



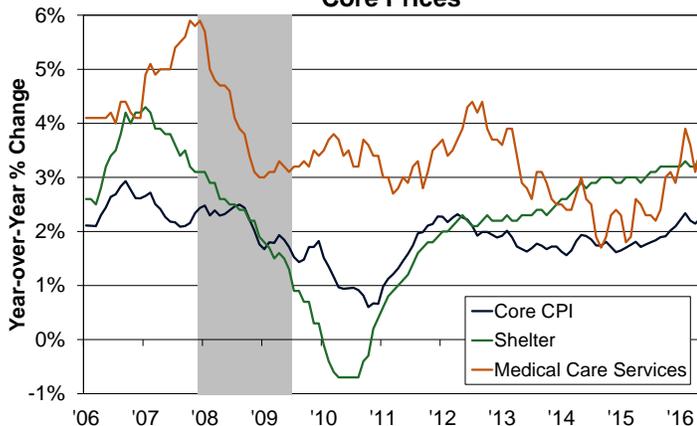
Weekly Note – June 17, 2016

Economics: Fed Forecast Shows Less Tightening Appetite

This week's data were a mixed bag. In the positive column, headline and core retail sales posted solid increases in May. Combined with strong April consumer spending, the gain in May core retail sales, which are used to estimate goods consumer spending, suggests that second quarter real consumer spending growth will likely pick up by more than one percentage point from the first quarter's 1.9 percent annualized pace. Small business sentiment also improved in May, albeit slightly, boosted by a jump in expectations for the economy to improve. Measures of inflation have gradually moved higher as the drags from the decline in energy prices and dollar strength have abated. Notably, core CPI inflation picked up, boosted by a jump in shelter costs despite reports of slowing rent gains in most of the nation. Nonetheless, year-over-year core retail inflation remains within a narrow range of 2.1 to 2.3 percent witnessed since last December. In the negative column, industrial production fell in May for the third time over the last four months, and last week's initial unemployment claims posted the biggest jump since early May. The Federal Open Market Committee left rates unchanged at its meeting this week. However, the Summary of Economic Projections, which is released on a quarterly basis, showed lowered expectations for future rate rises compared with the March release. While the median number of rate increases expected this year remains at two, six participants expect only one hike, up from one participant in March. We still expect one rate increase this year, most likely in September, the same view we've held since April.

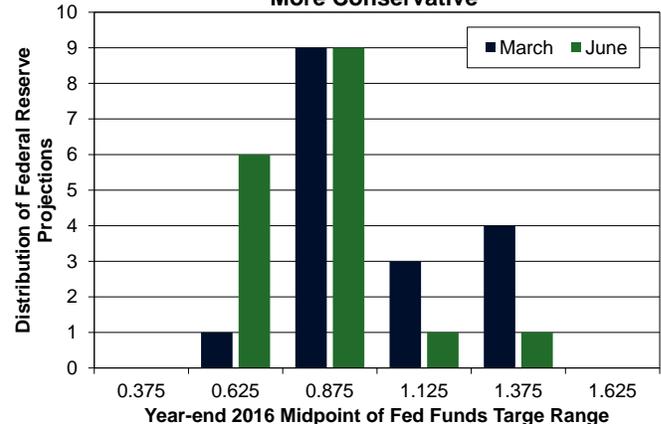
- **Retail Sales** rose 0.5 percent in May, according to the Census Bureau. Core retail sales (excluding autos, gas stations, and home improvement stores) rose 0.4 percent.
- **The Consumer Price Index (CPI)** advanced 0.2 percent in May. Core prices (excluding food and energy) also rose 0.2 percent, as core goods prices fell 0.2 percent while core services prices rose 0.3 percent. The gain in the latter reflected a pickup in the costs of shelter and medical services. Shelter costs increased 0.4 percent from April and 3.4 percent from a year ago, marking the biggest year-over-year rise since September 2007. Prices for medical care services rose 0.5 percent from April and 3.5 percent from last May. From a year ago, the headline and the core indices rose 1.0 percent and 2.2 percent, respectively. **The Producer Price Index (PPI)** for final demand of goods and services increased for the second straight month in May, rising 0.4 percent. **Import prices** increased 1.4 percent in May, driven by the biggest monthly gain in petroleum prices since 1999. Excluding fuel, prices also accelerated, increasing 0.3 percent. (The Bureau of Labor Statistics produces all three reports.)
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** edged up from 93.6 to 93.8 in May. The net share of small businesses expecting the economy to improve rose 5 percentage points to -13.
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, dropped 0.4 percent in May, according to the Federal Reserve Board. Manufacturing production fell 0.4 percent, the third drop over the last four months, weighed down by weakness in motor vehicles production. Ex-motor vehicles and parts, manufacturing production edged down 0.1 percent. Utilities production fell 1.0 percent following a 6.1 percent surge in April. Mining output edged up 0.2 percent, marking the first rise in eight months, driven by an increase in coal production. Drilling of oil and gas wells fell 7.8 percent in May, the ninth consecutive monthly drop.
- **Initial claims for unemployment insurance** increased 13,000 to 277,000 in the week ending June 11, according to the Department of Labor. The four-week moving average edged down to 269,250.

