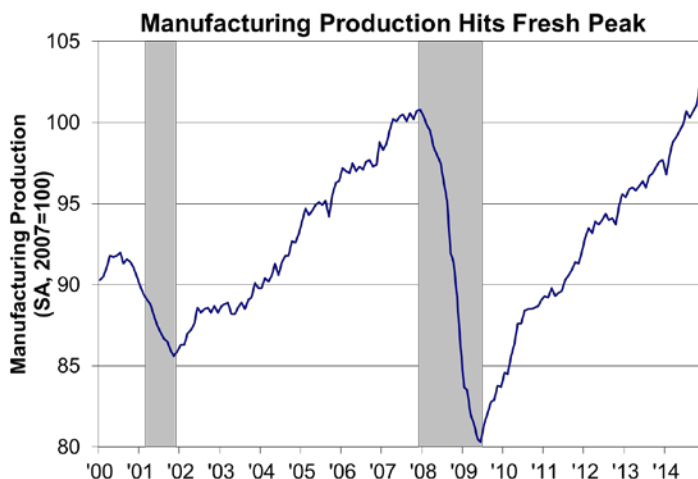


In our final Economic and Housing Weekly Note of 2014, the Economic and Strategic Research Group wishes you all happy holidays and a fruitful New Year. See you in 2015.

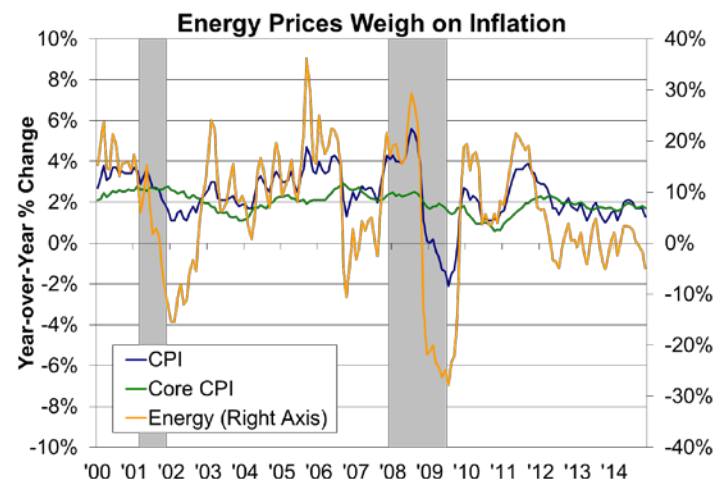
## Economics: Poised for 2015 Policy Transition

All eyes turned to the Janet Yellen-led Fed this week and its [December 16-17 FOMC meeting statement](#), [subsequent press conference](#), and [updated economic projections](#) for hints on how recent global developments have impacted the Fed's assessment on the appropriate lift-off date for the target fed funds rate. Such developments include sharply lower oil prices (driving the largest monthly decline in the November Consumer Price Index since December 2008), declining global bond yields and inflation, and ongoing challenges in Chinese, European, and Russian economies amid an improving domestic outlook. For all the attention, the Fed provided only modest changes to the language in its statement. As expected, the Fed removed the qualifying phrase "considerable time" from its forward guidance on how long its current target fed funds rate of 0 to ¼ percent will remain appropriate. More surprising was the lengths the Committee (and Yellen herself in the press conference) went to soften that change. The updated statement reads that the "Committee judges that it can be patient in beginning to normalize the stance of monetary policy" and that it "sees this guidance as consistent with its previous statement." In her press conference, Yellen went even further, stating that the "new language does not represent a change in our policy intentions." Meanwhile, incoming data underscore ongoing strength in the domestic economy. The solid November industrial production report featured the largest monthly gain in utilities production in seven years and a healthy increase in manufacturing production. In particular, upward revisions to October data showed the highest manufacturing production on record—surpassing the previous peak set prior to the onset of the Great Recession. An index of leading indicators posted another large gain in November, rising in 14 of the past 16 months. These data provide support for our forecast of accelerating economic growth in 2015 of 2.7 percent, up from an estimated 2.1 percent in 2014.

- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, jumped 1.3 percent in November—the largest monthly gain in over four years, according to the Federal Reserve Board. Manufacturing production, which accounts for approximately three-fourths of industrial production, rose 1.1 percent. Utilities production surged 5.1 percent while mining production edged down 0.1 percent. Capacity utilization rose to an expansion-best 80.1 percent.
- **The Consumer Price Index (CPI)** declined 0.3 percent in November, according to the Bureau of Labor Statistics. Over the past 12 months, prices are up 1.3 percent—the lowest annual inflation since February. Falling energy prices (down 3.8 percent in November and 4.9 percent from a year ago) drove the headline decline, though core CPI, which excludes the volatile food and energy sectors, edged up just 0.1 percent in November and 1.7 percent over the past year.
- **The Conference Board Index of Leading Economic Indicators**, a gauge of the economic outlook over the next three to six months, increased 0.6 percent in November following a 0.6 percent gain in October. Eight of the 10 components posted gains during the month, led by significant improvement in the financial components including stock prices, the leading credit index, and the interest rate spread. Jobless claims and building permits weighed on the index.
- **Initial claims for unemployment insurance** declined 6,000 to 289,000 in the week ending December 13, 2014, according to the Department of Labor. The four-week moving average ticked down to 298,750.



