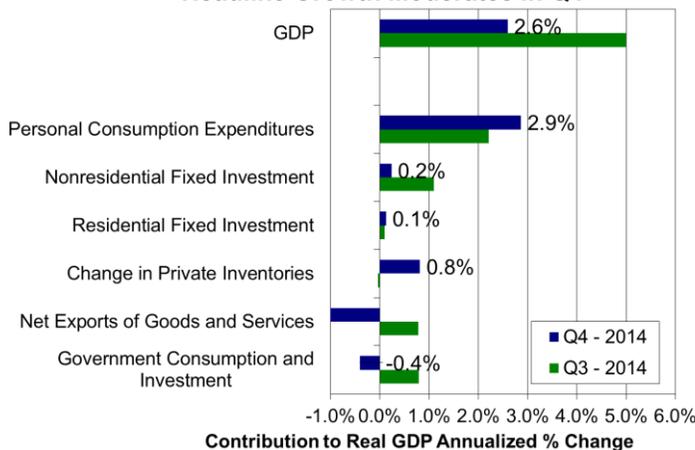


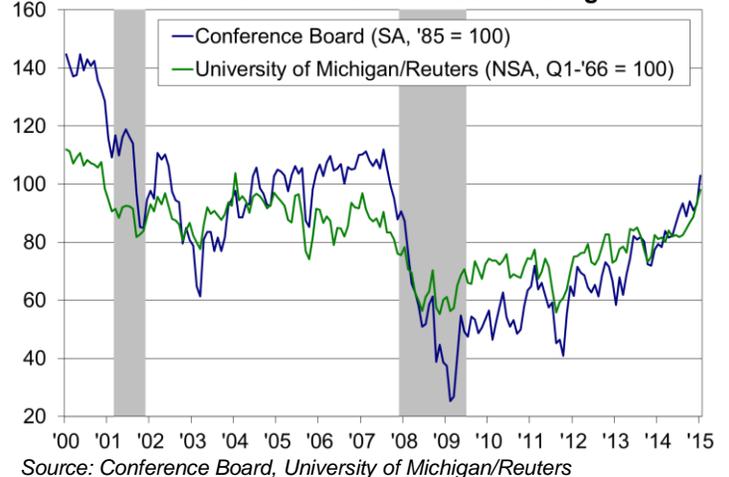
## Economics: Headline Growth Catches its Breath, Consumers Keep on Running

Headline GDP growth moderated in Q4 after two quarters of rapid expansion. As expected, consumers provided the key support to the economy during the quarter with the strongest consumer spending since 2006—boosted by falling gasoline prices and increased purchasing power. More concerning was weakness in business equipment investment to end 2014, which, gauging from sagging core durable goods orders, is likely to extend into this year. Looking ahead, our forecast for 3.1 percent growth in 2015 is supported by a strengthening consumer sector, evident from the strongest consumer confidence in January since before the Great Recession. Though the Martin Luther King holiday last week is likely to have impacted the jobless claims numbers, which showed the lowest claims since April 2000, the layoff trend remains modest, and the labor market seems to be chugging along. Treasuries rallied this week amid [Wednesday's Federal Open Market Committee \(FOMC\) meeting statement](#) in which the Fed reiterated its ability to be patient before raising rates. The 10-year Treasury yield fell below 1.7 percent Friday morning, down more than 10 basis points from last week.

