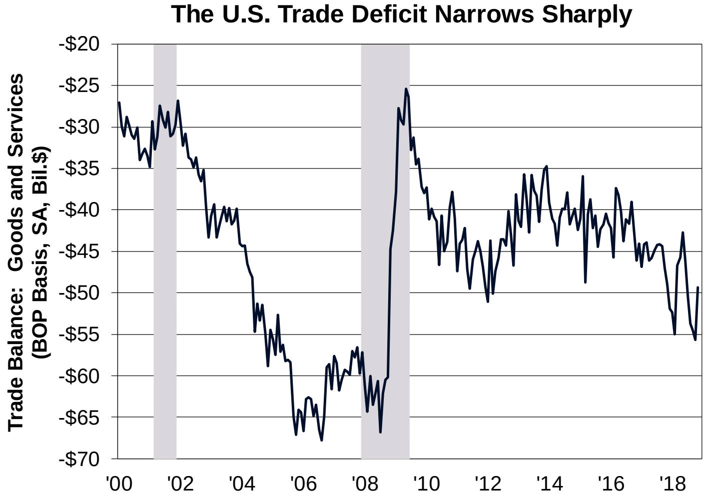
Weekly Note – February 8, 2019

Economics: The Narrowing Trade Gap Bodes Well for Q4 Economic Growth

The biggest news this week was the upside surprise in the U.S. trade deficit, which narrowed sharply in November and could help boost fourth quarter real gross domestic product (GDP) growth above our estimate of 2.7 percent annualized. However, details were less upbeat as exports declined for the second consecutive month and the fifth time in the past six months. Recent weaknesses in exports likely reflected the slowdown in global economic growth and past appreciation in the U.S. dollar. Meanwhile, imports fell for the first time since April 2018 and recorded the largest percentage decline since March 2016. Notably, the deficit with China is poised to deteriorate further in 2018 from 2017. Year-to-date through November, the deficit with China widened to $382 billion from $345 billion during the same period in 2017, largely because of an increase in imports, as exports to China fell only modestly. As we approach March 1, when the truce in hiking tariffs on Chinese imports is set to expire, trade tensions between the U.S. and China weighed on the market this week in response to comments from National Economic Council Director Larry Kudlow that "there is a pretty sizable distance to go" in trade talks between the nations. Other news was mixed. The service industry expanded in January at the slowest pace since last July and factory orders fell in November for the second consecutive month. However, consumer credit increased at a solid clip in December, driven by nonrevolving credit (largely student and auto loans), as revolving credit (largely credit card debt) posted the smallest gain in three months. Lastly, initial jobless claims fell last week but managed to reverse only a fraction of the surge in the prior week that sent claims to a four-month high.

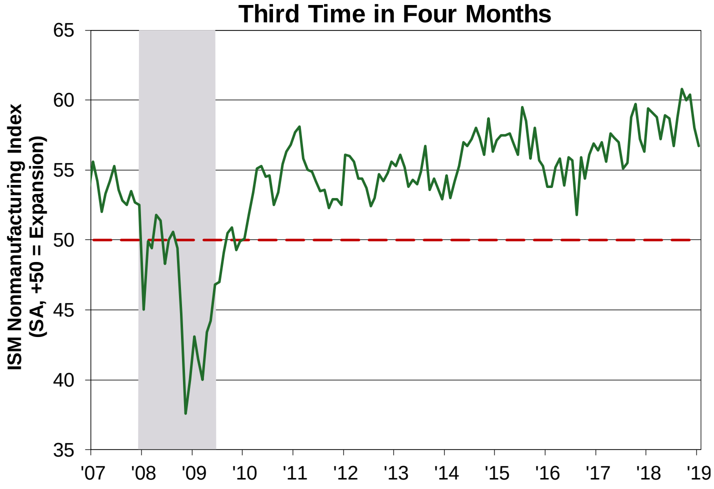
- **The U.S. trade deficit** narrowed to $49.3 billion in November from $55.7 billion in October, according to the Census Bureau. Imports fell 2.9 percent while exports decreased 0.6 percent. The real goods deficit, which is an input used to estimate GDP, narrowed by $7.5 billion to $80.8 billion.
- **Factory orders** fell 0.6 percent in November, according to the Census Bureau. Shipments also fell 0.6 percent. Revisions were small relative to those in the advance durable goods report, with the latest data showing core capital goods orders and core capital goods shipments declining 0.6 percent and 0.2 percent, respectively. Inventories fell 0.1 percent, the first drop since September 2016.
- **The ISM Nonmanufacturing Index**, a gauge of service sector activity, retreated 1.3 points to 56.7 in January (any reading above 50 indicates expansion). This marks the third drop in four months. The sector is unlikely to rebound meaningfully as forward-looking components declined sharply during the month, with the new orders index dropping to the lowest level since December 2017 and the export orders index falling to a two-year low.
- **Consumer (non-mortgage) credit outstanding** increased $16.5 billion in December, according to the Federal Reserve Board. The gain was driven by a $14.8 billion increase in the nonrevolving segment. Revolving credit rose $1.7 billion. On an annual basis, nonrevolving and revolving credit rose 5.6 percent and 2.0 percent, respectively.
- **Initial claims for unemployment insurance** fell 19,000 to 234,000 in the week ending February 2, according to the Department of Labor. The four-week moving average increased 5,000 to 225,000.

