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The Day Ahead: What's In a GDP Report?

GDP was hotly anticipated this week and rightfully so. The trading reaction has been the week's most volatile and has carried the most volume. Paradoxically, the 3.2% vs 2.0% reading resulted in a bond market RALLY (just the opposite of what anyone would expect from such a big beat). To understand why this is happening, we need to look more deeply into the nuances of the report.

Warning! The following table of data is obviously huge and potentially overwhelming at first glance. I've taken the liberty of highlighting a few key ingredients. The red circles are the main sub-headings of the GDP number. They add up to the 3.2% total (3.18% technically, but the report is always rounded to the nearest 0.1%). The red circles are unimportant for the purpose of our conversation today. I just wanted you to see that they are the broad categories and that the other circles are components inside those categories.

Speaking of the other circles. The blue ones (health care and inventories) show **big additions** to GDP that aren't necessarily economically impressive. For instance, consider that line 40 shows a 0.65% increase to GDP in today's 3.2% reading while the Q2-2018 report was **1.17% LOWER** than it otherwise would have been due to inventory draw-down. In other words, absent inventories, Q2-2018's GDP would have been 5.4% versus today's 2.6% (3.2 minus the inventory contribution). Strike one.

As far as health care is concerned, many economists **completely ignore** this number when it comes to gauging the strength of the economy because it is considered relatively inelastic or at the very least not nearly as indicative of demand and economic growth as other metrics.

The main heading that **speaks most to that notion of demand and economic growth** is line 2: Personal Consumption Expenditures. Here we see today's report with a paltry 0.82% compared to the heavy hitters from 2018 at 2.57% and 2.37%. In fact, 0.82 is the weakest consumption we've had in the past several years apart from Q1-2018.

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 5.0	99.35	-0.16
MBS GNMA 5.0	99.91	-0.04
10 YR Treasury	3.9039	+0.0424
30 YR Treasury	4.1932	+0.0468

Pricing as of: 8/30 5:59PM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85

Moving to line 20, food services and accommodations spending was down 0.06%. Contrast this to the higher growth reports in 2018 and 2015 when that number is over 0.30%. Food/accommodations is a great off-the-beaten path economic indicator, and it tends to correlate with strong consumption numbers.

	Rate	Change	Points
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30

Next, let's check out line 27, Fixed Investment. Businesses invest in structures, equipment, software/IP, etc. for all sorts of reasons. That's added together with inventory building (or draw-down) to arrive at line 26's "gross private domestic investment" heading. In general, more fixed investment and less inventory building is a stronger sign for the economy. Today's report is the opposite: low fixed investment and more inventory building.

Table 2. Contributions to Percent Change in Real Gross Domestic Product

April 26, 2019

Line	Seasonally adjusted at annual rates												Line						
	2016			2017				2018						2019					
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1			
1	1.6	2.2	2.9	3.3	1.0	0.4	1.5	2.3	1.9	1.8	1.8	3.0	2.8	2.2	4.2	3.4	2.2	3.2	1
Percent change at annual rate:																			
1	Gross domestic product																	1	
Percentage points at annual rates:																			
2	Personal consumption expenditures																	2	
3	Goods																	3	
4	Durable goods																	4	
5	Motor vehicles and parts																	5	
6	Furnishings and durable household equipment																	6	
7	Recreational goods and vehicles																	7	
8	Other durable goods																	8	
9	Nondurable goods																	9	
10	Food and beverages purchased for off-premises consumption																	10	
11	Clothing and footwear																	11	
12	Gasoline and other energy goods																	12	
13	Other nondurable goods																	13	
14	Services																	14	
15	Household consumption expenditures (for services)																	15	
16	Housing and utilities																	16	
17	Health care																	17	
18	Transportation services																	18	
19	Recreation services																	19	
20	Food services and accommodations																	20	
21	Financial services and insurance																	21	
22	Other services																	22	
23	Final consumption expenditures of nonprofit institutions serving households																	23	
24	Gross output of nonprofit institutions																	24	
25	Less: Receipts from sales of goods and services by nonprofit institutions																	25	
26	Gross private domestic investment																	26	
27	Fixed investment																	27	
28	Nonresidential																	28	
29	Structures																	29	
30	Equipment																	30	
31	Information processing equipment																	31	
32	Industrial equipment																	32	
33	Transportation equipment																	33	
34	Other equipment																	34	
35	Intellectual property products																	35	
36	Software																	36	
37	Research and development																	37	
38	Entertainment, literary, and artistic originals																	38	
39	Residential																	39	
40	Change in private inventories																	40	
41	Farm																	41	
42	Nonfarm																	42	
43	Net exports of goods and services																	43	
44	Exports																	44	
45	Goods																	45	
46	Services																	46	
47	Imports																	47	
48	Goods																	48	
49	Services																	49	
50	Government consumption expenditures and gross investment																	50	

Taken together, the message is clear: this was a great GDP headline, but it had a much weaker profile of internal components than the headline suggested. As such, we can actually reconcile the bond market rally this morning. As to why stocks are rallying, what can I say... I feel like the average big bond trader is a lot more interested in these internals and the average trader contributing to the stock market's movement is just looking at the 3.2%.

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