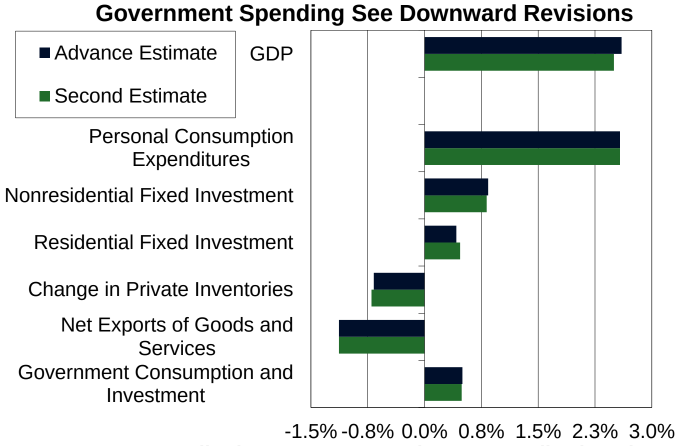
Weekly Note – March 2, 2018

Economics: Consumer Spending Loses Steam

This week's releases suggested some cooling in domestic demand this quarter amid a one-tenth downgrade in fourth quarter real GDP growth. Durable goods orders posted the largest monthly decline since July 2017 in January, thanks to aircraft and defense orders. Details in the report were also bearish. Core capital goods shipments (nondefense excluding aircraft), an input used to estimate the business spending on equipment component in GDP, showed the weakest monthly gain in a year. In addition, core capital goods orders, a forward-looking indicator of shipments, posted the first back-to-back drops since May 2016, suggesting a substantial softening in equipment spending growth this quarter from last quarter's pace, which was the fastest in more than three years. On the consumer front, real consumer spending fell 0.1 percent in January, the first drop in five months amid flat real personal income. However, disposable personal income rose sharply, boosted by individual tax cuts, and significantly outpaced spending increases. As a result, the saving rate jumped seven-tenths to 3.2 percent, a five-month high. The Federal Reserve's preferred measure of inflation, the personal consumption expenditures (PCE) deflator, rose the most since last September in January. However, the year-over-year growth rate remained three-tenths below the 2.0 percent target. Annual growth in the core PCE deflator (excluding food and energy) was unchanged as well. Auto sales fell in February for the fourth time in five months, hitting a sixth-month low. Two measures of consumer confidence improved in February as consumers were upbeat about both the present situation and the future. Despite bullish consumers, first quarter real consumer spending growth is tracking to slow by nearly 2 percentage points from last quarter's 3.8 percent annualized pace. A survey of purchasing managers showed manufacturing maintained recent momentum, as a gauge of activity in the sector increased in February to reach its highest level since May 2004. Finally, initial unemployment claims fell last week to the lowest level since 1969.

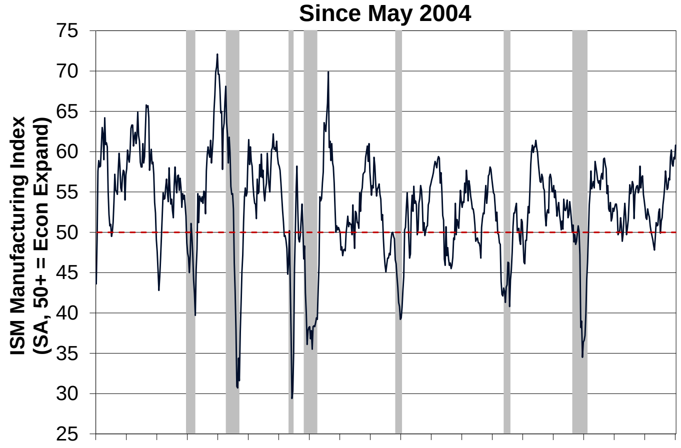
- **Gross domestic product (GDP)**, adjusted for inflation, grew by 2.5 percent annualized in Q4 2017, according to the second estimate from the Bureau of Economic Analysis. Downward revisions to business investment in intellectual property products, change in inventories, and government spending outweighed upward revisions in residential fixed investment, business investment in structures and equipment, and net exports. Consumer spending was unrevised.
- **Durable goods orders** fell 3.7 percent in January, according to the Census Bureau. Core capital goods orders fell 0.2 percent. Core capital goods shipments ticked up 0.1 percent.
- **Personal income**, adjusted for inflation, was flat in January while real disposable income rose 0.6 percent, according to the Bureau of Economic Analysis. The PCE deflator rose 0.4 percent from December and 1.7 percent from last year. The core deflator increased 0.3 percent during the month and 1.5 percent from a year ago.
- **The Conference Board Consumer Confidence Index** rose 6.5 points in February to 130.8. **The University of Michigan Consumer Sentiment Index** rose 2 points to 99.7 in the February final reading.
- **The ISM Manufacturing Index** rose 1.7 points to 60.8 in February (any reading above 50 indicates expansion). Gains in employment, supplier deliveries, and inventories drove the increase.
- **Light vehicle sales** edged down 0.5 percent to 17.1 million annualized units in February, according to Autodata.
- **Initial claims for unemployment insurance** decreased by 10,000 to 210,000 in the week ending February 24, according to the Department of Labor. The four-week moving average decreased by 5,000 to 220,500.

