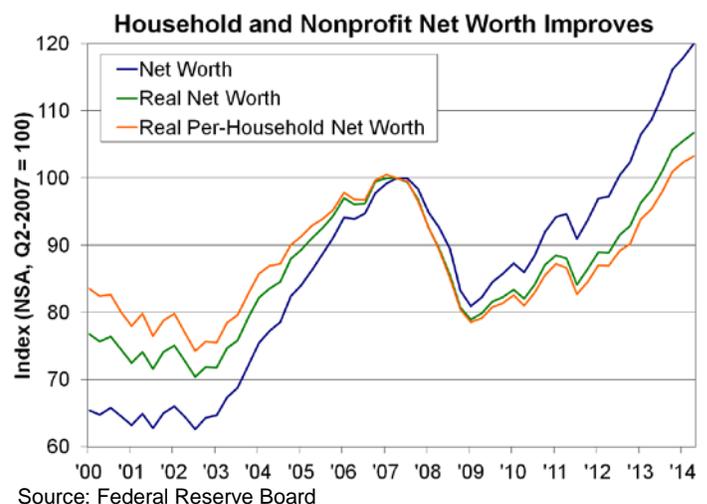
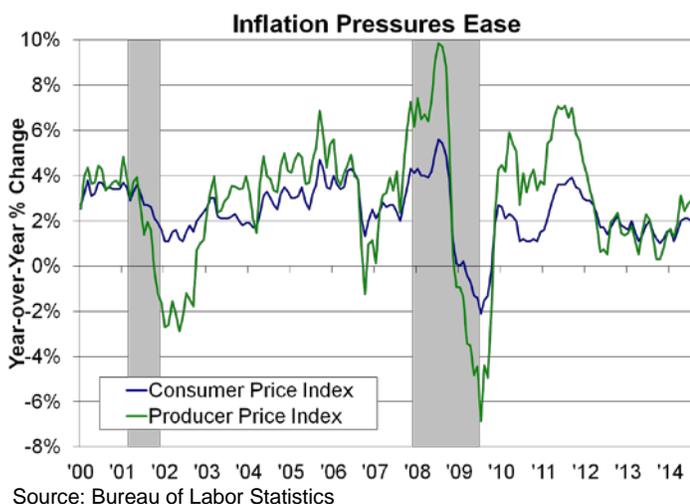


Economics: Subdued Inflation Supports the Fed's Retention of the Interest Rate Forward Guidance

Declining retail inflation appears to have prompted a slight alteration in this week's Federal Open Market Committee (FOMC) statement. The new statement describes inflation as "running below" the Fed's target, compared with moving "somewhat closer" to it in the prior statement. Much of the speculation going into the meeting focused on if the Fed would abandon the pledge to keep interest rates near zero for "a considerable time" after tapering ends or would modify the description of the labor market as having "significant underutilization of labor resources." As it turned out, the Fed retained both phrases; however, among its updated economic projections from committee members, the new dot plot, which shows the mid-point of the range of the projected target fed funds rate, indicated that the median fed funds rate forecast over the next few years moved up somewhat. Given what appeared to be conflicting messages, Fed chair Janet Yellen insisted that policy is data-dependent. Our expectation is that the Fed will likely hike the target rate around mid-2015.

