Outlook and Market Review – First Quarter 2016

The U.S. economy grew at a 0.8% annual rate in the first quarter according to the second estimate of the Bureau of Economic Analysis. U.S. economic growth in the fourth quarter of 2015 was revised upward to 1.4%. Much stronger growth will be needed for the remainder of the year to come close to the revised consensus forecasts of 2% growth for 2016. Expansionary fiscal policy is off the table due to overuse of deficits in the past and growth of national public debt to over 19 trillion dollars. Monetary policy remains easy with the Fed Fund rate well below a normal rate of about 1% for current conditions, as explained in the Fourth Quarter 2015 Outlook. Relatively weak jobs data combined with dismal growth data make it unlikely that the Fed will raise short term rates in June.

The U.S. dollar softened in the first quarter but conditions remain in favor of a strong to stable dollar throughout 2016. Relatively tighter monetary policy in the U.S. along with low income growth abroad fuel strong demand for U.S. securities which supports a higher dollar. Current account deficits will continue to be a drag on growth, and private investment remains sluggish due to both an uncertain business outlook and slow absorption of Sarbanes-Oxley and Dodd-Frank regulatory costs. Finally, the taxation of corporate profits as well as a second tax on the dividends paid out of corporate profits makes the tax burden of U. S. corporations high in global comparisons. All these factors are working against higher GDP growth.

Slow trade and deficient aggregate demand with a high level of uncertainty are global phenomena with no easy fix. The U. S. economy is no exception. The economy is running on only two cylinders with relatively strong consumer spending and residential investment on one hand, and weak export growth and capital investment on the other. Government policies are best described as trying not to make things worse rather than working to make things better. Analysts are now revising growth estimates downward with 1.75%–2.25% GDP expectations for 2016. Because of lags in the labor market, wage growth should pick up as the economy flirts with full employment. Even so, job creation will stay below the 200,000 monthly average of the recovery.

The Fed will be slow to make another increase in the Fed Fund rate until there are signs of much stronger growth for the second quarter. Even though April's CPI spiked to a .4% monthly rate, inflation remains below the Fed's 2% target with little pressure for marked increases until later in the year. Oil prices are rising but should not break through $50 a barrel for the next few quarters. The strong dollar and relative safety of holding dollars should keep the demand for longer term U. S. securities strong and keep long term rates from spiking. Long term solutions to the deficit are not on the horizon with the national debt growing by about half-a-trillion dollars this year even with the sequestration in place. When interest rates do rise, the debt service will be a major drag on GDP growth.

Survey of Professional Forecasters – Downward GDP Revisions

Less Optimism for GDP Growth

The Survey of Professional Forecasters offers a window into the current thinking of professional economists. Forecasters continue to be more pessimistic about U. S. GDP growth following downward revisions in their forecasts three months ago. Overall, the economy is weaker with only consumer spending and residential investment showing positive contributions. For all of 2016 the economists in the survey call for GDP growth of 2.1%, which is a full 50 basis points lower than the forecast three months ago. Even so, forecasters have been overly optimistic in the past few years with overly optimistic expectations of higher private investment and wage driven consumer spending. For example, the table below shows the consensus forecast for the next four quarters plus the forecast provided for the first quarter of 2016, which is now history. Forecasters were way off on first quarter GDP growth, missing the 0.5% preliminary growth by 150 basis points.

Table 1. Forecasts for 2016 and First Quarter of 2017

Quarter	Real GDP Growth (%)		Unemployment (%)		Payrolls (000s per Month)	
	Prior	Revised	Prior	Revised	Prior	Revised
1Q 2016*	2.5	2.0*	4.9	4.9*	188.2	195.0
IIQ 2016	2.5	2.1	4.8	4.8	193.5	183.2
IIIQ 2016	2.3	2.4	4.7	4.7	192.0	195.0
IVQ 2016	2.5	2.3	4.6	4.7	181.2	152.6
IQ 2017	2.4	2.4	4.6	4.6	NA	177.1
II Q 2017	NA	2.4	NA			

* *First quarter 2016 preliminary GDP growth was only 0.5% and unemployment was 5%.*

The forecast for the second quarter of 2016 calls for 2.1% annual growth with 2.4% growth in the third quarter. For 2016, the economy is expected to grow 1.7%, which is 40 basis points lower than the prior forecast. The longer run forecast for 2017 growth remained at 2.4%.

The employment outlook was generally unchanged with slightly lower unemployment from the current 5% to 4.8% by the end of the year and a 4.6% rate in 2017, 2018, and 2019. Forecasters see stable improvement in jobs creation. Since the Great Recession the economy has been adding about 200,000 jobs monthly (approximately 2,400,000 added to the payroll each year) with more modest increases in the first quarter of 2016. Forecasts for job gains in 2016 and 2017 are slightly below the post-recession average but are consistent with an economy approaching full employment. Forecasters see nonfarm payroll employment growing at a rate of 183,200 jobs per month in the second quarter of 2016 and 195,000 jobs per month next quarter. Monthly job growth is likely to be closer to 175,000. The rate of job growth will be slow at the end of 2016 and early 2017 as full employment is approached.

Figure 1. illustrates the annual payroll gains over the past ten years. Payroll gains have been improving steadily since the recession but have plateaued.

