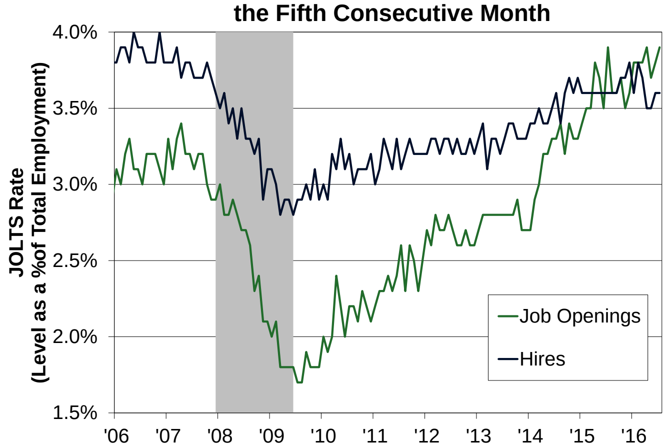
Weekly Note – September 9, 2016

Economics: A Shot Across the Bow for Data-Dependency

Economic data released this week provided one big surprise as the rest of the reports stuck to the script. The downside surprise came from the ISM Nonmanufacturing Index, a gauge of activity in the service sector based upon a survey of purchasing managers. The largest drop of the expansion pushed the index down to the lowest level since February 2010 and suggested the service sector is hovering just above contraction territory. Steep declines in the business activity and new orders components drove the decline. Following release of the ISM report, the fed funds futures' odds of a rate hike for September dropped sharply but have recovered to 36 percent at the time of the writing. The episode shows the risk of data-dependent monetary policy, as major downside surprises before a meeting of the Federal Open Market Committee (FOMC) could sway market expectations. This is crucial because the Fed has rarely increased the target rate when the futures market has put the probability of a hike at less than 40 percent within three weeks of the FOMC meeting. Other news this week was encouraging. Consumers remain willing to take on debt, as both nonrevolving (primarily auto and student loan debt) and revolving (largely credit card debt) credit rose in July. Steady growth in credit will be a key support for consumer spending, which has been driving economic growth. The Job Openings and Labor Turnover Survey (JOLTS) confirmed that the labor market was upbeat in July, as job openings reached an all-time high, driven by a spike in professional and business services. The job openings rate outpaced the hires rate for a fifth consecutive month, marking the longest stretch with more openings than hires since the survey began in December 2000. The dynamic suggests that firms are having difficulty finding qualified candidates to fill open positions. Another positive from the report was the fifth consecutive drop in the number of layoffs and discharges, a trend that appears to have continued since July, as initial claims for unemployment insurance fell in early September for the fourth time in five weeks. However, the relatively subdued August jobs report dampened the optimism surrounding the labor market and created more uncertainty about the near-term future of monetary policy.

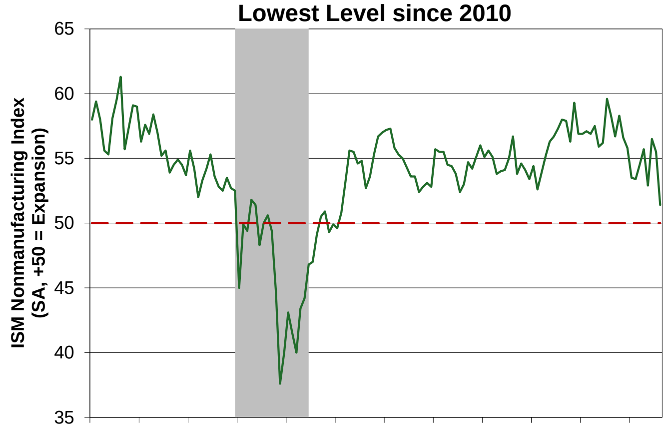
- **The Institute for Supply Management (ISM) Nonmanufacturing Index** dropped 4.1 points to 51.4 in August, marking the third decline in the last four months (any reading above 50 indicates expansion). Both the business activity and new orders components posted the biggest monthly declines of the expansion but still remain in expansion territory. The employment component fell slightly to 50.7.
- **Consumer (non-mortgage) credit outstanding** grew $17.7 billion in July, according to the Federal Reserve Board. Nonrevolving credit drove the gain, rising $14.9 billion. Revolving credit increased $2.8 billion, marking the sixth monthly rise. From a year ago, nonrevolving credit increased 6.1 percent for a second consecutive month, as revolving credit posted a 5.9 percent gain, slowing slightly from the prior month.
- **The Job Openings and Labor Turnover Survey (JOLTS)** showed that job openings rose 4.0 percent in July to 5.9 million, according to the Bureau of Labor Statistics. As a share of total employment, the job openings rate rose one-tenth for a second straight month to tie an all-time high at 3.9 percent. The hires rate was flat at 3.6 percent. The quits rate, a gauge of working confidence in the labor market, was unchanged at 2.3 percent for a third straight month.
- **Initial claims for unemployment insurance** decreased by 4,000 to 259,000 in the week ending September 3, according to the Department of Labor. The four-week moving average decreased by 1,750 to 261,250, the lowest level in a month.

