

In our final Economic and Housing Weekly Note of 2015, the Economic and Strategic Research Group wishes you all happy holidays and a fruitful New Year. See you in 2016.

Economics: So Long Zero Interest Rate Policy; We Thought You'd Never Leave

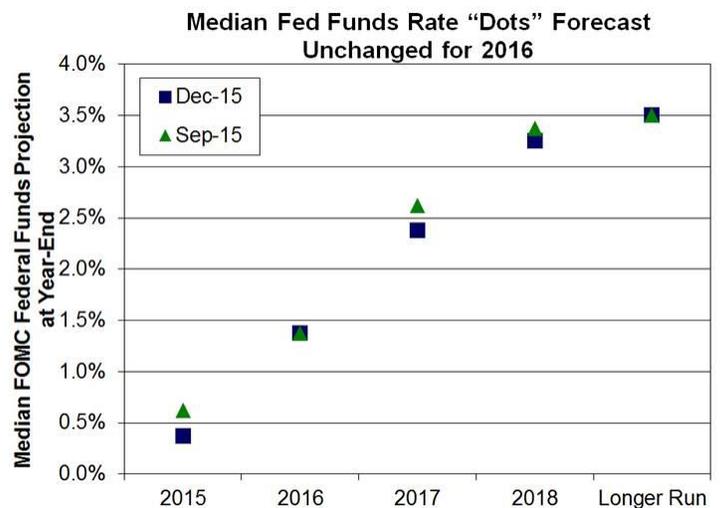
The big event this week was the meeting of the Federal Open Market Committee (FOMC), which decided to hike the fed funds rate by 25 basis points, to no one's surprise. In our view, the dovish statement and the press conference confirmed our expectations of a gradual pace of tightening next year. The word gradual, used in reference to prospective policy moves, appeared twice in the statement, and Fed Chair Yellen used it many times during her press conference. The Fed also released its Summary of Economic Projections, including FOMC members' projection of where the fed funds rate would be at the end of the year (or the "dot plot"). The Fed's median projection for 2016 showed an increase of 100 basis points in the fed funds rate, unchanged from its projection in September. This implies one more hike than we predict and two more than the fed funds futures market expects. The dots for 2017 and 2018 were revised down slightly. Regarding its reinvestment policy, the Fed said it will maintain the current practice until the fed funds rate normalization is "well under way," suggesting that any shrinking of the Fed's balance sheet would not begin until perhaps a year from now.

Taking a back seat to the FOMC meeting, this week's economic data featured a report showing that industrial production declined on an annual basis in November for the first time since 2009, as unseasonably warm weather and slumping oil prices dragged on utility and mining output. Declining energy prices in November also weighed on the headline Consumer Price Index, but core prices firmed during the month. On a positive note, the solid back-to-back gains in the Leading Economic Index in October and November confirm our outlook for a slight pickup in economic growth early next year.

- **The Consumer Price Index (CPI)** was unchanged in November, as declining energy and food prices largely offset increases in the prices of services, according to the Bureau of Labor Statistics. The core index, which excludes food and energy, increased 0.2 percent from October and 2.0 percent from last November. Core services prices rose 0.3 percent, outweighing the 0.2 percent drop in core goods prices. The drop in the latter, partly because of the strong dollar, was the largest since last December. The rent components continue to rise, albeit at more moderate paces than in prior months.
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, fell 0.6 percent in November, according to the Federal Reserve Board. This marks the third consecutive monthly drop. Unseasonably warm weather led to less heating demand, bringing down utility output by 4.3 percent. Mining output fell 1.1 percent, as oil and gas well drilling declined sharply for a third consecutive month, suggesting a bigger drop in nonresidential investment in structures in Q4 2015 than we had expected. Manufacturing production was unchanged.
- **The Conference Board Leading Economic Index (LEI)**, a gauge of the economic outlook over the next three to six months, rose 0.4 percent in November after a 0.6 percent rise in October. Positive contributors included building permits, stock prices, interest rate spreads, and credit conditions. A modest rise in initial jobless claims and a weaker November print for the Institute for Supply Management's New Orders Index partially offset those gains.



