Fannie Mae

Economic and Strategic Research

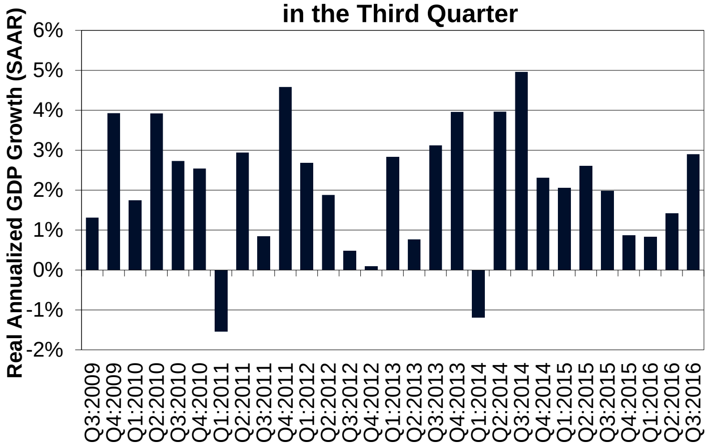
Weekly Note – October 28, 2016

Economics: A Much Needed Boost in Growth

Economic growth in the third quarter surprised to the upside, posting the fastest pace of growth in two years. The jump in the growth is encouraging for an economy that averaged a meager 1.1 percent in the first half of the year. Consumer spending was again the largest contributor to growth, but it slowed predictably from the robust pace in the second quarter, with trade and inventories making up the slack. Trade was boosted by the 10.0 percent annualized growth in exports; however, separate data suggest that a one-time spike in shipments of agricultural products, specifically soybeans, supported the gain. The boost helped net exports make the largest contribution to growth in nearly three years. After the first drawdown in inventories in nearly five years, the increase in the third quarter suggests that businesses are more confident in future demand. Net exports and inventories are the most volatile components of GDP. Underlying consumer and business demand, as measured by real final sales to private domestic purchasers (which excludes inventories, net exports, and government spending), grew 1.6 percent annualized – a significant slowdown from the 3.2 percent pace in the second quarter. On the investment side, business fixed investment grew for the second consecutive quarter, as gains in investment in structures and intellectual property outweighed a fall in equipment investment. Meanwhile, residential fixed investment posted only the second back-to-back declines of this expansion. In other news this week, two indices of consumer attitudes declined in October, with the University of Michigan Sentiment Index dropping to a 13-month low and the Conference Board Confidence Index slipping from the second-highest reading of the expansion the prior month. On the labor market front, the Employer Cost Index showed compensation maintained its recent steady pace of growth, as a pickup in the growth in benefits cancelled out a slowdown in the growth of wages and salaries. Lastly, the durable goods report showed that core capital goods orders, a proxy for future business investment in equipment, fell sharply in September. However, core orders rose during the third quarter as a whole for the first time in a year, an encouraging sign for fourth quarter investment in equipment.

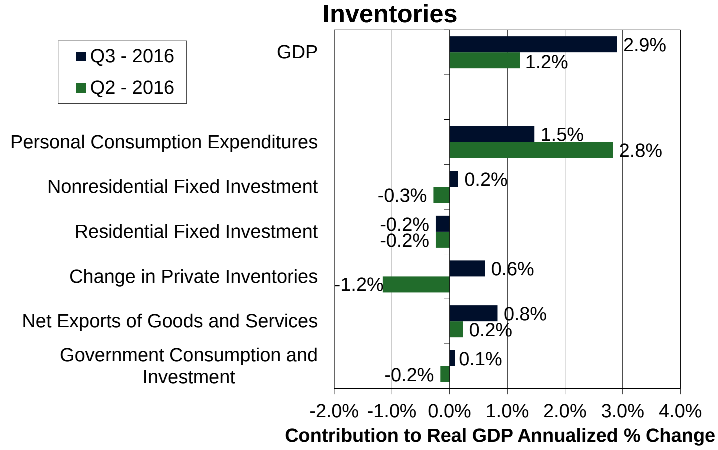
- **Gross domestic product (GDP)**, adjusted for inflation, rose 2.9 percent in Q3 2016 according to the advance estimate from the Bureau of Economic Analysis (BEA), a sizable improvement from the sluggish 1.4 percent pace in the second quarter. While consumer spending continued to drive growth, it made a smaller contribution in the third quarter of 1.5 percentage points. Net exports and inventories also contributed to growth by 0.8 and 0.6 percentage points, respectively. Business fixed investment and government spending also contributed slightly. Residential fixed investment was the only major sector to drag on growth.
- **The University of Michigan Consumer Sentiment Index** declined 4.0 points to 87.2 in the final October reading. **The Conference Board Consumer Confidence Index** dropped 4.9 points in October to 98.6. Both indices saw the present situation and expectations components decline during the month.
- **The Employment Cost Index (ECI)**, a measure of labor compensation, rose 0.6 percent in Q3 2016 for the third consecutive quarter, according to the Bureau of Labor Statistics. Growth in wages and salaries slowed one-tenth during the quarter to 0.5 percent, but growth in benefits rose to a nine-quarter best of 0.7 percent.
- **Durable goods orders** edged down 0.1 percent in September, according to the Census Bureau. Core capital goods orders (nondefense capital goods excluding aircraft) dropped 1.2 percent. August durable goods and core capital goods orders were revised upward.

