Fannie Mae

Economic and Strategic Research

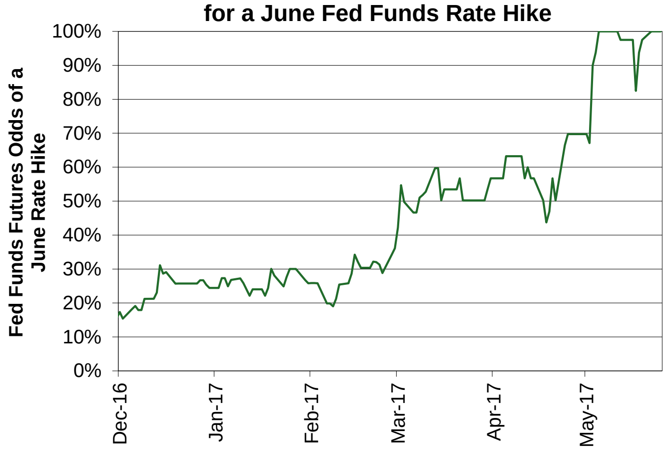
Weekly Note – May 26, 2017

Economics: For the Fed, Does "Soon" Rhyme with "June"?

The minutes from the May Federal Open Market Committee (FOMC) meeting showed most members judged it would "soon be appropriate" to raise the fed funds rate if incoming economic data meet expectations. The fed funds futures market believes "soon" means June, fully pricing in a hike at the June 13-14 meeting. The minutes revealed more detail on the Fed's plans to shrink its balance sheet, and nearly all members expect the process to start this year. The minutes support our call of two hikes in the fed funds rate in June and September, followed by a change in the reinvestment policy in December. The second estimate of first quarter economic growth painted a slightly less gloomy picture than initially reported. Four of the six GDP components—consumer spending, nonresidential investment, net exports, and government spending—were upgraded. The drag from inventory investment was bigger than initially reported. The net result was that economic growth was boosted by half of a percentage point over the advance estimate. However, economic growth still slowed from the fourth quarter for the fourth consecutive year. The report offered the first glimpse of corporate profits, which fell in the first quarter following two consecutive quarterly gains. Shifting to the second quarter, durable goods orders slipped in April for the first time in five months, while shipments fell for the third time in four months. Core capital goods orders, a leading indicator of business investment in equipment, were flat for the second consecutive month, suggesting the contribution to GDP from equipment investment will likely moderate after a strong boost in the first quarter. Consumer confidence continued to advance in May along the high plateau established following the presidential election, as the University of Michigan Sentiment Index increased for the third consecutive month, staying just below the expansion high reached in January. The labor market continued to tighten in May, as the four-week moving average of initial claims for unemployment insurance fell last week to a new 44-year low.

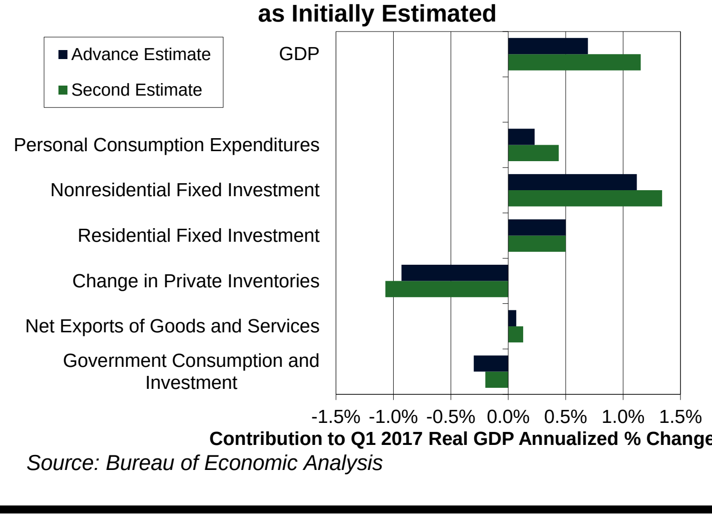
- **Gross domestic product (GDP)**, adjusted for inflation, expanded by 1.2 percent annualized in Q1 2017, according to the second estimate from the Bureau of Economic Analysis. Real consumer spending was revised upward, contributing 0.4 percentage points to growth, compared to 0.2 percentage points in the first estimate. The contributions from nonresidential investment and net exports were revised higher, and the drag from government consumption and investment was revised lower. The drag from inventory investment worsened in the second estimate, while residential investment was unchanged. Corporate profits fell by 1.9 percent (not annualized) from the prior quarter but were 3.7 percent higher than a year ago. Profits from both financial and nonfinancial domestic firms declined, while profits earned abroad edged up.
- **Durable goods orders** slipped 0.7 percent in April, according to the Census Bureau. However, March data were revised higher to show a 2.3 percent increase, more than double the original estimate. Shipments of durable goods fell 0.3 percent in April. Core capital goods orders (nondefense capital goods excluding aircraft) were unchanged, while core shipments edged down 0.1 percent. Both core goods orders and core shipments were revised downward in March by 0.5 percent and 0.3 percent, respectively.
- **The University of Michigan Consumer Sentiment Index** edged up 0.1 points from April to 97.1 in the final May reading. The rise in the expectations component outweighed a drop in the current economic conditions component.
- **Initial claims for unemployment insurance** increased by 1,000 to 234,000 in the week ending May 20, according to the Department of Labor. The four-week moving average decreased by 5,750 to 235,250.