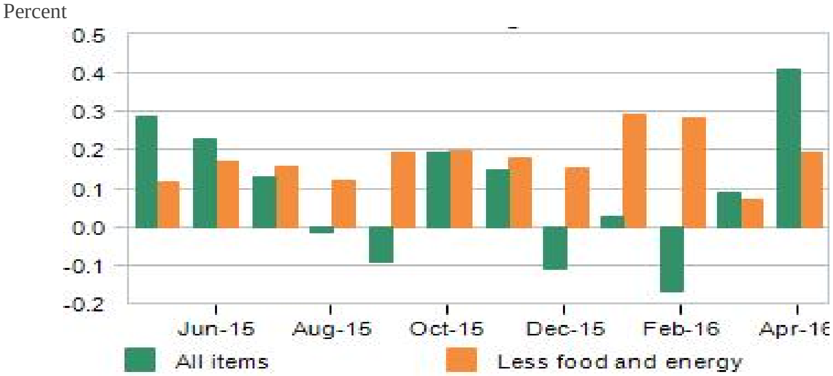
Figure 1. Change in Payroll from One Year Ago (thousands of people annually)

Source: Bureau of Labor Statistics

Little Change in the Headline Inflation Outlook

Forecasts of inflation have remained stable with expectations for headline (all items) CPI annual rates hovering around 2% and PCE (Fed's favorite measure) remaining under 2% for 2016. The CPI has risen just 1.1% in the past 12 months through April but the CPI spiked to a .4% monthly rate in April. The figure below illustrates the monthly CPI movement and April's surprising spike. There are no price pressures on the immediate horizon with low import prices linked to a strong dollar, global competition for domestic producers, excess production capacity, and moderate wage pressures going forward. Nevertheless, the Fed will pay close attention to the May inflation data to see if a trend is developing.

Figure 2. Monthly Rates of Change for the All Items and Core CPI



Source: Bureau of Labor Statistics

Core inflation should slowly approach the headline rate as energy prices recover. The table below summarizes near-term inflation forecasts for the CPI and PCE. Differences in prior forecasts and revised forecasts are small. Upward revisions are noted in red.

Table 2. Survey of Professional Forecasters Inflation Forecasts

Quarter	CPI Headline		CPI Core		PCE Headline		PCE Core	
	Prior	Revised	Prior	Revised	Prior	Revised	Prior	Revised
IIQ 2016	1.6	1.9	2.0	2.0	1.6	1.6	1.5	1.5
IIIQ 2016	2.1	2.0	2.0	2.0	1.8	1.8	1.7	1.0
IVQ 2016	2.1	2.1	2.0	2.1	1.8	1.9	1.7	1.8
IQ 2017	NA	2.1	NA	2.2	NA	1.9	NA	1.9

Long run inflation forecasts are inherently more difficult and less accurate than near term forecasts. Using a fourth quarter over fourth quarter measure, forecasters predict headline CPI inflation to average 1.5% in 2016 followed by 2.1% in 2017 and 2.3% in 2018. Projections for the next three years remained about the same compared to three months ago. Estimates of the PCE inflation rate also remained stable and slightly below the CPI estimates.

Fed Fund Rate Increase? – Little Pressure to Make Adjustments Now

Though the Federal Open Market Committee stood pat at its April meeting, it left the door open for another rate hike as soon as June. While most analysts believe the Fed will make one or two more rate increases in 2016, there is little pressure from inflation to support immediate moves. Poor growth data also suggest Fed inaction in the June meeting. The yield curve remains relatively flat with little pressure on long term yields given low expected inflation combined with strong demand for longer term U.S. Treasuries. The Fed has traditionally tried to be neutral in an election year and major moves between now and November might be taken as political statements. Labor participation will pick up slightly as a mature labor market is slowly providing better paying jobs. While the unemployment rate is nearing full employment benchmarks, excess production capacity is well below the long run average. Businesses are hesitant to take risks in the uncertain global and domestic political environment, putting pressure on consumer spending to spur growth. Raising rates would strengthen the value of the dollar, which is currently hurting export growth. Overall, this is not an ideal environment for the Fed to raise rates.

The Value of the Dollar Rides with Oil

A strong dollar weighs on U. S. growth by making U.S. exports more expensive in foreign markets and dampens U.S. inflation by making imports into the U.S. cheaper, preventing domestic price increases. The strength of the dollar is closely linked to the price of oil, as the figure below illustrates.

Figure 3. Correlation between Oil Prices and the Value of a Dollar

Source: FRED – Federal Reserve Bank of St. Louis

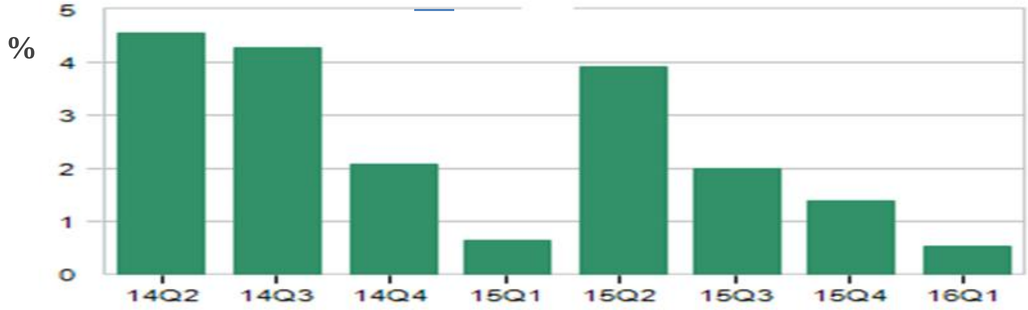
The global price of oil is in dollars, leading to a natural inverse relationship between the price of oil and the value of the dollar. Other key factors supporting a higher dollar value include relatively higher interest rates in the U.S. and concern for global risks. All else equal, the slow improvement in the price of oil has helped weaken the dollar in the early months of 2016. This pattern is favorable from the Fed's perspective since it should help promote growth through higher exports and nudge inflation higher. The dollar's path going forward is uncertain but a steady improvement in oil prices would put the Fed in a better position to raise interest rates later in the year.

