ESR Economic and Housing Weekly Note *September 18, 2015*

Economics: Zero Interest Rate Policy Continues for a Bit (or a Lot) Longer

All eyes were on the most anticipated interest rate decision in years at yesterday's conclusion of the Federal Open Market Committee (FOMC) meeting. While the result—an unchanged fed funds rate—may be disappointing for some, it wasn't much of a surprise given the lack of consensus going into the meeting. The tone of the statement was dovish, as the committee indicated increased concern that "recent global economic and financial developments" could put additional downward pressure on inflation, and stated that it will be monitoring "developments abroad" to assess their impact on the U.S. economy. It's unlikely that these global concerns will get settled any time soon, thereby reducing the likelihood that inflation will move up to the Fed's target in the medium term. The implication is that the rate liftoff is likely to be at least months away. Economic news was mixed this week. Despite a weak headline in August retail sales, core sales suggest that real consumer spending growth this quarter will likely rival the 3.1 percent annualized pace in the prior quarter. On the inflation front, headline retail prices declined in August for the first time since January due to renewed drops in gasoline prices. Meanwhile, core prices have stabilized, posting a 1.8 percent annual rise for the third consecutive month and the fifth time over the last six months. The August industrial production report was bearish. Hurt by the strong dollar, weak global demand, and plunging energy investment, industrial output is tracking on a path that would yield one of the worst years on record outside of the last recession. Year-to-date, overall industrial production is down 1.1 percent annualized, with manufacturing output up just 0.1 percent. On a positive note, initial weekly jobless claims fell sharply, and a gauge of the near-term economic outlook advanced in August, the fifth gain over the last sixth months.

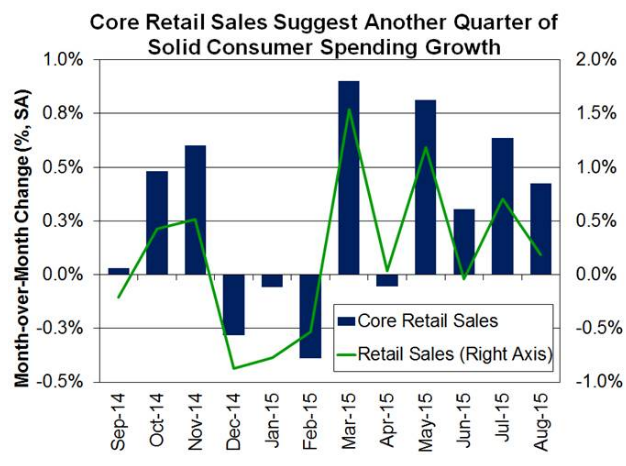
- **Retail sales** rose 0.2 percent in August, according to the Census Bureau. Auto and restaurant sales posted solid gains while gasoline, furniture, and building material sales fell. Core sales (ex-autos, gas, building materials)—an input used to estimate consumer spending on goods—rose 0.4 percent following upward revisions to prior months' figures.

- **The Consumer Price Index (CPI)** fell in August for the first time since January, declining 0.1 percent, according to the Bureau of Labor Statistics. Gasoline prices drove the decline in the headline index. The core index, which excludes food and energy, edged up 0.1 percent. Core goods prices fell for the fourth consecutive month while core services prices edged up only slightly, as gains in the residential rent measures slowed during the month. On a year-ago basis, the headline CPI rose 0.2 percent, and the core index was up 1.8 percent.

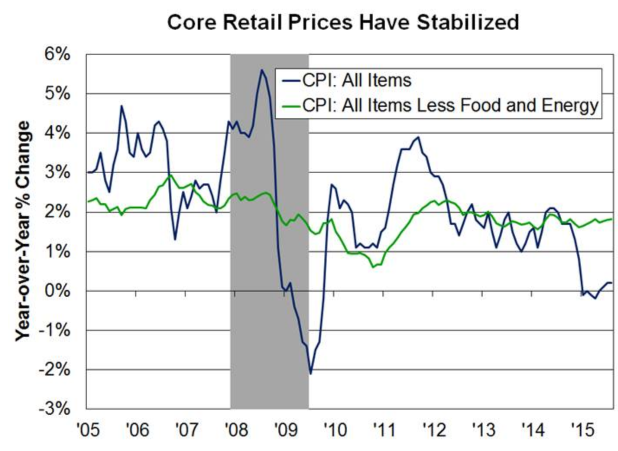
- **Industrial Production**, a gauge of output in the manufacturing, utility, and mining sectors, fell 0.4 percent in August, according to the Federal Reserve Board. Manufacturing, which accounts for about three-fourths of the index, dropped 0.5 percent after a 0.9 percent jump in July. This reflected volatility in motor vehicle and parts production, which pulled back sharply in August after spiking in July, as a shorter-than-usual retooling shutdown boosted the seasonally adjusted numbers in the prior month. Excluding autos, manufacturing output was flat. Mining output declined 0.6 percent. Oil and gas well drilling rose for a second consecutive month following nine months of steep declines. Utility output was up 0.6 percent.

- **The Conference Board Leading Economic Index (LEI),** a gauge of the economic outlook over the next three to six months, edged up 0.1 percent, and July's figure was revised up 0.2 percentage points to zero.

- **Initial claims for unemployment insurance** fell 11,000 to 264,000 in the week ending September 12, according to the Department of Labor. The four-week moving average decreased by 3,250 to 272,500.



