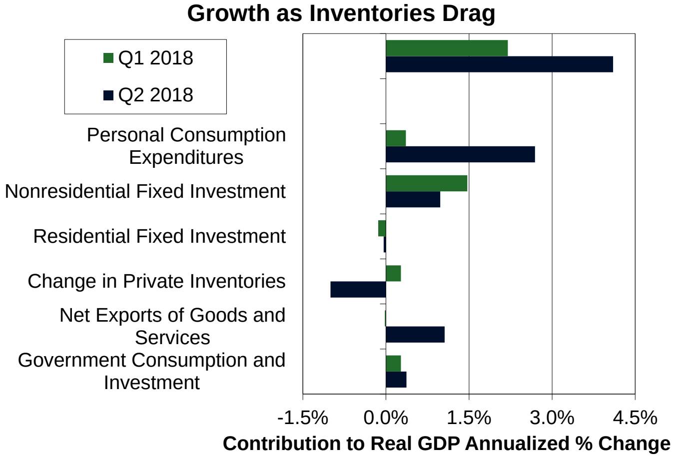
Weekly Note – July 27, 2018

Economics: Best Economic Growth in Nearly Four Years

This week's economic news featured the first glance of second quarter real gross domestic product, which grew 4.1 percent annualized, the strongest increase since the third quarter of 2014. The headline growth figure was close to our estimate of 4.2 percent in the July forecast. Consumer spending contributed 2.7 percentage points to growth, the biggest boost since the end of 2014. Net exports added to growth for the first time in three quarters, more than offsetting the drags in the prior two quarters. Exports grew strongly, partly because businesses abroad rushed to import U.S. products ahead of the imposition of tariffs, while imports fell slightly. We expect the large contribution from net exports to be a one-off, however, and project that trade will revert to subtracting from GDP in the second half of the year. The strong increase in government spending, especially at the federal level, reflected the impact of the spending appropriations from this year's Budget Act. Nonresidential investment also helped spur growth, though its contribution was less than in the first quarter. Housing was left out of the glory, as residential investment dragged on growth for the fourth time in five quarters. Inventory was the only other drag on GDP, declining for the first time in five quarters. The drawdown in inventories bodes well for the near-term outlook, however, as businesses will need to build more inventories in the second half of the year than we anticipated. The durable goods orders report showed increased momentum at the end of the second quarter, signaling that business equipment spending growth will pick up in the near term. Core capital goods shipments, an input used to estimate business equipment spending, rose in June by the most since February, and core capital goods orders, a forward-looking indicator, increased for the third consecutive month on the heels of an upward revision in the prior month. Other economic news this week was uneventful: consumer sentiment edged down slightly in July and initial jobless claims rebounded last week, but the four-week moving average fell to the lowest level since May.

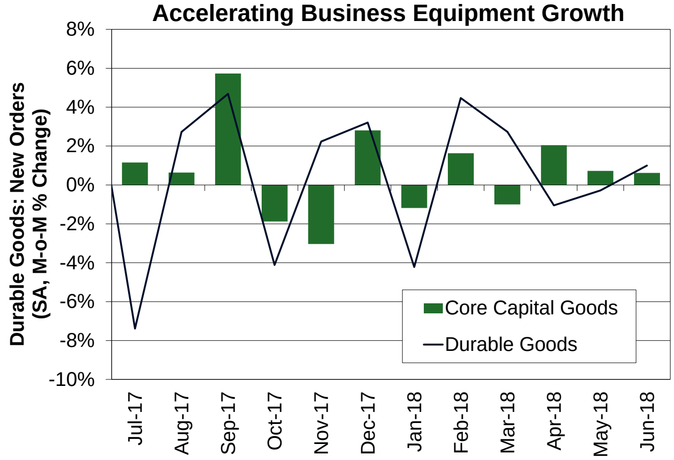
- **Gross domestic product (GDP)**, adjusted for inflation, increased 4.1 percent annualized in Q2 2018, accelerating from an increase of 2.2 percent in the prior quarter (an upward revision from 2.0 percent), according to the advance estimate from the Bureau of Economic Analysis. Real consumer spending grew 4.0 percent as durable goods spending rebounded strongly from a drop in the prior quarter. Real nondurable goods and service spending also posted solid gains. Real business fixed investment rose 7.3 percent, as equipment investment, structures investment, and intellectual property spending increased 3.9 percent, 13.3 percent, and 8.2 percent, respectively. Inflation-adjusted residential investment declined 1.1 percent. Real government spending was up 2.1 percent. Net exports contributed 1.1 percentage points to growth, while inventories subtracted a percentage point. The GDP price index rose 3.0 percent, while the Personal Consumption Expenditures deflator rose 1.8 percent and core prices increased 2.0 percent.
- **Durable goods orders** increased 1.0 percent in June, the first increase in three months, according to the Census Bureau. Commercial aircraft orders and orders for vehicles and parts showed strong gains amid a sharp drop in defense capital goods orders. Core (nondefense orders excluding aircrafts) capital goods shipments rose 1.0 percent. Core capital goods orders rose 0.6 percent, and the increase in May was revised higher four-tenths to 0.7 percent.
- **The University of Michigan Consumer Sentiment Index** edged down 0.3 points from June to 97.9 in the July final reading, as the drop in the current conditions component outweighed an improvement in the expectations component.
- **Initial claims for unemployment insurance** rose 9,000 to 217,000 in the week ending July 21, according to the Department of Labor. The four-week moving average fell 3,000 to 218,000.

