Economics: Some Bumps in the Road

Economic data released this week gave some reason for concern, though we stand by our expectation for above-trend economic growth in the second half of this year driven by improving private sector activity amid neutral public sector activity. However, an early indicator of Q3 consumer income and spending was largely downbeat, with softening income growth and a decline in spending in July. We expect this weakness to be temporary, as measures of consumer confidence in August were upbeat, especially regarding the current conditions component. Durable goods orders jumped in July at the fastest monthly rate since record keeping began in 1992, though it was mostly driven by a jump in civilian aircraft orders, which is likely to reverse in August. The big unknown remains the current geopolitical tension in both Eastern Europe and the Middle East, which is reflected in both the sharp bond rally in long-dated Treasury bonds (particularly the 30-year U.S. Treasury) and the decline in the expectations component of consumer confidence.

- **Personal income**, adjusted for inflation, ticked up 0.1 percent in July—a slowdown from the healthy pace of growth witnessed in the first half of the year. Despite the weak July figure, year-over-year growth in real income of 2.7 percent is the strongest since December 2012 when income was pulled into 2012 to avoid the federal tax hike enacted at the outset of 2013. Real personal consumption expenditures (PCE) contracted 0.2 percent in July and grew just 2.0 percent over the prior 12 months—a five-month low. The PCE chained price index increased 0.1 percent in July, and 1.6 percent year-over-year, well below the Fed’s target of 2.0 percent.

- **Gross domestic product (GDP)**, adjusted for inflation, increased at a 4.2 percent annualized rate in Q2 in the Bureau of Economic Analysis’ second estimate, a modest upgrade from the 4.0 percent advance estimate and a sizable rebound from the 2.1 percent decline in Q1. The revision went largely as expected, with stronger nonresidential fixed investment, less contribution from inventory buildup, and a smaller drag from the trade sector. Other components were little changed.

- **The Conference Board Consumer Confidence Index** rose 2.1 points in August to 92.4, the highest since late 2007. The current conditions component registered a 6.7 point gain during the month, surpassing a six-year high, while the expectations component ticked down 1.0 point. Details were mostly solid, as the difference between those indicating that jobs are plentiful and those indicating that jobs are hard to get improved for the fourth consecutive month, while both auto and home buying plans ticked up. The final reading of the University of Michigan/Reuters Consumer Sentiment Index increased 0.7 points in the final August reading from July, and reversed the 2.6 point decline reported in the preliminary August reading. An increase in the current conditions component outweighed a steep decline in consumer expectations.

- **Durable goods orders** jumped 22.6 percent in July, boosted by a 318.0 percent surge in orders for civilian aircraft and parts according to the Census Bureau. Other details were mixed; motor vehicles and parts orders jumped 10.2 percent for the month, while nondefense capital goods excluding aircraft—a leading indicator of business investment in equipment in the calculation of GDP—dipped 0.5 percent after a robust gain in June.

- **Initial claims for unemployment insurance** edged down 1,000 to 298,000 in the week ending August 23 according to the Department of Labor. The four-week moving average, a better gauge of the underlying trend, moved below 300,000 for the fourth time in five weeks.

![Income Growth Slows, Spending Falls](Source: Bureau of Economic Analysis)

![Consumers Are More Optimistic About Jobs](Source: Conference Board)
Housing: Two Steps Forward, One Step Back

Housing data released this week were a mixed bag, as a healthy pickup in July pending home sales following last week’s report on increasing existing home sales shows strengthening momentum in the resale market, while new home sales continued to tread water—essentially moving sideways for the better part of two years. Though existing home sales have rebounded from recent lows earlier in the year, we maintain our expectation for a year-over-year decline in total home sales for all of 2014. Two measures of home prices continued the familiar trend of moderating annual growth, though that growth remains widespread regionally, with all 20 cities measured by the S&P/Case-Shiller index and all nine census divisions measured by the FHFA purchase-only index showing year-over-year price growth. Mortgage applications picked up a bit last week, but remain only modestly above multi-year lows even amid the lowest 30-year fixed mortgage rate since last year of 4.10 percent, according to Freddie Mac.

- New single-family home sales dipped 2.4 percent in July to a seasonally adjusted annualized pace of 412,000 units, according to the Census Bureau. Year-to-date new home sales through the first seven months of 2014 are down 0.7 percent compared to the same period last year. The inventory of new homes for sale continued to trend higher, increasing 4.1 percent in July to 205,000. The combination of rising inventory and falling sales pushed the inventory/sales ratio (or months’ supply) up to 6.0—nearly a three-year high. However, even with an uptick in the median number of months for sale since completion to 3.5 months, it remains well below the average of 5.5 months witnessed since 1988. The median sales price, which is unadjusted for the composition of sales, fell for the second consecutive month, but was up 2.9 percent from July 2013.

- The National Association of REALTORS® pending home sales index, which records contract signings of existing homes and typically leads existing home sales by one to two months, increased 3.3 percent in July to an 11-month high following a 1.3 percent dip in June. Over the past 12 months, pending home sales are down 2.1 percent.

- The S&P/Case-Shiller composite 20-city home price index (not seasonally adjusted) increased 1.0 percent in the three months ending in June, down from the 1.2 percent gains witnessed in April and May. Prices were up 8.1 percent from a year ago, steadily declining from their recent peak of 13.7 percent year-over-year appreciation recorded in November and marking the slowest pace since January 2013.

- The FHFA purchase-only home price index (reported by FHFA on a seasonally adjusted basis) increased 0.4 percent in June and 5.1 percent from a year ago, down from a peak of 8.5 percent recorded last July. The quarterly index (also seasonally adjusted) rose 0.8 percent in Q2 2014, the slowest quarterly growth in more than two years. From a year ago, prices were up 5.3 percent, down from their peak of 8.4 percent in Q3 2013.

- Mortgage applications rose 2.8 percent in the week ending August 22, according to the Mortgage Bankers Association, due to a rise in both purchase and refinance demand amid the second consecutive weekly drop in the contract interest rate for 30-year fixed rate mortgages to 4.28 percent—the lowest rate in three months. After falling for three consecutive weeks, purchase mortgage applications rose 2.6 percent while refinance applications increased 2.8 percent.

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