ESR Economic and Housing Weekly Note *February 27, 2015*

Economics: Lower Oil Prices Spark (Transitory?) Consumer Price Deflation

Economic data released this week point to trudging progress. As expected, headline GDP growth was revised downward, largely due to slower inventory accumulation—a positive for growth in the current quarter as it suggests less drag from inventories. Two main measures of consumer confidence dropped this month, a payback from the surges in January, but both still remain near expansion highs. Inflation continued to reflect the effects of declining gasoline prices, as the January consumer price index (CPI) fell year-over-year for the first time since the Great Recession—thanks to the 18.7 percent plunge in gasoline prices to the lowest level since the end of 2008. However, the sizable drop in gasoline prices did not bleed into core prices, which rallied this month. In her semiannual congressional testimony on Tuesday, Federal Reserve Chair Janet Yellen echoed the minutes from the January Federal Open Market Committee meeting that inflation should eventually return to target as the transitory impacts of declining energy prices fade. The stabilization of oil prices in February supports the view that the biggest drag to headline inflation from oil prices may have peaked. We continue to expect the Fed to initiate its liftoff in the fed funds rate in September, though a June rate hike is possible if incoming data show continued improving labor market conditions and provide support that inflation would move higher toward the target.

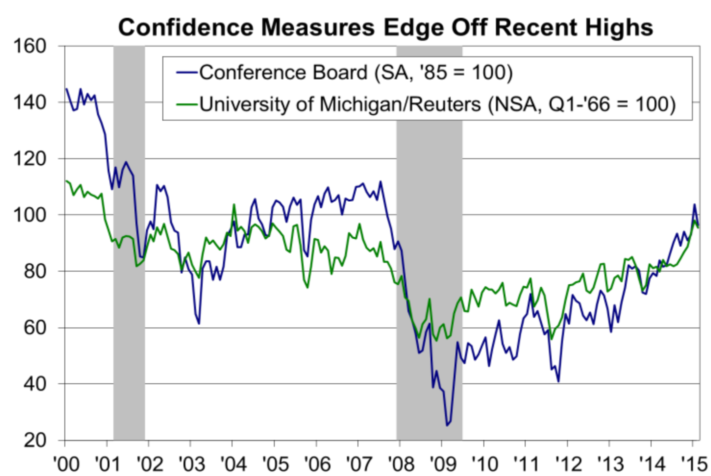
- **Gross domestic product (GDP)**, adjusted for inflation, increased at a 2.2 percent annual rate in Q4 2014, according to the second estimate from the Bureau of Economic Analysis (BEA), down from the 2.6 percent growth pace in the first estimate. The downward revisions in inventory investment, consumer spending, residential investment, and net exports outpaced upward revisions in nonresidential fixed investment (including investment in structures, equipment, and intellectual property product) and government spending.

- **The Conference Board Consumer Confidence Index** fell 7.4 points in February to 96.4, reversing some of the surge in January that sent the index to a seven-year high. Of the two components of the index, consumer expectations fell the hardest, dropping the most since October 2013. The present expectation component fell modestly. **The Reuters/University of Michigan Consumer Sentiment Index** final February reading was up from the preliminary reading. However, the index posted a 2.7 point drop from January to 95.4 after six consecutive months of improvement to a 10-year high.

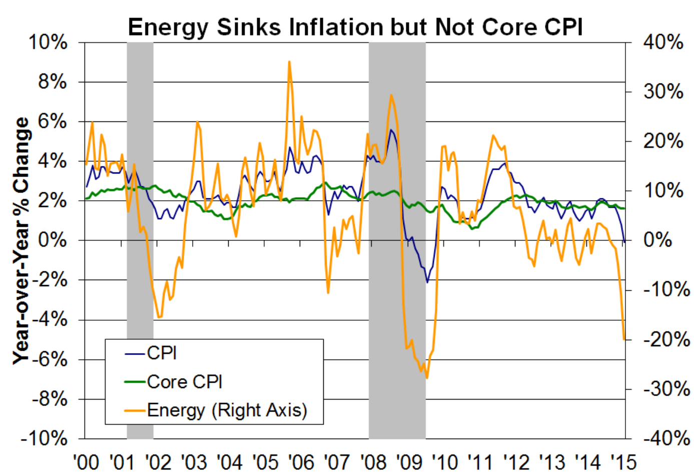
- **The Consumer Price Index (CPI)** dropped 0.7 percent in January, marking three consecutive months of decline, according to the Bureau of Labor Statistics. Energy, and specifically oil, continue to drive the fall, with the energy index falling 9.7 percent in January, the largest drop since in November 2008. Excluding food and energy prices, core CPI rose 0.2 percent in January. Year-over-year, the CPI is down 0.1 percent, but core CPI is up 1.6 percent.

- **Durable goods orders** rose 2.8 percent in January, the first rise in three months, according to the Census Bureau. A 128.5 percent surge in nondefense aircraft and parts drove the increase. Nondefense capital goods orders (excluding aircraft), a leading indicator in business investment in equipment in the estimation of GDP, rose 0.6 percent after four months of decline.

- **Initial claims for unemployment insurance** increased 31,000 to 313,000 in the week ending February 21, according to the Department of Labor. Claims tend to be volatile around the Federal holidays, and the latest week's figure incorporated an adjustment to the Presidents' Day. The four-week moving average increased by 11,500 to 294,500.



