Economics: A Slowdown in Underlying Demand May Continue in This Quarter

This week offered the first glimpse of Q3 2015 economic growth, which slowed markedly from the prior quarter. While growth in consumer spending, business investment, and housing moderated from Q2, the sole negative component of economic growth was an expected inventory drawdown from unsustainable levels during the first half of the year. Other reports this week point to less rosy near-term outlooks for consumer and business capital spending. The September durable goods orders report showed back-to-back drops in core capital goods orders, a leading indicator of business equipment spending. The continued decline raised some concern that the strong pickup in business equipment reported for Q3 could be short-lived. In addition, the September personal consumption expenditures (PCE) report showed that while consumer spending growth was solid for Q3 as a whole, it lost momentum heading into Q4. Core PCE annual inflation remained stuck at the rate seen most of this year. The Federal Open Market Committee (FOMC) met this week and kept the fed funds rate unchanged, as universally expected. The FOMC's statement added "Household and business fixed investment have been increasing at solid rates," which seems at odds with the latest data. The statement removed the reference that recent global economic and financial developments are likely to put downward pressure on inflation, signaling that the committee is less concerned about overseas events. The Fed also stated that it will assess progress toward its goals of maximum employment and 2.0 percent inflation to see if it will raise the rate "at its next meeting." By explicitly mentioning the December meeting, the Fed is attempting to persuade market participants that a December rate hike is on the table, which pushed up fed funds futures' odds of a December liftoff to a coin toss.

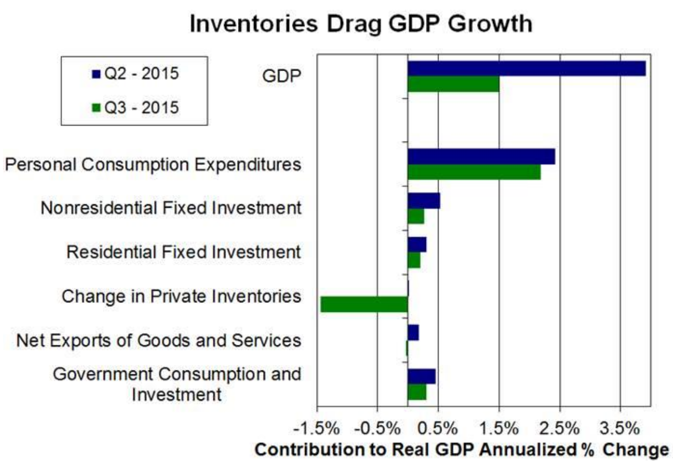
- **Gross domestic product (GDP)**, adjusted for inflation, grew 1.5 percent annualized in Q3 2015, slowing from 3.9 percent in Q2, according to the Bureau of Economic Analysis (BEA)'s advance estimate. Real consumer spending rose 3.2 percent, while nonresidential and residential fixed investment advanced 2.1 percent and 6.1 percent, respectively. Final sales to private domestic purchasers—a gauge of underlying domestic demand—rose at a solid 3.2 percent rate, albeit moderating from 3.9 percent in Q2. Real government spending increased 1.7 percent. Real inventory investment slowed to $56.8 billion, subtracting 1.4 percentage points from GDP growth, while net exports were essentially neutral to growth.

- **Personal Consumption Expenditures**, adjusted for inflation, rose 0.2 percent in September following a 0.4 percent rise in August, according to the BEA. The core PCE price index rose 0.1 percent from August and 1.3 percent from a year ago.

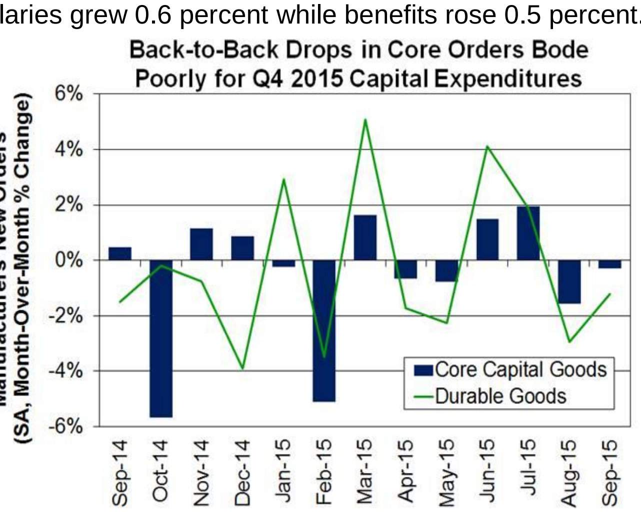
- **The University of Michigan Consumer Sentiment Index** rose 2.8 points from September to 90 in the final October reading, driven largely by the expectations component. Long-term expected inflation dropped to 2.5 percent, matching the record low set in September 2002. **The Conference Board Consumer Confidence Index** fell 5 points to 97.6 in October, due to a sharp drop in the present situation index and a modest decline in the expectations component.

- **Durable goods orders** fell 1.2 percent in September, driven by a large decline in nondefense aircraft orders, according to the Census Bureau. Core capital goods orders (nondefense capital goods excluding aircraft) fell 0.3 percent after a 1.6 percent drop in August, a downgrade from the 0.8 percent decline initially reported.