Source: Federal Reserve Board



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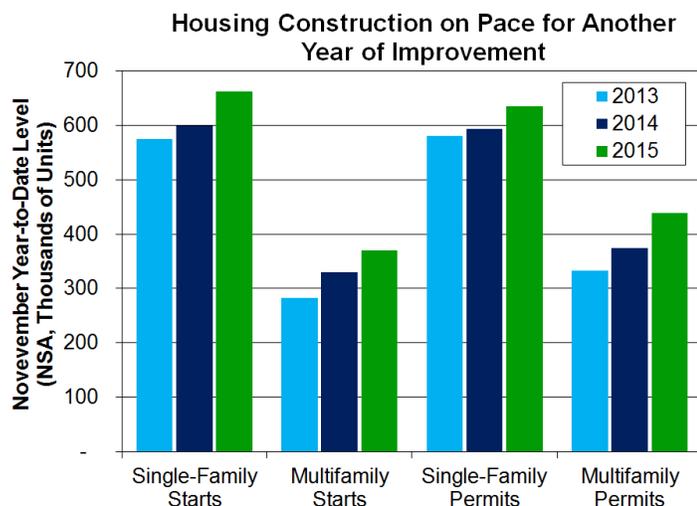
Housing: Warm, Sunny Days Boost November Home Construction

Housing data released this week built a case for an improving construction outlook. After stumbling the prior month, both single-family and multifamily starts bounced back in November as unusually warm weather in many parts of the country allowed construction to continue later into the year than normal. Single-family starts jumped to the highest level since January 2008. However, with single-family permits lagging behind starts even after a strong gain in November, the pace of single-family building could slow down in the near term. The pipeline for future multifamily building also received a boost with the biggest jump in permits since March 2012. With the recent uptrend of household formation as the Millennials come of age, strong demand for housing should spur further expansion of construction in both sectors. Constraints on the supply side, especially the shortage of qualified construction workers, have held back the sector, though the November jobs report suggested an improving situation. While November proved a strong month for residential construction, homebuilders' confidence in the market slipped for the second straight month in December from the decade-high reached in October, as builders reported concerns over the high cost of lots and labor. Optimism for both current and future sales dropped for a second consecutive month, while traffic of prospective buyers fell for the first time in five months from a 10-year best in November. Mortgage applications fell for the third time in four weeks as purchase applications have stumbled out of the gate during the first two weeks of December after a strong month of gains in November. Refinance applications, however, have improved after disappointing at the end of November. The 30-year fixed mortgage rate increased two basis points again this week to 3.97 percent, according to Freddie Mac's survey. We expect mortgage rates to trend up gradually over the next year now that the Fed (finally) began raising short-term interest rates on Wednesday, December 16.

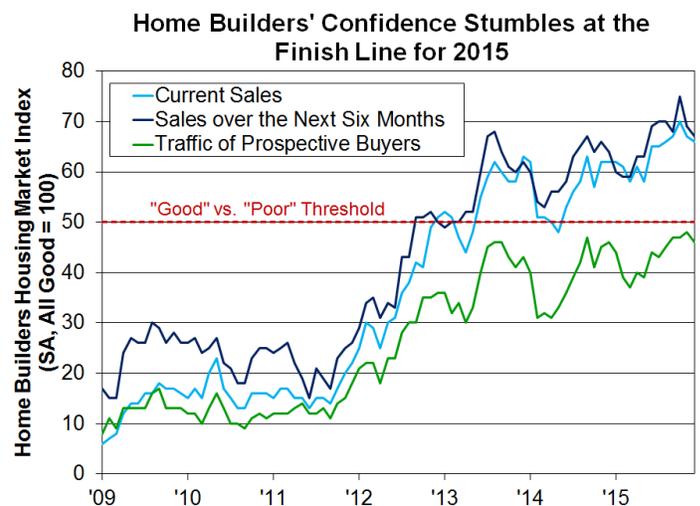
➤ **Housing starts** jumped 10.5 percent in November to 1.17 million annualized units, according to the Census Bureau. Single-family starts increased 7.6 percent to 768,000, and multifamily starts rose 16.4 percent to 405,000. Through the first 11 months of the year, single-family starts are 10.5 percent higher than the same period a year ago, while multifamily starts have increased 12.0 percent. New residential building permits also jumped in November, rising 11.0 percent to 1.29 million annualized units. Multifamily permits drove the growth, increasing 26.9 percent, while single-family permits edged up 1.1 percent. On a year-to-date basis, multifamily and single-family permits are up 17.5 percent and 7.0 percent, respectively, from a year ago.

➤ **The National Association of Home Builders/Wells Fargo Housing Market Index**, a gauge of homebuilders' confidence, slipped one point to 61 in December (a reading higher than 50 means more builders see an improving market than a deteriorating one). The current sales index fell one point to 66, while expectations of future sales dropped two points to 67. The traffic of prospective buyers component fell two points to 46.

➤ **Mortgage applications** reversed last week's gain, falling 1.1 percent in the week ending December 11, according to the Mortgage Bankers Association. Purchase applications drove the decline, slipping 2.8 percent. Refinancing applications, on the other hand, rose for the second week running, increasing 1.4 percent as the survey's 30-year fixed mortgage rate remained unchanged at 4.14 percent.



Source: Census Bureau



Source: National Association of Home Builders/Wells Fargo

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