Summary of Recent Economic Data

Gross Domestic Product – *The preliminary GDP growth rate for the first quarter of 2016 was only 0.5% following a revised 1.4% growth rate in the fourth quarter of 2015. Consumer spending on nondurable goods, residential investment, and state and local government spending were the key contributors. Inventories, exports, federal government spending, and business investment were the key drags on growth.*

- The preliminary estimate for first quarter 2016 GDP growth by the Bureau of Economic analysis was an anemic .5%. The winter months (fourth and first quarters) have been especially weak in both of the past two years, even after seasonal adjustments. Figure 4. shows the quarterly GDP growth rates from the second quarter of 2014 to the first quarter of 2016.

Figure 4. Real GDP Growth Rates (II Q 2014 – I Q 2016)



Source: Bureau of Economic Analysis

- Table 3. below provides a breakdown of the annual growth rates for the components of GDP for the past five quarters. The inventory adjustment trend reflects lower retail sales expectations as well as the effects from growing e-commerce. Trade will continue to be a chronic drag given the high value of a dollar and slow global growth.

Table 3. Annualized Percentage Change in GDP Components (IQ 2015 – IQ 2016)

	I 2016	IV 2015	III 2015	II 2015	I 2014
Consumption	1.27	1.66	2.04	2.42	1.19
Fixed Investment	**- 0.27**	0.06	0.60	0.83	0.52
Residential	0.49	0.33	0.27	0.30	0.32
Nonresidential	**- 0.76**	**- 0.27**	0.33	0.53	0.20
Inventories	**- 0.33**	**- 0.22**	**- 0.71**	0.02	0.87
Net Exports	**- 0.34**	**- 0.14**	**- 0.26**	0.18	**- 1.92**
Government	0.20	0.02	0.32	0.46	**- 0.01**
GDP	0.54	1.39	1.98	3.92	0.64

Source: Bureau of Economic Analysis

- Year-over-year growth continues to be below expectations. Real GDP was up 2% from the comparable quarter in 2015, the same as in the fourth quarter and the weakest result since the first three months of 2014. Final sales, which exclude the impact on GDP from inventories, added 0.9%, after rising 1.6% in the fourth quarter.

- After-tax corporate profits have not yet been reported for the first quarter, but the second half of 2015 was dismal. Table 4. provides the annualized growth rate for after-tax corporate profits for the past five quarters.

Table 4. Annual Growth Rates for After-tax Corporate Profits

	I 2016	IV 2015	III 2015	II 2015	I 2014
After-tax Corporate Profits	NA	**- 8.08**	**- 3.30**	6.35	2.00

Source: Bureau of Economic Analysis

Production, Manufacturing and Sales *– Inventory correction, weak growth, dormant business investment and a strong dollar all contributed to a production slowdown in the last two quarters. Capacity utilization remains approximately 5% below the long run average. Nonfarm business output fell for the second consecutive quarter. Overall productivity is hampered by extensive reworking of the financial system in line with the Dodd-Frank Act and reconstruction of the healthcare system under the Affordable Care Act.*

- Productivity declined for the second quarter in a row for nonfarm business. Lower productivity matched with stronger compensation is pushing unit labor costs up. On a year-ago basis, nonfarm output per hour is up only 0.6%.

- Industrial production fell 0.6% in March for a second month in a row. For the first quarter as a whole, industrial production fell at an annual rate of 2.2%. At 103.4% of its 2012 average, total industrial production in March was 2.0% below its year-earlier level.

- Industrial capacity utilization declined by 0.5% in March to 74.8%. The utilization rate is 5.2% below its long-run (1972–2015) average.

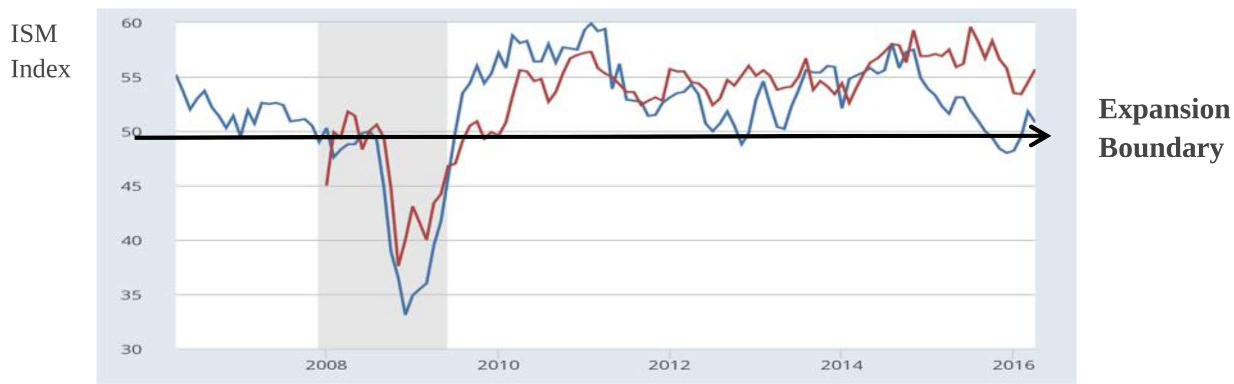
- The nonmanufacturing segment is improving after slowing during the winter months. The ISM service index increased from 54.5 in March to 55.7 in April. The ISM nonmanufacturing index is based on surveys of more than 400 non-manufacturing firms' purchasing and supply executives.

- The ISM Manufacturing index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM monitors employment, production, inventories, new orders and supplier deliveries. The April ISM manufacturing index was

50.8%, a decline of 1% from March. An index over 50 suggests an expansion although not necessarily the strength of the expansion.

- Figure 5. below shows the movement of the Nonmanufacturing and Manufacturing ISM indexes over the past decade. Both indexes have generally remained above the index level of 50 since the Great Recession. Most recently, the services index is stronger than the manufacturing index, which is flirting with a contraction signal.

