Economics: Third Quarter Growth Upgrade Adds Downside Risk to Outlook

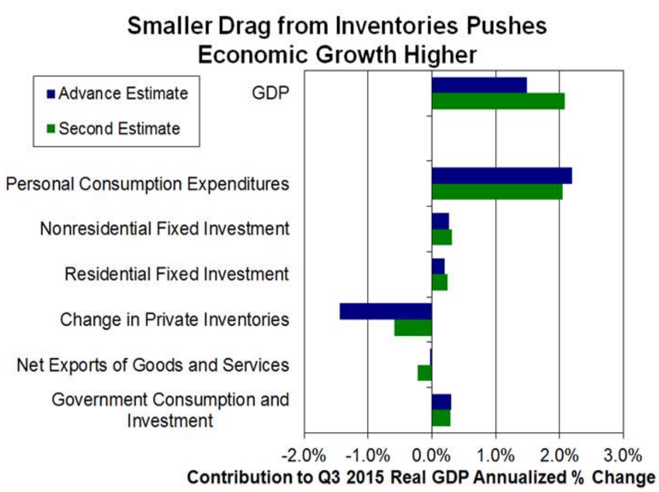
This week's economic reports have negative implications for economic growth for the current quarter. While Q3 2015 gross domestic growth was revised higher in the government's second estimate, the upward revisions were largely in inventory investment, which remains unsustainably high. This suggests that a large unwind in stockpiles could be a bigger drag on growth this quarter, presenting downside risk to our forecast for Q4 2015 economic growth of 2.6 percent annualized. The second estimate of GDP offered the first glimpse of corporate profits, which had the worst year-over-year decline since the recession, hurt by weak global growth. Because corporate profits, especially those from domestic industries, have implications for hiring and capital investment, their trend bears careful watching. This week's reports also provide insights into both consumer and business spending for this quarter, and the news isn't rosy. Real consumer spending remained anemic in October amid the highest saving rate in nearly three years, and two measures of consumer confidence were mixed in November. The October durable goods report showed a drop in core shipments, which is an input to estimate business equipment spending, but the forward-looking core orders is encouraging, posting the biggest gain since July. Overall, this week's reports suggest weaker consumer and business spending growth in Q4 2015 than we projected in our November forecast, and a potentially bigger drag from inventory investment during the quarter.

- **Gross domestic product (GDP)**, adjusted for inflation, rose 2.1 percent annualized in Q3 2015, according to the Bureau of Economic Analysis (BEA). The upward revision of 0.6 percentage points from the first estimate was largely a result of a sizable upgrade to inventory investment. Following an unsustainable pace of $113.5 billion in Q2 2015, inventory investment moderated to $56.8 billion in the first estimate but was revised higher to $90.2 billion in the second estimate. As a result, the inventory drag on GDP was revised lower to 0.6 percentage points from an initial estimate of 1.4 percentage points. Real consumer spending growth was revised down from 3.2 percent to 3.0 percent. Upward revisions in nonresidential and residential investment spending roughly offset a downward revision in net exports. Corporate profits fell 1.1 percent (not annualized) from the prior quarter and 4.7 percent from a year ago, the biggest drop since Q2 2009, as profits from domestic industries rose modestly while those from the rest of the world fell sharply.

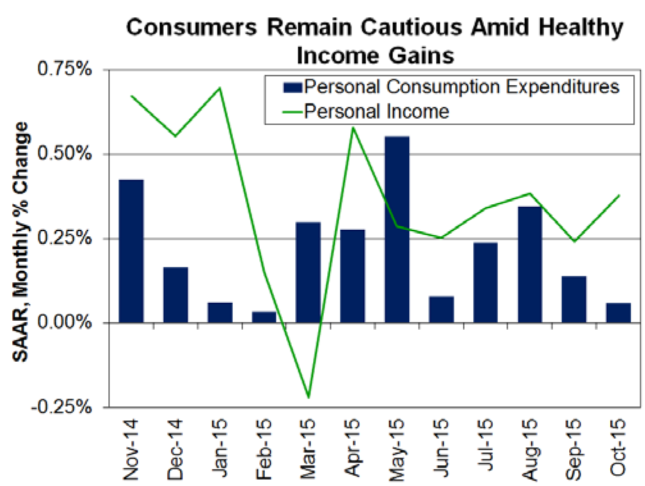
- **Personal income**, adjusted for inflation, rose 0.4 percent in October, according to the BEA. Strong wage and salary income growth drove the gain. Real personal consumption expenditures (PCE) ticked up 0.1 percent. The saving rate rose to 5.6 percent, the highest level since December 2012. The PCE deflator edged up 0.1 percent, while the core index was unchanged from September and was up 1.3 percent from a year ago for the 10^{th} consecutive month.

- **The Conference Board Consumer Confidence Index** dropped 8.7 points to 90.4 in November, the lowest reading since September 2014. Deterioration in consumers' current assessment and outlook for labor market and business conditions largely drove confidence lower. **The University of Michigan Consumer Sentiment Index** rose 1.3 points to 91.3 in the final November reading, marking the second consecutive monthly gain.

- **Durable goods orders** rose 3.0 percent in October, the first rise in three months, boosted by volatile aircraft orders, according to the Census Bureau. Core shipments (nondefense capital goods excluding aircraft), dropped 0.4 percent. However, core orders rose 1.3 percent and the 0.3 percent decline in September was revised to a 0.4 percent gain.



