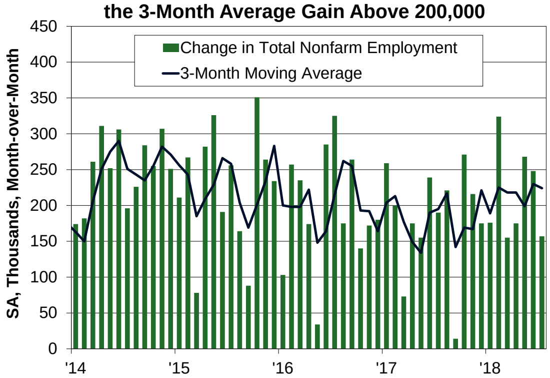
Weekly Note – August 3, 2018

Economics: The Labor Market Hums Along

The labor market stepped into the spotlight this week with a weakened hiring headline in the July jobs report, though the report's details contained much to like. Sizable upward revisions in the prior two months put the 3-month average job gain at 224,000, near the upper-end of this year's range. Furthermore, July's job gain was weighed down by a massive drop in employment in sporting goods and hobby stores, which is likely a one-off event related to the bankruptcy of a major toy company, and thus we do not see any warning signals flashing for the labor market. With annual wage growth holding steady, we continue to expect gradual normalization of monetary policy. The unemployment rate ticked down as the gain in employment outpaced the increase in the labor force, and the broadest measure of labor underutilization (U6) fell to the lowest level in 17 years. In addition, the employment-to-population ratio rose to an expansion high. The strong job market has benefited workers with less than a high school degree, as their unemployment rate fell to a record low since the series began in 1992. Though annual wage growth has shown no signs of accelerating this year, the Fed's preferred measure of inflation has picked up recently and stayed elevated in June. The annual gain in the personal consumption expenditures (PCE) deflator remained at 2.2 percent in June, the fourth straight month at or above the Fed's 2-percent target. The statement following the August Federal Open Market Committee meeting reflected this acceleration, noting that inflation has remained "near 2 percent" rather than "moved close to 2 percent." The Fed also noted the strength of economic growth, propelled by household spending and business fixed investment. We continue to believe that the Fed will raise the fed funds rate in September and December of this year. In other news, real consumer spending increased solidly in June for the fourth straight month. Disposable income and consumer spending rose by the same amount, keeping the saving rate steady. Consumer spending growth will likely slow from the second quarter's robust pace, however, given that vehicle sales fell in July to their lowest level in almost a year. Consumers remain optimistic as confidence rose in July, with the present situation component spiking to a 17-year high. Both factory orders and nondurable goods orders rose to their highest levels in almost four years in June. Finally, the trade deficit widened in June for the first time in four months.

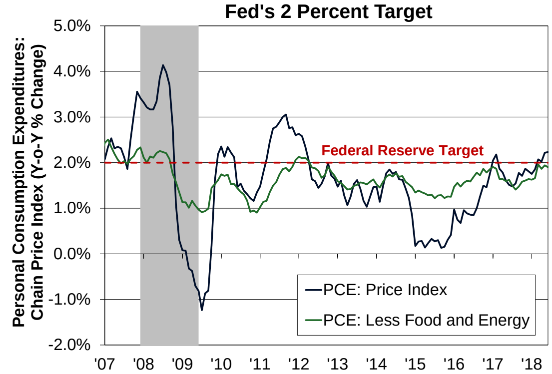
- **Nonfarm payroll employment** expanded by 157,000 in July, according to the Bureau of Labor Statistics. Job gains in the prior two months were revised up 59,000. The unemployment rate fell one-tenth to 3.9 percent while the labor force participation rate was flat at 62.9 percent. The U6 rate fell three-tenths to 7.5 percent. The average workweek ticked down to 34.5 hours. Average hourly earnings increased 0.3 percent from June and 2.7 percent from a year ago.
- **Personal income**, adjusted for inflation, improved 0.3 percent in June, according to the Bureau of Economic Analysis. Real PCE rose 0.3 percent and the saving rate was flat at 6.8 percent. Both the PCE and core PCE deflator rose 0.1 percent from May. Core prices rose 1.9 percent from a year ago for the third consecutive month.
- **The Employment Cost Index**, a measure of labor compensation, increased 0.6 percent (not annualized) in Q2 2018, according to the Bureau of Labor Statistics. Wages increased 0.5 percent, while benefits improved 0.9 percent.
- **Light vehicle sales** fell 2.7 percent to 16.8 million annualized units in July, according to Autodata.
- **The Conference Board Consumer Confidence Index** ticked up 0.3 points in July to 127.4, as a 4.2 point gain in the present situation component outweighed a 2.3 point drop in the expectations component.
- **Factory orders** rose 0.7 percent and factory shipments increased 1.0 percent in June, according to the Census Bureau. Nondurable goods orders, the new piece of data in the report, rose 0.5 percent.
- **The ISM Manufacturing Index** fell 2.1 points to 58.1 in July (any reading above 50 indicates expansion). **The ISM Nonmanufacturing Index**, a gauge of service sector activity, fell 3.4 points to 55.7 in July.
- **The U.S. trade deficit** widened $3.2 billion to $46.3 billion in June, according to the Census Bureau. The inflation adjusted goods deficit, used to calculate net exports in the GDP estimate, widened $3.8 billion to $79.3 billion.

