

Economics: The Fed May Soon Start to Lose “Patient”

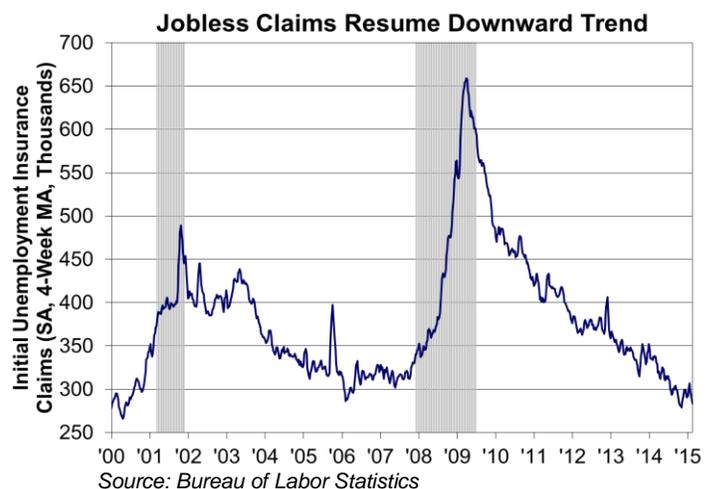
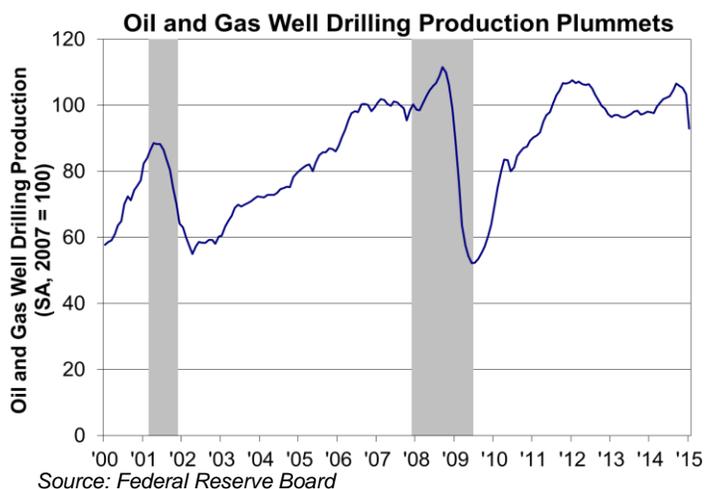
This week's two economic reports revealed the impacts of declining oil prices. On the positive, the plunge in gasoline prices dragged headline inflation at the wholesale level down further. The negative is reflected in the continued decline in mining output and capacity. The Leading Economic Index pointed to continued economic growth, but the moderating trend in the index over the past several months suggests somewhat weakening momentum in near term growth. Meanwhile, labor market conditions remain upbeat, with the four-week moving average of initial jobless claims declining to its lowest level since late October, boding well for the February employment report. The [minutes to the January 27-28 Federal Open Market Committee \(FOMC\) meeting](#) showed that the Committee expects declining energy prices to have only a transitory impact on core inflation. On the timing of the liftoff, the FOMC appeared to be in no hurry, as it noted that “many” participants were inclined to keep the fed funds rate near zero “for a longer time,” while “some” thought that rates have already been at zero for a sufficient length of time. The minutes showed the Committee’s concern that, with regard to beginning to normalize the stance of monetary policy, dropping the “patient” language from the statement could negatively affect financial markets. However, if the labor market continues to show robust hiring, the FOMC may decide to lose the word (or replace with something similar) in its next meeting on March 17-18.

➤ **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, rose 0.2 percent in January, according to the Federal Reserve Board. Manufacturing output, which accounts for about two-thirds of industrial production, also increased 0.2 percent, held down by a 0.6 percent drop in motor vehicles and parts production, while manufacturing output in the prior three months was revised lower. Mining production fell 1.0 percent in January for the third time in four months, mirroring the decline in oil prices over that time. A 10 percent drop in output related to drilling oil and gas wells pulled mining output lower. Utilities production rose 2.3 percent, recouping nearly half of the drop in the prior month. The total capacity utilization rate held steady at 79.4 percent, weighed down by the drop in the capacity utilization rate in mining operations, which fell one percentage point in January and three percentage points since June.

➤ **The Conference Board Leading Economic Index**, a gauge of the economic outlook over the next three to six months, advanced 0.2 percent in January, the smallest rise since last August. The gains were broad-based, with the financial and consumer expectations components providing the most positive impact.

➤ **The Producer Price Index (PPI)** fell 0.8 percent in January, according to the Bureau of Labor Statistics. A 24.0 percent plunge in gasoline prices pulled down producer inflation. From a year ago, the PPI was flat, compared with a 1.1 percent annual rise in the prior month. Excluding food and energy, core PPI edged down 0.1 percent from December and rose 1.6 percent from last January.

➤ **Initial claims for unemployment insurance** dropped 21,000 to 283,000 in the week ending February 14, nearly reversing the 25,000 rise in the prior week, according to the Department of Labor. Claims continued their declining trend, with the four-week moving average decreasing by 6,500 to 283,250, marking the fourth consecutive weekly drop.



