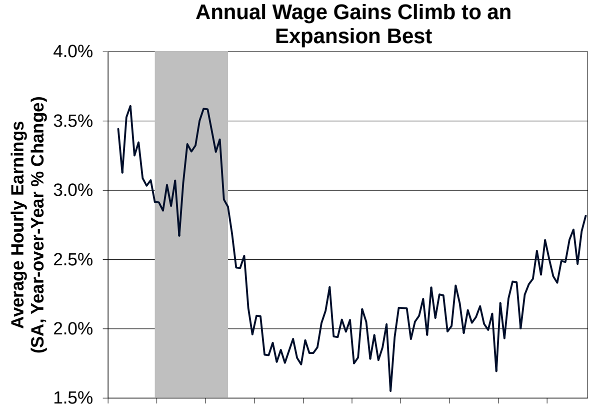
Weekly Note – November 4, 2016

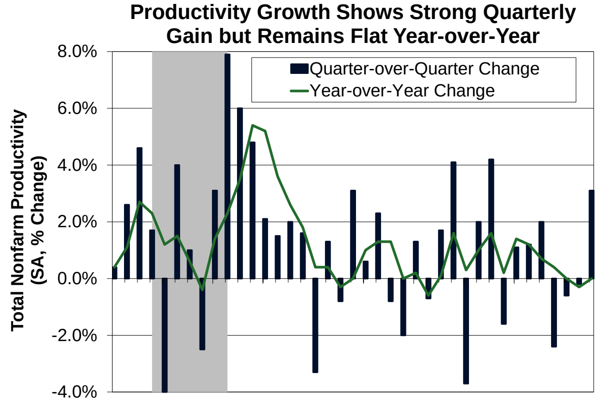
Economics: All Systems Go for a December Rate Hike

We believe the October jobs report seals the deal for a December target rate hike. Evidence includes a solid job gain in October, upward revisions for the prior two months of 44,000 jobs, and the biggest annual wage gain since June 2009. The decline in the labor force participation rate was a slight blemish. However, the drop in the broadest measure of labor underutilization – the U6 – to more than an eight-year low should overcome any concern that significant labor market slack remains. As always, a few things can throw a monkey wrench into the Fed's plan, but the bar for inaction this year is now extremely high. Inflation, the other half of the Fed's mandate, also showed signs of life in September. The PCE deflator, the Fed's favored inflation measure, posted the highest annual growth rate since November 2014, boosted by a jump in energy prices, while annual growth in the core deflator remained near a two-year best. The other news this week was also largely positive. September consumer spending more than recovered from the August drop, outpacing income growth and pushing the saving rate lower. The increase in October auto sales to the second strongest pace of the expansion bodes well for consumer spending. The trade deficit narrowed in September as exports grew for a fourth straight month to reach the highest level since July 2015 and imports fell for the second time in three months. Factory orders rose in September for a third consecutive month, and the ISM surveys reported the factory sector expanded faster in October amid a slowing expansion of the service sector. Lastly, third quarter productivity posted the largest jump in two years, largely offsetting compensation growth and flattening unit labor costs. The trend remains weak as productivity was unchanged over the past year. Unit labor costs rose 2.3 percent from a year ago, similar to the recent trend.

- **Nonfarm payroll employment** expanded by 161,000 in October, according to the Bureau of Labor Statistics. The three-month moving average change moderated to 176,000, the lowest level in four months. The unemployment rate ticked down one-tenth to 4.9 percent, as the participation rate fell one-tenth as well to 62.8 percent. Average hourly earnings increased 0.4 percent from September and 2.8 percent from a year ago. The average workweek was flat at 34.4 hours. The U-6 rate decreased two-tenths to 9.5 percent.
- **Personal income**, adjusted for inflation, edged up 0.1 percent in September, according to the Bureau of Economic Analysis. Real personal consumption expenditures (PCE) rose 0.3 percent. The saving rate fell back one-tenth to 5.7 percent. The PCE deflator increased 0.2 percent during the month and 1.2 percent since September 2015. Excluding food and energy, the core deflator ticked up 0.1 percent from August and 1.7 percent from a year ago.
- **Nonfarm business productivity** jumped 3.1 percent annualized in Q3 2016, according to the Bureau of Labor Statistics. Compensation per hour rose 3.4 percent annualized. As a result, unit labor costs rose only 0.3 percent.
- **The Institute for Supply Management (ISM) Manufacturing Index** edged up 0.4 points to 51.9 in October (any reading above 50 indicates expansion). Employment reached an 18-month high. **The ISM Nonmanufacturing Index**, a gauge of service sector activity, pulled back 2.3 points to 54.8 in October, as all four components dropped.
- **Light vehicle sales** increased 1.5 percent to an 18.0 million annualized rate in October, according to Autodata.
- **The U.S. trade deficit** narrowed $4.2 billion in September to $36.4 billion, according to the Census Bureau, as exports rose 0.6 percent and imports fell 1.3 percent. The inflation-adjusted goods deficit, used in the calculation of net exports in the GDP estimate, narrowed $2.4 billion to $55.0 billion, the lowest level since February 2015.
- **Factory orders** improved 0.3 percent in September, according to the Census Bureau. Nondurable goods, the new piece of data in the report, increased 0.9 percent. The drop in core capital goods orders was revised down further.



