Economics: Consumer Spending Poised to Lift Q2 Growth

This week’s news was upbeat, featuring an early look at consumer spending at the end of the second quarter. Nominal retail sales posted a solid gain in June following a sizable upward revision for May. Core sales (excluding autos, building materials, and gasoline), which are an input used to estimate consumer spending for goods in GDP calculations, disappointed, as they were unchanged from May. However, the increase in May core sales was upgraded by three-tenths to 0.8 percent, the biggest rise since last November. The upward revision pushed the second quarter increase to a 6.5 percent annualized rate, compared with 2.1 percent in the first quarter. The report supported our view that second quarter real consumer spending growth likely tripled the 0.9 percent annualized pace in the first quarter, helping to drive economic growth to more than double the first quarter’s 2.0 percent rate. Separately, a pickup in June industrial production also pointed to accelerating economic growth last quarter, as manufacturing output rebounded strongly from a drop in the prior month. Mining output remained a bright spot, increasing for the fifth consecutive month and the ninth time in ten months to reach the highest level since the inception of the series in 1921. Mining output is now up 13 percent from a year ago, thanks to rising oil prices, which have boosted activity in the oil and gas sector. The upturn in oil-related mining output is one of the tailwinds for the economy this year. The rest of this week’s reports were also positive: The Conference Board Leading Economic Index—a gauge of the economic outlook over the next three to six months—registered the biggest rise since February in June, suggesting solid growth in the second half of the year, and initial jobless claims fell last week to the lowest level since 1969. Finally, this week also offered Fed Chairman Powell’s testimony before Congress, in which he reinforced a case for continued gradual interest rate increases given that the labor market has improved and inflation has moved up. Echoing the June Fed meeting minutes, Powell noted that trade policy is weighing on business equipment spending plans and downplayed the notion that the flattening yield curve is signaling increased recession risks.

- **Retail sales** rose 0.5 percent in June, according to the Census Bureau. May’s initially-reported 0.8 percent gain was revised higher to a 1.3 percent increase, the largest advance since last September. Sales increased at motor vehicle and parts dealers, gasoline stations, building material stores, and restaurants. Notably, nonstore sales posted the biggest gain since last November. Sales fell at grocery, clothing, and sporting goods/hobby stores.

- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, increased 0.6 percent in June, according to the Federal Reserve Board. Manufacturing output advanced 0.8 percent after a 1.1 percent drop in May, as vehicle production jumped 7.7 percent, rebounding from an 8.5 percent drop in May due to a major fire at a parts supplier that disrupted truck assemblies. Mining output rose 1.2 percent. Despite unseasonably warm weather in late June, utility output declined 1.5 percent, as unexpected declines in electricity use outweighed gains in natural gas. For the second quarter, industrial output rose at a 6.1 percent annualized rate, accelerating from the first quarter’s 2.3 percent pace. Capacity utilization rose three-tenths to 78.0 percent.

- The **Conference Board Leading Economic Index** rose 0.5 percent in June after a flat reading in May. Seven of the ten components added to the index. Two components were neutral, while building permits dragged on the index.

- **Initial claims for unemployment insurance** fell 8,000 to 207,000 in the week ending July 14, according to the Department of Labor. The four-week moving average dropped by 2,750 to 220,500.
Housing: Second Quarter Home Building Disappoints

Housing data disappointed this week as starts, permits, and mortgage demand all fell. Total housing starts posted the largest monthly decline since November 2016 in June as both multifamily starts and single-family starts fell. Adding to the dreary report were downward revisions to both April and May, reducing starts by a total of 23,000 units. On a quarterly basis, total home construction declined for the first time in four quarters, driven by the largest quarterly drop in multifamily building since the second quarter of 2013. Meanwhile, single-family building edged up, rising for the third time in four quarters. Despite the lackluster second quarter performance, single-family and multifamily starts during the first half of the year were up 8.0 percent and 7.3 percent, respectively, compared with the same period last year. The near-term outlook for home building was bleak, as multifamily permits fell for the third consecutive month and single-family permits only partially recovered from May’s large decline. Year to date, single-family permits increased 6.3 percent compared with the same period last year, while multifamily permits were little changed. Home builders’ confidence in the single-family market held steady in July as the National Association of Home Builders (NAHB)/Wells Fargo Housing Market Index was unchanged after declining for five of the prior six months. The NAHB reported that builders are burdened by rising construction material costs, which affect their ability to provide affordable homes for the expanding first-time home buyer market. Mortgage demand fell last week, as the first drop in purchase applications in three weeks outweighed the first rise in a month in refinance applications, which were coming off the prior week’s expansion low. Finally, mortgage rates were virtually unchanged this week, with the average 30-year fixed mortgage rate falling just 1 basis point to 4.52 percent, according to Freddie Mac.

- **Housing starts** fell 12.3 percent in June to 1.17 million annualized units, according to the Census Bureau. Multifamily starts declined 19.8 percent to 315,000, and single-family starts fell 9.1 percent to 858,000. Multifamily permits dropped 7.6 percent to 423,000, while single-family permits edged up 0.8 percent to 850,000. In the second quarter, multifamily starts fell 15.4 percent, while single-family starts rose 1.2 percent.

- **The National Association of Home Builders/Wells Fargo Housing Market Index** was flat at 68 in July. A reading above 50 indicates that more builders view the single-family market as “good” rather than “poor.” The present sales component was steady at 74, while the sales in the next six months component fell 2 points to 73, the lowest reading in ten months. The traffic of prospective buyers component increased 2 points to 52.

- **Mortgage applications** declined 2.5 percent for the week ending July 13, according to the Mortgage Bankers Association. Purchase applications fell 5.2 percent as both conventional and government applications declined. Refinance applications rose 2.2 percent, driven by both the conventional and government segments. The MBA survey’s average 30-year fixed mortgage rate ticked up 1 basis point to 4.77 percent.

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