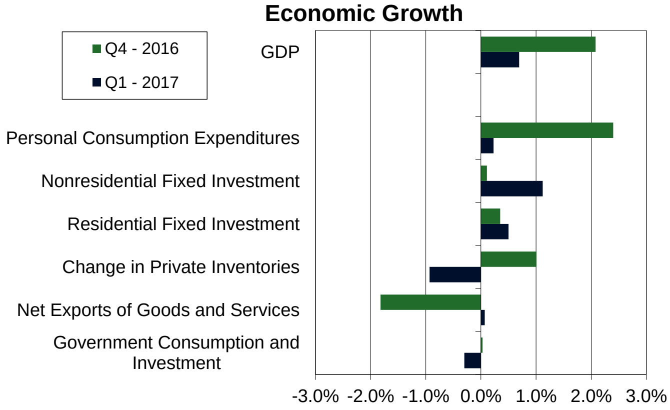
Weekly Note – April 28, 2017

Economics: Economic Growth Fails to Clear the Low Bar

A busy week of economic data offered the first glimpse of first quarter real GDP growth, and the view wasn't pretty as the economy barely grew, compared with 2.1 percent annualized growth in the fourth quarter. This marks the fourth consecutive year that growth has decelerated to start the new year. Weak growth was partly due to residual seasonality—the persistence of seasonal patterns in seasonally-adjusted data. We expect activity to rebound in the second quarter, as the influence of residual seasonality and other special factors that suppressed growth partially unwind. The slowdown in the first quarter this year was largely a result of nearly flat personal consumer expenditures (PCE), which added only 0.2 percentage points to GDP, the smallest contribution since the final quarter of 2009. A pullback in motor vehicle sales from a near-record high at the end of 2016 and the unseasonably warm winter weather, which depressed utilities spending, weighed heavily on overall spending. The bright spot was a broad-based improvement in private fixed investment across structure, equipment, and residential components. Inventories and government expenditures subtracted from GDP, while trade was largely neutral amid a relatively stable dollar and stronger global growth. Inflation also firmed, with the PCE deflator, the Fed's favored measure of inflation, posting the strongest quarterly increase in nearly six years. Another report this week also showed a pickup in labor compensation. The employment cost index rose strongly in the first quarter, registering the biggest quarterly increase since the end of 2007, boosted by strong rises in both wages and benefits. The durable goods orders report suggests that business equipment expenditures will continue to improve this quarter for the third consecutive quarter, as core orders, its leading indicator, rose in March for the sixth straight month. Elsewhere, consumers remained upbeat in April. The Consumer Confidence Index pulled back but remained at the second best level of the expansion, while the Michigan Consumer Sentiment Index was little changed at an elevated level. Given our expectation that the stalled growth of the first quarter will be temporary and inflation and labor compensation measures have shown signs of firming, we continue to expect the Fed to raise the fed funds rate in June.

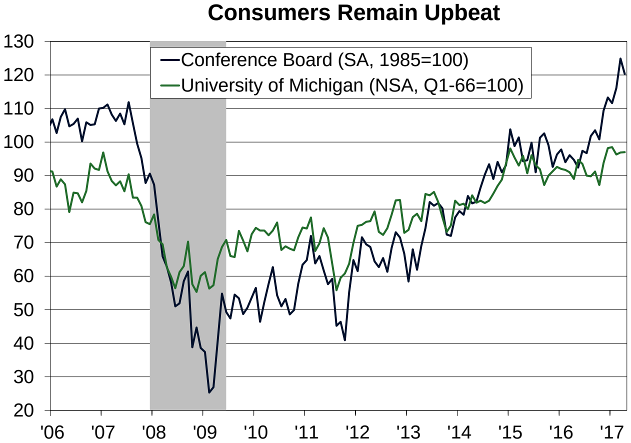
- **Gross domestic product (GDP)**, adjusted for inflation, rose 0.7 percent annualized in Q1 2017, according to the advance estimate from the Bureau of Economic Analysis (BEA). Real consumer spending grew 0.3 percent. Real business fixed investment rose 9.4 percent, and real residential investment increased 13.7 percent. Two drags on GDP were inventories and real government spending, which subtracted 0.9 percentage points and 0.3 percentage points from GDP, respectively. All inflation measures accelerated during the quarter, with the GDP price index increasing 2.3 percent annualized. The PCE and the core PCE price deflators rose 2.4 percent and 2.0 percent annualized, respectively, from the prior quarter.
- **The Employment Cost Index (ECI)** increased 0.8 percent in Q1 2017, according to the Bureau of Labor Statistics, driven by a 0.8 percent rise in wages and salaries, the biggest gain since Q3 2008. Benefits rose 0.7 percent, the most since Q2 2014.
- **The University of Michigan Consumer Sentiment Index** edged up 0.1 points to 97.0 in the final April reading. **The Conference Board Consumer Confidence Index** fell 4.6 points to 120.3 in April.
- **Durable goods orders** rose 0.7 percent in March, according to the Census Bureau. Excluding defense and aircraft orders, core orders rose 0.2 percent, while shipments of core capital goods rose 0.4 percent.
- **Initial claims for unemployment insurance** rose 14,000 to 257,000 in the week ending April 22, according to the Department of Labor. The four-week moving average fell 500 to 242,250.

