Economics: Inflation and Corporate Profits Rise

Economic news released this week provided updates on inflation, consumer spending, and consumer confidence. The annual increase in the Fed’s preferred measure of inflation, the personal consumption expenditures (PCE) deflator, accelerated further above the Fed’s 2.0 percent target in July, hitting the highest annual gain since March 2012. Core inflation (excluding food and energy) also increased, rising to 2.0 percent for the third time this year. On the consumer front, real consumer spending posted the weakest monthly gain in five months in July but registered the strongest annual growth rate since last November. The rise in spending slightly outpaced the increase in disposable income, pushing the saving rate down to the lowest level this year. This bodes well for third quarter consumer spending, but we still expect it to moderate from the second quarter’s 3.8 percent annualized pace. Consumer sentiment was mixed this month. According to the Conference Board, consumer confidence jumped in August to the highest level since October 2000, driven by improvements in both the present situation and expectation components. Consumers remained much more optimistic about the present situation than about the future. However, according to the University of Michigan, consumer sentiment fell for the fourth time in five months in August to the lowest level since January. In other news, the second print of second quarter real GDP growth showed a one-tenth upgrade. Corporate profits, the new piece of data in the report, rose for the fifth straight quarter, posting the largest quarterly gain in four years. Growth in after-tax profits decelerated from the first quarter’s large jump. However, on an annual basis, after-tax corporate profits surged 16.1 percent following a 15.1 percent gain in the first quarter, marking the largest gain in six years. The spike in after-tax profits this year demonstrated the impact of the cut in the corporate tax rate to 21 percent from 35 percent. Finally, initial jobless claims rose for the first time in a month last week, but the four-week moving average fell to the lowest level in 48 years.

- **Personal income**, adjusted for inflation, rose 0.2 percent in July, the same increase as real disposable income, according to the Bureau of Economic Analysis. Real PCE rose by 0.2 percent from June and 2.8 percent annually. The personal saving rate was down a tick to 6.7 percent. The PCE deflator increased 0.1 percent from June and 2.3 percent from a year ago. The core deflator rose 0.2 percent during the month and 2.0 percent year over year.

- **The Conference Board Consumer Confidence Index** improved 5.5 points in August to 133.4. The present situation component increased for the fourth consecutive month, while the expectations component rose for the first time in three months. The **University of Michigan Consumer Sentiment Index** fell 1.7 points to 96.2 in the August final reading, driven by a large drop in the current conditions component and a slight drop in the expectations component.

- **Gross domestic product**, adjusted for inflation, expanded 4.2 percent annualized in Q2 2018, according to the second estimate from the Bureau of Economic Analysis. Personal consumption expenditures were revised down but remained the main driver of growth, contributing 2.6 percentage points to the headline gain, while private inventories were revised up but remained the largest drag on growth, detracting 1.0 percentage point. Corporate profits (before taxes) rose 3.3 percent from the prior quarter (not annualized) as profits for domestic firms rose, while profits earned abroad declined. From a year ago, profits rose 7.7 percent. After-taxes profit rose 2.4 percent, decelerating from 8.2 percent in the prior quarter.

- **Initial claims for unemployment insurance** increased by 3,000 to 213,000 in the week ending August 25, according to the Department of Labor. The four-week moving average fell by 1,500 to 212,250.
Housing: No Signs of a Turnaround for Home Sales

This week’s news added more items to the negative column for home sales’ near-term outlook. Pending home sales, which track contract signings on existing homes and tend to lead closings by 1-2 months, fell in July, erasing much of the gain in the prior month. Sales declined on a monthly basis for the third time in four months. On an annual basis, pending sales have fallen every month this year. Another leading indicator of home sales, purchase mortgage applications, fell last week for the sixth time in seven weeks. Average purchase applications for August are poised to drop from July, which would mark the second consecutive monthly decline and the third drop in four months. Overall, this week’s reports are consistent with earlier data showing lackluster housing starts and new and existing home sales in July, and support our August forecast that real residential investment will decline in the third quarter for the third straight quarter. While for-sale inventories of existing homes have shown signs of improving over the past two months, the improvement is unlikely to be enough to save existing home sales this year, which we project will decline for the first time in 4 years. Annual home price appreciation for the nation eased in June for the second consecutive month to the slowest pace this year, according to the S&P CoreLogic Case-Shiller Index. The price gain remained solid, however, staying within the range of 6.0 percent to 6.5 percent seen since last September. Strong home price increases, along with a rise in mortgage rates of nearly 60 basis points since the start of the year, should continue to weigh on home purchase affordability. The average yield on 30-year fixed-rate mortgages has been little changed over the past three weeks, with the rate ticking up 1 basis point to 4.52 percent this week, according to Freddie Mac.

• The National Association of REALTORS® Pending Home Sales Index edged down 0.7 percent to 106.2 in July. From a year ago, pending sales fell 2.3 percent. Sales were mixed across Census regions, declining on a monthly basis in the South and West but increasing in the Northeast and Midwest. Every region posted year-over-year drops.

• The S&P CoreLogic Case-Shiller National Home Price Index (not seasonally adjusted) was up 0.8 percent in June. From a year ago, the index increased 6.2 percent.

• Mortgage applications fell 1.7 percent for the week ending August 24, according to the Mortgage Bankers Association. Purchase applications declined 0.9 percent following a 2.9 percent increase in the prior week, as the drop in conventional applications outweighed a small rise in the government segment. Refinance applications fell 3.0 percent after a 6.0 percent increase in the prior week, which was the biggest percentage increase since mid-June and the first gain in three weeks. The survey’s average 30-year fixed mortgage rate fell 3 basis points to 4.78 percent.

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