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Mast Report *Making the Important Decisions*

WEEK'S ECONOMIC REPORTS

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Real Gross Domestic Product increased at a 0.69% annualized rate in the first quarter. This slow pace of U.S. economic growth was not a surprise given weakness in real consumer spending, estimated real retail sales, and declines in unit motor vehicle sales during the first three months of this year. Reflecting this, real personal consumption expenditures rose at only a 0.33% annualized rate, with real consumer spending on durable goods declining at a 2.52% annualized rate. One reason for the sluggish growth in real consumer spending was that real disposable personal incomes rose at only a 1.03% annualized rate. In addition to slower growth in real incomes, the personal savings rate was a relatively low 5.46% in the fourth quarter of last year. This created an environment that was not conducive to strong real spending by consumers.

In addition to sluggish real consumer spending, real consumption and investment in the government sector fell at a 1.69% annualized rate, with real defense spending by the federal government rate declining at a 3.98% annualized rate. Also, real business inventories in the private sector were accumulated at a much slower pace than in the final quarter of last year. This reduced real GDP by 0.93 percentage points.

The biggest positive in the first quarter GDP report was in real private sector fixed investment. Real nonresidential fixed investment rose at a sizable 9.40% annualized rate, and real residential fixed investment at a 13.67% annualized rate. Also, there was a very slight improvement in real net exports in the first quarter, as real exports rose at a 5.75% annualized rate, following a 4.47% annualized decline in the fourth quarter of 2016.

Even with minimal growth in real consumer spending, real domestic private final sales rose at a 2.20% annualized rate in the first quarter, owing to the very strong increases in private sector fixed investment.

As is nearly always the case, a single month's or quarter's data are inadequate to see what is going on in the economy. Four quarter rates of change (year-over-year rates of change in 4-quarter averages) show that the heart of the U.S. economy (real consumption and fixed investment in the private sector) continues to grow at a decent pace in light of demographic headwinds, related slow growth in the civilian labor force, and heavy and often poorly thought out government regulations. This measure of real domestic private sector final sales (the sum of real consumer spending and real private sector fixed investment) grew by 2.44% over the past four quarters. But total real GDP increased by only 1.70% by this measure. This is because real net exports retarded real GDP growth by 0.13 percentage points, changes in real business inventories by 0.31 percentage point, and real government spending and investment that increased by only 0.17%.

Orders for new durable goods trying to achieve some liftoff. Going back to the latter part of 2015, new durable goods orders had been declining. Twelve month rates of change showed that total orders were down 3.49% in September 2015. Looking at new orders excluding the transportation sector, the 12-month rate of change was -2.31% in December 2015. Conditions have become much less negative since late 2015. In March, the 12-month rate of change in total new durable goods orders was a slightly positive 0.32%, and for orders excluding transportation, up 1.09%. This is not much growth, but it beats declines. Continued acceleration in these 12-month rates of change in new durable goods orders would be an obvious positive sign.

More positive news from the residential housing sector. A week ago, new home sales were reported to have increased. The 12-month rate of change in new home sales was a strong 14.49%, and accelerated from an 8.14% increase in May 2016. Throughout the recovery in home sales, increases in sales of new homes have been noticeably stronger than sales of existing homes. This continues to be the case. One significant reason has been an insufficient supply of existing homes for sale. But, the 12-month rate of change has stopped declining and has accelerated slightly, to 3.70% in March from 3.38% in January of this year. This measure had slowed from a 6.88% increase in January 2016.

However, existing homes for sale continue to decline. The 12-month rate of change in existing homes for sale was -7.03% in March; in October 2014 it was +4.10. When existing homes for sale are falling at a significant pace, sales of existing homes cannot increase very fast.

With a declining supply of existing homes for sale, the sales prices of those that are sold were bound to have increased. This has clearly occurred. The Case-Shiller National Home Price Index, seasonally adjusted, rose at a 6.93% annualized rate in the December 2016-February 2017 period from the September-November 2016 period. The Case-Shiller Home Price Index covering 20 major metropolitan areas rose at an even faster 10.20% annualized rate over this period. Both of these home price indices were up about 5.75% over the past year and rates of change continue to accelerate modestly.

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