Economic and Housing Weekly Note
August 1, 2014

Economics: Economy Poised for Strong Second Half

A healthy serving of economic data releases left us feeling optimistic about our forecast for above-trend growth over the second half of 2014. GDP rebounded faster than we anticipated in Q2 while the sharp decline in growth in Q1 was softened by revisions. Payroll growth cooled a bit in July but the trend remains upbeat, supported by July jobless claims—the lowest monthly average in more than eight years. Measures of consumer confidence diverged in July, but we expect them to move higher amid continued job growth and an improving income picture. A little changed Federal Open Market Committee statement following its 2-day meeting on Wednesday placed market focus on wage growth as a precursor for policy normalization. The release of the employment cost index for Q2 showing the biggest gain since 2008 contributed to a sharp sell-off as market participants feared an earlier rate hike than the mid-2015 consensus. Despite the flat average hourly earnings in Friday’s jobs report, the market continued to move lower by mid-day. However, the muted wage pressure, combined with below-target PCE inflation, supports our expectation for a first rate hike in mid-2015.

- **Nonfarm payroll employment** rose 209,000 in July while upward revisions to the prior two months contributed an additional 15,000 jobs. Despite the deceleration of job growth in July from the 277,000 average monthly gain in Q2, it was the sixth consecutive month with employment gains above 200,000—a first since 1997. Other details were soft, with average hourly earnings and average hours worked both flat. In the separate survey of households, the unemployment rate ticked up one tenth to 6.2 percent as an increase in the labor force outpaced a modest gain in household employment.

- **Gross Domestic Product (GDP)**, adjusted for inflation, jumped at a 4.0 percent annual rate following a 2.1 percent decline in Q1. Strengthening consumer spending growth (2.5 percent in Q2 following a Q1 pace that was the slowest in more than two years) and a rebound in inventory investment drove headline growth, while broad-based improvement in fixed investment (including a 7.5 percent jump in residential investment following two quarterly declines) and a modest increase in government spending also contributed to headline growth. Trade was the only major sector to drag on growth, as a jump in imports outpaced a pickup in exports. **Real personal income and real personal consumption expenditures** (PCE) both increased 0.2 percent in June and 2.3 percent over the past 12 months. The personal saving rate held steady at 5.3 percent. The PCE chained price index, the Fed’s favored measure of inflation, edged up 0.2 percent from May and 1.6 percent from a year ago—below the Fed’s target of 2.0 percent.

- **The Conference Board Consumer Confidence Index** jumped to a near seven-year high in July, rising 4.5 points following a 4.2 point rise in June. Details were positive with healthy gains in both the current conditions and expectations components. The final July reading of the **University of Michigan/Reuters Consumer Sentiment Index** rose 0.5 points from the preliminary estimate, but declined 1.2 points from the June final as a decline in consumer expectations outweighed an increase in the current conditions component. Inflation expectations remained well anchored.

- **The Institute for Supply Management (ISM) manufacturing index** rose 1.8 points to 57.1 in July (any reading above 50 indicates expansion in the sector) with strength in the forward-looking new orders index, the coincidental production index, and a particularly large jump in the employment index—corroborating the healthy July increase in manufacturing employment reported by the Bureau of Labor Statistics.
Housing: Losing Momentum Going into the Second Half of the Year

While recent economic reports support our view of stronger economic growth in the second half of 2014, news from the housing and mortgage market has been less encouraging. This week’s housing news was on the soft side. After three consecutive monthly gains, pending home sales took a breather in June. Despite their improvement going into the spring selling season, through the first half of 2014 pending sales still remain substantially below their levels a year ago. In line with a sub-par performance in home sales compared with the prior spring, the S&P/Case-Shiller house price index provided further evidence that the pace of house price gains is moderating from last year’s robust pace. Construction spending fell sharply in June, with broad-based declines across the residential, nonresidential, and public segments. The drop in construction spending on new single-family homes was presaged by the plunge in June single-family housing starts. Finally, the Housing Vacancy Survey for Q2 showed continued improvement in the rental housing market vacancy rate and deterioration in the homeownership rate amid lackluster household formation.

- The National Association of REALTORS® pending home sales index fell 1.1 percent in June, following a 6.0 percent jump in May. The pullback in pending home sales, which record contract signings of existing homes, came after last week’s plunge in June new home sales, which track contract signings of new homes.

- The S&P/Case-Shiller 20-City Composite Home Price Index (not seasonally adjusted) increased 1.1 percent in the three months ending in May and was up 9.3 percent from a year ago, the weakest year-over-year gain since February 2013. On a seasonally adjusted basis, the index declined 0.3 percent, the first drop since January 2012.

- The Census Bureau released the Housing Vacancy Survey (HVS) showing Q2 2014 results for housing stock, household formations, housing vacancies, and the homeownership rate. The rental vacancy rate plummeted 0.8 percentage points to 7.5 percent. The drop is among the largest on record, pushing the rate down to the lowest reading since Q1 1977. The homeowner vacancy rate fell one tick to 1.9 percent, remaining within the tight range witnessed over the past two years. The homeownership rate edged down 0.1 percentage points to 64.7 percent, marking the lowest level since Q2 1995 and down from its peak of 69.2 percent in Q2 2004. The HVS also showed a continued sluggish pace of household formations, with most of the newly-created households going into rental units.

- Total construction spending dropped 1.8 percent in June, as construction spending in the private residential, private nonresidential, and public sectors fell 0.3, 1.6, and 4.0 percent, respectively. The decline in private residential construction spending was due primarily to a drop in spending on new single-family homes, which outweighed gains in spending on new multifamily homes and on residential improvements.

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