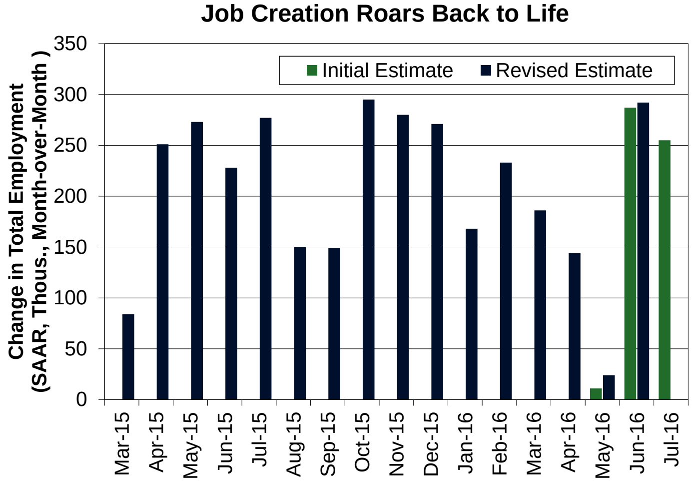
Weekly Note – August 5, 2016

Economics: Labor Market Revs the Engine

In a rare event, the July jobs report provided a strong headline number with few blemishes in the details. Upward revisions to prior months' job gains, combined with a strong July increase, pushed the three-month hiring average to the highest level since March, after dipping to a near four-year low just two months ago. Annual wage growth tied a seven-year best. The unemployment rate was unchanged because the strong employment gain offset a robust increase in the labor force. The report gives support to those at the Fed hoping to increase rates this year, especially if the numbers are supported in future releases. The report should also help soothe concerns over the health of businesses, which have seen sustained declines in capital expenditures. The rest of the news this week was mixed. Real personal income growth remained tepid in June, but real consumer spending growth was solid during the month as consumers continue to rein in their savings to fund their spending. Headline inflation has been stuck under 1.0 percent since February, according to the PCE index, nowhere near the Fed's target of 2.0 percent. Core inflation has also been stuck in a rut, hovering around 1.6 percent during the period. Auto sales bounced back in July to reach the highest level since November 2015. Manufacturing continues to limp onward, as factory orders fell for the second consecutive month and a survey of purchasing managers reported the sector has expanded marginally for the past five months. The June trade deficit worsened for the third consecutive month to the widest level since March 2015. The deficit could widen further in response to the strengthening dollar following Brexit.

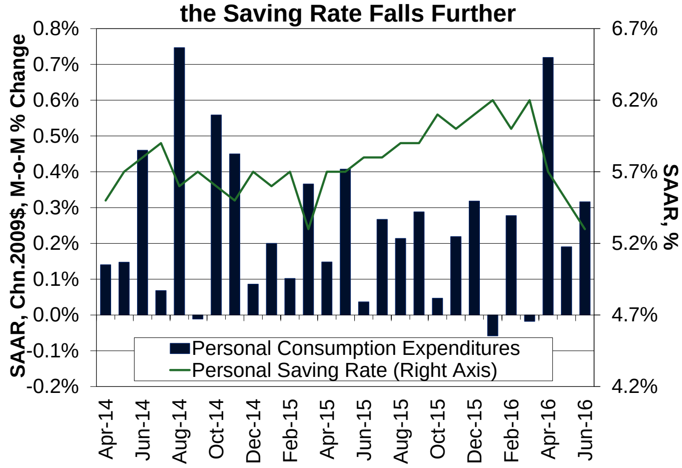
- **Nonfarm payroll employment** expanded by 255,000 in July, according to the Bureau of Labor Statistics. The three-month average change rose to 190,000 from 153,000 in June. The unemployment rate was flat at 4.9 percent as the participation rate ticked up one-tenth to 62.8 percent. Average hourly earnings rose 0.3 percent from the prior month and 2.6 percent from one year ago. The average workweek ticked up one-tenth to 34.5 hours. The broadest measure of the unemployment rate (U-6) edged up one-tenth to 9.7 percent, which was the only real blemish in the report.
- **Personal income**, adjusted for inflation, edged up 0.1 percent in June, according to the Bureau of Economic Analysis. Real personal consumption expenditures (PCE) rose 0.3 percent. The saving rate fell for the third consecutive month, dropping two-tenths to 5.3 percent, marking the lowest level since March 2015. The PCE deflator rose 0.1 percent from May and 0.9 percent from June 2015. Excluding food and energy, the core PCE deflator increased 0.1 percent from the prior month and 1.6 percent from one year ago.
- **The Institute for Supply Management (ISM) Manufacturing Index** dropped 0.6 points to 52.6 in July (any reading above 50 indicates expansion). **The ISM Nonmanufacturing Index**, a gauge of service sector activity, declined a full point in July to 55.5. Drops in supplier deliveries drove the declines in both indices.
- **Light vehicle sales** jumped 6.8 percent in July to a 17.9 million annualized rate, according to Autodata.
- **The U.S. trade deficit** widened $3.6 billion in June to $44.5 billion, according to the Census Bureau. The 1.9 percent increase in imports outweighed the slight 0.3 percent rise in exports. The inflation-adjusted goods deficit, used in the calculation of net exports in the GDP estimate, widened $3.8 billion to $64.7 billion.
- **Factory orders** fell 1.5 percent in June, according to the Census Bureau. Nondurable goods, the new piece of data in the report, increased 1.0 percent. Both core capital goods orders and shipments were revised upward two-tenths.

