Fannie Mae

Economic and Strategic Research

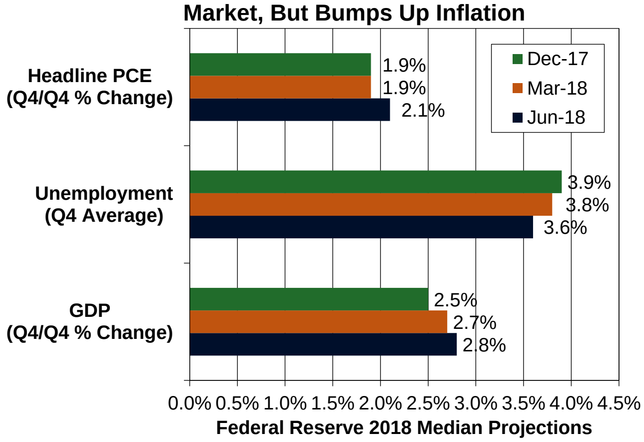
Weekly Note – June 15, 2018

Economics: Fed Tightens Amid Optimistic Projections

This week's top story was the June Federal Open Market Committee (FOMC) meeting, where the Fed voted unanimously to raise the federal funds rate 25 basis points to a range of 1.75 percent to 2.0 percent. The Fed also released a more hawkish post-meeting statement and upbeat economic projections. The updated quarterly projections for 2018 showed stronger growth, lower unemployment rates, and higher inflation rates than in the March projections. The Fed now projects that both headline and core inflation will overshoot the 2 percent target by one-tenth of a percentage point over the next two years. The dot plot, which shows FOMC members' federal funds rate projections, moved up to imply four rate increases in 2018, versus the three hikes projected in March. The dot plot continues to indicate three rate increases in 2019 but now implies only one increase in 2020 instead of two, leaving the projected fed funds rate at the end of 2020 unchanged at 3.4 percent. The "longer run" rate was also unchanged at 2.9 percent, which implies that the rate will exceed the "longer run" rate by late 2019, if the fed funds rate follows the Fed's projected appropriate policy path. The statement showed that the Fed discontinued forward guidance by dropping the language, "the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run." Fed Chair Powell announced that, beginning in January, the Fed will hold press conferences at every meeting, which will give the committee more flexibility in the pace of future interest rate changes. Consistent with the upgrade in the Fed's inflation projections, the Consumer Price Index (CPI) posted the largest annual rise in over six years in May, and core CPI accelerated to the fastest pace in over a year. Other news was mixed. On the bullish side, retail sales jumped in May. Core retail sales, which are an input for the consumer goods spending component of GDP, also increased and April's number was revised higher, supporting our view that real consumer spending will pick up sizably this quarter. Consumer sentiment rose in June to just 2.1 points below the expansion best, while the NFIB Small Business Optimism Index spiked in May to its highest level since 1983. On the bearish side, industrial production fell in May due to the largest drop in manufacturing output since January 2014.

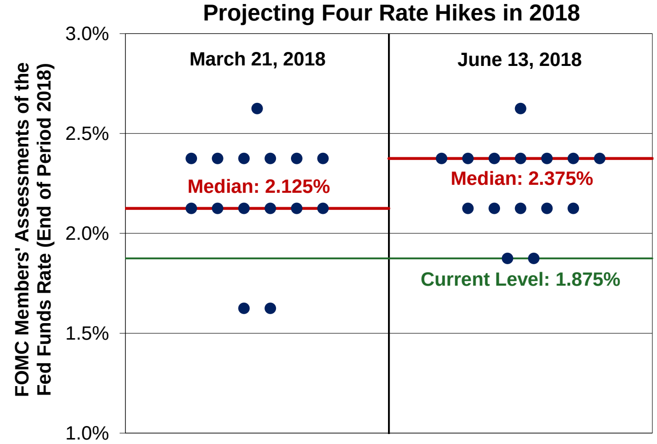
- **The Consumer Price Index** grew 0.2 percent in May and increased 2.8 percent on an annual basis. Core prices edged up two-tenths from April and 2.2 percent from a year ago. **Import prices** rose 0.6 percent in May and 4.3 percent annually. **The Producer Price Index** for final demand of goods and services rose 0.5 percent in May. On an annual basis, headline and core PPI gains accelerated to 3.1 percent and 2.6 percent, respectively. The Bureau of Labor Statistics produces each of these reports.
- **Retail sales** rose 0.8 percent and core retail sales increased 0.5 percent in May, according to the Census Bureau. The April gains in headline and core retail sales were both revised up. Annual growth in headline and core retail sales both increased to 5.9 percent and 5.0 percent, respectively.
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, edged down 0.1 percent in May, according to the Federal Reserve Board. Manufacturing output fell 0.7 percent while utility and mining output rose 1.0 percent and 1.7 percent, respectively.
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** jumped 3 points to 107.8 in May. The net share of small businesses reporting now is a good time to expand and the share reporting that they raised worker compensation in the past 3 months both increased to record highs.
- **The University of Michigan Consumer Sentiment Index** rose 1.3 points to 99.3 in the June preliminary reading as a boost in confidence in current conditions outweighed a drop in expectations.