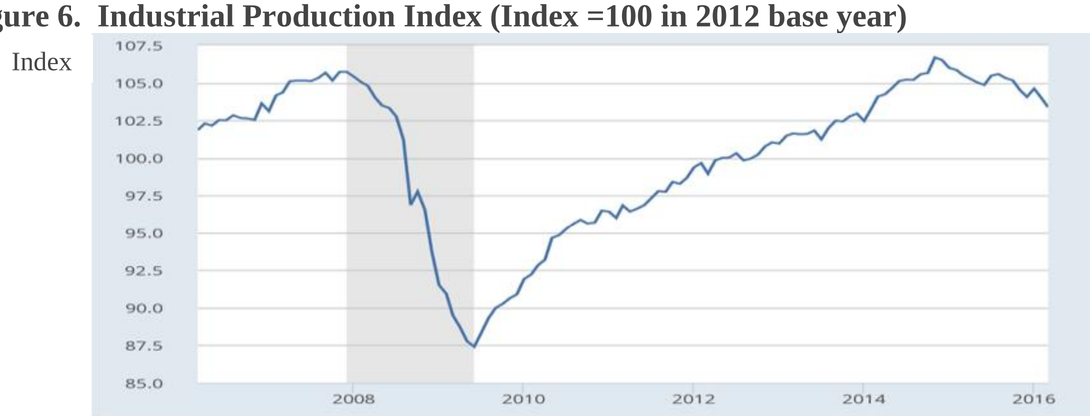
Figure 5. ISM Manufacturing and Nonmanufacturing Index (2006 – 2016)



Source: Federal Reserve Bank of St. Louis
(Index > 50 suggests expansion)

- The Board of Governors Industrial Production Index fell 0.6% in March for a second month in a row. For the first quarter, industrial production fell at an annual rate of 2.2%. The 103.4 index in March was 2.0% below its level one year ago. Capacity utilization for the industrial sector fell 0.5% in March to 74.8%, a rate that is 5.2% below its long-run (1972–2015) average. Figure 6. shows movement of the index over the past decade.

Figure 6. Industrial Production Index (Index =100 in 2012 base year)



Source: Federal Reserve Bank of St. Louis

- Retail sales in the United States fell 0.4% in March following zero growth in February and declining 0.4% in January. Weak sales are linked with the inventory reduction trend seen in the GDP data.

- New factory orders increased 1.1% in March, after losing ground in February. February orders were revised downward from -1.7 to -1.9%.

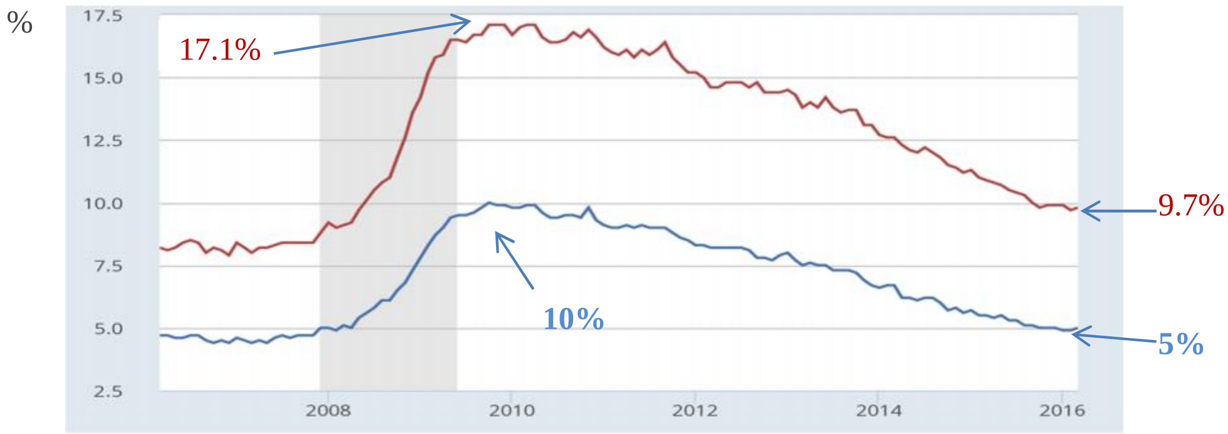
Unemployment and Labor Markets – *Unemployment edged up to 5% from 4.9% in the first quarter, largely due to an uptick in the labor participation rate. Job gains slowed in a weak first quarter but the labor market remains strong compared to the rest of the economy. Wages and salaries are starting to recover as labor markets are tightening, but improvement is slow.*

- The "headline" unemployment rate (U-3) inched back up to 5% in the first quarter of 2016 from 4.9% at the end of 2015.

- The U-6 rate is a broader measure of labor market conditions that includes marginally attached and part time employment due to economic reasons. The U-6 rate at the end of the first quarter of 2016 reached 9.7%.

- The peak of the U-6 unemployment rate following the Great Recession was 17.1% with a corresponding U-3 rate of 10%. The trend of declining unemployment and the slow but steady narrowing between U-6 and U-3 is illustrated in the graph below.

Figure 7. U-3 and U-6 Unemployment Rates (2006 – 2016)



(U-3) (Number of unemployed as % of Labor Force)
(U-6) (Unemployed plus marginally attached plus employed part time for economic reasons)

- Total payrolls added only 160,000 jobs in April and gains from February and March were revised downward by 19,000. A pullback in retail trade after several strong months explains much of the April downshift. Employment increased in construction, and health care. Job losses occurred in manufacturing and mining. Monthly payroll gains have been averaging a healthy 200,000 new jobs a month since the Great Recession. The graph below shows the pattern for monthly payrolls over the past ten years.

Figure 8. Monthly Payroll Gains over the Past Decade

Source: Bureau of Labor Statistics

- The labor force participation rate increased from 62.5% to 62.9% in March. The post WWII high was 67.3% (first quarter of 2000). The graph below illustrates the recent history of the participation rate.