Source: Census Bureau



Source: Bureau of the Labor Statistics

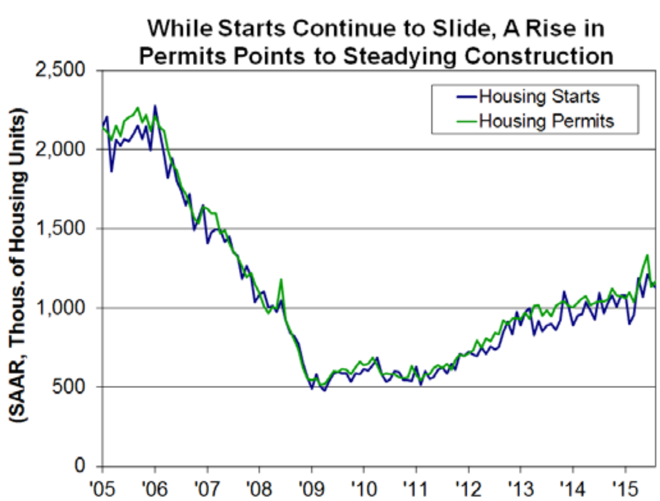
Housing: Like Hannibal Crossing the Alps, Single-Family Home Building Recovery Is Slow, but Steady

Data released this week suggest a slow, uneven, but generally improving trend for the housing market. The focus of the week was residential construction, where housing starts dropped for the second month in a row after reaching a post-recession high in June. In addition, the July headline number was revised down 43,000 units to 1.16 million annualized units. Housing starts came into the spotlight this week, when Fed chair Janet Yellen characterized the housing market as "very depressed," as housing starts remain at low levels, inconsistent with demographics and ongoing job growth. We agree that single-family starts are still at depressed levels, but largely because of permitting regulations and a shortage of skilled labor. On a positive note, year-to-date starts in 2015 have been the strongest since 2007. The key difference between pre- and post-crisis activity is the increase in the multifamily share, as almost all new households formed are renters. The near-term outlook for homebuilding activity is positive, as permits bounced back slightly after a large drop in July from a post-recession high and are now running ahead of starts, suggesting more building is in the pipeline. Permits for single-family units edged up to a new expansion high, although they remain at historically low levels. Home builders shrugged off the recent retreat in activity, as an index gauging their confidence in the single-family market rose to yet another post-recession high. Mortgage applications have recently slipped into a funk, as applications for both refinancing and purchase mortgages fell for a second consecutive week. The 30-year fixed mortgage rate from Freddie Mac's survey ticked up for the third week in a row, reaching 3.91 percent. The interest rate environment will likely continue to be muddled following the Fed's decision to delay liftoff.

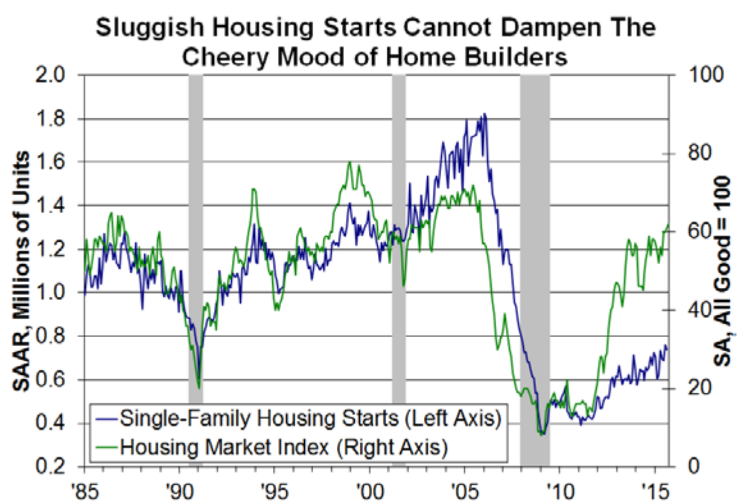
- **Housing starts** slipped for the second month in a row, falling 3.0 percent in August to 1.13 million annualized units, according to the Census Bureau. Both multifamily and single-family starts dropped 3.0 percent to 387,000 units and 739,000 units, respectively. Through the first eight months of the year, single-family starts have increased 11.2 percent from the same period a year ago, while multifamily construction has risen 11.6 percent. New residential permits, in contrast, rose 3.5 percent to 1.17 million annualized units in August. After the largest drop in July in seven years, multifamily permits increased 4.7 percent. Single-family permits grew 2.8 percent to reach the highest level since January 2008. Through the first eight months of 2015, single-family and multifamily permits increased 6.8 percent and 21.1 percent, respectively, from the year-ago period.

- **The National Association of Home Builders/Wells Fargo Housing Market Index** climbed a point for the second month in a row, reaching 62 in September, a new post-crisis high. A reading above 50 indicates more builders view the single-family market as "good" rather than "poor." Builders' assessment of current sales and buyer traffic increased to new post-crisis bests, while expectations for the next six months fell for the first time in seven months.

- **Mortgage applications** fell 7.0 percent in the week ending September 11, according to the Mortgage Bankers Association. Purchase applications decreased 4.2 percent, the second straight week of declines. Refinance applications also tumbled again this week, falling by 9.1 percent to the lowest level in over a month, after reaching a four month high two weeks ago. The survey's 30-year fixed mortgage rate ticked down one basis point to 4.09 percent.



Source: Census Bureau



Source: Census Bureau, National Association of Home Builders

Frank Shaw and Orawing T. Velz
Economic and Strategic Research Group
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