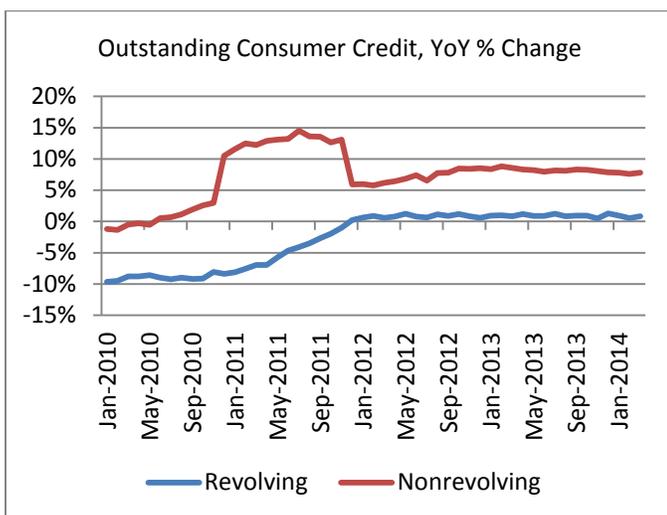


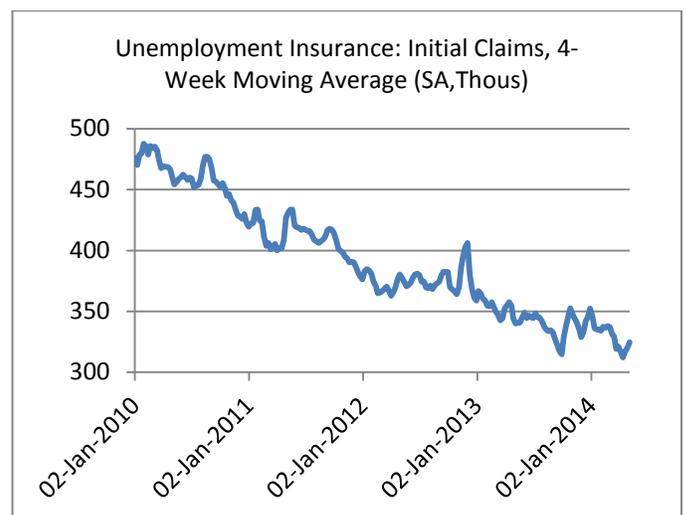
Economics: Continued Good News Supports Positive Outlook

This week's economic indicators were upbeat, signaling a pickup in both the domestic and global economies at the end of Q1 2014 and the start of Q2 2014. The trade deficit narrowed in March as an increase in U.S. exports of industrial supplies signaled growing production abroad, while the April ISM Nonmanufacturing survey showed a faster expansion in service activity across 14 of 18 industries surveyed. On the consumer side, growth in nonrevolving consumer credit continued to gain steam in March, consistent with a report of a jump in unit auto sales during the month. Nonfarm business productivity slumped in Q1 2014, in line with stalled economic growth. However, the more timely indicators released this week and the employment report from last week suggest that the economy is poised for growth in 2014.

- **The ISM Nonmanufacturing Index** increased from 53.1 in March to 55.2 in April, reaching the highest level since August (any number greater than 50 indicates an expansion). Details were mostly positive as business activity and new exports increased for the second consecutive month. New orders jumped from 53.4 to 58.2, increasing for the fourth consecutive month. Although the employment index and supplier deliveries both fell in April, they remain in expansionary territory.
- **The U.S. trade deficit** decreased to \$40.4 billion in March, down from \$41.9 billion in February, as the increase in exports outweighed the gain in imports. The solid gains in both exports and imports helped soothe concerns about both domestic and foreign demand. The deficit in goods, which had been widening for three months, narrowed from \$61.3 billion to \$60.7 billion as the deficit in petroleum narrowed from \$20 billion to \$18.6 billion. The services surplus more than gained back the \$0.7 billion drop seen in February, adding \$0.9 billion in March.
- **Nonfarm business productivity** fell at a 1.7% annual rate in Q1 2014. Unit labor costs increased 4.2%, the first increase in three quarters, while compensation per hour grew 2.4% after growing 1.9% in Q4 2013. The decrease in productivity should be only temporary as we expect that output is poised to pick up in Q2 2014.
- **Consumer credit** expanded by \$17.5 billion, marking the first acceleration of credit expansion since December. The majority of the increase was due to a \$16.4 billion dollar jump in nonrevolving credit, which includes financing for expensive items such as cars, boats, and student loans. The remaining \$1.1 billion of the increase consisted of revolving credit, which includes credit cards. Although both categories are increasing, revolving credit is increasing at a slower pace.
- **Initial claims for unemployment insurance** fell by 26K last week to 319K, for the week ending May 3. Although the four-week moving average ticked up by 4.5K to 324.8K, the figure hovered near expansionary lows. Continuing claims for unemployment insurance decreased by 76K to 2.69 million for the week ending April 26.