Economic Growth Snags a Rebound in the Third Quarter



Source: Bureau of Economic Analysis

GDP Gets a Boost from Net Exports and Inventories



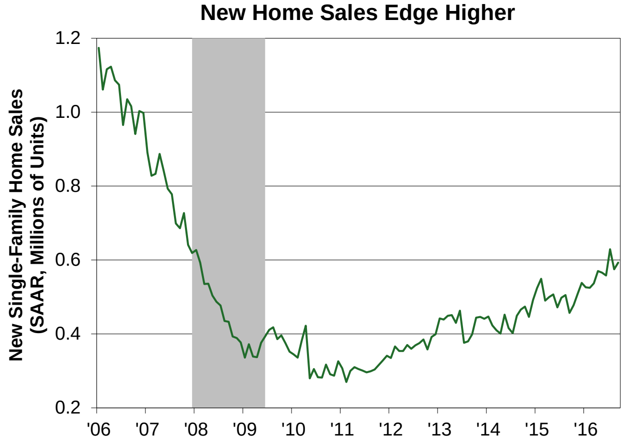
Source: Bureau of Economic Analysis

Housing: Getting Back on Track

Data released this week suggested the housing market has pushed through the recent soft patch. New home sales edged higher in September after falling sharply the prior month from an expansion high. In addition, new home sales in the third quarter posted the highest average level since 2007. The number of homes available for sale flatlined over the past three months; however, the September rise in single-family starts is a positive for the near-term outlook for inventory. The existing home market also received good news as pending home sales, which records contract signings of existing homes and typically leads closings by one to two months, rose, halting a recent downward trend after hitting a 10-year best in March. The Q3 2016 Housing Vacancy Survey reported positive news for household formation and homeownership. For the first time in a year, and only the sixth time in this expansion, more than one million households were formed. More encouraging was the largest gain in homeowner households in a decade, a welcome piece of data considering the rental market has dominated the owner-occupied market despite historically low mortgage rates. The homeownership rate rose off of a more than 50-year low, another boost for the owner-occupied market. The one piece of bad news this week was the continued slide in mortgage demand, as purchase applications hit the lowest level since the start of the year and refinancing applications reached the lowest level since June. This week, the average 30-year fixed mortgage rate reversed the prior week's five-basis-point gain to return to 3.47 percent, according to the survey by Freddie Mac.

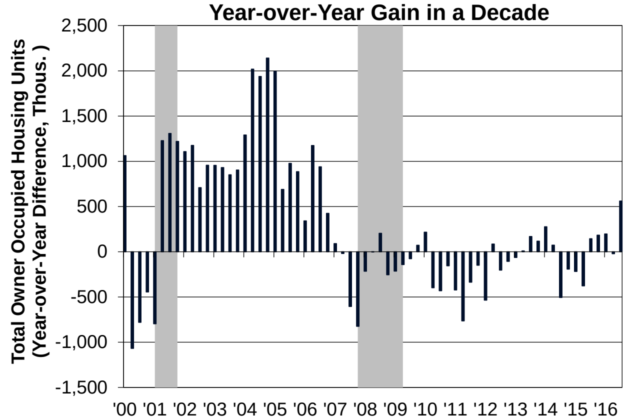
- **New single-family home sales** rose 3.1 percent in September to 593,000 units (seasonally adjusted annualized rate), according to the Census Bureau. Through the first nine months of the year, new home sales are 13.4 percent higher than the same period a year ago. The number of homes for sale fell 0.4 percent from August, but rose 7.0 percent from September 2015. The months' supply (inventory-to-sales ratio) slipped one-tenth to 4.8 months. The median sales price of new homes, which is not adjusted for the composition of sales, rose 1.9 percent annually.
- **The National Association of REALTORS® pending home sales index** increased 1.5 percent in September, partially recovering the 2.5 percent drop the previous month.
- **The Housing Vacancy Survey (HVS)** for Q3 2016 (not seasonally adjusted) showed that the homeownership rate improved to 63.5 percent, just two-tenths below the level a year ago, according to the Census Bureau. The rental vacancy rate rose from a 36-year low in the second quarter to 6.8 percent, marking the first increase in a year. The homeowner vacancy rate also rose to reach 1.8 percent. The number of households increased 1.19 million from a year ago, as homeowner households rose 561,000 and rental households improved 628,000.
- **The S&P/Case-Schiller National Home Price Index** (not seasonally adjusted) rose 5.3 percent year over year in the three months ending in August. **The FHFA Purchase-Only House Price Index**, reported on a seasonally adjusted basis, grew 0.7 percent on a monthly basis in August and 6.4 percent from one year ago.
- **Mortgage applications** declined 4.1 percent in the week ending October 21, according to the Mortgage Bankers Association. Purchase applications decreased for the third time in the past four weeks, falling 6.9 percent. In addition, refinancing applications slipped for the fifth time in six weeks, dropping 2.3 percent. The pullback in mortgage demand was widespread, as both loan products saw declines in government and conventional applications. The average 30-year fixed mortgage rate declined for the first time this month, dropping two basis points to 3.71 percent.

New Home Sales Edge Higher



Source: Census Bureau

Homeowner Households Post Largest Year-over-Year Gain in a Decade



Source: Census Bureau

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