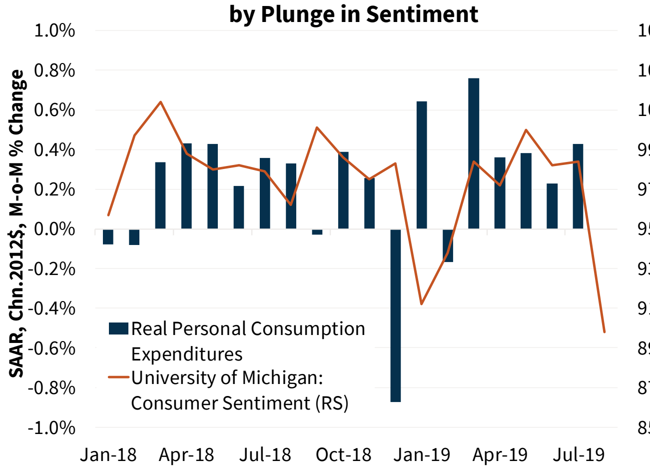
Economics: Sliding Sentiment Threatens Strong Spending

Real consumer spending increased strongly in July, supported by a steep decline in personal current taxes and a resulting increase in real disposable personal income. The broad-based gain in consumption bodes well for third quarter consumption growth, but we still expect it to moderate from the second quarter's impressive 4.7 percent annualized pace. One downside risk to continued consumer spending is declining sentiment. Two measures of consumer sentiment fell in August, both driven mainly by steep drops in expectations. According to the University of Michigan survey, consumer sentiment posted the largest monthly decline since December 2012 with roughly one-third of respondents making negative references to tariffs. If U.S.-China trade tensions continue to escalate, sentiment may continue to slide, dragging down consumption and weakening one of the primary drivers of continued GDP growth. Manufacturing data were also concerning this week. Although headline durable goods orders rose for the second consecutive month in July, the gain was largely due to a spike in the nondefense aircraft segment from Boeing orders, while new orders outside of the transportation segment fell 0.4 percent. The annual increase in the Fed's preferred measure of inflation accelerated slightly in July but remained below the Fed's 2.0 percent target for the ninth straight month, while core inflation (excluding food and energy) was unchanged from the prior month and was also well below the Fed's target rate. The second print of second quarter real GDP growth showed a one-tenth downgrade, with every component revised lower except personal consumption expenditures, which was revised up to its fastest annualized pace since 2014. The most important piece of good news aside from continued strength in consumer spending was after-tax corporate profits, which increased from the prior quarter and from the prior year – after year-over-year profits had declined in the first quarter for the first time since 2016.

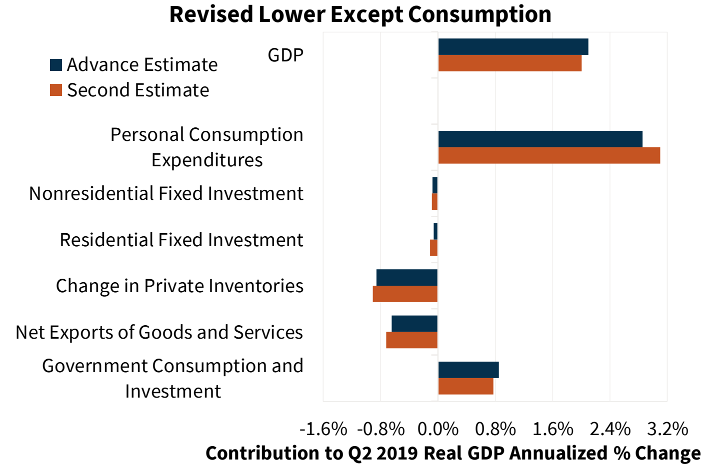
- **Personal income**, adjusted for inflation, edged down 0.1 percent in July, according to the Bureau of Economic Analysis. Real disposable income, however, rose 0.1 percent. Real PCE increased 0.4 percent from June and 2.7 percent from a year ago. The personal saving rate fell three-tenths to 7.7 percent, the lowest level this year. The PCE deflator edged up 0.2 percent over the month and 1.4 percent annually. The core deflator also rose 0.2 percent in July but was up 1.6 percent year over year.
- **The University of Michigan Consumer Sentiment Index** fell 8.6 points to 89.8 in the final August reading, driven by a large drop in the expectations component and a smaller drop in the current conditions component. **The Conference Board Consumer Confidence Index** edged down 0.7 points in August to 135.1. The present situation component jumped 6.3 points, rising strongly for the second consecutive month, while the expectations component dropped 5.4 points.
- **Durable goods orders** rose 2.1 percent in July, according to the Census Bureau. The largest growth in aircraft orders in nearly a year drove the increase. Shipments of durable goods declined 1.1 percent, the first drop in three months, and were dragged down by a sharp drop in the commercial aircraft component. Core capital goods shipments (nondefense excluding aircraft) dropped 0.7 percent, while core capital goods orders rose 0.4 percent, increasing for the third straight month.
- **Gross domestic product**, adjusted for inflation, expanded 2.0 percent annualized in Q2 2019, according to the second estimate from the Bureau of Economic Analysis. Personal consumption expenditures were revised up and remained the largest driver of growth, contributing 3.1 percentage points to the headline gain. The largest detractors from growth were business inventories and net exports; neither had significant revisions. Corporate profits (before taxes) rose 5.3 percent from the prior quarter (not annualized) as profits for both domestic and foreign firms increased. From a year ago, profits rose 2.7 percent both before and after taxes.