July Hiring Slows, But Large Revisions Keep the 3-Month Average Gain Above 200,000



Source: Bureau of Labor Statistics

Headline Inflation Remains Above the Fed's 2 Percent Target



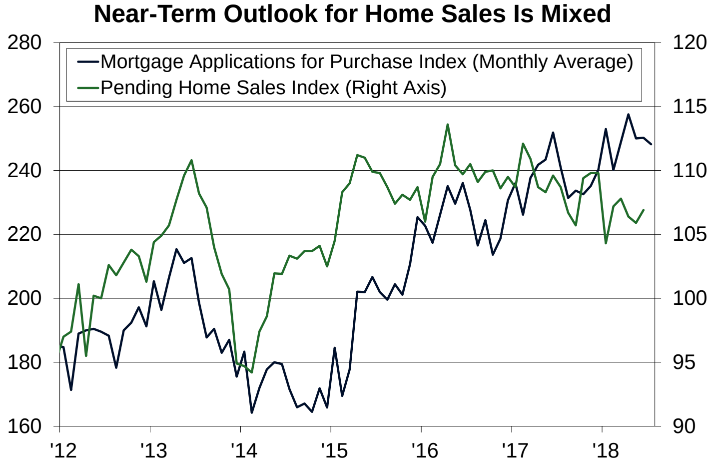
Source: Bureau of Economic Analysis

Housing: Outlook Remains Cloudy

This week's news was on the soft side. While pending home sales (which record contract signings of existing homes and typically lead closings by one to two months) rose in June, the gain was quite small, failing to offset the prior two months' drops. Pending sales have registered annual declines every month so far this year. The other forward-looking indicator of home sales – purchase mortgage applications – fell last week for the third consecutive week, and average monthly applications decreased in July for the second time in three months. Recent trends in pending sales and purchase mortgage demand support our forecast that existing home sales will decline this year for the first time in four years. We expect that declining affordability from strong home price appreciation and rising mortgage rates will continue to squeeze home buyers. Annual appreciation in the S&P CoreLogic Case-Shiller national home price index remained strong in May, staying within a tight range of 6.3 percent to 6.5 percent seen over the last six months. Mortgage rates were up this week for the second consecutive week, with the average 30-year fixed mortgage rate increasing 6 basis points to 4.60 percent, the highest reading since mid-June, according to Freddie Mac. Rising rates have pushed refinancing activity lower, as refinance demand last week hovered near the expansion low and average monthly refinance applications dropped in July for the sixth consecutive month. Lastly, residential construction spending fell more than expected in June, driven lower by both new single-family and multifamily units. The construction spending report pointed to a more pronounced drop in real residential investment in the second quarter than indicated last week in the first estimate of gross domestic product. The trend in new construction spending over the past year has remained bearish. After its recent peak last September, annual growth in single-family construction spending has moderated, with the year-over-year increase in June declining to the weakest showing since September 2016. Meanwhile, the multifamily sector has registered very little growth since the end of 2016.

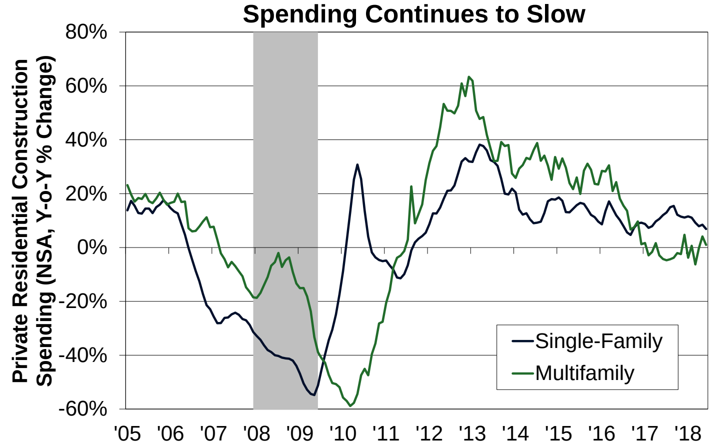
- **The National Association of REALTORS® Pending Home Sales Index** edged up 0.9 percent to 106.9 in June, with all four regions registering gains. From a year ago, the index fell 2.5 percent.
- **The S&P CoreLogic Case-Shiller National Home Price Index** (not seasonally adjusted) rose 1.1 percent in May. On an annual basis, the index rose 6.4 percent for the second consecutive month.
- **Private residential construction spending** fell 0.5 percent in June, marking the first drop in three months, according to the Census Bureau. Spending on new single-family and new multifamily construction declined 0.4 percent and 2.8 percent, respectively, outweighing a 0.1 percent rise in spending on home improvements. On an annual basis, new single-family construction spending increased 6.9 percent, compared with a 1.0 percent gain for multifamily.
- **Mortgage applications** decreased 2.6 percent for the week ending July 27, according to the Mortgage Bankers Association (MBA). Purchase applications fell 3.1 percent, while refinance applications dropped 1.7 percent, the first decline in three weeks, as the drop in conventional demand outpaced the increase in the government segment. The survey's average 30-year fixed mortgage rate was up 7 basis points to 4.84 percent. For July, average purchase applications edged down 0.8 percent, following a 0.1 percent increase in June and a 2.9 percent decrease in May. Average refinance applications fell 3.8 percent in July.

Near-Term Outlook for Home Sales Is Mixed



Source: National Association of REALTORS® and MBA

Annual Growth in Single-Family Construction Spending Continues to Slow



Source: Census Bureau

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