Figure 9. Labor Force Participation Rate (2006 – 2016)

Source: Bureau of Labor Statistics

- The Employment Cost Index rose 0.6% in the first quarter of 2016 compared to a revised 0.5% in the fourth quarter of 2015. Year-over-year growth in the index was up 1.9% in the first quarter. Wages and salaries, which are about 70% of employment costs, increased 0.7% from the prior quarter while benefits rose 0.5%. Wages and salaries were up 2% from a year ago, while benefits grew 1.7%.

- New unemployment filings increased by 17,000 in the week ended April 30 to a level of 274,000. Figure 10. below shows the pattern of the four-week moving average of initial claims, which climbed to 258,000 for the last week of April.

Figure 10. 4-Week Moving Average of Initial Unemployment Claims

# of Claims

Source: Federal Reserve Bank of St. Louis

- Table 5. below summarizes output, compensation, and unit labor cost relationships for the past five quarters.

Table 5. Productivity, Compensation, and Unit Labor Costs

	I 2016	IV 2015	III 2015	II 2015	I 2014
Nonfarm Business					
Output per Hour	**-1.0**	**-1.7**	2.0	3.1	**-0.8**
Compensation per Hour	3.0	0.9	2.3	5.2	1.8
Unit Labor Costs	4.1	2.7	0.4	2.0	2.6
Nonfinancial Corporations					
Output per Hour	na	**-2.2**	0.7	1.1	**-1.7**
Compensation per Hour	na	0.9	2.4	5.2	0.8
Unit Labor Costs	na	3.1	1.7	4.1	2.6
Manufacturing					
Output per Hour	1.9	**-1.0**	3.7	1.5	**-1.7**
Compensation per Hour	0.6	2.5	4.0	5.6	**-2.4**
Unit Labor Costs	**-1.2**	3.6	0.3	4.0	**-0.7**

Source: Bureau of Labor Statistics

***Consumer Income and Savings** – Personal income remains on a path of about 4% annual growth after a rebound in March. The saving rate rose to 5.4% in April. Wages and salaries improved in March but the pattern remains uneven with an annual growth rate expected to be around 4.5%. Wages and salaries account for about 50% of personal income. Overall, income and wages appear to be on a path much like the prior two years.*

- On a year-ago basis, nominal personal income in March was up 4.2%, which is in line with growth for 2015 and 2014. Wage and salary growth, especially in the private sector, accounted for the bulk of March's recovery from the previous month. Private wages and salaries increased $26.3 billion compared with a decrease of $8 billion in February.

Government wages and salaries advanced by $2.8 billion, down slightly from the $3.4 billion gain in February.

- Growth in personal income outpaced spending in March with an increase in the saving rate to 5.4% from 5.1% in February.
- Non-wage income is less likely to boost personal income in 2016 as interest rates remain low and asset valuations remain relatively flat.
- Consumers have benefited from the steep drop in energy prices and from retail price deflation. These relationships also help explain the rising saving rate.
- Table 11. below shows growth in income, wages and salaries, and the saving rate for the past two quarters. The increasing pattern for the saving rate suggests that consumers are being more cautious. Going forward, a higher saving rate is good in the long run but lower consumption may dampen short term GDP growth in the near term.

Table 11. Income, Wages and Salaries, and the Saving Rate (Last six Quarters)

	March 2016	Feb. 2016	Jan. 2016	Dec. 2016	Nov. 2016	Oct. 2016
Personal Income (Year Ago % Change)	4.2	3.8	4.1	3.9	4.0	4.3
Personal Income (Monthly % Change)	0.4	0.1	0.4	0.3	0.3	0.3
Disposable Income (Monthly % Change)	0.4	0.1	0.4	0.3	0.2	0.2
Wages and Salaries (Monthly % Change)	0.4	**-0.1**	0.6	0.2	0.5	0.6
Saving Rate	5.4	5.1	5.2	5.0	4.9	5.1

Source: Bureau of Economic Analysis

- Wages and salaries are expected to improve as the labor market remains close to full employment. Quit rates are rising suggesting a tight market with increased worker mobility. The labor participation rate is improving offering a good sign that workers are finding more attractive employment opportunities.

Inflation – *The world economy remains too weak to generate significant inflationary pressure. The growth in prices remains low for all inflation measures. The Federal Reserve Bank remains in the awkward position of wanting to back away from a long period of excessively low interest rates, but anemic growth and low inflation remain a concern. The Fed opted to leave rates alone in April and it is likely to follow suit in June unless inflation pressures pick up.*

- The GDP deflator used to adjust nominal GDP into real GDP has been under 2% for the past three quarters and below 1% for the past two quarters (see Table 12). The GDP deflator shows how much a change in the base year's GDP is due to changes in the price level. The GDP deflator is a much broader price index than the CPI and PCE (which only measure consumer prices) or PPI (which only measures producer prices). The deflator reflects all prices of all domestically produced goods and services in the economy rather than just consumer prices.

Table 12. GDP Price Deflator (First Quarter 2015 – First Quarter 2016)

	I 2016	IV 2015	III 2015	II 2015	I 2015
Implicit Price Deflator	0.70	0.94	1.30	2.12	0.12

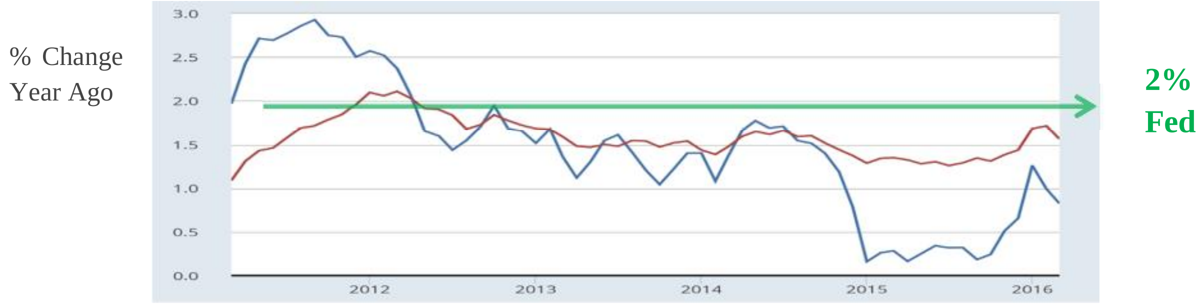
Source: Bureau of Economic Analysis

- Energy prices increased 1.1% in March, which is the first increase since November.

