



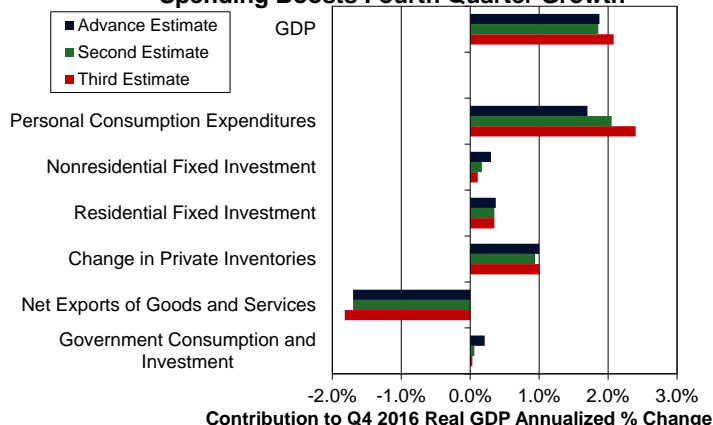
Weekly Note – March 31, 2017

Economics: Fickle Consumers and Rising Inflation

Economic data released this week centered on consumers and inflation. Consumer spending has been the main driver of economic growth for the past three years, and the trend continued at the end of 2016. The third estimate of fourth quarter gross domestic product (GDP) upwardly revised consumer spending, boosting overall economic growth above 2.0 percent, as the other main components of GDP saw only minor revisions. Corporate profits, the new data in the report, improved slightly in the fourth quarter from the prior quarter, but posted a solid annual gain after declining between the second quarter of 2015 through the second quarter of 2016. Turning to consumer spending data for this quarter, real personal consumption expenditures (PCE) fell for the second consecutive month in February, the first back-to-back drops since March and April 2009. Despite a pullback in spending during the first two months of the year, consumers were more upbeat in March. The Conference Board Consumer Confidence Index jumped to the highest level in more than 16 years, and the University of Michigan Consumer Sentiment Index improved from February, remaining just below the 13-year high reached in January. On the inflation front, the Federal Reserve's preferred price measure, the PCE deflator, rose in February above the 2.0 percent annual growth target for the first time in nearly five years. After the release of the data this morning, the odds of a June fed funds rate hike jumped 10 percentage points to 60 percent, according to the futures market. However, the annual growth in the headline PCE deflator is, in part, inflated by energy prices, which have risen from the 12-year low reached around this time last year. In contrast, annual growth in the core PCE deflator, which excludes energy and food prices, has been more stable, hovering between 1.7 percent and 1.8 percent for the past seven months.

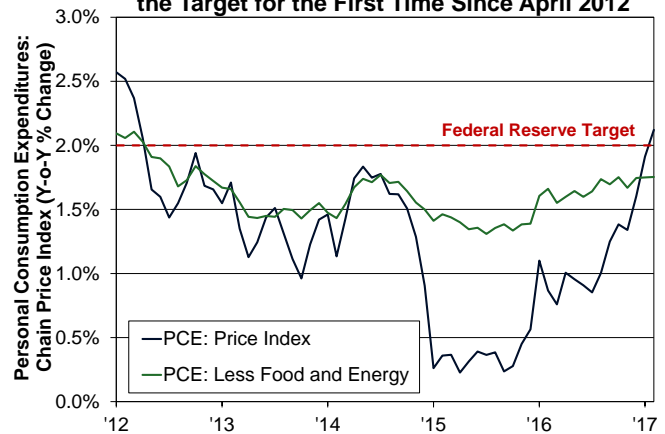
- **Gross domestic product (GDP) growth**, adjusted for inflation, was revised two-tenths higher to 2.1 percent annualized in Q4 2016, according to the third estimate from the Bureau of Economic Analysis (BEA). Growth in personal consumption expenditures saw the largest revision, rising 0.5 percentage points to 3.5 percent. Change in inventories was the only other component to be revised upward, as residential fixed investment was unchanged and business fixed investment, net exports, and government spending were all revised down slightly. Corporate profits edged up 0.5 percent (not annualized) from the prior quarter, after rising 5.8 percent in the third quarter of 2016. A rise in profits for foreign firms outweighed the drop in profits for domestic companies. Year over year, profits rose 9.3 percent, the largest increase since the third quarter of 2012.
- **Personal income**, adjusted for inflation, increased 0.2 percent in February, according to the BEA. Real PCE declined 0.1 percent and the personal saving rate increased 0.2 percentage points for the second consecutive month to 5.6 percent. The PCE deflator edged up 0.1 percent from January and 2.1 percent from February 2016. Core PCE prices, excluding food and energy, rose 0.2 percent on a monthly basis, and 1.8 percent from a year ago.
- **The Conference Board Consumer Confidence Index** jumped 9.5 points to 125.6 in March. Both the present situation and expectation components rose during the month to reach more than 15-year highs. **The University of Michigan Consumer Sentiment Index** edged up 0.6 points from February to 96.9 in the final March reading. The rise in the current economic conditions component drove the gain, as the expectations component was unchanged.
- **Initial claims for unemployment insurance** decreased by 3,000 to 258,000 in the week ending March 25, according to the Department of Labor. The four-week moving average increased by 7,750 to 254,250.

