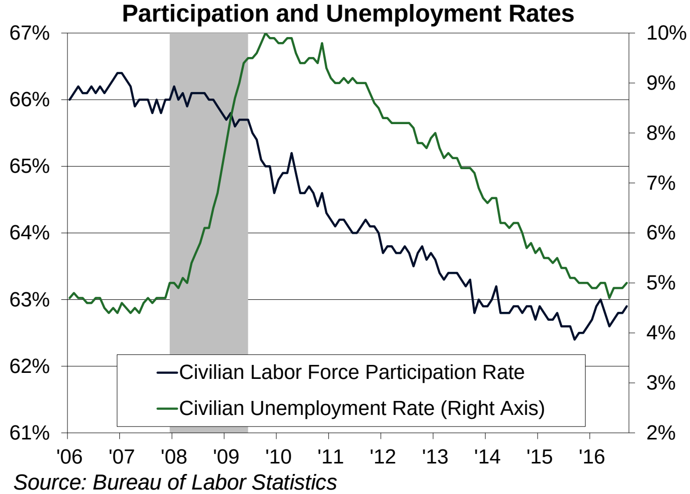
Weekly Note – October 7, 2016

Economics: Labor Market Holds Up Its End of the Bargain

The biggest news this week – the jobs report – conveyed a decent picture for the labor market in September. Job gains were healthy, the average workweek rebounded, and annual earnings growth picked up. The unemployment rate edged up but for a good reason, as a large number of people joined the labor force, slightly outweighing the gain in household employment. Interestingly, the three-month average gains in both nonfarm payrolls and private payrolls were exactly the same as those in September 2015, a couple of months before the first rate hike this cycle. In addition, the U.S. economy has added jobs every month for six consecutive years, the longest streak of continuous payroll gains on record. While labor market conditions by themselves are not a hurdle for the Fed to raise the fed funds rate this year – something Fed officials said they want to do – several weak spots in the economy, including the housing sector, and the lack of inflation pressures may curb the Fed's enthusiasm. Other news this week was largely positive. Two surveys of purchasing managers reported a rebound in activity in September for both the manufacturing and service sectors after surprising drops the prior month. The manufacturing index indicated the sector resumed its expansion after dipping into contraction territory in August while the service sector index jumped to an 11-month high. Auto sales also bounced back in September to a pace slightly above the annual average so far this year. Encouragingly for manufacturing, exports rose for the third straight month in August, although the third rise in the past four months in imports caused the trade deficit to widen slightly. In real terms, the trade deficit narrowed for the second consecutive month, suggesting that net exports likely contributed to third quarter economic growth.

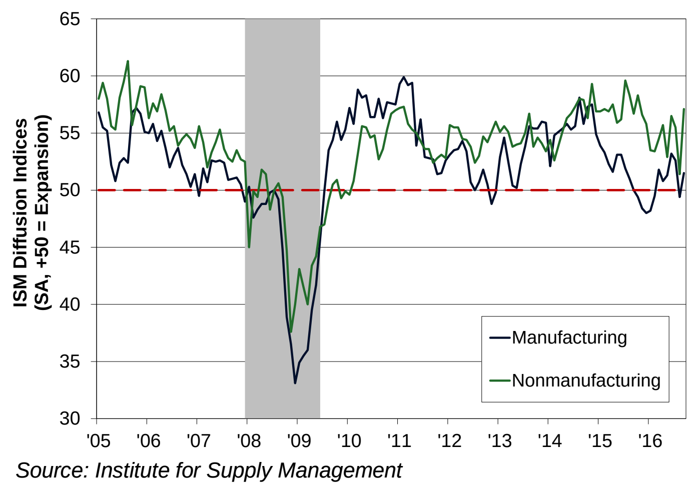
- **Nonfarm payroll employment** expanded by 156,000 in September, according to the Bureau of Labor Statistics. The three-month average change moderated from 230,000 in August to 192,000. The past two months' gains were revised downward by 7,000 on net. The unemployment rate ticked up one-tenth to 5.0 percent, as the participation rate edged up one-tenth as well to 62.9 percent. Average hourly earnings increased 0.2 percent from August and 2.6 percent from one year ago. The average workweek rose one-tenth to 34.4 hours. The broadest measure of the unemployment rate (U-6) was unchanged at 9.7 percent for the third straight month.
- **The Institute for Supply Management (ISM) Manufacturing Index** increased 2.1 points to 51.5 in September (any reading above 50 indicates expansion), as every component except supplier deliveries rose. **The ISM Nonmanufacturing Index**, a gauge of service sector activity, jumped 5.7 points to 57.1 in September. Business activity, new orders, and employment all rose sharply, as suppliers' deliveries slipped slightly.
- **Factory orders** edged up 0.2 percent in August, marking the second monthly rise, according to the Census Bureau. Nondurable goods, the new piece of data in the report, also increased 0.2 percent, after falling 0.8 percent the prior month. Core capital goods (nondefense excluding aircraft) new orders and shipments both were revised upward, though shipments still fell slightly during the month.
- **Light vehicle sales** improved 4.5 percent to a 17.8 million annualized rate in September, according to Autodata.
- **The U.S. trade deficit** widened by $1.2 billion in August to $40.7 billion, according to the Census Bureau. The 1.2 percent increase in imports outweighed the 0.8 percent rise in exports. The inflation-adjusted goods deficit, used in the calculation of net exports in the GDP estimate, narrowed by $747 million to $57.5 billion.