- The PCE deflator increased 0.1% in March after falling 0.1% in February and the core PCE deflator (which excludes food and energy) also rose 0.1% in March.

- On a year-ago basis, the core PCE was up 1.6% after posting 1.7% annual growth in each of the previous two months. The Figure shows the monthly year-to-year % change of the PCE and Core PCE over the past year.

Figure 12. Personal Consumption Expenditure (PCE) (April 2015 – March 2016)



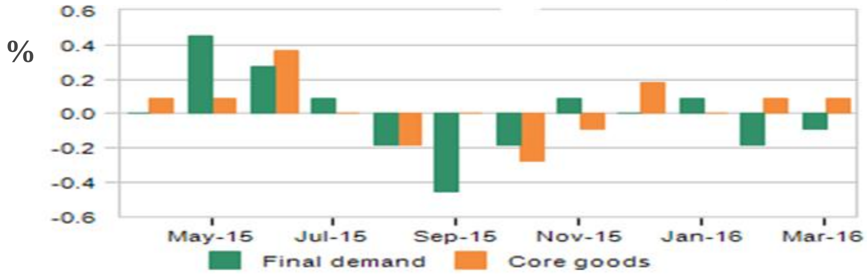
Headline PCE *Core PCE* *Source: Bureau of Economic Analysis*

- The core CPI was up only 0.1% after rising 0.3% in each of the prior two months. The headline CPI rose 0.1% as food prices fell 0.2% and the energy CPI rose 0.9%.

- On a year-ago basis, the seasonally adjusted headline CPI was up 0.9%, compared with 1% in February. The core index was up 2.2% on a year-ago basis. The core CPI normally runs 0.5% ahead of the core PCE, which is the Fed's preferred measure.

- The Producer Price Index (PPI) is a weighted index of wholesale prices. The PPI for final demand fell 0.1% in March, seasonally adjusted. Final demand prices fell 0.2% in February and advanced 0.1% in January. The final demand index fell 0.1% for the 12 months ended in March. The core PPI (final demand PPI less foods, energy, and trade services) was unchanged in March after four consecutive advances. For the 12 months ended in March the core PPI rose 0.9%. Figure 13. shows the PPI performance last year.

Figure 13. Final Demand and Core Producer Price Index (Last 12 months)



Source: Bureau of Economic Analysis

Sentiment and Confidence *– Sentiment measures offer a mixed picture of consumer confidence in the economy. While leading indicators over the first quarter were positive, the Michigan Index of Consumer Sentiment has been falling. A relatively strong labor market has yet to generate significant wage gains and lower energy prices are beginning to turn. Two consecutive quarters of very low GDP growth have taken a toll on consumer optimism.*

- The Conference Board Index of leading indicators climbed 0.2% in March with strong contributions from financial components and a drag from building permits. Six out of 10 index components made positive contributions. The leading indicator's six-month annualized growth rate accelerated to 1.3%, while the coincident index's rate was 1.2%.

- Figure 14. shows the monthly leading indicator over the last year. The first quarter provided a positive upward pattern that suggests a stronger second quarter but reversals are common in the series and longer trends are required to suggest a stronger recovery.

Figure 14. Leading Economic Indicator (Last 12 months)

Source: Federal Reserve Bank of St. Louis (FRED)

- The University of Michigan Index of Consumer sentiment fell for the fourth month in a row in April. The index in April fell 2 points from March to hit 89 with worsening expectations outweighing an increase in current conditions.

- Figure 15. shows the University of Michigan Sentiment Index over the last year. Overall, the index is approximately where it was prior to the recession. Nevertheless, the index has trended downward over the past year, largely due to falling consumer expectations.

Figure 15. University of Michigan Sentiment Index

Source: University of Michigan

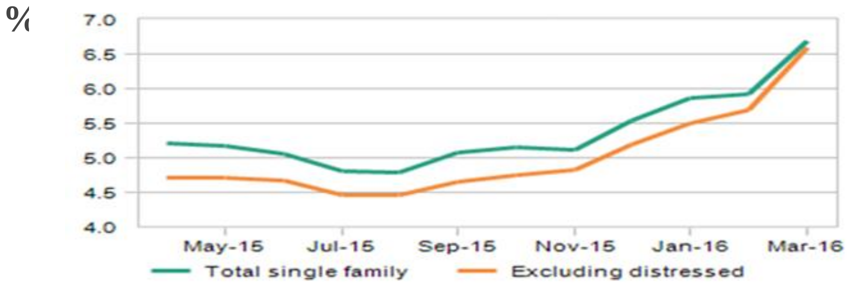
Housing *- Overall conditions remain favorable for housing with low mortgage rates and a potential increase in demand as wages begin to improve. Both housing starts and existing-home sales were sluggish in the first few months of 2016 but the economic fundamentals are favorable for housing demand. Mortgage rates remain low with an average of 3.6% for 30-year fixed rates. High rental rates should also help encourage a higher demand for home ownership. Pending home sales are improving and housing prices continue to rise at a stable rate.*

- Low vacancy rates on apartments and other multifamily dwellings are putting strong upward pressure on rental rates. Higher rental rates will eventually encourage households to enter the market to purchase homes.