Source: Federal Reserve Board



Source: Department of Labor

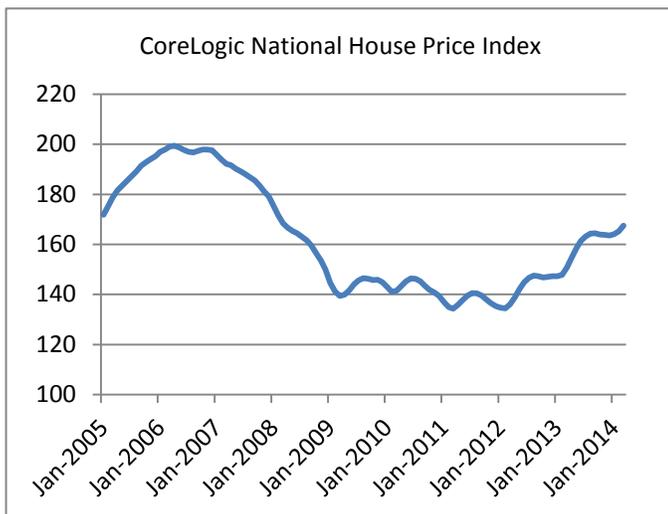
Housing: Decreasing Affordability and Weakening Demand Contribute to Slowdown

Home prices continued to rise in March and are up substantially year-over-year. The Federal Reserve's Senior Loan Officer Opinion Survey showed that banks continued to tighten lending standards for both traditional prime and nontraditional mortgage borrowers. Banks reported weaker demand for mortgages amid deteriorating affordability conditions exacerbated by robust home price gains. In the near term, we may see an uptick in purchase mortgage applications throughout the spring. However, on a year-over-year basis, purchase mortgage application volume may remain subdued.

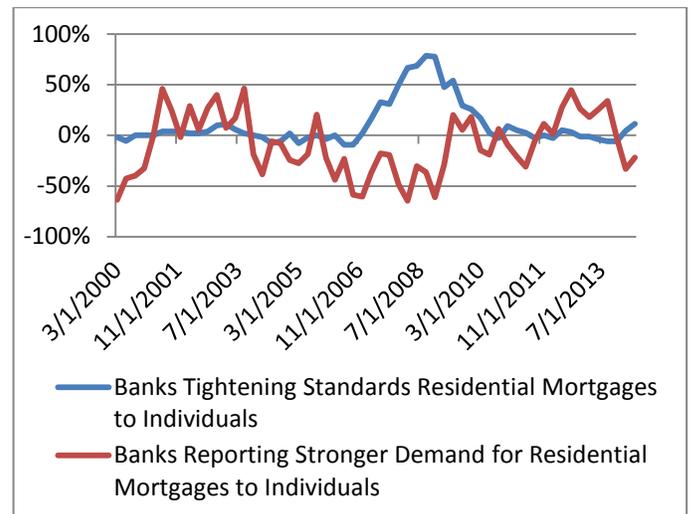
➤ **The U.S. CoreLogic Home Price Index** (not seasonally adjusted) increased 1.4% in March 2014 and is up 11.1% compared to March 2013. Year-over-year home price gains were seen throughout the country in 98 of the top 100 metro areas by population and 50 of 51 states and the District of Columbia. The index, excluding distressed sales, increased 0.9% in March 2014 and is up 9.5% compared to March 2013 as investors continued to fuel some of the gains seen in the overall index. Although the overall index has risen a cumulative 25% since the trough reached three years ago, it remains 16% below the April 2006 peak.

➤ **The Federal Reserve Senior Loan Officer Opinion Survey** showed that banks eased lending standards to businesses and consumers in Q1 2014, but continued to tighten mortgage standards. The net percentage of banks reporting tightening mortgage standards for prime borrowers held steady at 1.4% for the second consecutive quarter, while the net percentage of banks reporting tightening standards for nontraditional mortgage borrowers surged to 24.3% in the three-month period ending in March, up from 8.6% in the prior three months. The net share of banks reporting stronger demand for mortgages remained negative for both the prime and nontraditional sectors for the third consecutive quarter, with a net of -25.7% of banks reporting stronger demand for prime mortgages and a net of -16.2% reporting stronger demand for nontraditional mortgages.

➤ **The Mortgage Bankers Association Mortgage Applications Survey** showed that mortgage applications bounced back after sliding for two weeks, with total applications increasing 5.3% and purchase applications increasing 8.9% in the week ending May 2nd. We expect purchase applications to continue to increase throughout the spring buying season. However, purchase applications are down 16.1% year-over-year.



Source: CoreLogic



Source: Federal Reserve Board

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May 9, 2014

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