Source: Conference Board, Reuters/University of Michigan



Source: Bureau of Labor Statistics

Housing: Winter Hiccup in Home Sales

A heavy week of housing data exemplified the uneven nature of the ongoing housing recovery. The first peak at home sales activity in 2015 was a bit disappointing following a pickup in seasonally adjusted activity in December. New sales held near an expansion-high, but resales declined sharply. Pending home sales picked up in January, giving hope that the roughly 7.0 percent cumulative decline in existing home sales since October will stabilize in coming months. Even as sales volumes faltered at the outset of the year, new and existing home inventory remains tight, supporting home price growth that has moderated from the peaks in recent years but remains quite healthy—the seasonally adjusted FHFA purchase-only home price index grew in January at the fastest monthly rate since May 2013. On the mortgage market side, Q4 2014 data on mortgage delinquency highlighted the link between rapid improvements in the labor market and sharply lower early-stage delinquency, which stands at the lowest rate since the 1970s. Late-stage delinquency continued to march lower, albeit remaining historically high. Mortgage applications data continued the trends we've seen in recent weeks, with overall activity leveling off following the early-year surge. Meanwhile, FHA continued to outperform conventional demand, ostensibly due to the recent reduction in FHA mortgage insurance premiums (MIPs). The Freddie Mac 30-year fixed mortgage rate increased 4 basis points to 3.80 percent—the high for 2015 so far.

- **New single-family home sales** were little changed in January, edging down 0.2 percent to 481,000 annualized units according to the Census Bureau. However, sales were revised higher in each of the prior three months. Total units for sale rose 1.4 percent, though the months' supply held firm at 5.4 months, below the historical average of 6.1 months.

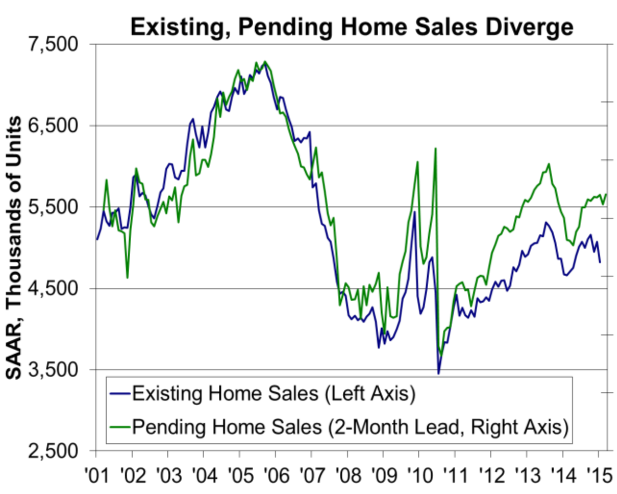
- **Existing home sales** declined 4.9 percent to 4.82 million annualized units in January, the slowest sales pace since last April, according to the National Association of REALTORS®. From a year ago, sales were up 3.2 percent—the fourth consecutive month of year-over-year sales increases. The number of homes available for sale edged up 0.5 percent, leaving the months' supply at 4.7 months, up from a 23-month low of 4.4 months in December.

- **The National Association of REALTORS® pending home sales index**, which records contract signings of existing homes and typically leads closings by one to two months, rose 1.7 percent in January, more than reversing the December decline. The index was up 8.4 percent from January 2014.

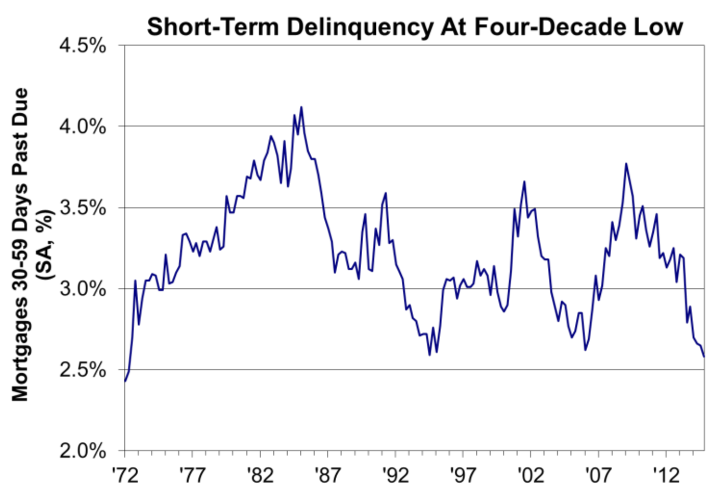
- **Mortgage delinquency** continued to trend lower in Q4 2014, according to the Mortgage Bankers Association National Delinquency Survey. The total delinquency rate declined 17 basis points during the quarter to 5.68 percent—the lowest since Q3 2007. Short-term delinquency, or mortgages 30-59 days past due, fell 7 basis points to a more than 40-year low of 2.58 percent. The serious delinquency rate (not seasonally adjusted), or mortgages 90 days or more past due or in the process of foreclosure, declined 13 basis points to 4.52 percent, down from a peak of 9.67 percent reached in Q4 2009.

- **The S&P/Case-Shiller composite 20-city home price index** (not seasonally adjusted) ticked up 0.1 percent in December and was 4.5 percent above the December 2013 level. The national index declined 0.1 percent in December but was up 4.6 percent on the year. **The FHFA purchase-only house price index** (reported by FHFA on a seasonally adjusted basis) increased 0.8 percent in December on a monthly basis, and 5.4 percent over the past 12 months.

- **Mortgage applications** declined for a third consecutive week, falling 3.5 percent in the week ending February 20, according to the Mortgage Bankers Association. Refinance applications sank 7.5 percent amid a 6 basis point increase in the contract interest rate for 30-year fixed mortgages to 3.99 percent—the high so far this year. Purchase applications broke a streak of five straight weekly drops, rising 4.6 percent.



Source: National Association of REALTORS®



Source: Mortgage Bankers Association

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February 27, 2015