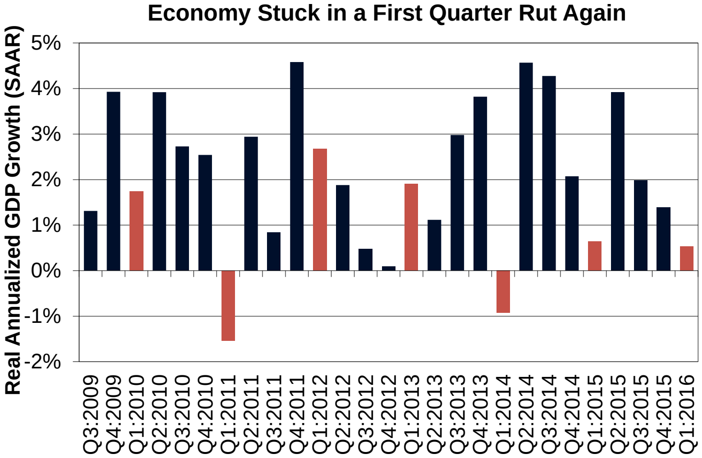
Weekly Note – April 29, 2016

Economics: Growth Sings the First Quarter Blues…Again

The economy was off to yet another sluggish start this year, posting the weakest growth rate in two years in the first print of Q1 2016 GDP. While the data may have suffered from residual seasonality issues (the display of seasonal patterns in data that have already been seasonally adjusted), growth was weak across numerous sectors. Consumer spending, while continuing to drive economic growth, expanded at the slowest pace in a year. Consumers are cautious, as the saving rate jumped to a 13-month high in March, and two measures of confidence fell in April. One bright spot was residential investment, which made the largest contribution to growth since Q4 2012. Business investment in structures and equipment, net exports, and inventories were drags on growth, partly reflecting the lagging impacts of a strong dollar and still low, albeit rising, energy prices. Notably, the decline in equipment investment was the worst of the expansion, and the drop in investment in structures was the second-worst of the recovery. The March durable goods orders report suggests that a near-term turnaround in business equipment investment is unlikely, as its leading indicator — core capital goods orders — remained unchanged after a sharp drop in the prior month. The Federal Reserve's favored measure of inflation showed a slowdown in annual inflation in March for both the headline and core indices, with the former drifting further away from the Fed's target of 2.0 percent. With all of this evidence of an economy stuck in the mud, outside of a strong labor market, the statement following the April Federal Reserve Open Market Committee meeting was little changed from previous communications. While the Committee dropped the reference that "global economic and financial developments continue to pose risks," it pledged to "closely monitor" those developments as well as inflation indicators. Overall, the statement suggests that a June hike remains on the table, though the markets remain doubtful, as the odds of a June hike were a paltry 12 percent according to fed funds futures at the time of this writing.

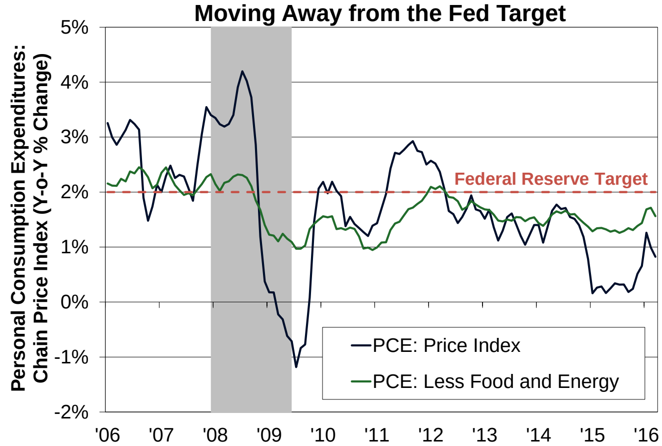
- **Gross domestic product (GDP)**, adjusted for inflation, expanded at a 0.5 percent annual rate in Q1 2016, according to the advance estimate from the Bureau of Economic Analysis (BEA). Real consumer spending continued to drive growth, rising 1.9 percent annualized and contributing 1.3 percentage points to growth. Residential investment and government spending were the other two main contributors, adding 0.5 and 0.2 percentage points to growth, respectively. Inventories, net exports, and business fixed investment were drags on growth.
- **Personal income**, adjusted for inflation, increased 0.3 percent in March, according to the BEA. Real personal consumption expenditures (PCE) were flat from February. The saving rate climbed three-tenths to 5.4 percent. The PCE deflator edged up 0.1 percent from last month and 0.8 percent from a year ago. Excluding food and energy, the core PCE deflator rose 0.1 percent on a monthly basis, and 1.6 percent annually.
- **The University of Michigan Consumer Sentiment Index** dropped two points from March to 89 in the final April reading. The current conditions component improved, but the expectations component dropped to the lowest level since September 2014. **The Conference Board Consumer Confidence Index** fell 1.9 points to 94.2 in April, as the drop in the expectations component outweighed the rise in the present situation component.
- **Durable goods orders** rose slightly in March by 0.8 percent, driven by the jump in defense orders, according to the Census Bureau. Core capital goods orders, which exclude defense and aircraft items, were flat from February, and core shipments only edged up 0.3 percent.
- **The Employment Cost Index (ECI)**, a measure of labor compensation, rose 0.6 percent in Q1 2016, according to the Bureau of Labor Statistics. The wages and salaries component rose 0.7 percent and benefits rose 0.5 percent.

