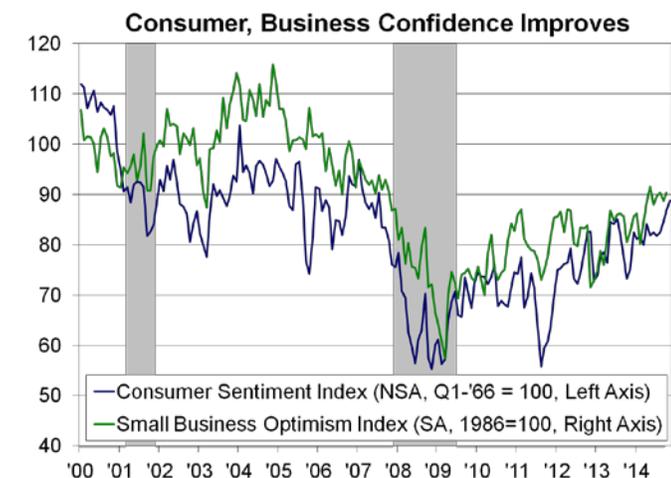


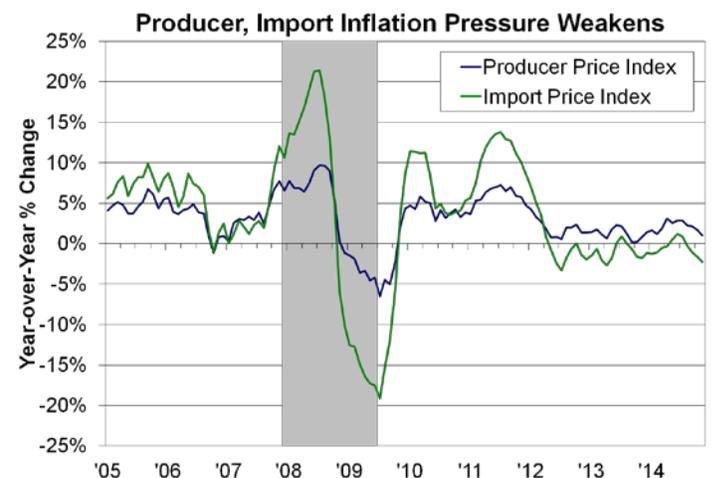
Economics: Consumers Wrapping Up 2014 on a High Note

This week featured encouraging data on consumer fundamentals. Retail sales soared in November, suggesting our forecast for stronger consumer spending in the fourth quarter is on target. A preliminary measure of consumer sentiment in December showed the cheeriest consumers since January 2007, and why not? Data from the JOLTS survey in October showed openings, hires, and quits (a sign of confidence in the labor market) holding near expansion bests, while the four-week moving average of jobless claims has held below 300,000 for 13 consecutive weeks. Small businesses have gotten the memo, showing the highest confidence in November since January 2007. Meanwhile, the deteriorating global growth outlook has put continued pressure on oil prices to below \$60 per barrel for the first time since 2009, providing yet another boost to consumers while weighing on inflation. Interest rates also moved lower on the week, with the 10-year Treasury yield falling to 2.12 percent at the time of this writing, which would be the lowest close since June 2013.

- **Retail sales** jumped 0.7 percent in November after an upwardly revised 0.5 percent gain in October, according to the Census Bureau. Healthy gains in sales at motor vehicle and parts dealers (1.7 percent), furniture stores (0.5 percent), electronics and appliance stores (0.9 percent), building, garden equipment, and supply dealers (1.4 percent), health and personal care stores (0.8 percent), and clothing and accessory stores (1.2 percent) offset the sixth consecutive decline in gasoline station sales. Core sales (excluding auto, building supplies, and gasoline stations sales), which are input to estimate consumer spending in the GDP account, rose a strong 0.6 percent, suggesting that consumer spending will be a stronger driver of growth in the current quarter than in the third quarter.
- **The Reuters/University of Michigan Consumer Sentiment Index** jumped 5.0 points to an expansion-best 93.8 in the preliminary December reading. The current conditions and expectations components both strengthened substantially.
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** increased 2.0 points in November to an expansion-best 98.1. The net share of firms expecting the economy to improve jumped 16 percentage points to 13 percent—a four-year high. In addition, compared to last month, more firms expect higher real sales over the next six months and are planning to increase employment.
- **The Job Openings and Labor Turnover Survey (JOLTS)** showed a 3.2 percent increase in job openings in October to 4.83 million—just shy of the 13-year best 4.85 million reached in August, according to the Bureau of Labor Statistics. Hires edged down 0.4 percent to 5.06 million from a near-seven-year high in September. Quits also moved lower, falling 0.5 percent to 2.72 million in October from September's six-year high.
- **Initial claims for unemployment insurance** declined 3,000 to 294,000 in the week ending December 6, 2014, according to the Department of Labor. The four-week moving average ticked up to 299,000.
- **The Producer Price Index (PPI)** declined 0.6 percent in November and increased just 1.0 percent over the past 12 months, according to the Bureau of Labor Statistics. The decline was led by a 2.7 percent plunge in energy costs. Excluding food and energy, core PPI edged up 0.1 percent on the month and 2.0 percent on the year. **Import prices** declined 1.5 percent in November and 2.3 percent from a year ago, led by a 6.9 percent monthly decline in petroleum import prices.



