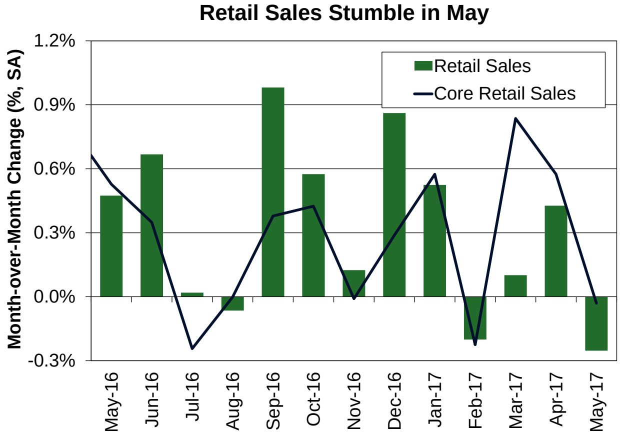
Weekly Note – June 16, 2017

Economics: Fed Stays the Monetary Normalization Course

This week's spotlight was on the Federal Open Market Committee meeting. The Fed raised the fed funds rate 25 basis points, as widely expected, and the updated economic projections left Fed officials' interest rate forecast essentially unchanged, with one more rate increase expected this year. The Fed also provided more clarity on how it will taper reinvestment of principal payments from its securities holdings but not on when the process will begin, other than "this year." The post-meeting statement noted that annual inflation has declined recently to below the Fed's 2.0-percent target, and the committee expects it to remain below the target in the near term. This week's data underscored the slowing inflation trend. Notably, the Consumer Price Index moderated further in May, with annual inflation posting the smallest gain since November. The annual increase in core CPI also decelerated, showing the slowest pace in two years. Other news this week was largely soft. The industrial production report for May showed a decline in manufacturing output offsetting improvements in both the mining and utility sectors. The University of Michigan Consumer Sentiment Index fell in early June to the lowest level since November. The NFIB Small Business Optimism Index was flat in May and also provided more evidence that businesses are having difficulty filling open positions. Last but not least, retail sales retreated in May. While core retail sales, which are used to estimate the consumer spending for goods component of gross domestic product, were flat, prior months' data were revised higher. Overall, this week's reports still support our forecast that real consumer spending will rebound to about 3.0 percent annualized this quarter from 0.6 percent last quarter.

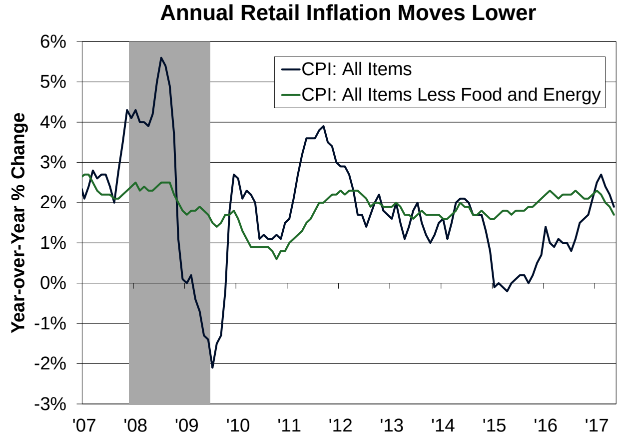
- **Retail sales** fell 0.3 percent in May, according to the Census Bureau. Weaknesses were broad-based, with auto, gasoline station, electronics and appliance stores, and department stores sales declining. Non-store retailers, clothing, and furniture sales rose. Core sales (excluding autos, gasoline, and building material) were unchanged.
- **The Consumer Price Index (CPI)** edged down 0.1 percent in May, driven by a decline in energy prices. The annual increase moderated to 1.9 percent. Excluding food and energy, the core CPI rose 0.1 percent from April and 1.7 percent from a year ago. **The Producer Price Index (PPI)** for final demand of goods and services was unchanged in May and rose 2.4 percent from a year ago. Core PPI rose 0.1 percent from April and 2.0 percent from last May. **Import prices** dropped 0.3 percent in May, driven by a large decrease in petroleum prices. Nonfuel import prices were unchanged. The Bureau of Labor Statistics produces all three reports.
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** was unchanged in May. The net share of small firms expecting the economy to improve in six months edged up. The share of firms with a hard-to-fill job opening rose but the net percentage of firms planning to raise compensation was flat.
- **The University of Michigan Consumer Sentiment Index** dropped 2.6 points to 94.5 in the June preliminary reading. This marks the largest decline since October, sending the index to the lowest level since November. Current conditions fell for the third consecutive month to a seven-month low of 109.6. Expectations also weakened to 84.7.
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, was unchanged in May, according to the Federal Reserve Board. Manufacturing output dropped 0.4 percent. Both motor vehicles and parts production and non-auto production (including business equipment production) fell. Mining production rose 1.6 percent, the fourth increase in the past five months, but is still 10 percent below its cyclical peak. Given the recent decline in global oil prices and weaker growth in active rotary rig counts, gains in mining output will likely moderate. Utility output rose 0.4 percent.