Source: Bureau of Labor Statistics



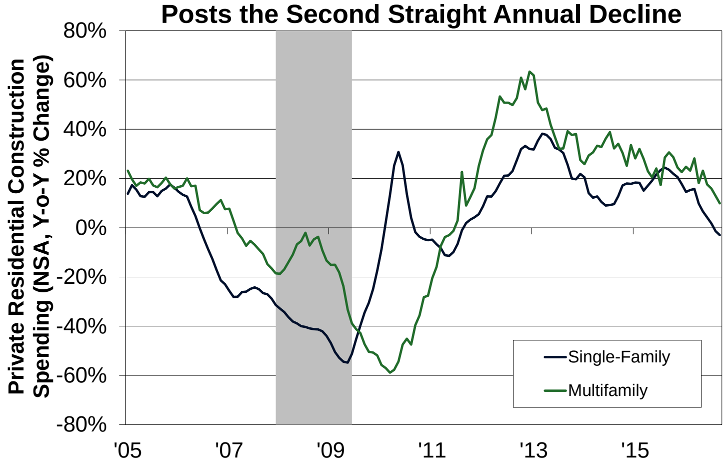
Source: Bureau of Labor Statistics

Housing: Lackluster Activity amid Stronger Price Gains

This week's housing news was mixed. Spending on new residential construction in September ended the quarter on a modestly positive note, as outlays on new single-family construction increased slightly, ending a string of six consecutive monthly declines, and spending on new multifamily construction rose for the second consecutive month. The year-over-year trend remained weak, especially for the single-family sector, which posted a second straight decline. While the annual change for new multifamily construction spending stayed positive, the gain was the weakest in five years. Mortgage demand continues to be subdued, with applications for both purchase and refinance loans declining during the last week of October for the second consecutive week as mortgage rates rose to the highest level since June. For October, purchase applications fell 4.8 percent, more than offsetting the gain in the prior month, which was the first rise in three months. Refinance applications fell for the third consecutive month, declining 10.1 percent. The drop was solely because of decreased activity in the conventional market, as activity in the government segment rose. Freddie Mac's survey showed that mortgage rates jumped seven basis points this week, the biggest weekly rise since late April, to 3.54 percent. One piece of data that has not changed much this year is home prices, which continue to appreciate rapidly, supported by lean inventories that are unlikely to improve any time soon.

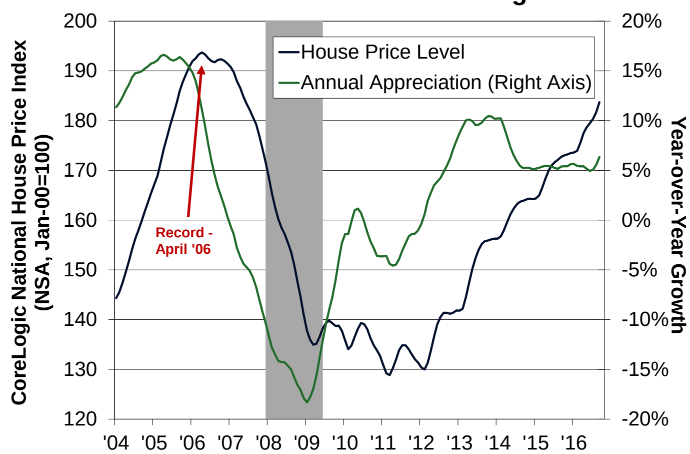
- **Private residential construction spending** edged up 0.5 percent in September, according to the Census Bureau. Spending on new single-family construction ticked up 0.1 percent while spending for new multifamily construction increased 2.0 percent, the fourth gain over the last five months. Spending on home improvements rose 0.6 percent. From a year ago, new single-family construction spending fell 3.0 percent following a 1.4 percent drop in the prior month. Meanwhile, new multifamily construction spending rose 9.9 percent from last September.
- **The CoreLogic National Home Price Index**, a repeat sales measure (not seasonally adjusted), increased 1.1 percent in September. From a year ago, prices rose 6.3 percent, the biggest gain since June 2014. The CoreLogic index tends to be downwardly revised in subsequent releases, however, and we expect this downgrade trend to continue. Home prices have risen 43 percent since bottoming in March 2011 but are still 5.2 percent below the April 2006 peak.
- **Mortgage applications** fell 1.2 percent for the week ending October 28, according to the Mortgage Bankers Association. Purchase applications edged down 0.4 percent, marking the fourth decline over the last five weeks. Refinance applications dropped for the fourth straight week, falling 1.6 percent. The average rate for 30-year fixed-rate mortgages rose four basis points to 3.75 percent.

New Single-Family Construction Spending Posts the Second Straight Annual Decline



Source: Census Bureau

Annual Home Price Gain Strengthens



Source: CoreLogic

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