- The S&P / Case-Shiller home price index was higher in the three months ending in February relative to the same period in January. The national index rose 5.3% over the 12 months ended in February, unchanged from January.

- The CoreLogic Home Price Index was up by 6.7% in March on a year-over-year basis (see Figure 16). Prices increased by 2.1% in March, which is the fastest in three years. The Home Price Index has grown for four consecutive months. Home prices are 40% higher than the low of March 2011. The index is 5% lower than the peak in April 2006.

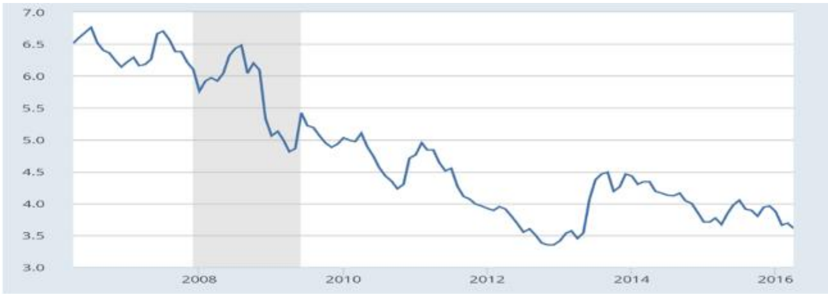
Figure 16. Monthly Percentage Change in the CoreLogic Home Price Index



- Mortgage rates remain low with an average of 3.6% in April. The figure below shows the pattern of the 30-year mortgage rate over the past ten years.

Figure 17. 30-Year Fixed Rate on Mortgages over the last Decade

%

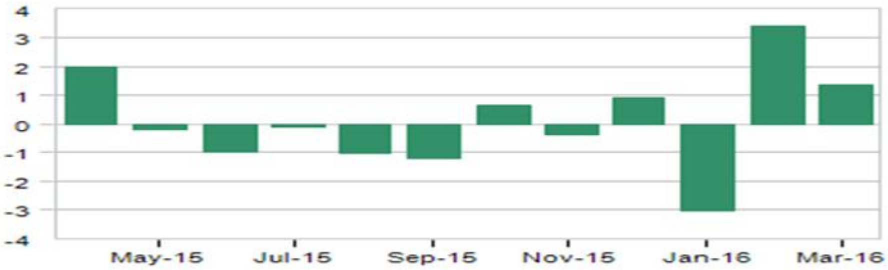


Source: Federal Reserve Bank of St. Louis (FRED)

- The pending home sales index grew 1.4% on a seasonally adjusted basis to 110.5 in March, the highest level since May of 2015 (see Figure 18). The index is only 1.4% above its year-ago level, which is a sharp increase from the decade low in mid-2010.

Figure 18. Pending Home Sales Monthly Percentage Change

%



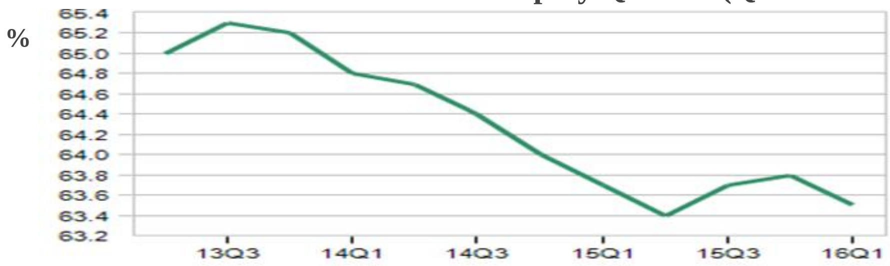
Source: National Association of Realtors

- New-home sales dipped in March by 1.5% from February. Sales were up by 5.4% from March 2015. While the data are not strong at this point, the new-home market remains strong enough to keep single-family construction trending upward over the past year.

- Homeownership fell by 0.2% to 63.5% in the first quarter of 2016 on a year-over -year basis. First quarter homeownership declined by 0.3% from the previous quarter. The homeowner vacancy rate fell to 1.7% from 1.9% from the same quarter in the previous year and the fourth quarter of 2015.

- The rental vacancy rate edged down by 0.1% to 7% from the same quarter in the previous year and was unchanged from the previous quarter. Figure 19. shows the pattern of homeownership since the second quarter of 2013.

Figure 19. Percent of Household Homeownership by Quarter (Q II 2013 – Q I 2016)

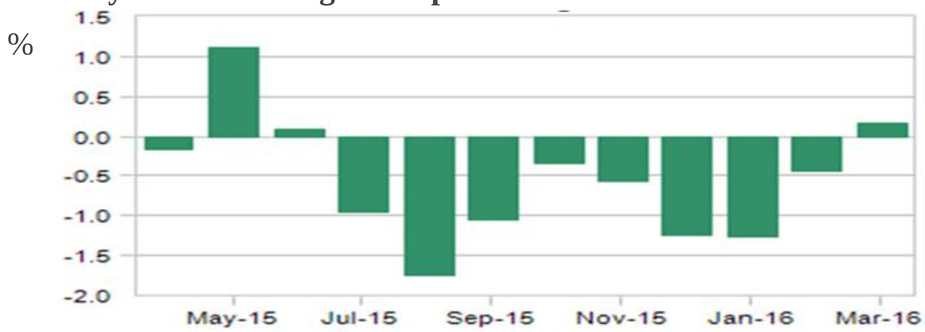


Source: National Association of Realtors

U.S. Trade - *Trade deficits continue to be a drag on U.S. growth. In the first quarter the U.S. dollar softened, largely due to lower oil prices. The dollar should remain strong into the second quarter due to relatively higher U.S. interest rates and lower inflation compared to global trading partners. The current account deficit and capital account surplus help keep the demand for U.S. securities strong and long term rates low.*

- With low import prices U.S. inflation remains low as consumers pay lower prices for imports and domestic producers are constrained from raising prices. This pattern should continue through the next few quarters. The figure below shows the monthly change in import prices with an uptick in March due largely to higher oil prices.

