



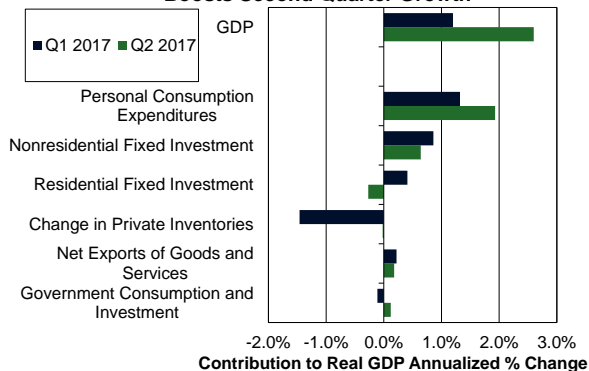
Weekly Note – July 28, 2017

### Economics: Growth Rebounds Close to Expectation

This week offered the first look at second quarter real GDP growth, which picked up to 2.6 percent annualized, a touch lower than our expectation of 2.7 percent in the July forecast. Inventory investment, which subtracted 1.5 percentage points from first quarter growth, was neutral, and a strong increase in consumer spending along with a healthy gain in nonresidential investment also helped boost growth. Encouragingly, business equipment investment posted the strongest gain since the third quarter of 2015. However, residential investment fell sharply, payback from the weather-induced surge in the first quarter. The report included annual revisions to GDP dating back to 2014. First quarter growth was revised two-tenths lower to 1.2 percent, putting average growth during the first half close to 2 percent. Inflation was subdued during the second quarter, which was consistent with the [statement](#) following the Federal Open Market Committee meeting that concluded on Wednesday. The Fed held the fed funds rate steady, as widely expected, and stated that it expects to begin implementing its balance sheet normalization program “relatively soon.” It also noted that annual inflation has declined recently and is running below its two-percent target. This week’s Employment Cost Index underscores the lack of wage pressure, as both wages and benefits posted only modest increases in the second quarter. We continue to expect the Fed to announce a tapering of the balance sheet in September, but weak wage and inflation pressures could delay the next rate hike, which we expect to be in December, until 2018. Lastly, two consumer surveys showed mixed confidence in July. The Conference Board’s Confidence Index rose to the highest reading since March, with a marked improvement in the labor market assessment, while the University of Michigan’s Sentiment Index slipped for the second consecutive month.

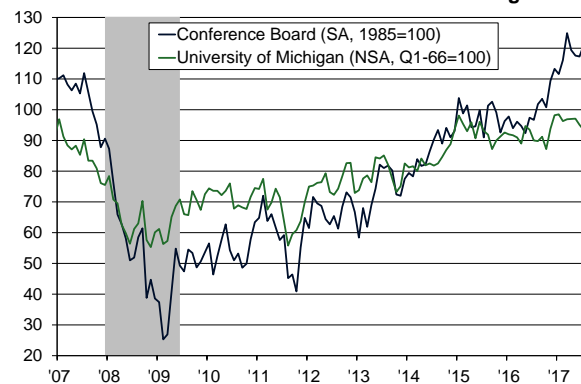
- **Gross domestic product (GDP)**, adjusted for inflation, rose 2.6 percent annualized in Q2 2017, according to the advance estimate from the Bureau of Economic Analysis. Real consumer spending increased 2.8 percent, adding 1.9 percentage points to GDP. Nonresidential investment posted a 5.2 percent increase, driven by an 8.2 percent rise in equipment investment. Structure investment rose 4.9 percent. Residential investment declined 6.8 percent, while government spending increased slightly. The personal consumption expenditures deflator, the Fed’s favored measure of inflation, rose 0.3 percent from the first quarter and 1.6 percent from a year ago, slowing from the 2.0 percent annual increase in the prior quarter. GDP growth was revised higher in 2014 and 2015, but lower in 2016.
- **The Employment Cost Index (ECI)**, a measure of labor compensation, increased 0.5 percent (not annualized) in Q2 2017, according to the Bureau of Labor Statistics. Wages rose 0.5 percent and benefits improved 0.6 percent. From a year ago, the ECI rose 2.4 percent, unchanged from the prior quarter.
- **The University of Michigan Consumer Sentiment Index** fell 1.7 points to 93.4 in the final July reading, as a decline in the expectations component outweighed a slight gain in the current economic conditions component. **The Conference Board Consumer Confidence Index** rose 3.8 points in July to 121.1. Consumers reported improved present conditions and higher expectations. The share of consumers reporting jobs plentiful less the share reporting jobs hard-to-get rose to 16.1, the highest level since August 2001.
- **Durable goods orders** rose 6.5 percent in June, driven by a surge in commercial aircraft orders, according to the Census Bureau. Excluding transportation, orders increased 0.2 percent. Core orders (nondefense capital goods excluding aircraft), edged down 0.1 percent, while core shipments ticked up 0.2 percent.
- **Initial claims for unemployment insurance** rose 10,000 to 244,000 in the week ending July 22, according to the Department of Labor. The four-week moving average was unchanged at 244,000.