A Large Gain in the Labor Force Pushes Up the Participation and Unemployment Rates



Source: Bureau of Labor Statistics

Manufacturing and Service Sectors Rebound



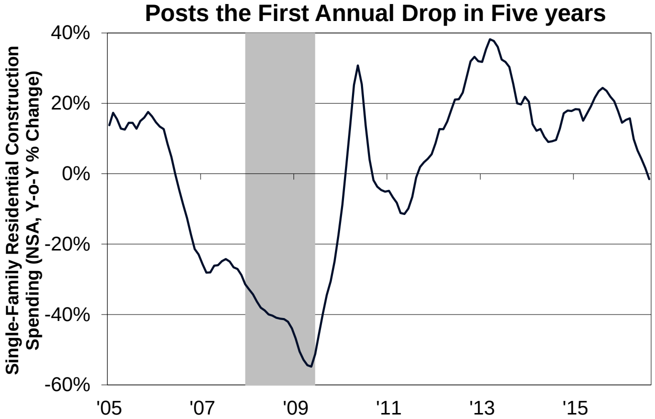
Source: Institute for Supply Management

Housing: Residential Investment Hits a Soft Patch

The week's news was a mixed bag, including bearish residential investment, strengthening home price appreciation, and improving mortgage demand. New construction spending fell in August for the fifth consecutive month. Combined with a decline in existing home sales in July and August (which affects residential investment through broker commissions), recent trends in new construction spending suggest that residential investment likely posted another sizable decline in the third quarter following the 7.8 percent annualized drop in the second quarter. This would result in back-to-back drops in residential investment for the first time since the first quarter of 2014 and for only the second time in the current expansion. On the home price front, the CoreLogic house price index showed the biggest annual gain in more than two years in August. Prices at the lower end of the market exhibited stronger appreciation than the national average, presenting a continuing affordability challenge for potential first-time home buyers. Finally, data from the Mortgage Bankers Association showed that purchase applications were little changed during the last week of September, while refinance applications rose for the first time in three weeks as mortgage rates fell. Average purchase applications during the month of September rose for the first time in three months, suggesting that home sales will likely rebound in late 2016 – an encouraging development following last week's report of a decline in August pending home sales. However, average refinance applications fell in September for the second consecutive month. The average 30-year fixed mortgage rate was unchanged at 3.42 percent this week, according to Freddie Mac's survey.

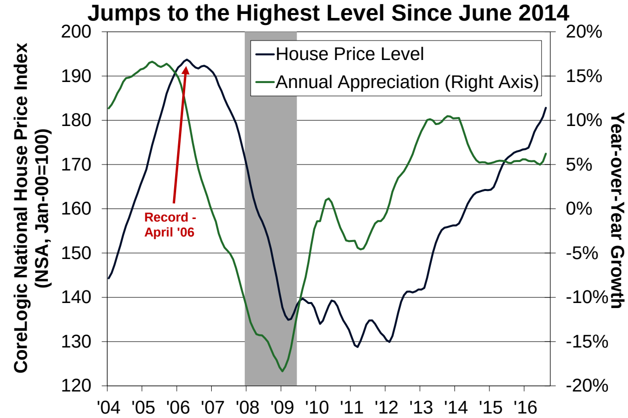
- **Private residential construction spending** fell 0.3 percent in August, according to the Census Bureau. Spending for new construction also dropped 0.3 percent, as the 0.9 percent decline in single-family spending outweighed the 2.4 percent increase in new multifamily spending. Home improvement spending fell 0.3 percent. From a year ago, new single-family construction spending fell 1.5 percent, the first annual drop since August 2011. Although multifamily construction spending increased 15.5 percent from August 2015, the annual gain was the weakest since October 2011.
- **The CoreLogic National Home Price Index**, a repeat sales measure, rose 1.1 percent in August (not seasonally adjusted). From a year ago, prices rose 6.2 percent, the biggest gain since June 2014. Although prices have increased 42 percent since the trough in March 2011, they are still 5.6 percent below the April 2006 peak. At the state level, the biggest annual gain was in Oregon, with a 10.3 percent increase, followed by Washington and Colorado. Connecticut remains the only state with annual home price declines. In addition to the overall indices, CoreLogic reports four home price tiers calculated relative to the median national home price. The low-price tier (75 percent or less of the median) rose 9.0 percent from one year ago, compared with 7.5 percent for the low-to-middle tier (between 75 and 100 percent of the median) and 6.6 percent for the middle-to-moderate tier (between 100 and 125 percent of the median). The high-price tier (greater than 125 percent of the median) rose 5.0 percent year.
- **Mortgage applications** rose 2.9 percent for the week ending September 30, according to the Mortgage Bankers Association. Purchase mortgage applications edged down 0.1 percent, while refinance applications increased 4.7 percent, the first rise in three weeks. Average purchase applications for September increased 3.7 percent over the prior month, compared with a 2.4 percent drop in average refinance applications. The average 30-year fixed mortgage rate fell four basis points to 3.62 percent, the lowest level since the week ending July 8.

New Single-Family Construction Spending Posts the First Annual Drop in Five years



Source: Census Bureau

Home Prices Push Higher, as Annual Growth Jumps to the Highest Level Since June 2014



Source: CoreLogic

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