



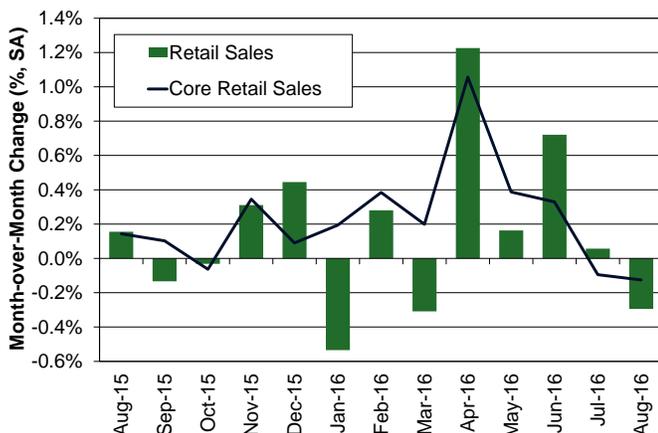
Weekly Note – September 16, 2016

Economics: Consumers Take a Breather

This week's economic news was on the soft side. Retail sales fell in August for the first time in five months. The decline was broad-based, with an exception in food and beverage store sales. Besides eating and drinking, consumers appeared to spend little on other goods. Notably, non-store (Internet) sales fell for the first time since January 2015. Core sales, which are used to estimate consumer spending for goods, dropped in August for the second consecutive month, the first time that has happened since early 2009. A slowdown in retail sales following robust gains in the second quarter is not surprising and remains consistent with our forecast of a marked deceleration in real consumer spending growth this quarter to nearly 3.0 percent from 4.4 percent annualized in the second quarter. Consumer sentiment was flat in August. However, the current political climate weighed on small business confidence in August. Businesses' view on the economic outlook deteriorated sharply, and the share of firms citing the political climate as a reason not to expand rose to a record high. The industrial production report points to continued challenges for the factory sector, as manufacturing output dropped sizably in August, reversing the prior month's gain. On a more positive note, mining output rose for the fourth consecutive month, reflecting the recent recovery in drilling activity. The inflation picture was mixed in August. While the PPI and import prices were subdued, the CPI surprised on the upside, especially for the core index. Core prices showed the biggest monthly gain since February, driven by the biggest surge in medical care services since 1990. The core CPI has been running ahead of the core Personal Consumption Expenditures deflator, the Fed's favored measure, and thus this week's inflation news presents no urgency for the Fed to raise interest rates.

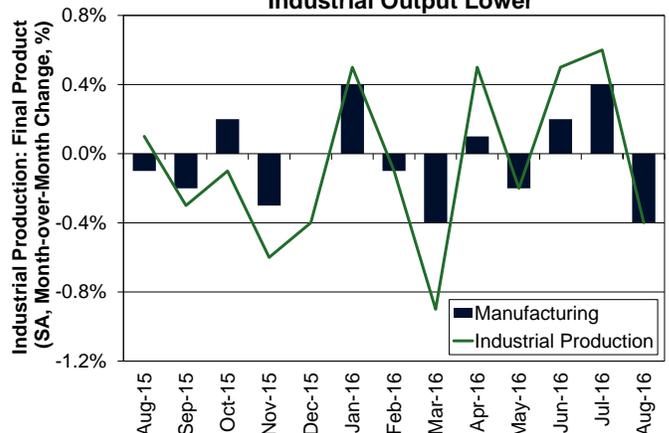
- **Retail sales** retreated 0.3 percent in August, according to the Census Bureau. Core sales, which excludes auto, gasoline and building material sales, edged down 0.1 percent following downward revisions to the prior two months.
- **The Consumer Price Index (CPI)** rose 0.2 percent in August. Core prices, which excludes food and energy items, increased 0.3 percent from July, driven by medical care services, which jumped 0.9 percent, and a 0.3 percent rise in shelter costs. From one year ago, the core CPI rose 2.3 percent, compared with 2.2 percent in the prior month. **Import prices** fell in August for the first time in six months, edging down 0.2 percent, driven by the decline in fuel prices. Nonfuel import prices were flat. From one year ago, import prices fell 2.2 percent. **The Producer Price Index (PPI)** for final demand of goods and services was flat in August. Core PPI ticked up 0.1 percent from July and 0.6 percent from one year ago (The Bureau of Labor Statistics produces all three reports.)
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** edged down to 94.4 in August from 94.6 in July. The net share of firms expecting the economy to improve posted the sharpest drop since January 2015, declining seven points to negative 12 percent. A record high 39 percent cited the political climate as a reason not to expand. The survey suggests that small businesses have difficulty hiring as 30 percent of businesses, an expansion high share, reported they had job openings they could not fill.
- **The University of Michigan Consumer Sentiment Index** was flat at 89.8 in the September preliminary reading.
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, fell 0.4 percent, according to the Federal Reserve Board. Manufacturing output dropped 0.4 percent while utility output declined 1.4 percent. Mining output rose 1.0 percent to post the biggest gain since last July.