Source: Bureau of Economic Analysis



Source: Bureau of Economic Analysis

Housing: Keep Calm and Carry On: Housing Stays on Track for a Strong 2015

A busy week in housing data suggested the housing market remains on course for its best year since 2007, even with a couple of month-to-month hiccups. Home sales had a mixed October, as new home sales recovered from September's stumble with their largest increase this year, but existing sales dropped for the second time in three months. However, both measures posted significant gains from 2014 levels. Inventories continue to be a concern, as the number of existing homes for sale has dropped persistently on an annual basis since June, with the October decline the largest since August 2013. Tighter inventories have created upward pressure on prices, as two key home price indices from the FHFA and S&P/Case-Shiller jumped both on a monthly and an annual basis in September, consistent with the previously released CoreLogic index. Volatility caused by the early October implementation of the new TRID regulations has made it difficult to assess the underlying trend in recent purchase mortgage demand. Following a double-digit jump in the prior week, purchase applications were little changed last week. Meanwhile, despite a drop in mortgage rates, refinancing applications resumed their declining trend after rising in the previous week for the first time in five weeks. Rates declined further this week, with the 30-year fixed mortgage rate dropping two basis points to 3.95 percent, according to Freddie Mac's survey.

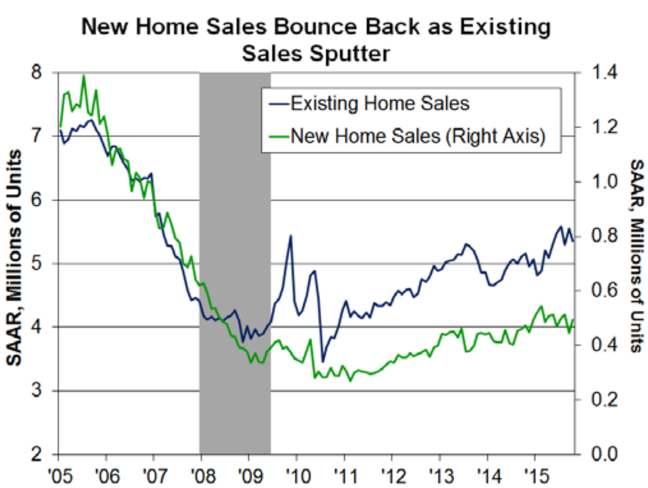
- **New single-family home sales** rebounded in October, rising 10.7 percent to 495,000 annualized units, according to the Census Bureau. Through October, year-to-date sales are up 15.0 percent from a year ago. The number of homes for sale, which is reported on a seasonally adjusted basis, rose for the second month in a row, increasing 1.3 percent. However, the months' supply (inventory/sales ratio) fell to 5.5 months from 6.0 months. The median sales price, which is not adjusted for the composition of sales, fell 6.0 percent from last year, marking the first annual decline since September 2014.

- **Existing home sales** dropped 3.4 percent to 5.36 million annualized units in October after surging 4.7 percent in September, according to the National Association of REALTORS®. Through the first 10 months of the year, sales are up 7.2 percent from the same period a year ago. The number of homes for sale, which is not seasonally adjusted, fell year-over-year for the fifth consecutive month, declining 4.5 percent from October 2014. The months' supply was 4.9 months, compared with 5.2 months a year ago. The median sales price of existing homes increased 5.8 percent from a year ago.

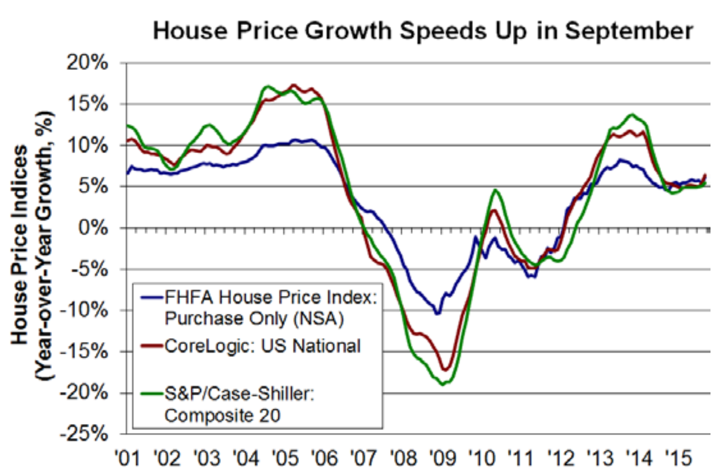
- **The FHFA purchase-only house price index**, reported on a seasonally adjusted basis, jumped 0.8 percent in September, the largest month-over-month increase since March 2013. From a year ago, the index rose 6.1 percent, the largest annual appreciation since March 2014. Prices in all nine Census divisions increased from last September.

- **The S&P/Case-Shiller composite 20-city home price index** (not seasonally adjusted) edged up 0.2 percent in September. From a year ago, the index increased 5.5 percent, the largest gain since last August. Of the 20 cities, San Francisco and Denver posted the highest annual appreciation, while price gains were smallest in Washington, D.C. and Chicago. The national index also posted the largest gain since August 2014, rising 4.9 percent.

- **Mortgage applications** declined 3.2 percent in the week ending November 20, according to the Mortgage Bankers Association. After a solid gain the previous week, purchase applications edged down 0.5 percent. Refinancing applications dropped for the fourth time in five weeks, decreasing 4.8 percent, even though the average contract interest rate for 30-year fixed-rate mortgages fell for the first time in five weeks, declining four basis points to 4.14 percent.



Source: Census Bureau, National Association of Realtors



Source: FHFA, CoreLogic, S&P/Case-Shiller

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