Source: Federal Reserve Board

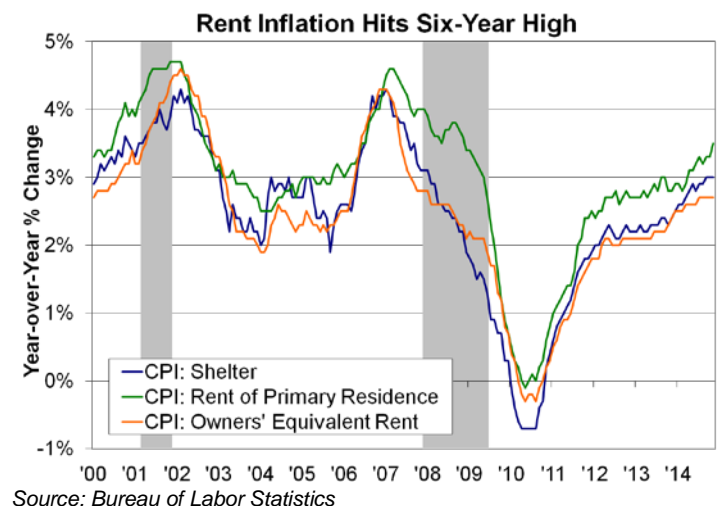
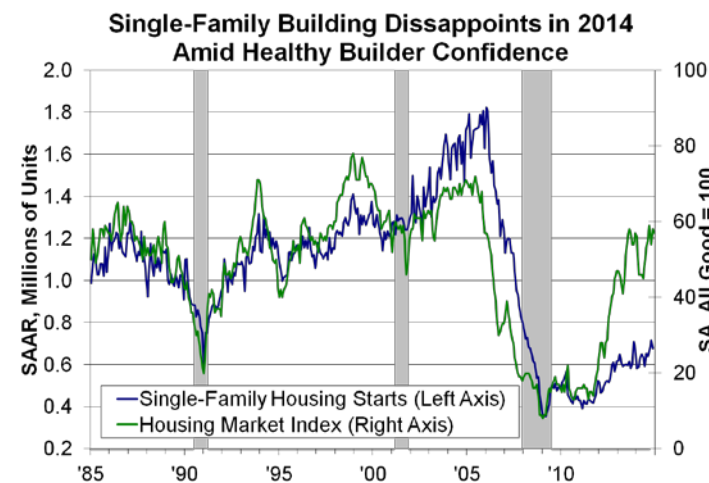


Source: Bureau of Labor Statistics

## Housing: Single-Family Building Disappoints in 2014

Housing data released this week support our cautious outlook for the sector as a whole and residential construction in particular. Homebuilding activity weakened in November, concentrated in the single-family market, and relatively flat builder sentiment in December suggests a robust near-term rebound is unlikely. We look for residential construction to improve next year in our [December Outlook](#), boosted by healthy job gains and early signs of wage acceleration; however, we remain concerned of both supply constraints in the industry and demand constraints associated with still very low levels of household formation that will limit the magnitude of growth. Mortgage demand deteriorated last week due to contracting purchase mortgage applications, which reversed nearly all of the improvement witnessed over the prior month. Housing demand has benefited only modestly thus far from the ongoing global flight-to-quality noted above, which continues to exert downward pressure on long-term Treasury yields and thus mortgage rates. According to Freddie Mac, the average yield for 30-year fixed-rate mortgages fell 13 basis points this week to 3.80 percent—the lowest since May 2013. Finally, somewhat lost in the shuffle of declining inflationary pressure in the CPI report detailed above is the underlying strength in housing-related inflation, particularly rents, which increased at the fastest year-over-year pace in six years. Consumers expect this trend to continue, according to our [November National Housing Survey](#), with a majority of survey respondents projecting both home price gains and rent increases over the next 12 months.

- **Housing starts** edged lower in November, falling 1.6 percent to 1.03 million annualized units, according to the Census Bureau. Single-family housing starts declined 5.4 percent on the month to 677,000 units, though the October figure was revised upward to an expansion best 716,000. Multifamily starts increased 6.7 percent to 351,000. Year-to-date through November, single-family and multifamily housing starts are up 4.4 percent and 15.9 percent, respectively. Housing permits fell 5.2 percent in November to 1.04 million from an expansion-high in October due to a 1.2 percent decline in single-family building permits and an 11.0 percent drop in multifamily building permits. Year-to-date through November, single-family permits are down 0.2 percent, while multifamily permits are up 8.5 percent.
- **The National Association of Home Builders/Wells Fargo Housing Market Index** edged down one point in December to 57 (a reading above 50 indicates more builders view the market as good than poor). Both the current sales and sales expectations components edged down one point but remained well above 50, while the buyer traffic index held steady at 45.
- **Mortgage applications** fell 3.3 percent in the week ending December 12, according to the Mortgage Bankers Association. Purchase applications fell 6.9 percent to a five-week low. Refinance applications were flat during the week even as the contract interest rate for 30-year fixed-rate mortgages in the survey fell five basis points to 4.06 percent—the lowest since May 2013.



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December 19, 2014

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