Retail Sales Stumble in May



Source: Census Bureau

Annual Retail Inflation Moves Lower

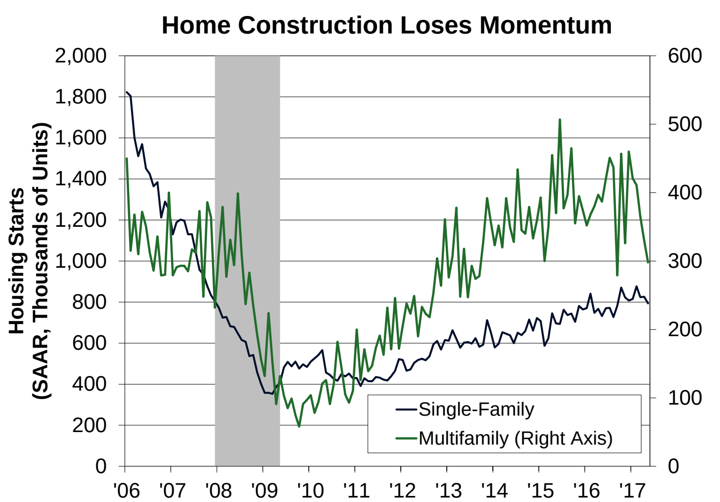


Source: Bureau of the Labor Statistics

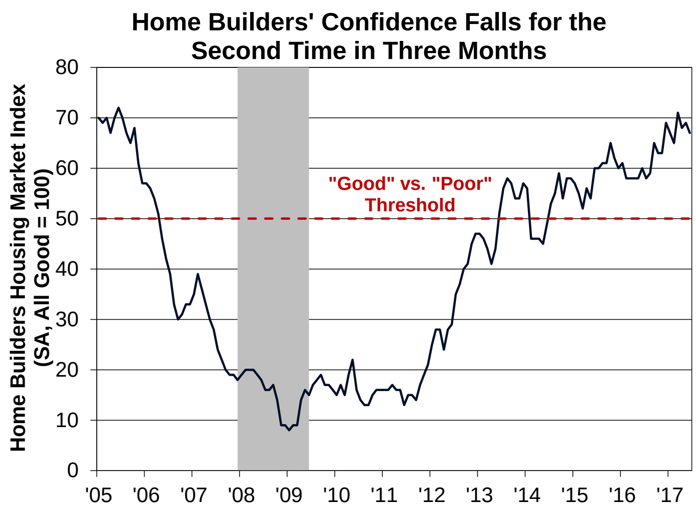
Housing: Home Building Wobbles

The home construction sector stumbled into the spotlight this week, as May housing starts disappointed in both the single-family and multifamily markets. Total housing starts declined for the third consecutive month to hit an eight-month low. In addition, total home construction has posted only one monthly rise so far in 2017, during the unusually warm month of February. Single-family starts declined for the second time in the past three months. Home builder's confidence might be starting to waver, as an index of their sentiment slipped for the second time in the past three months in June after reaching a 11-year high in March. The multifamily sector continues to show signs of being past peak, as starts have declined every month this year and permits also fell this month. Through the first five months of the year, multifamily starts and permits are both lower compared with the same period a year ago, but single-family starts and permits are up. Mortgage demand improved last week, boosted by a rise in refinance applications, which reached the highest level since mid-November. Purchase applications, on the other hand, fell back slightly from a seven-year high last week. Mortgage rates edged up slightly this week as the market reacted to the Federal Reserve increasing the fed funds rate on Wednesday. The average 30-year fixed mortgage rate edged up two basis points to 3.91 percent, marking the fourth consecutive week mortgage rates have been below four percent, according to Freddie Mac.

- **Housing starts** fell 5.5 percent to 1.09 million annualized units in May, according to the Census Bureau. Single-family starts declined 3.9 percent to 794,000 units, while multifamily starts dropped 9.7 percent to 298,000 units. Through the first five months of the year, single-family starts are 7.2 percent higher than the same period a year ago, while multifamily starts are 5.1 percent lower. New residential permits decreased 4.9 percent to 1.17 million annualized units. Single-family permits slipped 1.9 percent to 779,000 units and multifamily permits dropped 10.4 percent to 389,000 units. On a year-to-date basis, single-family permits are up 9.5 percent, while multifamily permits are down 2.1 percent.
- **The National Association of Home Builders/Wells Fargo Housing Market Index** fell two points to 67 in June. A reading above 50 indicates more builders view the single-family housing market as "good" rather than "poor." All three components – current sales, sales expectations over the next six months, and foot traffic of prospective buyers – fell during the month. Foot traffic slipped below 50 points for the first time in four months.
- **Mortgage applications** rose 2.8 percent for the week ending June 9, marking the third increase in the past four weeks, according to the Mortgage Bankers Association. Refinance applications drove the gain, improving 9.2 percent. Government refinance applications jumped 20.9 percent, the largest increase since early August 2016. Purchase applications fell 2.8 percent after a 10.0 percent jump the prior week. The survey's average 30-year fixed mortgage rate slipped one basis point to 4.13 percent, the lowest level this year.



Source: Census Bureau



Source: National Association of Home Builders

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