A Rebound in Consumer Spending Growth Boosts Second Quarter Growth



Source: Bureau of Economic Analysis

Consumer Confidence Measures Diverge



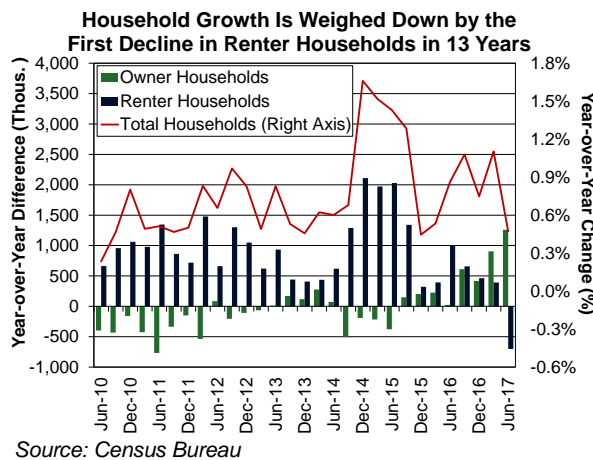
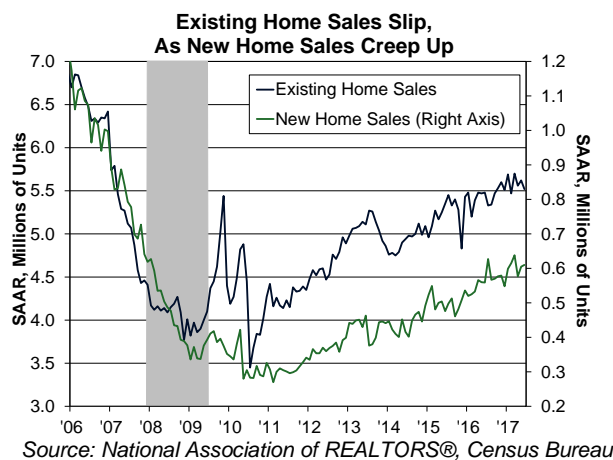
Source: University of Michigan and Conference Board



# Housing: The Saga of Low Supply and High Demand

Housing data released this week featured soft home sales for June. New home sales improved only slightly on the heels of sizable downward revisions, while existing home sales fell for the second time in three months. For the second quarter, both new and existing home sales declined from the prior quarter. The limited number of homes for sale is still holding back the market. The number of existing homes for sale has declined year-over-year for more than two years, and while the for-sale inventory of new homes has increased over the past year, the level remains historically low. Tight inventory continues to support home prices, as the Federal Housing Finance Agency and the S&P/Case-Shiller home price indices maintained strong annual growth in May. In other news, the Census Bureau released the Housing Vacancy Survey (HVS) for the second quarter, showing the first back-to-back annual increases in the homeownership rate since 2006, supporting our view that the rate is stabilizing following the multi-year downtrend. On a disappointing note, the survey reported the weakest annual household formation since the fourth quarter of 2015 as a result of a large drop in renter households, the first decline in 13 years. Homeowner households, on the other hand, posted the fastest annual rise in more than 12 years. Consistent with the shift from renting to owning, the rental vacancy rate rose to a seven-quarter high as the homeowner vacancy rate dipped to a 16-year low. Results from the HVS, especially on household formation, are volatile from quarter to quarter, and thus we caution against reading too much from each quarter's data. Lastly, mortgage demand was little changed last week as a rise in refinance applications outweighed a drop in purchase applications. Mortgage rates remain supportive of mortgage demand, with the 30-year fixed mortgage rate falling 4 basis points to 3.92 percent this week, according to Freddie Mac.

- **New single-family home sales** edged up 0.8 percent in June to a 610,000 seasonally-adjusted annualized rate (SAAR), according to the Census Bureau. Sales over the prior three months were revised downward 27,000, on net. Through the first six months of the year, new home sales are 11.0 percent higher than the same period a year ago. The number of homes for sale increased 1.1 percent from May and 13.2 percent from June 2016. The months' supply (inventory-to-sales ratio) was 5.4 months, two-tenths higher than last June.
- **Existing home sales** fell 1.8 percent in June to 5.52 million units (SAAR), according to the National Association of REALTORS®. Year-to-date sales were 3.0 percent higher than sales during the first six months of last year. From a year ago, the number of homes for sale fell 7.1 percent, while the months' supply slipped two-tenths to 4.3 months.
- **The Housing Vacancy Survey (HVS)** for Q2 2017 showed that the homeownership rate (not seasonally adjusted) was 63.7 percent, eight-tenths higher than in Q2 2016, according to the Census Bureau. The rental vacancy rate rose to 7.3 percent, while the homeowner vacancy rate edged down to 1.5 percent. The number of households increased 558,000 from a year ago, as homeowner households rose 1.26 million and renter households fell 702,000.
- **The S&P/Case-Shiller National Home Price Index** (not seasonally adjusted) rose 1.0 percent in the three months ending in May, posting a 5.6 percent annual rise for the fifth consecutive month. **The FHFA Purchase-Only House Price Index**, reported on a seasonally-adjusted basis, rose 0.4 percent from April and 6.9 percent from a year ago.
- **Mortgage applications** edged up 0.4 percent for the week ending July 21, according to the Mortgage Bankers Association. Refinance applications rose 3.4 percent, while purchase applications declined 2.2 percent. The survey's average 30-year fixed mortgage rate fell 5 basis points to 4.17 percent.



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