Economy Stuck in a First Quarter Rut Again



Source: Bureau of Economic Analysis

Inflation Reverses Course, Moving Away from the Fed Target

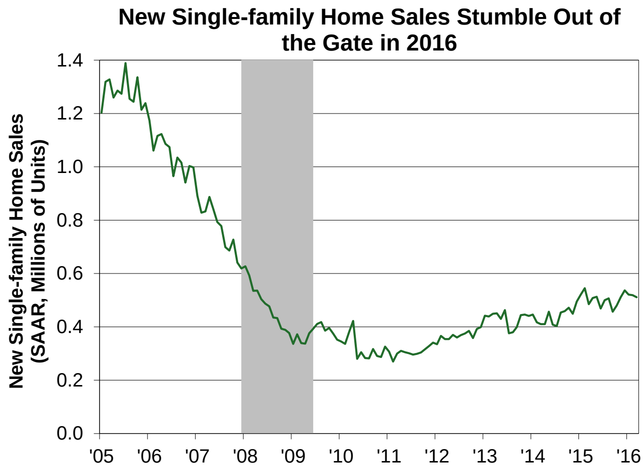


Source: Bureau of Economic Analysis

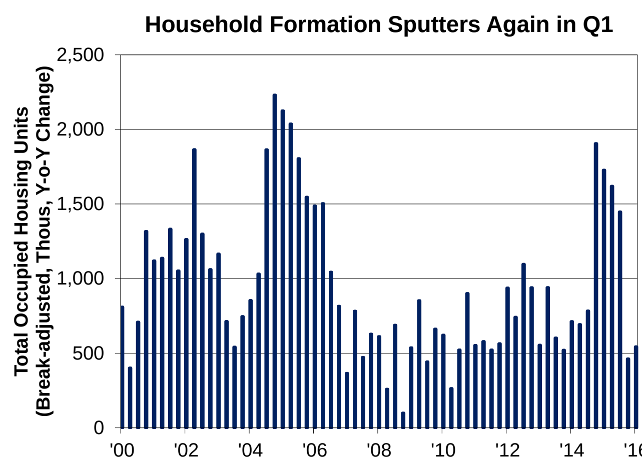
Housing: Moving Ahead along a Bumpy Road

This week's housing news was mixed. After rising each month during Q4 2015, new single-family home sales declined in every month in Q1 2016. However, for the quarter as a whole, new home sales managed to post a slight gain from Q4 2015. Builders are having some success bringing new supply to the market, as the inventory of new homes for sale increased on a monthly basis in March for the eighth consecutive month. Falling sales and rising inventory caused the months' supply to rise for a third month in a row to reach a six-month high. For the existing home sales market, the near-term outlook brightened, as pending home sales, which record contract signings of existing homes and typically lead closings by one to two months, rose for a second consecutive month to the highest level since last May. On a year-over-year basis, pending sales increased for the 19th consecutive month. Home price gains remained solid in February, as the Case-Shiller national house price index showed flat annual home price appreciation for a third consecutive month, though the gain remains above 5.0 percent. Mortgage applications pulled back last week, as purchase applications fell for the third time in the past four weeks, and refinance applications dropped after posting three strong gains. The average 30-year fixed mortgage rate jumped seven basis points — the largest rise since last November — to 3.66 percent, according to the survey by Freddie Mac. News was disappointing on the household formation front, according to the Census Bureau's Housing Vacancy Survey (HVS) for Q1 2016. The number of households posted another modest annual increase following robust year-over-year gains between Q4 2014 and Q3 2015. The HVS also showed that, after back-to-back gains, the homeownership rate fell to just one-tenth above a 48-year low reached in Q2 2015. However, on a year-over-year basis, the rate shows tentative signs of stabilizing over the last several quarters.

- **New single-family home sales** fell 1.5 percent in March to 511,000 annualized units, according to the Census Bureau. Through the first three months of the year, sales are up 1.5 percent from the same period a year ago. The number of homes for sale increased 2.1 percent from February 2016 and 19.8 percent from March 2015. The months' supply (inventory-to-sales ratio) increased two-tenths to 5.8 months. The median sales price of new homes, which is not adjusted for the composition of sales, fell 1.8 percent year-over-year.
- **The National Association of REALTORS® pending home sales index** rose 1.4 percent in March. The West was the only region that declined during the month.
- **The Housing Vacancy Survey (HVS)** for Q1 2016 (not seasonally adjusted) showed that the homeownership rate dropped three-tenths to 63.5 percent, according to the Census Bureau. The homeowner and rental vacancy rates were 1.7 percent and 7.0 percent, respectively. The number of households rose by 543,000 from a year ago, as renter households increased 363,000 and homeowner households rose by 177,000.
- **The S&P/Case-Schiller National Home Price Index** (not seasonally adjusted) rose on monthly basis for the first time since November, edging up 0.2 percent in the three months ending in February. From a year ago, prices increased 5.3 percent for the third consecutive month.
- **Mortgage applications** dropped 4.1 percent in the week ending April 22, according to the Mortgage Bankers Association. Purchase applications declined 2.4 percent after a 0.5 percent drop in the prior week. Refinance applications fell 5.0 percent. Notably, FHA refinance applications jumped 31.9 percent. The average contract interest rate for 30-year fixed-rate mortgages rose for a second consecutive week, ticking up two basis points to 3.85 percent.



Source: Census Bureau



Source: Census Bureau

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