Economics: Fed Digs in its Heels for a Rate Hike This Year

The statement following this week’s Federal Open Market Committee meeting offered additional signals that the first rate hike might be upon us. Citing “solid” job gains and “diminished” labor market slack, the Fed kept the door firmly open for a rate increase this year, with three meetings remaining. The Fed’s slightly more upbeat assessment of the economy was in line with the release of the first estimate of second quarter gross domestic product and its annual revisions showing a rebound in economic growth in the second quarter and an upgrade to the first quarter’s growth to a slight positive from a slight negative. However, the revisions showed somewhat weaker growth between 2012 and 2014. Consumer spending was the biggest driver during the second quarter, and housing also contributed to growth. Business investment in both structures and equipment subtracted from growth, but the positive advance report on durable goods orders showing a pickup in core capital goods orders hints at an improving outlook for business equipment investment. Consumers seemed unconvinced of the improving economic conditions, as two key measures of their expectations fell, with expectations plunging by the largest amount since August 2011. Evidence of firming wage growth failed to materialize this week, as the wage and salaries component in the Employment Cost Index showed the smallest gain on record since the inception of the series in 1982—something that will surely grab the Fed’s attention.

- **Gross domestic product (GDP)**, adjusted for inflation, expanded at a 2.3 percent annual rate in Q2 2015, according to the advance estimate from the Bureau of Economic Analysis (BEA). The first quarter of the year was revised upwards from a 0.2 percent contraction to a 0.6 percent expansion. In the second quarter, consumer spending continued to drive growth, rising 2.9 percent annualized and contributed two percentage points to GDP, with net exports, residential fixed investments, and the government sector also contributing. Inventory and business fixed investments were modest drags to growth, which through the first half of 2015 has been weaker than in 2014, growing at a 1.5 percent annual rate this year compared with 1.8 percent over the same period last year.

- **The Conference Board Consumer Confidence Index** fell 8.9 points in July to 90.9. Both the present situation and expectation components fell, with expectations plunging by the largest amount since August 2011. The **University of Michigan Consumer Sentiment Index** dropped by 3.0 points to 93.1 in July, with both the expectations and present conditions components dipping.

- **Durable goods orders** rose 3.4 percent in June breaking a two-month streak of declines, according to the Census Bureau. Nondefense aircraft orders drove the rise, with a 66.1 percent increase, thanks in part to the Paris air show. Boeing reported receiving 161 orders in June, compared to 11 in May. However, orders excluding transportation also rose for the second time this year, edging up 0.8 percent. Core shipments, an input to estimate business equipment investment in GDP, fell 0.1 percent, marking the second consecutive months of decline. However, their leading indicator, new orders for core capital goods (which exclude defense and aircraft items) rose 0.9 percent.

- **The Employment Cost Index (ECI)**, a measure of labor compensation, edged up 0.2 percent in Q2 2015, as the wages and salaries component rose 0.2 percent and benefits edged up 0.1 percent, according to the Bureau of Labor Statistics. The private sector ECI was flat for the first time in the history of the series.

- **Initial claims for unemployment insurance** increased by 12,000 to 267,000 in the week ending July 25, according to the Department of Labor. The four-week moving average, however, decreased by 3,750 to 274,750.
Housing: Homeownership Approaches Five-Decade Low

Housing data released this week were relatively soft compared to the recent string of upbeat housing activity. A week after the release of June existing home sales data showing a healthy increase to an eight-year high, leading indicators of home sales cooled. The National Association of REALTORS® pending home sales index fell in June, breaking a streak of five consecutive monthly gains. Purchase applications barely budged last week, holding below recent highs reached in June and early July. The home sales outlook remains healthy, however, as pending home sales remained above year-ago levels for the tenth consecutive month, and by a healthy margin. Furthermore, purchase applications still sit higher than at any point in 2014. Despite the improved home purchase picture so far this year, the Q2 2015 Housing Vacancy Survey showed the lowest homeownership rate in nearly half a century. Though household formation continues to strengthen, net household growth is due to rental households. This has pushed the rental vacancy rate down to a near three-decade low, supporting the ongoing boom in multifamily housing construction amid modest single-family building activity. The 30-year fixed mortgage rate fell six basis points to 3.98 percent this week, according to Freddie Mac.

- The National Association of REALTORS® pending home sales index, which records contract signings of existing homes and typically leads closings by one to two months, fell 1.8 percent in June. Declines in the Midwest and South outweighed modest gains in the Northeast and West regions. Over the 12 months ending in June, the index is up 8.2 percent—the 10th consecutive year-over-year gain.

- The Housing Vacancy Survey (HVS) for Q2 2015 (not seasonally adjusted) released by the Census Bureau showed a 0.3 percentage point decline in the homeownership rate to 63.4 percent—the lowest since Q1 1967. The homeowner vacancy rate ticked down one-tenth of a percentage point to 1.8 percent, matching an expansion low. The rental vacancy rate fell 0.3 percentage points to 6.8 percent—lower than any period since Q4 1985. The average number of households increased by 321,000 from Q1, and 1.6 million from Q2 2014. The net gain in household formation was due to rental households; owner-occupied households declined for a second consecutive quarter.

- The S&P/Case-Schiller composite 20-city home price index (not seasonally adjusted) increased 1.1 percent in the three months ending in May. The index is up 4.9 percent from May 2014; the annual gain has been little changed since January. All 20 cities measured had year-over-year home price growth, ranging from 1.3 percent in Washington DC to 10.0 percent in Denver. The index for the nation also showed steady annual appreciation so far this year, posting a 4.4 percent gain in May.

- Mortgage applications edged up 0.8 percent in the week ending July 24, according to the Mortgage Bankers Association. Refinance applications rose 1.6 percent amid a six basis point decline in the 30-year fixed mortgage rate to 4.17 percent. Purchase applications were little changed, slipping 0.1 percent.

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