Job Creation Roars Back to Life



Source: Bureau of Labor Statistics

Consumers Spending Improves as the Saving Rate Falls Further



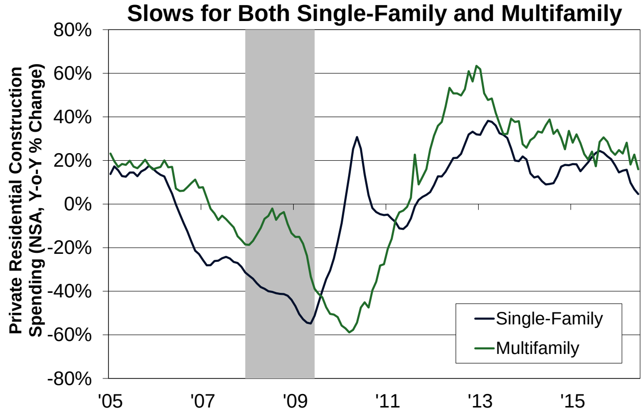
Source: Bureau of Economic Analysis

Housing: Struggling Single-Family Activity Drags on GDP

Housing data released this week suggested there is no relief in sight for a market facing tight supply amidst improving demand. Total private residential construction spending was little changed in June for a second straight month, after falling in April from March's expansion high. New single-family construction spending fell for the fourth consecutive month while multifamily spending decreased for the second time in three months. As a result, total construction spending declined in the second quarter, the first quarterly drop since the third quarter of 2014. The decline in construction spending was reflected in last week's release of the first print of second quarter gross domestic product (GDP), which showed that residential investment dragged on economic growth for the first time in more than two years. Meanwhile, the Federal Reserve's Senior Loan Officer Opinion Survey showed that mortgage demand over the last three months reached the highest level in two years and that banks eased lending standards for the ninth consecutive quarter. Mortgage applications have also been bullish. Average refinance applications for July climbed to more than a three-year high, spurred by the Brexit-induced drop in mortgage rates, which boosted activity early in the month. Refinance applications fell for the third consecutive week during the last week of July, however. While average purchase applications slipped slightly during the month, they remain near the six-year best reached in June. The boost to refinance activity could be subsiding as most of the adverse financial market conditions stemming from Brexit have unwound and long term Treasury yields have stabilized. Mortgage rates ended a three-week stretch of gains, falling five basis points to 3.43 percent, according to Freddie Mac's survey. The ongoing dynamic of limited new single-family building amid improving housing demand continues to support solid home price gains, with the CoreLogic index posting annual appreciation of between 5.0 and 6.0 percent every month for two years, though the index remains below its pre-recession peak.

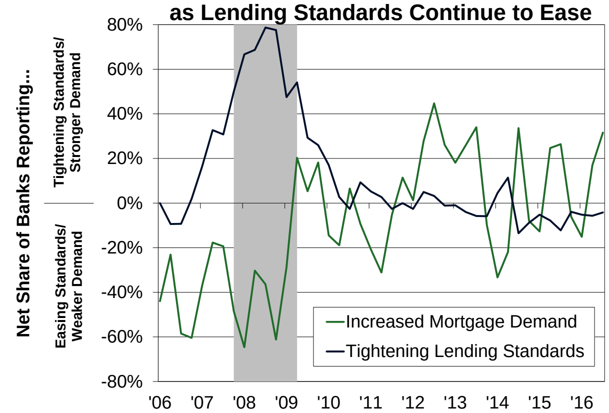
- **Private residential construction spending** was flat in June, according to the Census Bureau. New single-family construction expenditures declined 0.4 percent, compared with a 1.5 percent drop for multifamily. From one year ago, single-family and multifamily construction spending rose 4.6 percent and 15.9 percent, respectively, the slowest pace of increase since the end of 2011 for both sectors. Spending on improvements increased 1.2 percent from May, but declined on an annual basis for a third consecutive month, falling 4.9 percent.
- **The Federal Reserve Board Senior Loan Officer Opinion Survey** showed continued easing of lending standards for residential mortgage loans in the three months ending in July. Banks reported easing on lending standards on GSE-eligible, government, and jumbo loans. Demand for mortgages increased for the second consecutive quarter. Demand for home equity lines of credit increased for a ninth consecutive quarter as lending standards for this product type eased for the fifteenth straight quarter.
- **The CoreLogic National Home Price Index** (not seasonally adjusted), a repeat sales measure, increased 5.7 percent in June from one year ago. The index has increased on a year-over-year basis every month since February 2012, but remains 6.7 percent below the April 2006 peak.
- **Mortgage applications** decreased 3.5 percent for the week ending July 29, according to the Mortgage Bankers Association. Purchase and refinance applications fell by 2.4 and 4.2 percent, respectively. Applications for government purchase mortgages dropped to the lowest level since November 2015. Applications fell despite a drop in mortgage rates, with the average 30-year fixed mortgage rate edging down two basis points to 3.67 percent.

Annual Growth Rate of Construction Spending Slows for Both Single-Family and Multifamily



Source: Census Bureau

Mortgage Demand Rises to a Two-Year Best as Lending Standards Continue to Ease



Source: Federal Reserve Board

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