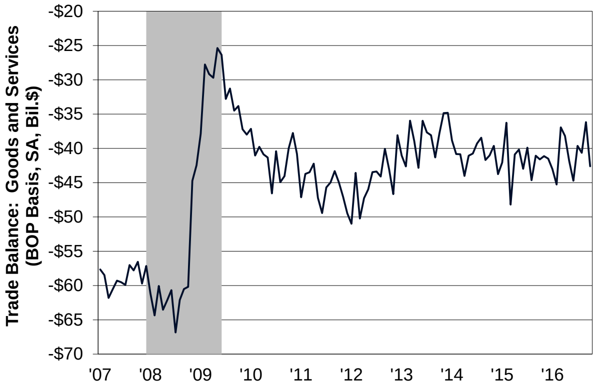
Weekly Note – December 9, 2016

Economics: A Productive Week, But the Dollar Lurks

A busy week of economic data was generally positive. The strongest jump in third quarter productivity growth in two years was unchanged in the second estimate, a welcome development for an economy that has been held back by anemic productivity growth. However, it will take more than one quarter to reverse the sluggish trend in this expansion, as productivity was still flat year-over-year. Unit labor costs were revised higher for both the second and third quarters, pushing the year-over-year growth in the third quarter to 3.0 percent from 2.3 percent in the initial estimate. This marks the first back-to-back annual increases of at least 3.0 percent in the current expansion. The manufacturing sector showed signs of turning a corner, as factory orders rose in October for the fourth consecutive month, posting the largest monthly jump since June 2015. The service sector made further progress in November, with a survey of purchasing managers showing the fastest expansion in 13 months. On the labor market front, the Job Openings and Labor Turnover Survey showed that job openings, hires, quits, and layoff rates were all unchanged. The hires rate was stuck at a two-year low, but the layoff rate also remained at a survey low. Consumers are increasingly upbeat, as the University of Michigan sentiment index jumped in early December to the highest level since January 2015. Consumers took on more debt in October but at the slowest pace in four months. Lastly, the trade deficit widened significantly in October, as goods exports dropped sharply, reflecting a sizable decline in agricultural product exports following a surge in the prior month. Continued strengthening of the dollar, which is approaching a 14-year high, would present headwinds for manufacturing and goods exports.

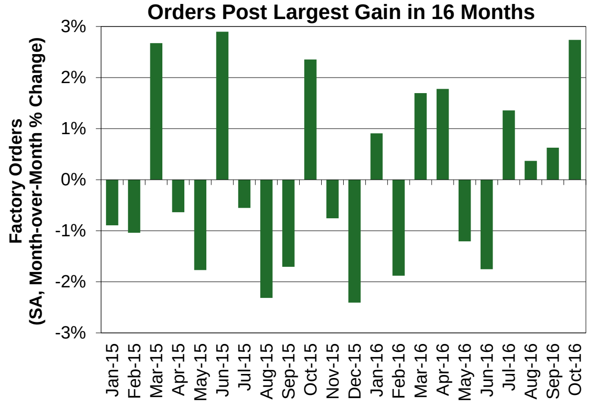
- **Consumer (non-mortgage) credit outstanding** expanded $16.0 billion in October, according to the Federal Reserve Board. Nonrevolving credit (mainly auto and student loan debt) grew by $13.7 billion, while revolving credit (mainly credit card debt) increased $2.3 billion. From a year ago, nonrevolving credit expanded 6.1 percent, while revolving credit rose 6.2 percent.
- **Nonfarm business productivity** grew 3.1 percent annualized in Q3 2016, according to the Bureau of Labor Statistics. Compensation per hour was revised upward four-tenths to 3.8 percent, causing unit labor costs to grow 0.7 percent. In Q2 2016, annualized unit labor costs growth was revised up substantially to 6.1 percent from 3.9 percent.
- **The Job Openings and Labor Turnover Survey (JOLTS)** showed that job openings fell 1.7 percent in October to 5.53 million, according to the Bureau of Labor Statistics. As a share of total employment, the job openings rate was unchanged at 3.7 percent. The hires rate was also unchanged at 3.5 percent. The quits rate remained at 2.1 percent for the fifth consecutive month. The layoff and discharge rate was flat at 1.0 percent.
- **The U.S. trade deficit** widened by $6.4 billion to $42.6 billion in October, according to the Census Bureau. Imports increased 1.3 percent while exports fell 1.8 percent. The inflation-adjusted goods deficit, used in the calculation of net exports in the GDP estimate, widened $6.2 billion to $60.3 billion.
- **Factory orders** rose 2.7 percent in October, according to the Census Bureau. Nondurable goods orders, the new piece of data in the report, improved 0.9 percent for the second straight month.
- **The University of Michigan Consumer Sentiment Index** rose 4.2 points to 98.0 in the December preliminary reading, as both the current conditions and consumer expectations components improved during the month.
- **The Institute for Supply Management (ISM) Nonmanufacturing Index**, a gauge of service sector activity, increased 2.4 points in November to 57.2 (any reading above 50 indicates expansion).

