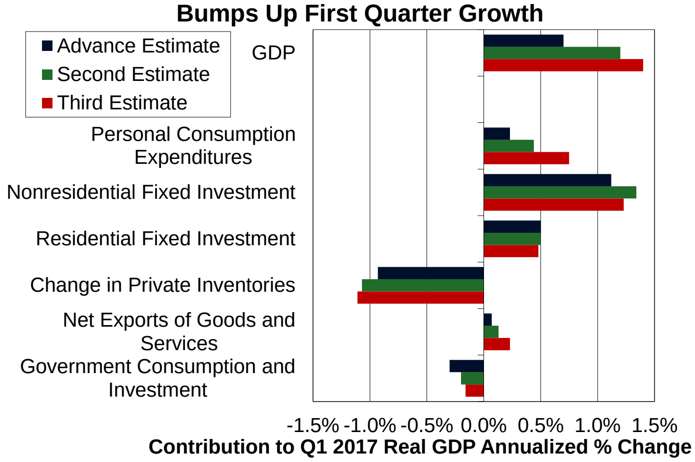
Weekly Note – June 30, 2017

Economics: The Search for a Pick Up in Growth Continues

Economic data released this week featured an upgraded view of first quarter economic growth but an uninspiring outlook for second quarter growth. The third estimate of first quarter gross domestic product (GDP) growth saw an upward revision to consumer spending, helping to boost overall growth to 1.4 percent annualized. Despite back-to-back upgrades in the second and third estimates, first quarter growth still slowed from the fourth quarter for the fourth consecutive year. Looking toward the second quarter, consumer spending posted a tepid gain in May despite the strongest monthly rise in real personal income in two years, pushing the saving rate to an eight-month high. Business fixed investment in equipment growth should slow sizably in the second quarter after posting the strongest quarterly growth since Q3 2015 in the first quarter. Core capital goods shipments, an input in the GDP calculation of business investment in equipment, declined in May for the first time in four months after a small gain in April. Core capital orders, the leading indicator, also declined for the first time in five months. Durable goods orders as a whole slipped in May for the second consecutive month, suggesting the manufacturing sector might lose some momentum in the near term. Inflation pressure eased further in May, as year-over-year growth in the personal consumption expenditures (PCE) deflator, the Fed's favored inflation measure, decelerated for the third consecutive month to six-tenths below the two-percent target. The further slowdown in inflation raises uncertainty over the pace of monetary policy normalization. Consumer confidence was muddled in June, as the two measures of their confidence, one by the Conference Board and the other by the University of Michigan, moved in opposite directions. Consumers' optimistic outlook is showing signs of eroding, however, as both confidence measures' expectations components fell.

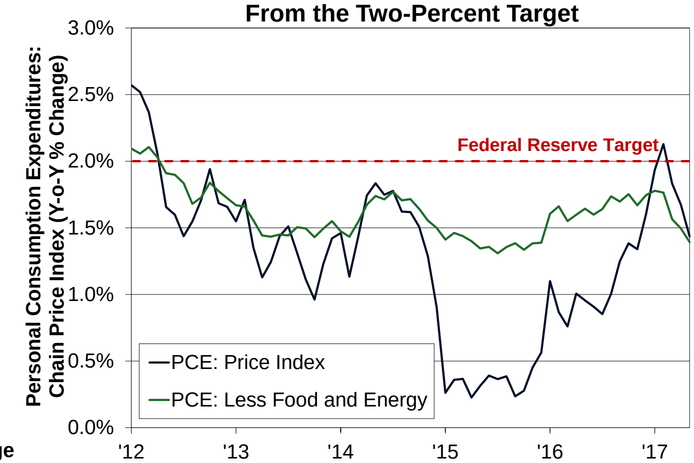
- **Gross domestic product (GDP) growth**, adjusted for inflation, was revised two-tenths higher to 1.4 percent annualized in Q1 2017, according to the third estimate from the Bureau of Economic Analysis (BEA). Growth in real PCE was revised upward half of a percentage point to 1.1 percent. Net exports and government spending were also revised upward. Business and residential fixed investment, on the other hand, saw downward revisions. Corporate profits were revised downward, declining 2.3 percent (not annualized) from the prior quarter. From a year ago, corporate profits increased 3.3 percent.
- **Personal income**, adjusted for inflation, rose 0.5 percent in May, according to the BEA. Real PCE edged up 0.1 percent, as the saving rate rose four-tenths to 5.5 percent. The PCE deflator slipped 0.1 percent from April, marking the second monthly drop in three months, and rose 1.4 percent from May 2015. The core PCE deflator, excluding food and energy, edged up 0.1 percent from a month ago, and 1.4 percent from a year ago.
- **Durable goods orders** fell 1.1 percent in May, according to the Census Bureau. April data were revised down one-tenth to a 0.9 percent drop. Shipments of durable goods rose 0.8 percent. Both core capital goods orders (nondefense capital goods excluding aircraft) and core shipments edged down 0.2 percent.
- **The University of Michigan Consumer Sentiment Index** fell two points to 95.1 in the final June reading. **The Conference Board Consumer Confidence Index**, on the other hand, rose 1.3 points to 118.9 in June.
- **Initial claims for unemployment insurance** increased by 2,000 to 244,000 in the week ending June 24, according to the Department of Labor. The four-week moving average decreased by 2,750 to 242,250.