- **Gross domestic product (GDP)**, adjusted for inflation, increased at a 2.6 percent annual rate in Q4 2014, according to the first estimate from the Bureau of Economic Analysis, moderating from the strongest two-quarter pace of growth since 2003 observed during Q2 and Q3 of last year. Personal consumption expenditures accelerated, growing 4.3 percent in Q4, though business equipment investment contracted following two quarters of double-digit gains. Inventory investment contributed 0.8 percentage points to growth during the quarter after holding neutral in Q3. The primary drags to Q4 growth were trade, which subtracted a full percentage point from headline growth amid the widest trade deficit in four years, and federal defense spending, which subtracted six-tenths from headline growth following a large gain in Q3. Residential fixed investment added just one-tenth to growth during the quarter. For all of 2014, growth came in at 2.5 percent—a moderation from the 3.1 percent pace in 2013. The chained personal consumption expenditures (PCE) price index declined 0.1 percent during the quarter and rose just 1.1 percent from Q4 2013, well below the Fed's 2.0 percent target.
- **The Conference Board Consumer Confidence Index** surged 9.8 points in January to 102.9—the highest since August 2007. Both the present situation and consumer expectations components jumped to multi-year bests, with the former showing the largest monthly gain in over a decade to a seven-year high. **The Reuters/University of Michigan Consumer Sentiment Index** was little changed from the preliminary reading, jumping 4.8 points in January to a final reading of 98.1—the best showing since January 2004.
- **Durable goods orders** sank 3.4 percent in December to a 10-month low, according to the Census Bureau. Nondefense capital goods orders excluding aircraft, a leading indicator in business investment in equipment in the estimation of GDP, declined for a fourth consecutive month, dropping 0.6 percent in December and 11.4 percent annualized in Q4.
- **The Employment Cost Index (ECI)** rose 0.6 percent in Q4 2014, slowing slightly from consecutive 0.7 percent gains in the prior two quarters. Over the past year, compensation was up 2.3 percent, tied with the Q3 rate for the best in six years, but well below the 3.5 percent average witnessed since record-keeping began in 1982.
- **Initial claims for unemployment insurance** plunged by 43,000 to 265,000 in the week ending January 24, according to the Department of Labor. The four-week moving average fell by 8,250 to 298,500.

**Headline Growth Moderates in Q4**


Source: Bureau of Economic Analysis

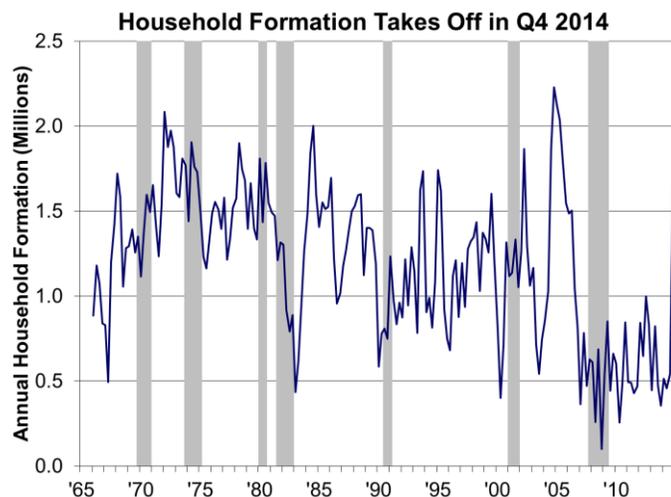
**Consumer Confidence Measures Surge**


Source: Conference Board, University of Michigan/Reuters

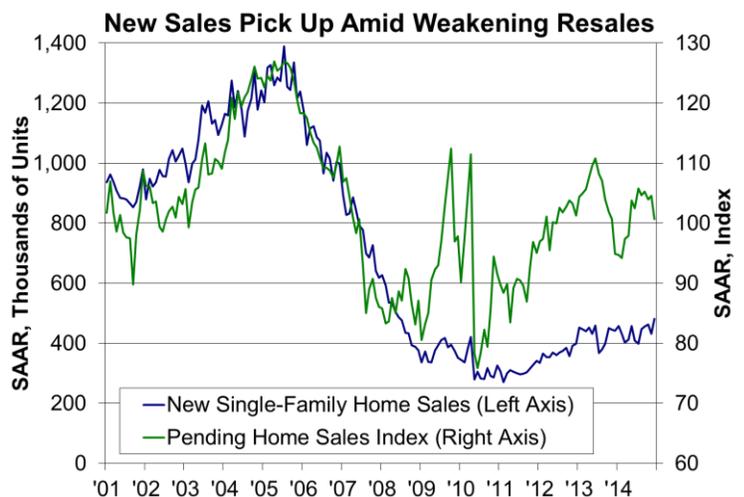
## Housing: The Ups and Downs of an Uneven Recovery