- **The Employment Cost Index (ECI)** rose 0.6 percent in Q3 2015, rebounding from a record low gain of 0.2 percent in Q2, according to the Bureau of Labor Statistics. Wages and salaries grew 0.6 percent while benefits rose 0.5 percent.



Source: Bureau of Economic Analysis



Source: Census Bureau

Housing: Near-term Pain Gives Way to Improving Outlook

Housing data released this week featured signs of improving long-term health for the housing market in the midst of short-term pains. The long-term view centered around household growth, which continued its recent surge, rising on a year-over-year basis by well over a million new households for the fourth consecutive quarter, after previously crossing the one million threshold only once in the current expansion. The makeup of new households offered good news for the single-family housing market, as owner households ticked up on an annual basis for the first time in five quarters. On an additional positive note, the homeownership rate rose for the first time in eight quarters, lifting off of last quarter's 48-year low. There was short-term pain on the home sales front, however. Pending home sales, which measure contract signings of existing homes, fell in September for the second consecutive month, while September new home sales, which record contract signings of new homes rather than closings, posted the biggest drop since July 2013. House prices showed the strongest annual appreciation in about a year, according to the S&P/Case-Shiller Home Price Index. After dramatic swings in recent weeks associated with the new disclosure regulation (TRID), mortgage applications pulled back modestly last week. The 30-year fixed mortgage rate fell for the sixth time in seven weeks, edging down three basis points to 3.76 percent, according to Freddie Mac's survey.

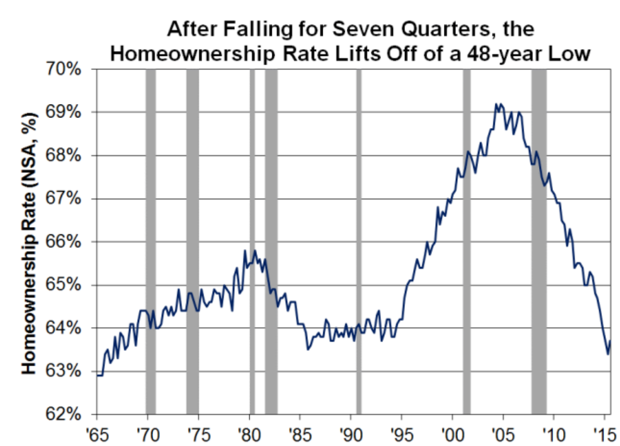
➢ **New single-family home sales** fell 11.5 percent in September to 468,000 annualized units, according to the Census Bureau. Through the first nine months of the year, sales were 16.7 percent higher than during the same period a year ago. The number of new single-family homes available for sale (reported on a seasonally adjusted basis) increased 4.2 percent in September after falling the previous month. The months' supply (inventory/sales ratio) jumped nine-tenths of one percentage point to 5.8, the highest level since July of last year. The median sales price, which is not adjusted for the composition of sales, is 13.5 percent higher than a year ago, the largest annual appreciation in more than a year.

➢ **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, declined 2.3 percent in September after also falling 1.4 percent in August. However, pending sales are still up 2.5 percent from a year ago.

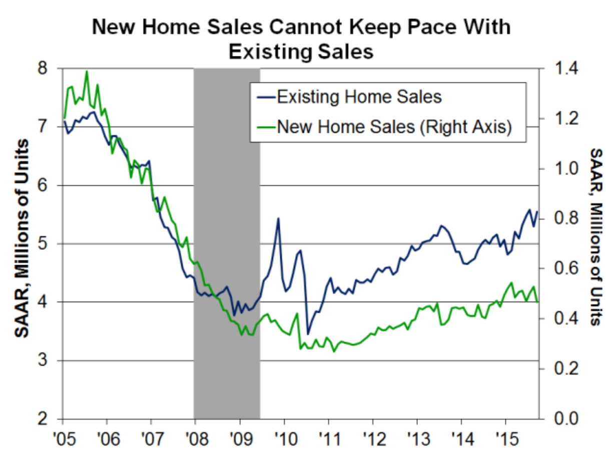
➢ **The Census Bureau's Housing Vacancy Survey (HVS)** for Q3 2015 showed a 0.3 percentage point quarterly rise (not seasonally adjusted) in the homeownership rate to 63.7 percent, the first increase since Q3 2013. However, the rate is 0.7 percentage points below the level a year ago. The number of households increased by 67,000 from the prior quarter. From a year ago, household growth posted a 1.4 million increase, boosted by a gain in rental households and the first rise in owner households for the first time since Q2 2014. The homeowner vacancy rate ticked up to 1.9 percent from last quarter's expansion low of 1.8 percent. The rental vacancy rate increased one-half of a percentage point, the largest rise since Q3 2011, to 7.3 percent.

➢ **The S&P/Case-Schiller composite 20-city home price index** (not seasonally adjusted) rose 0.4 percent in the three months ending in August. The index increased 5.1 percent from a year ago, the biggest gain since August 2014. The national home price index rose 4.7 percent from last August, the largest annual appreciation since September 2014.

➢ **Mortgage applications** decreased 3.5 percent in the week ending October 23, according to the Mortgage Bankers Association. Purchase applications fell 3.1 percent. Refinance applications decreased 3.8 percent as the survey's 30-year fixed mortgage rate rose for the first time in seven weeks, edging up three basis points to 3.98 percent.



Source: Census Bureau



Source: National Association of REALTORS®, Census Bureau

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