Upward Revision to Consumer Spending Bumps Up First Quarter Growth



Source: Bureau of Economic Analysis

Fed's Favored Inflation Measure Falls Further From the Two-Percent Target



Source: Bureau of Economic Analysis

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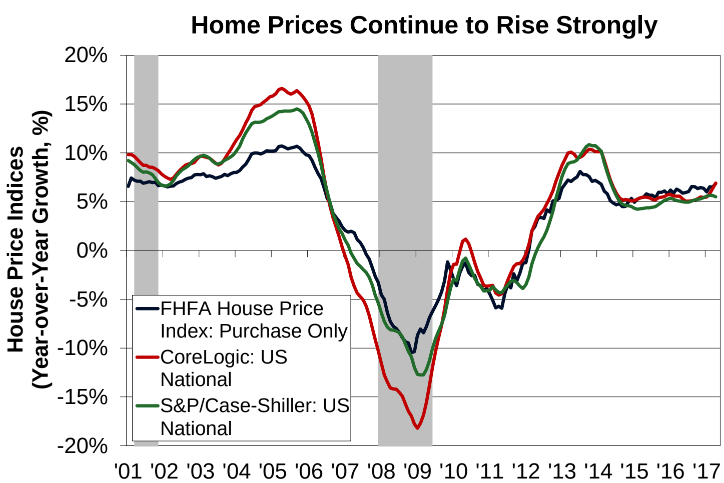
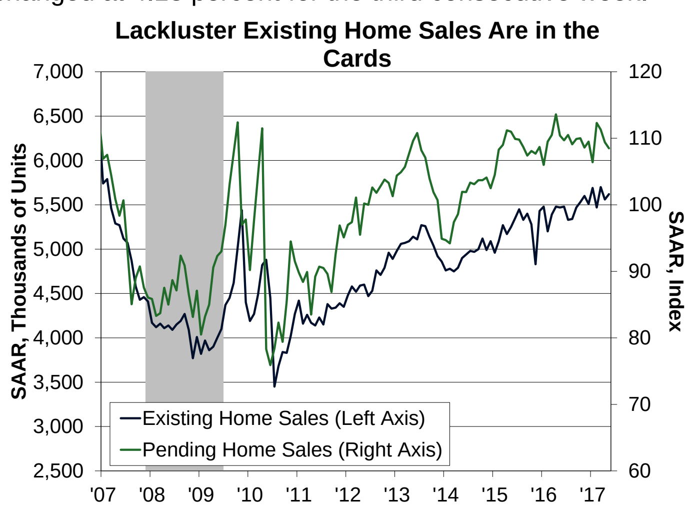
Housing: Deteriorating Affordability Restrains Sales

This week's housing news was on the soft side. Pending home sales, which record contract signings of existing homes and typically lead closings by one to two months, fell in May for the third consecutive month. In addition, sales registered a year-over-year drop for the second straight month, the first back-to-back annual declines since November and December 2016. The National Association of REALTORS® (NAR) noted a severe shortage of listings in the "affordable range" of the market amid rapidly rising prices as factors restraining sales. NAR pointed to last week's release of existing home sales, which showed a rebound in overall sales in May. However, the sales distribution recorded a sharp decline in home sales under $100,000 and only a modest increase in the sales of homes between $100,000 and $250,000. Annual home price appreciation continues to be strong, according to the S&P Case-Shiller National Home Price Index. However, the annual gain of 5.5 percent in the index in April was much smaller than other main measures of home prices, such as the CoreLogic and the FHFA Purchase-only indices, which both posted a year-over-year gain of nearly seven percent during the month. Lastly, demand fell last week for both purchase and refinance loans as mortgage rates held steady. While refinance applications declined for the first time in four weeks, purchase applications dropped for the third consecutive week and for the sixth time in the last seven weeks. Recent trends in purchase mortgage applications and pending home sales suggest lackluster existing home sales in coming months. Mortgage rates fell this week, according to Freddie Mac, with the average yield on 30-year fixed-rate mortgages declining two basis points to 3.88 percent. The drop should be short-lived, however, as Freddie noted it conducted the majority of its survey prior to Tuesday's sell-off in the Treasury market, which led to a rise in Treasury yields.

- **The National Association of REALTORS® Pending Home Sales Index** declined 0.8 percent to 108.5 in May. This marks the third straight drop, sending the index to its lowest level since January 2017 and 1.7 percent below its level last May. Pending sales fell in every region except the Midwest, where sales were flat.
- **The S&P/Case-Schiller National Home Price Index** (not seasonally adjusted) increased 0.9 percent in the three months ending in April. According to the index, year-over-year, prices rose 5.5 percent following three consecutive months of 5.6 percent annual gains. Thus, year-to-date, annual gains in the index stayed in a very narrow range between 5.5 percent to 5.6 percent, compared with a range between 5.1 percent and 5.3 percent during the first four months of 2016.
- **Mortgage applications** fell 6.2 percent in the week ending June 23, according to the Mortgage Bankers Association. Purchase applications dropped 4.1 percent. Refinance applications decreased 8.6 percent. The average contract interest rate for 30-year fixed-rate mortgages remained unchanged at 4.13 percent for the third consecutive week.



Source: Standard and Poor's, CoreLogic, and FHFA



Source: The National Association of REALTORS®

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