Source: University of Michigan/Reuters, NFIB



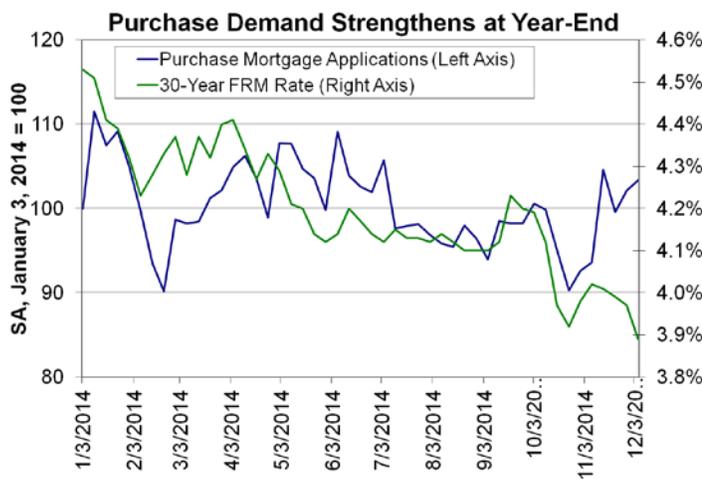
Source: Bureau of Labor Statistics

Housing: More Purchase Applications, Fewer ARMs

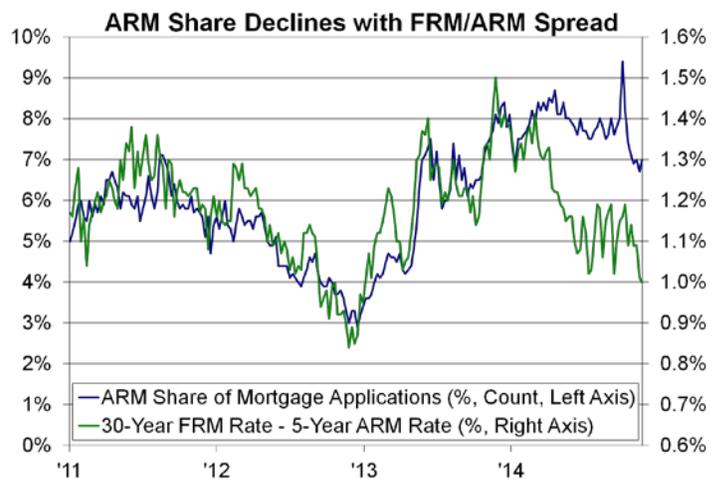
This week we take a closer look at the recent trends in the Mortgage Bankers Association (MBA) weekly survey of mortgage applications given typically sparse housing data in the second week of the month. Mortgage applications picked up 7.3 percent in the week ending December 5, 2014, according to the MBA. Purchase mortgage applications increased 1.3 percent on the week (the fifth increase in six weeks) and now sit at the second-highest level since early July. Still, purchase demand is down 4.5 percent on a year-over-year basis—mirroring the performance of total home sales, which are down 3.4 percent from 2013 year-to-date through October. Refinance applications rebounded last week, jumping 13.2 percent following five declines in the prior six weeks. Even with the increase, refinance applications remain subdued compared to recent history—down 7.1 percent from a year ago and 71.0 percent from May 2013 (the recent trough in mortgage rates). The refinance share of the dollar volume of loan applications was 61.0 percent last week, up from 55.4 percent in the prior week and the six-year low of 42.4 percent reached in May. The contract interest rate for 30-year fixed-rate mortgages in the MBA survey increased 3 basis points last week to 4.11 percent from an 18-month low of 4.08 percent.

While 30-year fixed rate mortgage (FRM) yields have moved lower for much of the year (from 4.72 percent in the first week of January to 4.11 percent last week), rates for adjustable rate mortgages (ARMs) have declined at a much more subdued pace (e.g., from 3.33 percent in the first week of January to 3.11 percent last week for 5-year ARMs), pushing the spread for FRM and 5-year ARM to just 1.0 percent—the narrowest since January 2013. Consumers have responded to the narrowing spread as well as the relatively tighter lending standards for ARMs: The ARM share of mortgage applications (as measured by both loan count and loan volume) has trended down significantly over the past two years. One exception was in mid-October, when the ARM share spiked to the highest level since June 2008 as the average refinance loan balance jumped to the highest reading in the survey's history. The one-off spike was due to a surge in refinance applications for jumbo loans into ARMs, which fizzled out quickly.

In the first week of December, the ARM share of mortgage applications increased 0.3 percentage points to 7.0 percent, but the 6.7 percent reported in the prior week was the lowest share since May 2013—before mortgage rates began the “Taper Tantrum” increase and FRM/ARM spreads widened. For more details on the factors driving ARM consumer adoption, please see our previous [Fannie Mae Commentary](#).



Source: Mortgage Bankers Association, Freddie Mac



Source: Mortgage Bankers Association

Brian Hughes-Cromwick
Economic and Strategic Research Group
December 12, 2014

Opinions, analyses, estimates, forecasts and other views of Fannie Mae's Economic and Strategic Research (ESR) Group included in these materials should not be construed as indicating Fannie Mae's business prospects or expected results, are based on a number of assumptions, and are subject to change without notice. How this information affects Fannie Mae will depend on many factors. Although the ESR group bases its opinions, analyses, estimates, forecasts and other views on information it considers reliable, it does not guarantee that the information provided in these materials is accurate, current or suitable for any particular purpose. Changes in the assumptions or the information underlying these views could produce materially different results. The analyses, opinions, estimates, forecasts and other views published by the ESR group represent the views of that group as of the date indicated and do not necessarily represent the views of Fannie Mae or its management.