Economics: Productivity Growth Shows Signs of Life

This week’s news was upbeat, featuring updates on consumer spending, production, and productivity. Nominal retail sales posted a solid gain in July, with motor vehicle and parts sales increasing despite an earlier report of declining unit auto sales. Core sales (excluding autos, building materials, and gasoline), which are an input used to estimate consumer spending for goods in GDP calculations, rebounded from June to post the fifth gain in the past six months. The report was a positive start to the third quarter, and we see some upside risk to our forecast of real consumer spending growth of 2.6 percent annualized this quarter. Industrial production ticked up to a fresh record high in July, driven entirely by manufacturing, which increased for the second straight month. Mining production fell for the first time in six months, as oil and gas well drilling posted the largest monthly decline in over two years. However, mining output is 12.9 percent above year-ago levels thanks to rising oil prices, which are now 33.5 percent higher, year to date, than the same period last year. Utility production declined in July despite warm weather during the month, as losses in electric outweighed gains in gas. Productivity growth picked up in the second quarter, reaching the fastest pace in over three years; however, the annual increase remains within the 1.0 percent to 1.4 percent range seen over the past year. Unit labor costs fell for the first time in four quarters, pushing down the annual increase to the lowest level since the end of 2016. The near-term outlook for economic growth is positive according to the Conference Board Leading Economic Index (LEI), which increased in July for the tenth month. All components of the LEI improved during the month, except weekly manufacturing hours, which was flat. The National Federation of Independent Business reported that small business confidence rebounded in July to reach a new all-time high. Businesses continue to hold off on investment, with the share making capital expenditures in the last six months falling to the lowest level in four months. Quality of labor remained the single most important problem for small businesses. Finally, consumer sentiment fell to the lowest level in eleven months in early August, driven by the largest monthly decline in the current conditions component in three years amid a flat reading in the expectations component.

- **Retail sales** rose 0.5 percent in July and 6.4 percent annually, according to the Census Bureau. June’s initially reported 0.5 percent gain was revised lower to a 0.2 percent increase. Sales increased the most at restaurants, apparel stores, and department stores. Sales declined sharply at sporting goods stores, furniture stores, and drugstores. Core retail sales increased 0.5 percent from June and 4.8 percent from a year ago.
- **Nonfarm business productivity** rose 2.9 percent annualized in Q2 2018, according to preliminary estimates by the Bureau of Labor Statistics. Annually, productivity and unit labor costs increased 1.3 percent and 1.9 percent, respectively, while real compensation edged up only 0.5 percent from a year ago.
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, edged up 0.1 percent in July, according to the Federal Reserve Board. Manufacturing output improved 0.3 percent, while mining and utilities output fell 0.3 percent and 0.5 percent, respectively. Capacity utilization was flat at 78.1 percent.
- **The National Federation of Independent Business Small Business Optimism Index** rose 0.7 points to 107.9 in July as the net share of firms expecting the economy to improve increased 2 percentage points to 35 percent.
- **The University of Michigan Consumer Sentiment Index** fell 2.6 points to 95.3 in the August preliminary reading. Short-term inflation expectations were flat, while the long-term inflation outlook ticked up.
- **The Conference Board Leading Economic Index**, a gauge of the economic outlook over the next three to six months that dates back to 1959, rose 0.6 percent in July to reach a new all-time high.
- **Import prices** were unchanged in July but rose 4.8 percent annually, according to the Bureau of Labor Statistics.

### Headline Retail Sales Post a Solid Gain and Core Sales Rebound From June

- **Month-over-Month Change (% SA)**
  - Core Retail Sales
  - Retail Sales

### Productivity Growth Rises to the Fastest Pace in Three Years

- **Quarter-over-Quarter (SAAR, % Change)**
  - Year-over-Year (SA, % Change)

Source: Census Bureau

Source: Bureau of Labor Statistics
Housing: Lackluster Building Activity and Sentiment

The week’s news showed that homebuilding activity failed to improve meaningfully in July following a large decline during the prior month, and that builder sentiment dropped in August, continuing the downward trend from the expansion best reached at the end of last year. Both single-family and multifamily starts edged up less than 1 percent following June’s 9.0 percent and 22.3 percent declines, respectively. Meanwhile, the Housing Market Index, a gauge of builder sentiment, fell to the lowest reading since last September. The decline was broad-based across all components, with the component gauging sales over the next six months dropping for the third consecutive month to the lowest level since November 2016. Builders are increasingly concerned about rising construction costs and shortages of skilled labor and buildable lots. The sharp drop in framing lumber prices in July from June’s all-time high is encouraging for the supply side; however, the outlook for housing demand appears to be deteriorating as rapidly rising home prices continue to weigh on affordability. Mortgage demand fell last week for the fifth consecutive week, with purchase demand declining to the lowest level since mid-February and refinance applications dropping to a fresh expansion low. Mortgage rates offered some good news this week, declining for the second consecutive week, as the average yield on 30-year fixed rate mortgages fell 6 basis points to 4.53 percent, according to Freddie Mac.

- **The National Association of Home Builders/Wells Fargo Housing Market Index** fell 1 point to 67 in August. (A reading greater than 50 means more builders view conditions as good than poor.) Both the component measuring current sales conditions and the component gauging expectations ticked down 1 point to 73 and 72, respectively, while the component assessing buyer traffic fell 2 points to 49.

- **Housing starts** rose 0.9 percent in July to 1.168 million units (seasonally-adjusted annualized rate), according to the Census Bureau. Single-family starts increased 0.9 percent to 862,000 units, and multifamily starts edged up 0.7 percent to 306,000 units. Total starts for the prior two months were revised lower. Year-to-date single-family starts were 7.2 percent greater than the level during the same period last year, while multifamily starts were 3.7 percent higher. Housing starts rose in the South for the first time in 3 months, increasing 10.4 percent, and gained 11.6 percent in the Midwest. Starts fell in the West for the fourth straight month, decreasing 19.6 percent, and declined 4.0 percent in the Northeast. Housing permits, a forward-looking indicator, were more encouraging, especially for the single-family segment. Single-family permits were up 1.9 percent in July on the heels of an upward revision to the prior month, sending permits to the highest level since February. Multifamily permits edged up 0.7 percent.

- **Mortgage applications** decreased 2.0 percent for the week ending August 10, according to the Mortgage Bankers Association. Purchase applications declined for the fifth consecutive week, falling 3.3 percent. Following two large weekly drops, refinance applications edged down slightly, as a decline in conventional refinance demand offset a rise in the government segment. The survey’s 30-year fixed mortgage rate declined 3 basis points to 4.81 percent.

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