Consumer Spending and Net Exports Propel Growth as Inventories Drag



Source: Bureau of Economic Analysis

Solid Core Capital Goods Orders Suggests Accelerating Business Equipment Growth



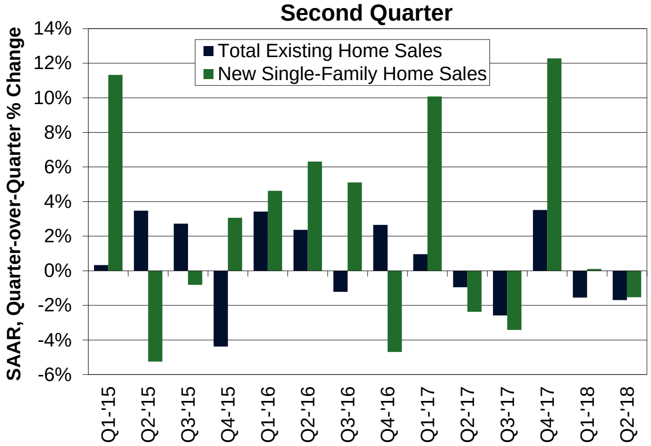
Source: Census Bureau

Housing: Home Sales Fall; Homeownership Rises

After last week's dreary home building news, housing continued to disappoint this week with declining home sales. New home sales posted the largest monthly decline of the year in June, dragging sales to the worst showing since October. Sales fell between the first and second quarters, posting their first decline in three quarters. However, during the first half of the year, new home sales were up 7.4 percent, compared with the same period last year. Total existing home sales fell for the third straight month in June. In the second quarter, existing sales were down for the fourth time in five quarters, sending year-to-date sales 2.2 percent lower than last year. The for-sale inventory of existing homes posted an annual increase, ending a string of year-over-year declines that had lasted for three years, pushing the months' supply to the highest level in almost a year. However, supply remains historically tight, with properties typically staying on the market in June for only 26 days, the shortest duration on record, for the third consecutive month. Lean inventory continues to support solid home price appreciation, with the annual gain in the FHFA purchase-only index still above 6 percent in May, though it has decelerated for the past three months. The Housing Vacancy Survey offered some good news in the owner-occupied sector. The homeownership rate ticked up in the second quarter and has increased on an annual basis for six quarters. Especially positive was the continued increase in the homeownership rate for young adults under age 35, which reached the highest level in five years. The increase in owner-occupied households outpaced the drop in renter households, resulting in an annual rise in the total number of households of more than 1 million for the third straight quarter. Finally, mortgage demand was virtually flat last week, and Freddie Mac's survey showed that the average 30-year fixed mortgage rate rose 2 basis points this week to 4.54 percent. The average rate for July, at 4.53 percent, was 4 basis points below June's average rate, the second monthly decline since rates hit a 7-year high in May.

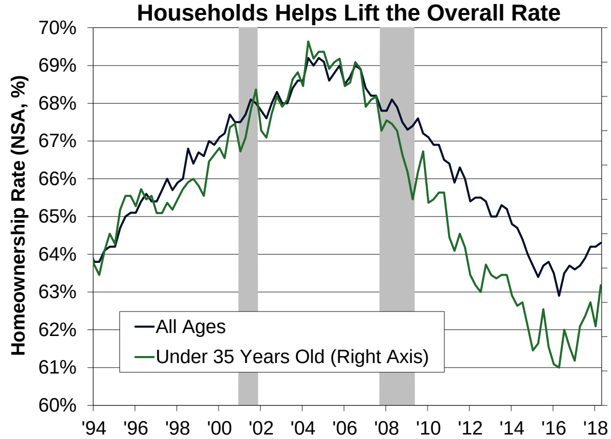
- **Existing home sales** fell 0.6 percent in June to 5.38 million units (seasonally-adjusted annualized rate or SAAR), according to the National Association of REALTORS®. The single-family sector drove the decline, dropping to 4.76 million units, while condo/coop sales were flat at 620,000 units. Average sales for Q2 2018 fell 1.7 percent from the first quarter. The number of homes for sale (not seasonally adjusted) rose 0.5 percent year-over-year, and the months' supply ticked up one-tenth from June 2017 to 4.3 months. The median sales price rose 5.2 percent annually.
- **New single-family home sales** fell 5.3 percent in June to 631,000 units (SAAR), according to the Census Bureau. Sales in the prior three months were revised lower by 27,000, on net. Sales rose only in the Northeast, bringing activity in that region to an expansion high. Sales fell 1.5 percent in Q2 2018 from Q1 2018. For-sale inventory rose 1.7 percent from May and 10.3 percent from a year ago. The months' supply rose four-tenths to 5.7 months.
- **The Housing Vacancy Survey** for Q2 2018 (not seasonally adjusted) showed that the homeownership rate rose a tick to 64.3 percent, according to the Census Bureau. The rate was 0.6 percentage points higher than in Q2 2017. The homeowner vacancy rate was unchanged at 1.5 percent, while the rental vacancy rate fell two-tenths to 6.8 percent. The number of households increased 1.67 million from a year ago.
- **The FHFA Purchase-Only House Price Index**, reported on a seasonally-adjusted basis, rose 0.2 percent in May. On an annual basis, the index rose 6.4 percent, decelerating two-tenths from April's increase.
- **Mortgage applications** edged down 0.2 percent amid flat mortgage rates for the week ending July 20, according to the Mortgage Bankers Association. Purchase applications fell 1.0 percent, outweighing a rise in refi applications.

Both New and Existing Home Sales Fall In The Second Quarter



Source: National Association of REALTORS® and Census Bureau

Rising Homeownership Rate for Younger Households Helps Lift the Overall Rate



Source: Census Bureau

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