Futures Market Is Ready for a June Fed Funds Rate Hike



Source: Bloomberg

First Quarter Economic Growth Was Not as Bad as Initially Estimated



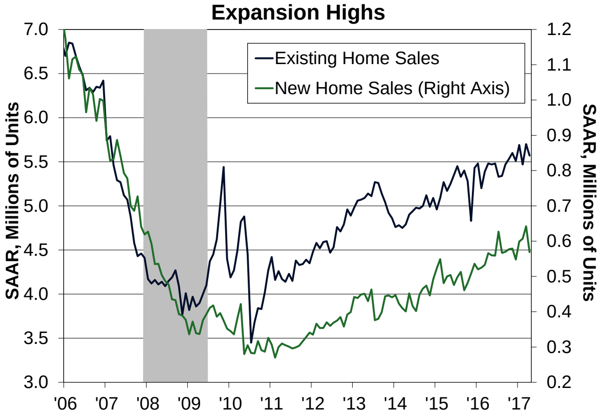
Source: Bureau of Economic Analysis

Housing: April Home Sales Cool from Hot March

This week's housing reports offered news on home sales at the start of the spring selling season. Both new and existing home sales pulled back in April after rising to expansion bests in March. Unusually warm winter weather, combined with declining mortgage rates in January and February, likely pulled forward some sales into the first quarter. New home sales, which record contract signings, suffered the biggest percentage drop in two years, sending sales to the slowest pace since December. However, the decline followed three consecutive monthly gains and sizable upward revisions for sales in the prior three months, which sent March sales to the strongest pace since October 2007. The decrease in existing home sales in April was presaged by a drop in March pending home sales (contract signings of existing homes). However, the decline in existing sales (i.e., closings) was much more pronounced than that in pending sales. Tight inventory in the existing home market continues to constrain sales. While the number of homes for sale (not seasonally adjusted) saw a seasonal rise in April, it remains significantly below last year's level, continuing annual declines that extend back nearly two years. The number of days on the market fell to a fresh record low, and the months' supply remained historically tight at 4.2 months versus 4.6 months last April. Extremely lean supply has helped support home prices. Since last August, the FHFA home price measure has posted annual gains of between 6.3 percent and 6.5 percent in every month except one. Declining mortgage rates boosted refinance applications, which posted the largest gain last week since July. Freddie Mac's survey showed rates dropped further this week, with the average rate on 30-year fixed-rate mortgages falling seven basis points to 3.95 percent, the lowest level since November.

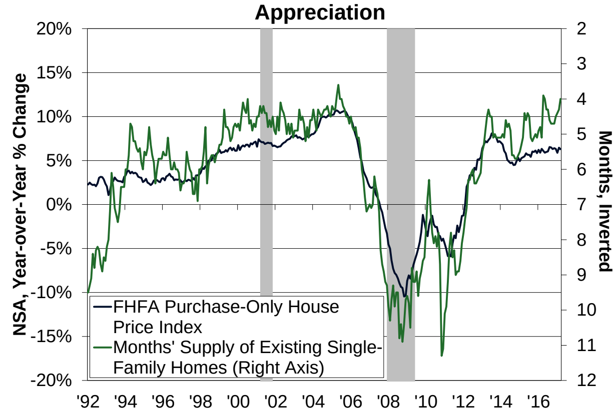
- **New single-family home sales** dropped 11.4 percent in April to a 569,000 seasonally-adjusted annualized rate (SAAR), according to the Census Bureau. The report reflected an annual data revision that boosted sales in the first three months of this year by a combined 55,000. Through the first four months of the year, new home sales were 11.1 percent higher than sales during the same period in 2016. Sales fell in April across all four regions, led by a 26.3 percent decline in the West. With the plunge in sales and a 1.5 percent rise in the number of homes for sale from the prior month to 268,000, the months' supply (reported on a seasonally-adjusted basis) jumped from 4.9 months to 5.7 months, the highest reading since September 2015. The median price, which is not adjusted for seasonality or the mix of sales, fell 3.8 percent from last April to $309,200.
- **Existing home sales** fell 2.3 percent in April to a 5.57 million unit annual pace (SAAR), according to the National Association of REALTORS®. Sales rose in the Midwest but fell in the other three regions. Year-to-date sales were 2.1 percent higher than last year. The number of homes for sale was 9.0 percent below last April's level, marking the 23rd consecutive month of annual declines. Homes were on the market for an average of 29 days, the shortest duration since record keeping began in 2011. The median price was up 6.0 percent from last April to $244,800.
- **The FHFA Purchase-Only House Price Index** (seasonally adjusted) rose 0.6 percent in March. The year-on-year growth rate edged down to 6.3 percent from 6.5 percent the prior month.
- **Mortgage applications** were up 4.4 percent for the week ending May 19, according to the Mortgage Bankers Association. Purchase applications fell for the second straight week, edging down 0.8 percent. Refinance applications rose 10.5 percent. The average rate for 30-year fixed-rate mortgages fell six basis points to 4.17 percent, the lowest level since November.

Existing and New Home Sales Pull Back from Expansion Highs



Source: National Association of REALTORS®, Census Bureau

Tight Inventory Helps Support Home Price Appreciation



Source: National Association of REALTORS®, FHFA

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May 26, 2017

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