Housing: Off to a Slow Start

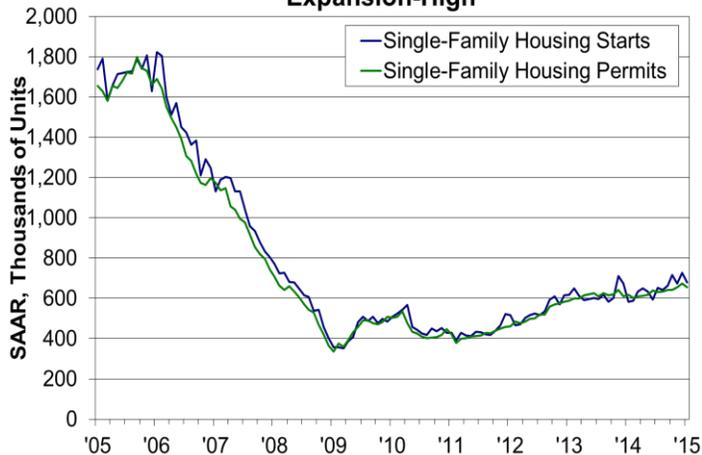
Housing data released this week were in line with our expectation that 2015 will be a year of incremental—and bumpy—improvement in housing activity, dragged upward by strengthening economic and labor market fundamentals, rather than a breakout year for the industry. Housing starts cooled in January after reaching an expansion-best pace in December, and builder confidence softened in February to a four-month low. Mortgage applications continued to retreat in February following a blockbuster January. However, the decline in FHA activity was less pronounced than in the conventional market, likely reflecting the cut in FHA's mortgage insurance premiums (MIP), which took effect in late January, helping FHA outperform conventional application activity for both purchase and refinance. The 30-year fixed mortgage yield rose 7 basis points this week to 3.76 percent, the highest rate since the end of 2014, according to Freddie Mac.

➤ **Housing starts** fell 2.0 percent in January to 1.07 million annualized units, according to the Census Bureau. Single-family starts declined 6.7 percent to 678,000 units. Multifamily housing starts rose for a second consecutive month, jumping 7.5 percent to a six-month high. Residential building permits, a leading indicator of housing starts, edged down 0.7 percent in January to 1.05 million annualized units as a 3.1 percent decline in single-family permits from an expansion-high in December outweighed a 3.6 percent increase in multifamily building permits.

➤ **The National Association of Home Builders/Wells Fargo Housing Market Index** edged down 2 points in February to 55 (a reading above 50 indicates more builders view the market as good than poor). The pullback was concentrated in the buyer traffic index, which declined to an eight-month low of 39. The single-family sales and sales expectations components were little changed on the month.

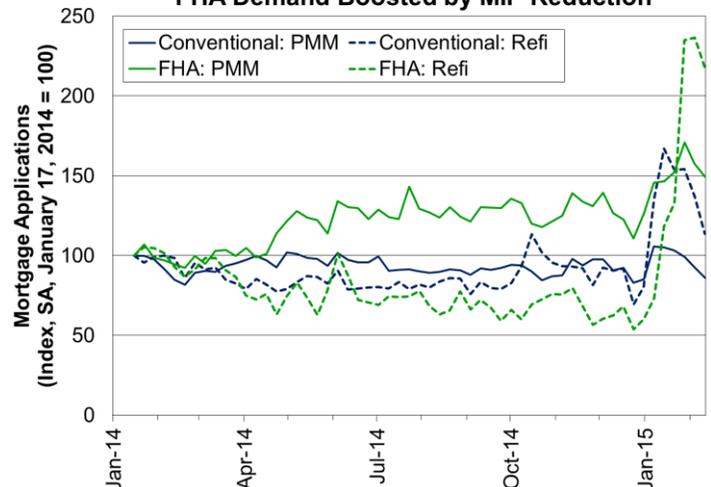
➤ **Mortgage applications** pulled back for a second consecutive week, falling 13.2 percent in the week ending February 13, according to the Mortgage Bankers Association. Purchase mortgage applications dropped for a fifth consecutive week, declining 7.1 percent to a six-week low. Refinance applications sank 16.0 percent following a double-digit decline in the prior week, though still remain above the level reached at any point last year. FHA purchase applications dropped 5.1 percent during the week, compared with a decline of 7.1 percent for the conventional market. For refinance applications, the decline in the FHA activity was less than half that of the conventional market. The contract interest rate for 30-year fixed mortgages increased 9 basis points to 3.93 percent.

Single-Family Building Retreats from Expansion-High



Source: Census Bureau

FHA Demand Boosted by MIP Reduction



Source: Mortgage Bankers Association

Brian Hughes-Cromwick and Orawin T. Velz
Economic and Strategic Research Group
February 20, 2015

Opinions, analyses, estimates, forecasts and other views of Fannie Mae's Economic and Strategic Research (ESR) Group included in these materials should not be construed as indicating Fannie Mae's business prospects or expected results, are based on a number of assumptions, and are subject to change without notice. How this information affects Fannie Mae will depend on many factors. Although the ESR group bases its opinions, analyses, estimates, forecasts and other views on information it considers reliable, it does not guarantee that the information provided in these materials is accurate, current or suitable for any particular purpose. Changes in the assumptions or the information underlying these views could produce materially different results. The analyses, opinions, estimates, forecasts and other views published by the ESR group represent the views of that group as of the date indicated and do not necessarily represent the views of Fannie Mae or its management.