Business Investment, Inventories, and Government Spending See Downward Revisions



Source: Bureau of Economic Analysis

Manufacturing Index Reaches Highest Level Since May 2004



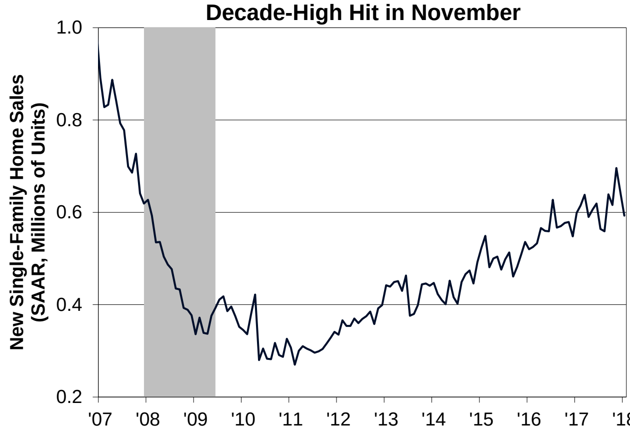
Source: Institute for Supply Management

Housing: Home Sales Face Plant Out of the Starting Gate

The home sales market's poor start to 2018 continued with data released this week. New home sales fell sharply for the second consecutive month after jumping to a decade-high in November. Sales are now at their lowest level since August of last year. Large drops in the Northeast (to a 17-month low) and in the South (to a 13-month low) drove the January decline. News for the new home market was not all negative, as sales in the previous three months were revised sizably upward. In addition, the supply picture continued to improve, as the number of new homes for sale climbed to a new expansion high. The near-term outlook for home sales took a sharp turn for the worse, according to two leading indicators released this week. First, pending home sales, which record contract signings of existing homes and typically lead closings by one to two months, fell sharply in January to the lowest level in over three years. Second, the monthly average of purchase mortgage applications declined in February, ending a three-month stretch of gains that had pushed applications to the highest level since October 2009 in January. Last week, mortgage demand increased for the first time in three weeks, as the first improvement in purchase applications in five weeks outweighed the third straight decline in refinance applications. Spending on residential construction was uninspiring in January, as the eighth consecutive monthly rise in new single-family spending barely outpaced a drop in multifamily spending. The sluggish start to construction spending and lackluster broker commissions from downbeat new home sales and existing home sales (released last week) suggest growth in residential investment will slow markedly in the first quarter from the robust fourth quarter pace. Home price growth remained strong in December, as the FHFA and Case-Shiller indices both posted greater than 6 percent year-over-year growth. Finally, mortgage rates edged higher by 3 basis points this week to 4.43 percent, bringing the year-to-date increase to 48 basis points, according to Freddie Mac.

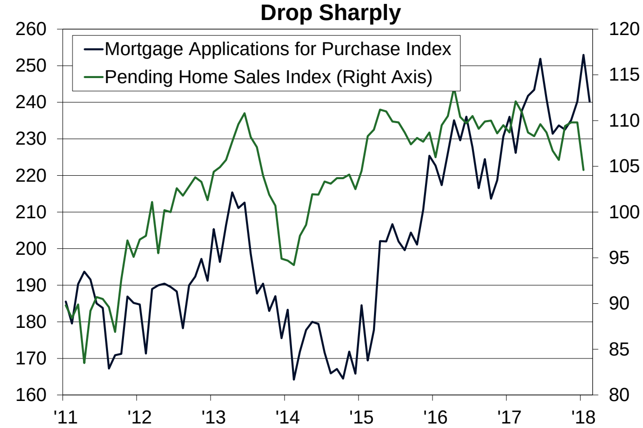
- **New single-family home sales** fell 7.8 percent in January to a seasonally-adjusted annualized rate of 593,000, according to the Census Bureau. Sales in the prior three months were revised upward 42,000, on net. On an annual basis, new home sales fell 2.2 percent. The number of new homes for sale (seasonally adjusted) increased 2.4 percent from December and 15.4 percent from a year ago. The months' supply rose six-tenths to 6.1 months.
- **The National Association of REALTORS® (NAR) Pending Home Sales Index** decreased 4.7 percent to 104.6 in January. The index declined 3.8 percent from January 2017. Pending sales slipped in all four Census regions.
- **Private residential construction spending** edged up 0.3 percent in January, according to the Census Bureau. Spending on new single-family construction increased 0.6 percent. Multifamily spending dropped 1.3 percent. Home improvement spending improved 0.2 percent during the month. From a year ago, single-family spending rose 9.0 percent, while multifamily spending slipped 1.8 percent.
- **The FHFA Purchase-Only House Price Index**, reported on a seasonally adjusted basis, increased 0.3 percent in December. The index rose 6.5 percent from December 2017. **The S&P/Case-Shiller National Home Price Index** (not seasonally adjusted) posted a 6.3 percent year-over-year gain in December.
- **Mortgage applications** improved 2.7 percent for the week ending February 23, according to the Mortgage Bankers Association (MBA). Purchase applications increased 6.2 percent, while refinance applications declined 1.2 percent. The MBA's average 30-year fixed mortgage rate was unchanged at 4.64 percent.

New Home Sales Fall Further from the Decade-High Hit in November



Source: Census Bureau

Leading Indicators for Home Sales Drop Sharply



Source: NAR & MBA

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