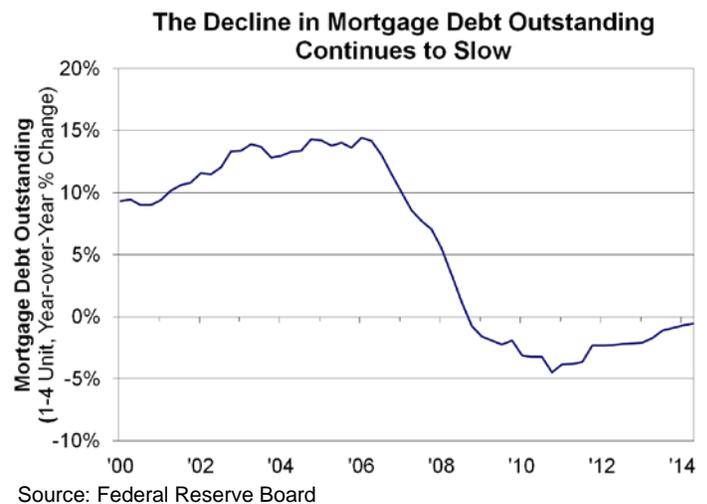
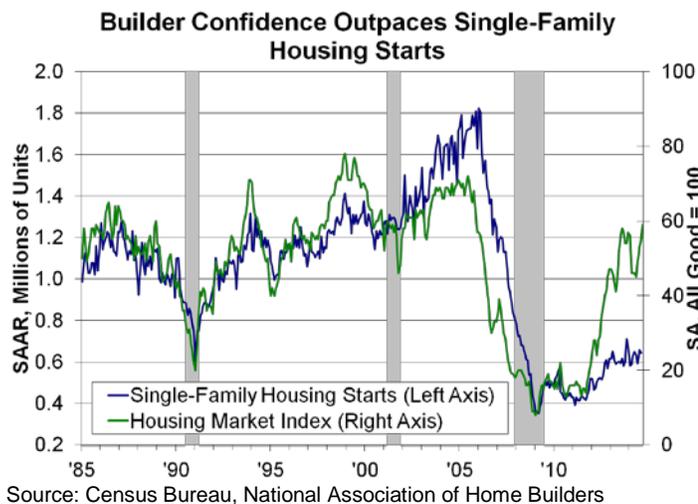
- **Industrial production**—a gauge of output in the manufacturing, utility, and mining sectors—fell 0.1 percent in August, marking the first drop this year, driven by a 0.4 percent decline in manufacturing output, according to the Federal Reserve Board. Data for the prior two months were revised lower. The decline in manufacturing output was the result of a 7.6 percent drop in motor vehicle production—a payback for the largest one-month surge in four years in July. The absence of some of the annual summer plant retooling shutdowns appears to have contributed to the volatility. Excluding motor vehicles and parts, manufacturing production edged up 0.1 percent for the second consecutive month. Utility output rose 1.0 percent, while mining output rose 0.5 percent.
- **The Consumer Price Index (CPI)** fell 0.2 percent in August, and core prices (excluding food and energy items) were flat—the weakest performance since April 2013 and October 2010, respectively, according to the Bureau of Labor Statistics. From a year ago, both headline and core prices were up 1.7 percent. **The Producer Price Index (PPI)** declined 0.4 percent in August, while the core PPI edged up 0.1 percent. From a year ago, PPI and core PPI increased 2.2 percent and 1.9 percent, respectively.
- **Initial claims for unemployment insurance** dropped 36,000—the largest decline this year—to 280,000 in the week ending September 13, according to the Department of Labor. The magnitude of the drop is likely attributable to difficulties in adjusting seasonal factors around the Labor Day holiday. The four-week moving average moved just below 300,000 for the fifth time over the past eight weeks.
- **The net worth of U.S. households and nonprofit organizations**—the value of homes, stocks and other assets minus debts and other liabilities—rose \$1.4 trillion between the first and second quarters of 2014 to \$81.5 trillion and was up \$26.5 trillion from the trough in Q1 2009, according to the Federal Reserve Board. Although the Fed does not adjust the data for inflation or households, our estimates show that real net worth and real net worth per household also set record highs in Q2 2014.
- **The Conference Board Index of Leading Indicators** rose 0.2 percent in August following an upwardly revised 1.1 percent gain in July. In the six months ending in August, the index increased by a healthy 8.0 percent annualized.



Housing: Builder Confidence and Activity Send Mixed Signals, Support our Outlook

Housing starts disappointed in August, falling for the third time in four months, even amid a rebound in homebuilder confidence to the highest level since November 2005. These data support our outlook for measured, rather than robust, improvement in homebuilding for the remainder of this year and into 2015 as builders face challenges in quickly ramping up production following years of deterioration in the supply chain for land, materials, and labor. Mortgage applications bounced back last week after a sharp decline to start September, suggesting that difficulty in seasonally adjusting around the early Labor Day holiday played a role. Meanwhile, mortgage debt outstanding appears close to reaching its cycle trough.

- **Housing starts** dipped 14.4 percent in August to 956,000 seasonally adjusted annualized units. After reaching a 14-year high in July on the heels of a 44.9 percent monthly jump, multifamily starts plunged 31.7 percent in August to an 11-month low of 313,000 units. Single-family starts also declined during the month, but at a more modest 2.4 percent pace, to 643,000 units. Through August, year-to-date single-family and multifamily housing starts increased 3.1 percent and 20.7 percent, respectively, from 2013. Building permits also declined in August, falling 5.6 percent due to 0.8 percent and 12.7 percent drops in single-family and multifamily permits, respectively.
- **The National Association of Homebuilders/Wells Fargo Housing Market Index** rose four points to a new recovery best of 59 in September (any reading above 50 indicates more builders view the market as good versus poor). Both the current and future sales components rose for the fourth consecutive month, while the buyer traffic index, which has remained below 50 since late 2005, has increased in each of the past five months to a reading of 47—near a nine-year best.
- **Mortgage applications** rebounded in the week ending September 12, rising 7.9 percent and reversing the decline in the prior week, according to the Mortgage Bankers Association (MBA). Purchase applications increased 4.8 percent to a 10-week high while refinance applications jumped 10.3 percent following a 10.7 percent drop in the prior week, despite a nine basis point jump in the contract interest rate for 30-year fixed rate mortgages to 4.36 percent—a three-month high.
- **Single-family (1-4 unit) mortgage debt outstanding (MDO)** held steady at \$9.86 trillion in Q2 2014 after declining every quarter except for one since Q1 2008. On a year-over-year basis, MDO is down just 0.5 percent from Q2 2013, the smallest annual decline since Q4 2008.



Orawin T Velz, Brian Hughes-Cromwick
Economic and Strategic Research Group
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