Sluggish Consumer Spending Growth Hampers Economic Growth



Source: The Bureau of Economic Analysis

Consumers Remain Upbeat



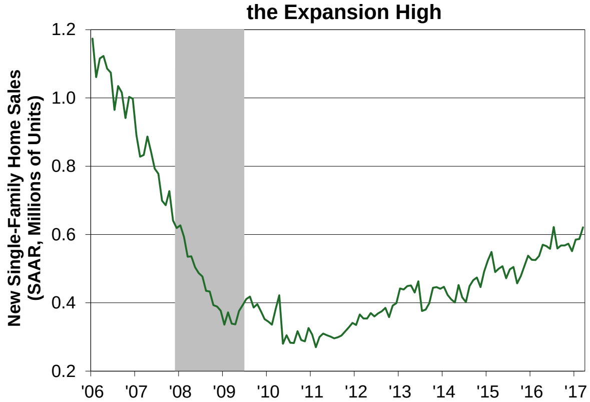
Source: The Conference Board; University of Michigan

Housing: Struggling to Keep Pace with Rising Demand

A busy week of data gave insight into how the housing market is coping with growing demand. First, new home sales climbed in March for the third straight month to a level just 1,000 units below the expansion best. In addition, data for each of the past three months were revised upward, totaling over 40,000 more home sales. The supply of new homes for sale also keeps improving, posting a new expansion high in each of the past seven months, but still remains historically low. Shifting to the existing home market, pending home sales slipped slightly in March from elevated levels as a dearth of supply weighed on contract signing activity. The home sales market is under pressure to provide the necessary supply to meet the demand of a growing number of households. The Q1 2017 Housing Vacancy Survey reported that the number of homeowner households posted the best year-over-year gain in over a decade, overtaking rental household formation for the first time in 10 years. The homeownership rate appears to have stabilized after trending downward since 2004, rising from a year ago for the first time since Q3 2006. The tight supply of homes, combined with increased demand, has created upward pressure on home prices. Two measures of home prices, the Case-Shiller National Home Price Index and the FHFA Purchase-Only Index, saw year-over-year growth accelerate in February to a near three-year high and a six-month high, respectively. In the mortgage market, purchase applications fell last week for the second straight week, reaching a five-week low. In contrast, refinance applications jumped to a five-week high in reaction to the steady decline in mortgage rates over the prior five weeks. This week, however, the average 30-year fixed mortgage rate rose six basis points to 4.03 percent, according to Freddie Mac.

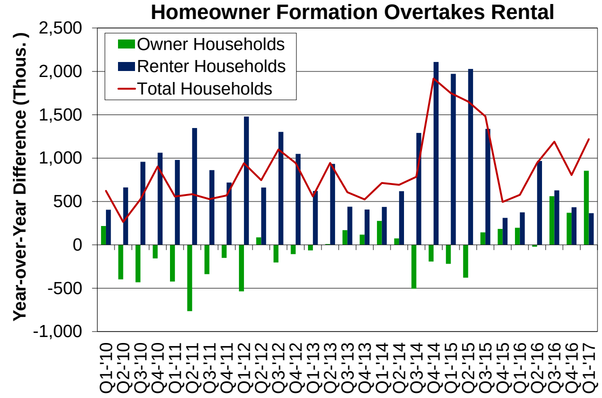
- **New single-family home sales** increased 5.8 percent in March to a seasonally adjusted annualized rate of 621,000, according to the Census Bureau. Sales over the prior three months were revised upward 43,000. Through the first three months of the year, sales are 11.2 percent higher than the same period a year ago. Sales in the West jumped to an expansion high. The number of homes for sale rose 1.1 percent from February, and increased 10.8 percent from a year ago. The months' supply fell two-tenths to 5.2 months. The median sales price, which is not adjusted for the composition of sales, rose 1.2 percent from March 2016.
- **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, slipped 0.8 percent in March.
- **The Housing Vacancy Survey (HVS)** for Q1 2017 (not seasonally adjusted) showed that the homeownership rate edged down one-tenth from the prior quarter to 63.6 percent, but rose one-tenth from Q1 2016, according to the Census Bureau. The homeowner vacancy rate ticked down to 1.7 percent, while the rental vacancy rate ticked up for the third straight quarter to 7.0 percent. The number of households increased 1.22 million from a year ago, as homeowner households increased 854,000 and renter households grew by 365,000.
- **The S&P/Case-Shiller National Home Price Index** (not seasonally adjusted) increased 0.2 percent in the three months ending in February. The index improved 5.8 percent year-over-year. **The FHFA Purchase-Only House Price Index**, reported on a seasonally adjusted basis, rose 0.8 percent in February and 6.5 percent from a year ago.
- **Mortgage applications** increased 2.7 percent in the week ending April 21, according to the Mortgage Bankers Association. Refinance applications drove the gain, rising 7.2 percent, outweighing the 1.0 percent drop in purchase applications. The survey's average 30-year fixed mortgage rate fell two basis points to 4.20 percent.

New Home Sales Climb Higher to Just Below the Expansion High



Source: Census Bureau

Household Formation Increases as Homeowner Formation Overtakes Rental



Source: Census Bureau

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