FOMC Has Rosier View of Growth and Labor Market, But Bumps Up Inflation



Source: The Federal Reserve

FOMC Members Grow More Hawkish, Projecting Four Rate Hikes in 2018



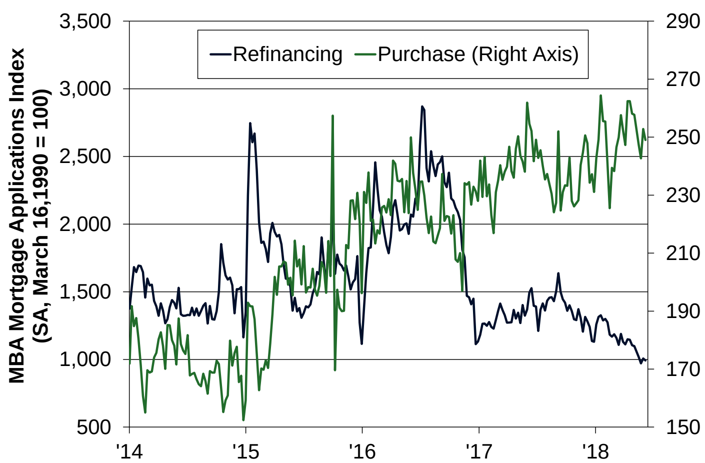
Source: The Federal Reserve

Housing: Mortgage Demand Resumes Downward Trend

In a quiet week of housing data, mortgage demand stumbled in the second week of June, marking the seventh decline in the past eight weeks. After falling in the last week of May to the lowest level since January 2016, total mortgage applications had rebounded in the first week of June before declining last week. Purchase and refinance applications fell last week due to declines in conventional mortgage applications. Demand for government mortgages, on the other hand, posted the largest weekly gain since February to mark the second consecutive weekly rise. Applications for both purchase and refinance government mortgages improved over the past two weeks. Overall mortgage demand has faltered recently as mortgage rates have risen sharply since the end of 2017, when rates averaged 3.99 percent in the last week of December. This week, mortgage rates jumped 8 basis points to 4.62 percent, 4 basis points below the seven-year high hit three weeks ago, according to Freddie Mac. Rising mortgage rates create an additional affordability challenge for a housing market that is already constrained by the low supply of homes for sale, which in the face of high demand is putting strong upward pressure on home prices.

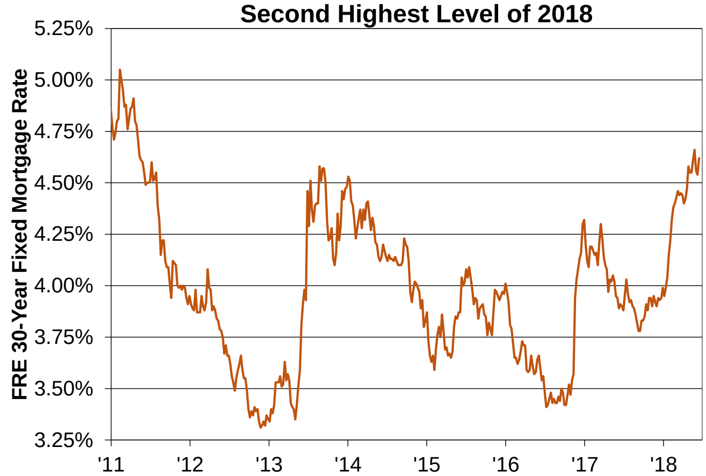
- **Mortgage applications** fell 1.5 percent for the week ending June 8, according to the Mortgage Bankers Association (MBA). Purchase applications dropped 1.5 percent, as conventional purchase applications decreased 3.8 percent but government applications rose 5.0 percent. Refinance applications also declined 1.5 percent, as a 3.0 percent drop in conventional refinance applications outweighed a 7.6 percent rise in government applications. The MBA survey's average 30-year fixed mortgage rate rose 8 basis points to 4.83 percent.

Purchase and Refinance Applications Decline



Source: Mortgage Bankers Association

Mortgage Rates Jump to the Second Highest Level of 2018



Source: Freddie Mac

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