Housing data released this week were a mixed bag. On the upside, new home sales hit their highest level since the middle of the recession (June 2008), although sales are nowhere near their pre-crisis peak reached in July 2005. The largest piece of good news was the dramatic increase in household formation in the fourth quarter of 2014 from the Housing Vacancy Survey (HVS), which showed a gain of about 1.7 million households from the fourth quarter of 2013, compared with average year-over-year growth of about 500,000 during the first three quarters of 2014. Many factors may have contributed to the faster pace of household formation, including the improving job market; however, we take the magnitude of the quarterly increase with a grain of salt. On the downside, pending home sales, a leading indicator for existing home sales, fell in December to the lowest reading since April. Nonetheless, the index remained well above the level at the end of 2013, posting the largest year-over-year increase in 18 months. Meanwhile, the HVS showed continued deterioration in the homeownership rate to the lowest level in nearly two decades. In addition, a three week streak of double-digit percent increases in mortgage applications ended this week as both purchase and refinance applications fell, according to the Mortgage Bankers Association. Freddie Mac's 30-year fixed-rate mortgage yield rose 3 basis points to 3.66 percent, although it has held under 4.0 percent since early November of last year.

- **New single-family home sales** increased 11.6 percent in December from November to a seasonally adjusted annual rate of 481,000, according to the Census Bureau. For the year, new home sales totaled 435,000, up just 1.2 percent from 2013. The months' supply, or inventory/sales ratio, fell 0.5 months to 5.5 months as the spike in sales outpaced a small increase in the number of homes available for sale. The median sales price, which can be biased due to the changing mix of sales, was up 8.2 percent from December 2013.
- **The National Association of REALTORS® Pending Home Sales Index**, which records contract signings on existing homes and typically leads closings by one to two months, decreased 3.7 percent in December following a 0.6 percent increase in November. The index has risen 6.1 percent since December of last year—the largest increase since June 2013. All four regions (Northeast, Midwest, South, and West) saw declines in pending sales month-over-month but had improvement year-over-year for December.
- **The Housing Vacancy Survey (HVS)** for Q4 2014 (not seasonally adjusted) released by the Census Bureau showed a 0.4 percentage point decline in the homeownership rate to 64.0 percent—the lowest since Q1 1995 and down from the 2004 peak of 69.2 percent. Rental vacancy fell again during the quarter to 7.0 percent, a 21-year low. Homeowner vacancy rates, on the other hand, ticked up 0.1 percent to 1.9 percent from a nine-year low. Despite a sizable increase of 1.34 million in Q4, the average number of households in 2014 increased just 792,000 from 2013.
- **The S&P/Case-Shiller composite 20-city home price index** (not seasonally adjusted) decreased for the third consecutive month, falling 0.1 percent in the three months ending in November. The annual year-over-year price growth of 4.3 percent was the slowest annual appreciation since October 2012. However, all 20 of the metro areas did experience year-over-year price growth during the month. The national index was up 4.7 percent during the month, compared with 4.6 percent in the prior month.
- **Mortgage applications** decreased 3.2 percent in the week ending January 23, according to the Mortgage Bankers Association (MBA), as both purchase and refinance applications fell during the week. The contract interest rate for 30-year fixed-rate mortgages increased three basis points to 3.83 percent—the first increase in 2015.



Source: Census Bureau Housing Vacancy Survey



Source: Census Bureau, National Association of Realtors®



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Economic and Strategic Research Group  
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