Retail Sales Have Softened



Source: Census Bureau

Manufacturing Output Drives Industrial Output Lower



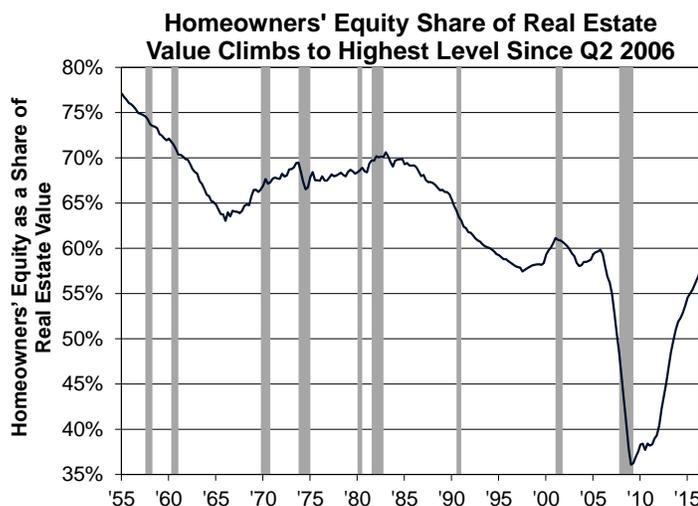
Source: Federal Reserve Board



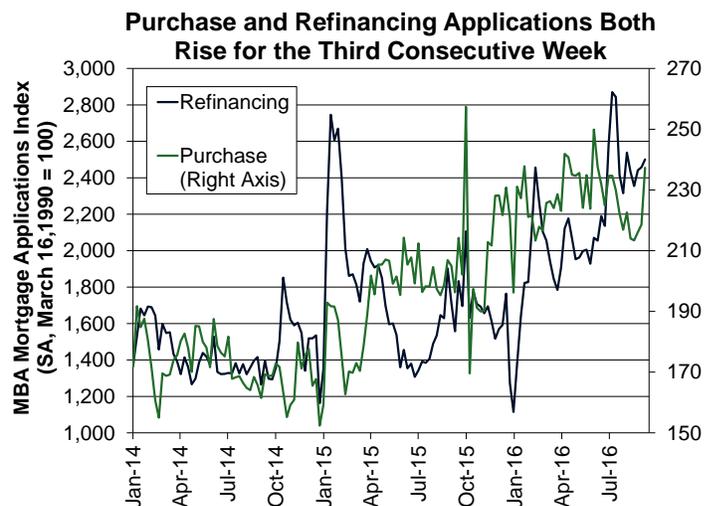
Housing: Strong Home Price Gains Help Boost Wealth

The main housing data released this week provided evidence of the continued improvement in household balance sheets. The Federal Reserve reported household net worth rose to a new all-time nominal high in the second quarter of this year, as gains in housing wealth accounted for 33 percent of the improvement in net worth. Strong growth in the CoreLogic National Home Price Index during the second quarter, the measure used by the Fed to estimate the value of real estate holdings, has helped boost household wealth. However, home equity has not fully recovered the ground lost during the crisis, remaining 4.5 percent below its pre-recession peak of Q1 2006 according to the Fed. Homeowners' equity as a share of real estate value has improved for five straight years to reach the highest level since Q2 2006. Growth in mortgage debt outstanding accelerated during the second quarter, posting the largest annual and quarterly gains since 2008. On the mortgage demand front, mortgage applications gained momentum last week, as both purchase and refinancing applications rose for the third consecutive time. The third largest jump in purchase applications this year sent applications to the highest level since early June. Surprisingly, the average 30-year fixed mortgage rate rose six basis points this week to 3.50 percent, marking the largest jump since the last week of May to send the average mortgage rate to the highest level since late June, according to Freddie Mac's Primary Mortgage Market Survey®.

- **The net worth of U.S. households and nonprofit organizations** — the value of assets minus liabilities — rose 1.2 percent, or \$1.1 trillion, in the second quarter to \$89.1 trillion, according to the Federal Reserve's Financial Accounts of the United States. Assets rose \$1.2 trillion, helped by the \$408.0 billion rise in housing assets, the largest gain since Q4 2013. Household liabilities rose \$163.2 billion, marking the largest increase since Q2 2014 and the second largest rise of the expansion. **The homeowners' equity in real estate as a percentage of household real estate** improved five-tenths to 57.1 percent, marking a new expansion high. **Single-family mortgage debt outstanding** increased 2.4 percent annualized from Q1 2016, and 1.5 percent from one year ago.
- **Mortgage applications** rose 4.2 percent for the week ending September 9, according to the Mortgage Bankers Association (MBA). Purchase applications jumped 8.6 percent, marking the biggest rise since early June. Both conventional and government purchase applications contributed to the increase, improving 8.0 percent and 9.8 percent, respectively. Refinance applications increased 1.7 percent, as conventional and government applications each rose during the week. The average 30-year fixed mortgage rate ticked down one-tenth to 3.67 percent according to the MBA.



Source: Federal Reserve Board



Source: Mortgage Bankers Association

Frank Shaw and Orawin T. Velz
Economic and Strategic Research Group
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