The U.S. Trade Deficit Narrows Sharply



Source: Census Bureau

The ISM Nonmanufacturing Index Drops for the Third Time in Four Months

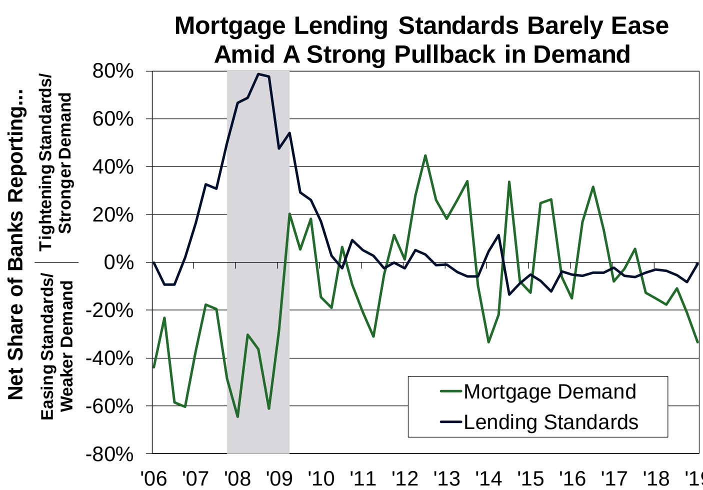


Source: The Institute for Supply Management

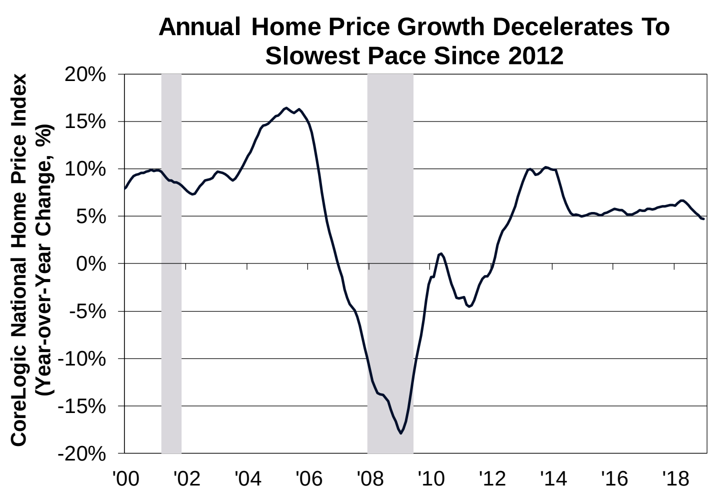
Housing: Home Price Growth at Slowest Pace in Six Years

Housing data released this week featured updates on lending standards, mortgage demand, and home price appreciation. Results from the first quarter Senior Loan Officer Opinion Survey showed that lending standards on residential mortgage loans eased for the 19th consecutive quarter, albeit at a slower pace. By type of mortgages, the Qualified Mortgage (QM)-Jumbo loans group was the only segment that experienced tighter standards in the first quarter, which marks the first tightening since record keeping began in 2015. Other mortgage loan categories recorded unchanged or slightly easing underwriting standards. On the demand side, banks reported the weakest demand for residential mortgages on net in the expansion, with all categories in the survey experiencing less demand. In a more timely measure of mortgage demand, mortgage applications dropped for the third consecutive week last week, driven entirely by purchase applications, which have now fallen back to the levels seen in early January. Refinance applications, on the other hand, were virtually unchanged after falling in the prior two weeks. In other news, the annual gain in the CoreLogic National Home Price Index decelerated in December for the ninth straight month to 4.7 percent, the slowest pace since August 2012, a marked slowdown from the recent peak of 6.7 percent in March 2018. In each month during the first half of last year, the year-over-year increase exceeded 6.0 percent, resulting in an average gain of 6.4 percent for the first half of 2018, 1.2 percentage points faster than the average appreciation during the second half. For all of 2018, the index rose 5.8 percent, down from a 5.9 percent in 2017, marking the first annual slowdown in three years. Finally, mortgage rates moved lower this week, as the average 30-year fixed mortgage rate fell 5 basis points to 4.41 percent, the lowest level since last April, according to Freddie Mac.

- **The Federal Reserve Board Senior Loan Officer Opinion Survey** in the three months ending in January showed modestly easing or unchanged lending standards on net relative to the prior three months for most residential mortgage types and weaker demand across the board. Standards eased the most for Non-QM Non-Jumbo loans and demand fell most for GSE-Eligible loans.
- **The CoreLogic National Home Price Index**, a repeat sales measure, rose 0.1 percent from November (not seasonally adjusted) and 4.7 percent from December 2017. In the third quarter, prices increased 4.9 percent from a year ago, the second straight quarter of deceleration. The lowest price tier (homes priced less than 75 percent of the median) continued to appreciate faster than all other price tiers.
- **Mortgage applications** fell 2.5 percent for the week ending February 1, according to the Mortgage Bankers Association. Applications for purchase mortgages declined 4.9 percent, while refinance applications edged up 0.3 percent. The average 30-year fixed mortgage rate in the survey fell 7 basis points to 4.69 percent.



Source: Federal Reserve Board



Source: CoreLogic

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