Shelter and Medical Care Services Help Boost Core Prices



Source: Bureau of Labor Statistics

FOMC Members' Rate Hike Expectations Are More Conservative



Source: Federal Reserve Board

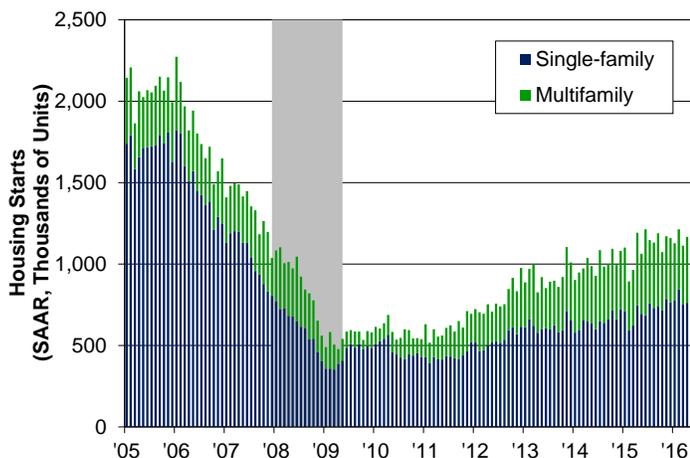


Housing: Home Construction Grinds Forward

Housing data released this week saw home construction take a breather in its grind forward. Total housing starts fell slightly after a solid gain in April, but are 10 percent higher through the first five months of the year than the same period a year ago. Single-family construction posted a second consecutive uninspiring monthly gain, failing to make up much ground from a sharp drop in March after reaching an expansion best in February. However, through the first five months of the year, single-family construction is off to its best start since 2007, suggesting the sector is slowly gaining momentum. And while single-family permits fell from a month ago, they have improved on a year-over-year basis for 18 straight months, pointing to further steady improvement for home building. Multifamily construction fell slightly in May after a big jump in the prior month to reach a seven-month high. The immediate outlook for the sector looks brighter, as multifamily permits posted the second consecutive gain after a stretch of four straight declines led to permits falling to the lowest level in March since August 2013. In another positive sign for the construction outlook, home builders' optimism improved in June after three months of no change. In addition, their outlook for future sales improved to an eight-month high and traffic of potential buyers reached a seven-month best. Mortgage demand cooled last week, as purchase applications fell back after the largest jump since early January last week and refinance applications declined slightly. Mortgage rates fell by six basis points for a second straight week to reach 3.54 percent, the lowest level in just over three years, according to the survey by Freddie Mac.

- **Housing starts** slipped 0.3 percent in May to 1.16 million annualized units, according to the Census Bureau. The 1.2 percent fall in multifamily building to 400,000 units drove the decline, while single-family building increased slightly by 0.3 percent to 764,000 units. Through the first five months of the year, single-family starts are 14.5 percent higher than the same period a year ago, and multifamily starts are up 2.0 percent. New residential permits edged up 0.7 percent to 1.14 million units annualized. A 5.9 percent increase in multifamily permits outweighed a 2.0 percent fall in single-family permits. On a year-to-date basis, single-family permits are 10.4 percent higher, while multifamily permits are 13.0 percent lower.
- **The National Association of Home Builders/Wells Fargo Housing Market Index** increased two points in June to 60, marking the highest level since January. A reading above 50 indicates more builders view the market as "good" rather than "poor." For the first time in a year, all three components—present sales, sales in the next six months, and prospective buyer traffic—rose during the month.
- **Mortgage applications** fell back 2.4 percent for the week ending June 10 after posting the largest jump in two months of 9.3 percent in the prior week, according to the Mortgage Bankers Association. Purchase applications drove the decline, dropping 4.9 percent, as both conventional and government applications fell. Refinance applications declined slightly as well, slipping 0.7 percent. An 11.6 percent decrease in government applications outweighed the 2.3 percent increase in conventional applications. The average 30-year fixed mortgage rate fell for the second consecutive week, declining 4 basis points to 3.79 percent, the lowest level since the end of January 2015.

Home Construction Takes a Breather...



Source: Census Bureau

...But Home Builders Have a Rosier View of Their Prospects



Source: National Association of Home Builders/Wells Fargo

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