Future Consumer Spending Threatened by Plunge in Sentiment



Source: University of Michigan, Bureau of Economic Analysis

Every Component of Second Quarter Growth Revised Lower Except Consumption

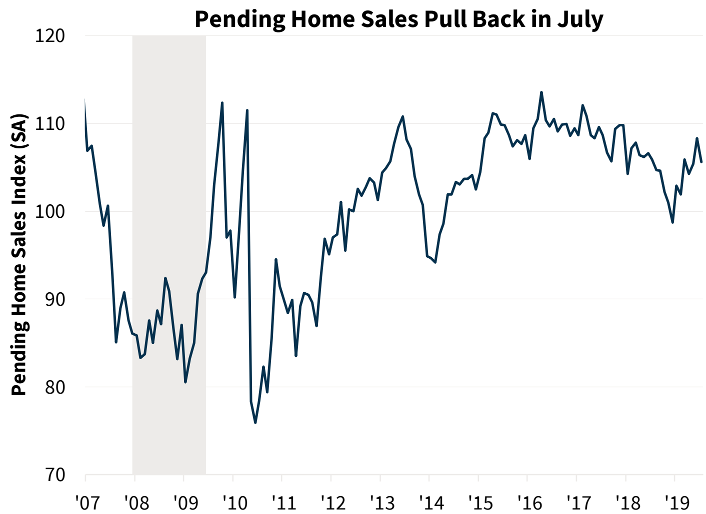


Source: Bureau of Economic Analysis

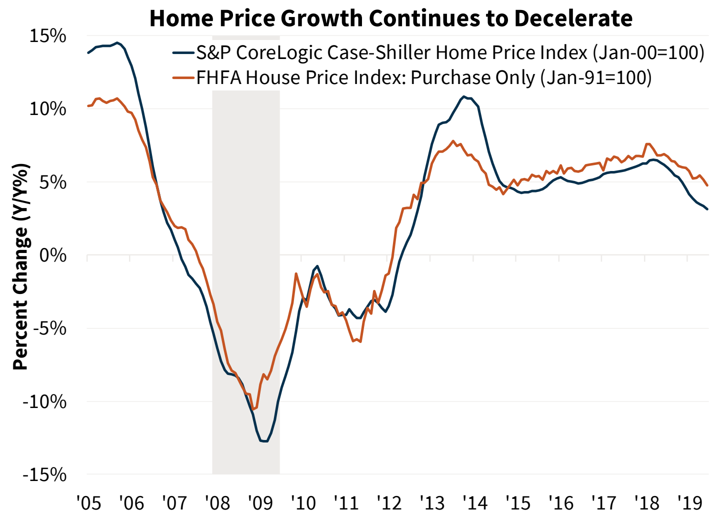
Housing: Steep Drop in Pending Sales Could Portend Lower Q3 Existing Sales

After two months of increases, pending home sales in July showed the largest drop since January 2018, essentially erasing the gain we saw in June. The decline in pending sales comes at a time when affordability conditions have generally improved. The average rate on 30-year fixed-rate mortgages rose 3 basis points this week to 3.58 percent, according to Freddie Mac, but remains near the lowest level since November 2016 and 94 basis points below year-ago levels; on a monthly basis, the average mortgage rate declined in August for the ninth consecutive month to 3.62 percent. While home prices remain at historically elevated levels, home price appreciation continued to decelerate on an annual basis in June: According to the S&P CoreLogic Case-Shiller National Home Price Index, home price growth decelerated for the fourteenth straight month to the slowest annual pace since September 2012, and according to the FHFA Purchase-Only Index, year-over-year home price growth decelerated to the slowest pace since October 2014. While low mortgage rates and the deceleration in home price growth should encourage homebuying sentiment, these improvements are being overshadowed by a scarcity of affordable housing supply and increased economic uncertainty. These factors, in combination with the sharp pullback in pending home sales, suggest a more modest outlook for existing home sales during the remainder of the third quarter. Supporting that view, mortgage applications also fell last week. While the steep decline last week in mortgage refinance applications can likely be attributed to mean reversion from the spike seen in mid-August, we believe the drop in purchase applications to the lowest level since February was likely due to homebuyer caution in response to recent uncertainty over trade and concerns over slower domestic growth.

- **The National Association of REALTORS® Pending Home Sales Index**, which records contract signings of existing homes and typically leads closings by one to two months, fell 2.5 percent in July. From a year ago, pending home sales dipped 0.3 percent. Pending sales fell in all four Census regions.
- **S&P CoreLogic Case-Shiller National Home Price Index** (not seasonally adjusted) rose 0.6 percent in June. From a year ago, the index rose 3.1 percent in June, and 3.3 percent in the second quarter. **The FHFA Purchase-Only House Price Index**, reported on a seasonally adjusted basis, rose 0.1 percent in June and 0.9 percent over the second quarter, the first quarter to see growth below 1.0 percent since the end of 2013. From a year ago, the index rose 4.7 percent in June, and 5.1 percent in the second quarter.
- **Mortgage applications** decreased by 6.2 percent in the week ending with August 23, according to the Mortgage Bankers Association. Refinance applications and purchase applications fell by 7.6 percent and 4.0 percent, respectively.



Source: National Association of REALTORS®



Source: Standard & Poor's, Federal Housing Finance Agency

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