Trade Deficit Widens Sharply



Source: Census Bureau

Manufacturing Turns a Corner, as Factory Orders Post Largest Gain in 16 Months



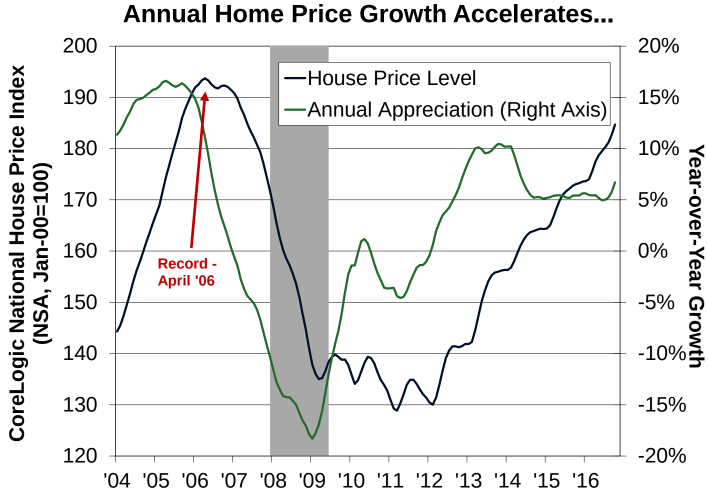
Source: Census Bureau

Housing: Solid Home Price Gains Boost Housing Wealth

This week's news was positive for homeowners but flashed a caution light for the mortgage market in coming months. The CoreLogic Home Price Index, the measure used by the Federal Reserve to estimate the value of household real estate assets, showed that home price appreciation strengthened in October. For the third quarter, the CoreLogic Index appreciated a strong 6.5 percent annualized, helping to boost the value of household real estate holdings and net worth. While strong home price appreciation benefits homeowners, it presents an affordability challenge to potential first-time homebuyers, especially given recent increases in mortgage rates. The sharp rise in mortgage rates over the past month has hurt mortgage demand, with mortgage applications falling last week for the sixth time in seven weeks. Unfortunately, no relief is in sight. Freddie Mac's survey showed that the average rate for 30-year fixed-rate mortgages continued to rise this week for the sixth consecutive week, increasing five basis points to 4.13 percent, the highest level since early October 2014. Such a surge in mortgage rates hasn't been seen since the 2013 "Taper Tantrum" and presents a headwind for the housing and mortgage market in the coming year.

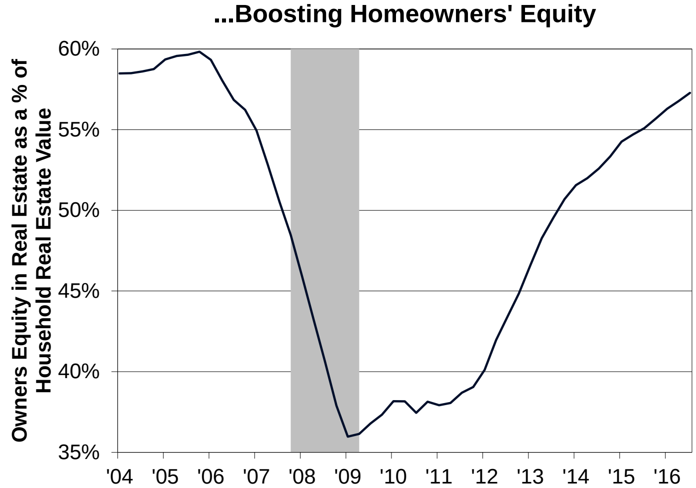
- **The net worth of households and nonprofit organizations**—the value of assets minus liabilities—increased $1.6 trillion to $90.2 trillion in Q3 2016, according to the Federal Reserve. Both housing and stocks helped boost household wealth. Housing wealth, which is strongly influenced by home values, rose $554 billion from Q2 2016, while **single-family mortgage debt outstanding** increased $93.5 billion. **Owners' equity in real estate as a percentage of the value of household real estate** increased to 57.3 percent, up substantially from the trough of 36.0 percent in Q1 2009 but below the previous peak of 59.8 percent reached in Q4 2005.
- **The Job Openings and Labor Turnover Survey (JOLTS)** showed that construction job openings fell 7.2 percent in October, according to the Bureau of Labor Statistics. The job openings rate fell two-tenths from the prior month to 3.0 percent as the hires rate picked up two-tenths to 4.9 percent. The quits rate was unchanged at 1.9 percent.
- **The CoreLogic National Home Price Index** (not seasonally adjusted) rose 1.1 percent in October. From a year ago, home prices gained 6.7 percent, the strongest annual increase since May 2014. The CoreLogic Index tends to get downgraded in subsequent revisions, however. Home prices have risen 43.3 percent since their trough in March 2011 and remain 4.7 percent below the April 2006 peak, according to the CoreLogic Index.
- **Mortgage applications** dipped 0.7 percent for the week ending December 2, according to the Mortgage Bankers Association. Purchase applications edged up 0.4 percent following a slight drop in the prior week. Refinance demand ticked down 0.7 percent, marking the ninth consecutive weekly drop. For both the purchase and refinance categories, government applications rose during the week but not enough to outweigh the drops in the conventional segment. The average rate for 30-year fixed-rate mortgages rose four basis points to 4.27 percent.

Annual Home Price Growth Accelerates...



Source: CoreLogic

...Boosting Homeowners' Equity



Source: Federal Reserve Board

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