy appreciation, greatly outpacing the rate of inflation. While strong gains in home values boost homeowner balance sheets, and may allow previously underwater borrowers to finally put their houses on the market, they reduce affordability for renters whose income growth by and large has not kept pace. Potential first-time homebuyers could face a bigger challenge—even as lending standards ease at the margins—as the Fed prepares to tighten monetary policy, which tends to lead to heightened volatility in interest rates. The 30-year fixed mortgage rate edged up three basis points to 3.87 percent this week according to Freddie Mac, the high for this year. Absent another dip in rates similar to the one witnessed over the prior six months, the refi-resurgence of 2015 has likely run its course.

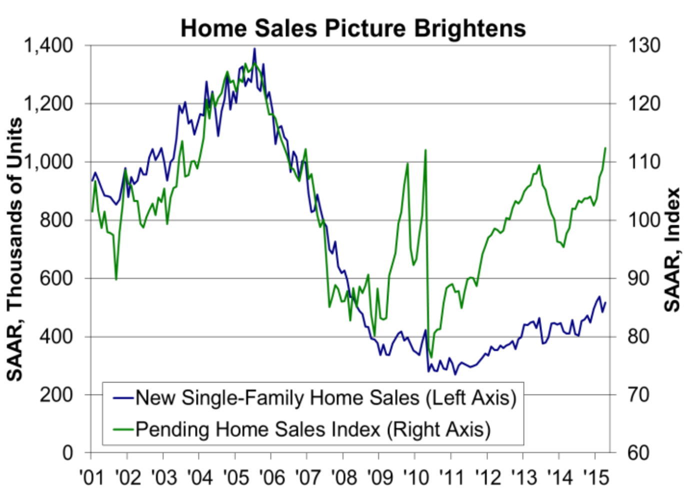
- **New single-family home sales** increased 6.8 percent in April to 517,000 annualized units, according to the Census Bureau. Through the first four months of 2015, new home sales are up 21.9 percent from the same period a year ago. The number of homes available for sale (reported on a seasonally adjusted basis) edged up just 0.5 percent in April, the first monthly rise in four months, and has increased 7.3 percent from April 2014. The months' supply, or inventory/sales ratio, was 4.8 during the month, down from 5.1 in March and 5.6 a year ago. The median sales price, which is not adjusted for the composition of sales, increased 8.3 percent on the year. The median number of months for sale since completion edged up 0.2 to 4.0 months—the longest since June 2013 but well below its peak of 14 months at the end of 2009.

- **The National Association of REALTORS® pending home sales index**, which records contract signings of existing homes, increased for a fourth consecutive month in April, rising 3.4 percent. Over the past 12 months, the index is up 14.0 percent.

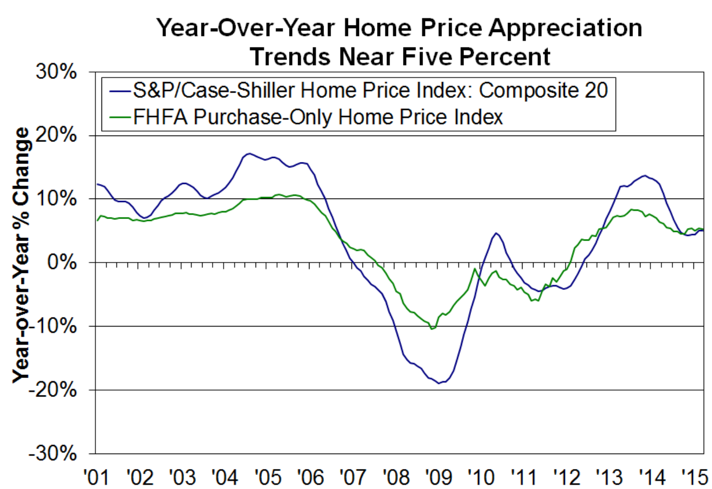
- **The FHFA purchase-only house price index**, reported on a seasonally adjusted basis, increased 0.3 percent in March and 5.2 percent from a year ago—moderating slightly from a 0.6 percent monthly gain and a 5.4 percent annual gain in February. All nine Census divisions recorded year-over-year appreciation. The quarterly index reported a 1.3 percent increase in Q1 2015 and a 5.0 percent increase from Q1 2014.

- **The S&P/Case-Shiller composite 20-city home price index** (not seasonally adjusted) increased 0.9 percent in the three months ending in March, up from 0.5 percent in February. From a year ago, the index is up 5.0 percent for the second consecutive month. All 20 cities saw annual price appreciation in March.

- **Mortgage applications** decreased for the fifth consecutive week, falling 1.6 percent in the week ending May 22, according to the Mortgage Bankers Association. The 30-year fixed mortgage rate edged up three basis points to 4.07 percent according to the survey—a 24-week high. Refinance applications declined 3.9 percent on the week, the fourth drop over the last five weeks, to a fresh 2015 low. Purchase applications increased for the first time in three weeks, rising 1.2 percent.



Source: Census Bureau, National Association of REALTORS®



Source: S&P/Case-Shiller, FHFA

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