Second Upward Revision to Consumer Spending Boosts Fourth Quarter Growth



Source: Bureau of Economic Analysis

Fed's Favored Inflation Measure Climbs Above the Target for the First Time Since April 2012



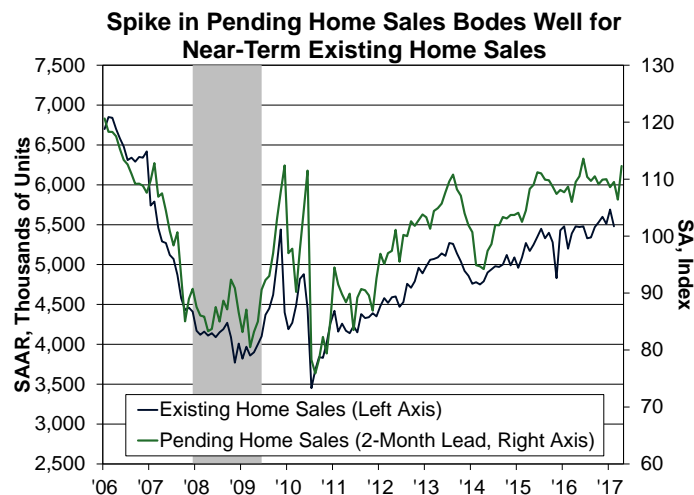
Source: Bureau of Economic Analysis



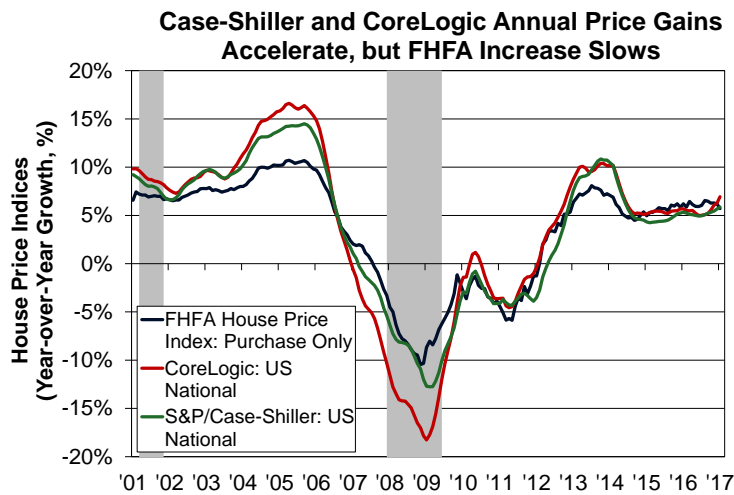
Housing: Near-term Outlook for Home Sales Brightens

The week's housing news was upbeat. While a report released last week indicated that closed sales on existing homes fell sharply in February from the expansion best reached in January, this week's release on pending home sales showed a jump in February to the second-highest level in more than a decade. Mild February weather helped boost sales, especially in the Midwest, which saw a double-digit gain following three consecutive monthly drops. In addition, another leading indicator of home sales—purchase mortgage applications—rose last week for the fourth time over the last five weeks. These developments suggest improving sales heading into the spring season, when the housing market should benefit from a seasonal increase in listings. On the home price front, the annual gain in the Case-Shiller House Price Index strengthened at the start of 2017, posting the biggest rise since June 2014. The pickup in annual home price appreciation corresponded with accelerated growth for CoreLogic's House Price index for January, but contrasted with moderating gain in FHFA's index during the month. Robust home price gains could encourage more listings to meet demand. Another positive for the housing market is the stabilization in mortgage rates. Freddie Mac's survey showed that, after reaching 4.30 percent during the second week of March, the average 30-year fixed mortgage rate fell this week for the second straight week, declining 9 basis points to 4.14 percent, the lowest level since the first week of March.

- **The National Association of REALTORS® Pending Home Sales Index**, which records contract signings of existing homes and typically leads closings by one to two months, surged 5.5 percent in February to 112.3, the second highest level since May 2006. Sales increased in all four regions.
- **The S&P/Case-Shiller National Home Price Index** (not seasonally adjusted) rose 0.2 percent in the three months ending in January. From a year ago, prices increased 5.9 percent.
- **Mortgage applications** edged down 0.8 percent for the week ending March 24, according to the Mortgage Bankers Association. Purchase application rose 1.2 percent. Refinance applications fell 2.9 percent, the second consecutive weekly drop.



Source: The National Association of REALTORS®



Source: Standard & Poor's, CoreLogic, Federal Housing Finance Agency

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Economic and Strategic Research Group
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