Job Openings Rate Out Paces Hires Rate for the Fifth Consecutive Month



Source: Bureau of Labor Statistics

Service Sector Activity Drops Sharply to the Lowest Level since 2010



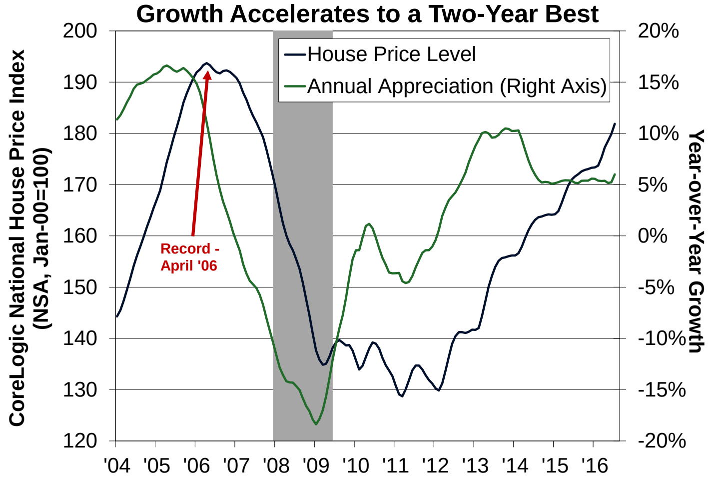
Source: Institute for Supply Management

Housing: Home Prices March Higher

This week's news was sparse but generally positive. With no supply relief in sight for existing homes, annual home price gains strengthened in July to a two-year best — a boon to homeowners' equity positions and overall mortgage performance. Continuing a recent trend, home price appreciation at the low-end of the price range posted a much bigger gain than the national average. This suggests that potential first-time homebuyers will continue to have a difficult time switching from renting to owning, which also impedes the ability of existing homeowners to trade up, presenting a hurdle for a broad-based improvement in home sales this year. The JOLTS was upbeat, showing a rebound in both job openings and hiring in the construction industry in July. However, because JOLTS is released with a one-month lag to the jobs report, it added little to what we already knew about construction industry hiring trends. On the mortgage demand front, average purchase applications fell in August for the second consecutive month to the lowest monthly reading since last November. Refinance applications have fared better, pulling back in August but remaining at elevated levels for the year. Mortgage rates remain supportive for the housing and mortgage market, with the average rate on the 30-year fixed-rate mortgage edging down two basis points to 3.44 percent this week according to Freddie Mac's survey.

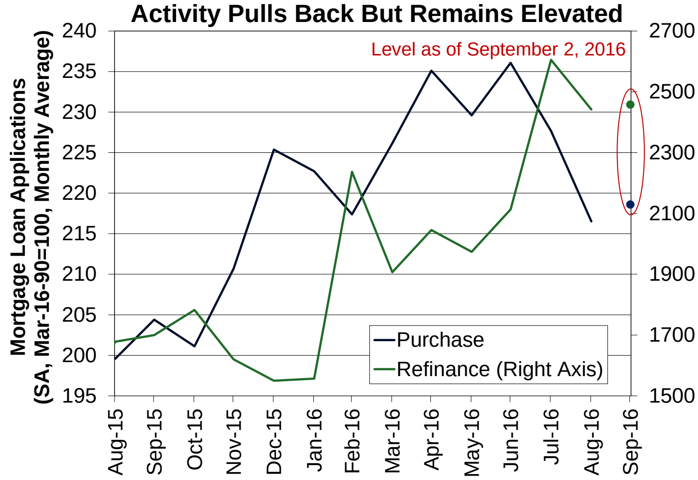
- **The CoreLogic National Home Price Index** (not seasonally adjusted) rose 1.1 percent in July, the biggest rise in three months. From one year ago, the index rose 6.0 percent, the strong pace since July 2014. Home prices have increased about 41 percent since reaching the trough in March 2011 but remain approximately 6 percent below the April 2006 peak. At the state level, Oregon showed the strongest appreciation, followed by Washington, with prices in both states rising by double-digits from last July. Connecticut was the only state with an annual home price decline. The low-price tier (homes priced at 75 percent or less of the median) showed the biggest rate of annual appreciation, increasing 8.8 percent in July, and is the only price tier to pass its pre-recession peak. The high-price tier (homes priced greater than 125 percent of the median) posted a 4.8 percent year-over-year gain, the slowest increase of all the price tiers, and remains 5.2 percent below its peak.
- **The Jobs Openings and Labor Turnover Survey (JOLTS)** showed that construction job openings jumped 14.4 percent in July, to a level just a touch below the expansion high reached in March, according to the Bureau of Labor Statistics. The job openings rate rose 0.4 percentage points to 3.1 percent, tying the expansion best in March. The hires rate rose for the first time in four months to 5.0 percent, but remains low for an expansion. The quits rate edged up for the first time in four months to 1.9 percent.
- **Mortgage applications** edged up 0.9 percent for the week ending September 2, according to the Mortgage Bankers Association. Purchase applications increased 1.2 percent, similar to the gain in the prior week. Refinance applications edged up 0.7 percent following a 3.7 percent rise in the prior week. The survey's average interest rate for 30-year fixed-rate mortgages ticked up to 3.68 percent.

Home Prices Climb towards Their Peak, as Growth Accelerates to a Two-Year Best



Source: CoreLogic

Purchase Applications Trend Lower While Refi Activity Pulls Back But Remains Elevated



Source: Mortgage Bankers Association

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September 9, 2016

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