Figure 20. Monthly Percent Change in Import Prices



Source: Bureau of Labor Statistics

- Global oil prices have stabilized, rising more than 50% from the 13-year low reached in February. Higher oil prices have contributed to a lower value of the dollar in March.

- The U.S. dollar's upward momentum was broken in the first quarter (see Figure 21). The U.S. trade-weighted dollar weakened in the first quarter but import and consumer good prices are affected with lags that may last up to a year.

Figure 21. Trade-weighted Value of a Dollar (Index = 100 in 1973)

Index

Source: Federal Reserve Bank of St Louis (FRED)

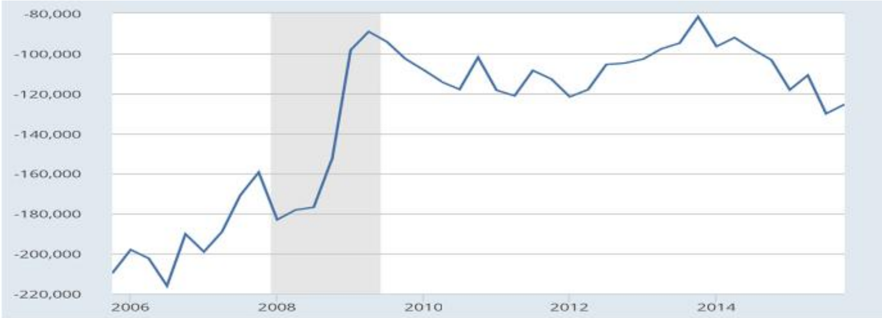
- The U.S. foreign trade deficit narrowed to $40.4 billion in March. February's result was revised from $47.1 billion to $47 billion. Exports fell from $178.2 billion to $176.6 billion, while imports declined from $225.1 billion to $217.1 billion on a monthly basis.

- The U.S. accumulated a trade deficit of $133.3 billion in the first three months of 2016, compared with a deficit of $134.3 billion in the same period a year earlier.

- The figure below shows the current account deficit of the U.S. over the past ten years. The U.S. current-account deficit is a measure of net transactions between the U.S. and the rest of the world in goods, services, investment income and compensation, and current transfers. The deficit fell to $125.3 billion (preliminary) in the fourth quarter of 2015 and is approximately 2.8% GDP.

Figure. 22. U. S. Current Account Deficit over the Past Decade

Millions of $s



Source: Bureau of Economic Analysis

Key Global Issues *– Oil and commodity prices are expected to remain low and place a burden on emerging economies. Global trade is slowing due to low demand for imports in distressed economies and adjustments taking place in China. Slow recoveries are in place in most advanced economies with monetary easing outside the U.S. Global growth is expected to be 3.4% in 2016 and 3.6% in 2017 but risks are tilted to the downside. Inflation remains low in advanced economies allowing room for monetary expansion.*

- In 2015, global economic activity was in line with growth of around 3%. Emerging market and developing economies, which are over 70% of the global economy, fell for the fifth consecutive year. Advanced economies are growing but recoveries are slow. Global trade growth has been marked down by more than ½ percentage for 2016 and 2017, reflecting developments in China as well as distressed economies.

- The World Economic Outlook (WEO) estimated growth to be 3.1% in 2015, and is projecting growth of 3.4% in 2016 and 3.6% in 2017. Growth is expected to be more gradual in emerging markets and developing economies. Downside risk is higher than upside potential for the global outlook due to China's debt issues, lower commodity prices, and the gradual reversal of accommodative monetary policy in the United States.

- Three important adjustments are taking place in the global economy:
  - A gradual slowdown and rebalancing of economic activity is underway in China with investment moving away from manufacturing toward consumption and services.
  - Lower prices for energy and other commodities is persisting.
  - Disjoint monetary policies in advanced economies continue. The U.S. is tightening its monetary policy as several other major advanced economy central banks continue to ease monetary policy.

- The oil price decline of 2015 may have bottomed with a pickup in prices in the early part of 2016. Futures markets pricing suggests only slight increases in oil prices in 2016 and 2017. Prices of other commodities, especially metals, are falling, which hurts the prospects of growth in emerging economies.

- Inflation rates remain low and are below central bank targets in advanced economies. Central banks are accommodative outside the U.S.

- In the euro area, private consumption is good due largely to lower oil prices and easy financial conditions. Net exports are weak due to poor global economic conditions.

- Economic activity is slowing in China with a faster than expected slowdown in imports and imports. Outstanding debt and the quality of that debt remains a problem. China's problems are spilling over to other economies through weaker commodity prices, lower trade, reduced confidence, and higher volatility in financial markets.

- Japan recently lowered the 2016-2017 forecast for GDP growth and inflation. The benchmark interest rate remained unchanged at -0.1% in April.

- Latin America and the Caribbean economies are likely to contract in 2016 but at a slower rate than in 2015.

- Growth in the Middle East is difficult to predict given low oil prices and ongoing geopolitical tensions.

- Emerging economies in Europe should continue to grow at a low pace. Russia should remain in recession with ongoing adjustments to low oil prices and Western sanctions.

- The UK outlook is complicated by the "Brexit" referendum on June 23. The odds are on the side of voting to stay in the European Union. Growth in the U.K. is likely to be in the 1.5%–2.0% range for 2016.

- India is forecast to grow at a 7.3% pace this year, about the same as last year.

- The political situation in Brazil is shaky with a good chance of a change in government.

- Mexico announced a joint fiscal/monetary tightening in February to regain investor confidence and halt the depreciation of the currency. Growth should be in the 2.5% to 2.8% range.