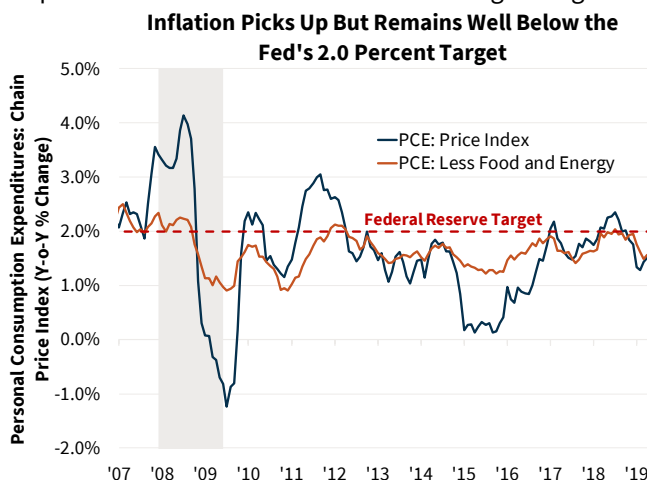


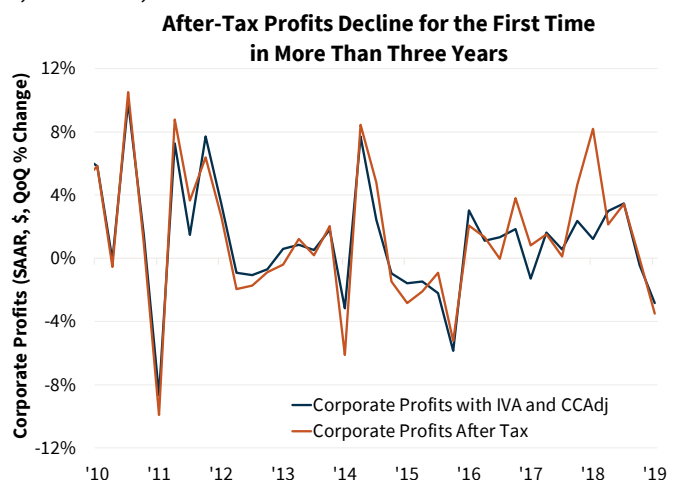
Economics: Confident Consumers are Reluctant to Spend

The economic spotlight this week fell on inflation, consumer spending, and consumer confidence. The annual increase in the Fed's preferred measure of inflation, the personal consumption expenditures (PCE) deflator, accelerated for the second straight month in April but remained well below the Fed's 2.0 percent target. After moderating in March to the slowest pace since September 2017, the annual gain in core inflation (excluding food and energy) accelerated for the first time in four months. On the consumer front, real consumer spending was flat in April due to weakness in durable goods purchases and, to a lesser extent, spending on services. On the other hand, the March increase in real consumer spending was revised higher by two-tenths to the largest monthly increase since 2009. We continue to regard consumer fundamentals as solid, especially given the continued health of the labor market, and we maintain our belief that consumer spending growth will pick up markedly this quarter from the first quarter's anemic pace. Two measures of consumer sentiment were positive in May, though they showed conflicting details. The Conference Board's measure of consumer confidence rose in May, moving close to the expansion highs reached late last year, primarily driven by strength in the present situation component, which rose to the highest level in more than 18 years. The University of Michigan Consumer Sentiment Index also improved to just shy of expansion highs, but its increase was driven entirely by a jump in the consumer expectations component to the highest level since January 2004, while the current economic conditions component declined for the fourth time in five months, continuing to trend down from its peak in March 2018. In other news, the second estimate of first-quarter real GDP growth showed a one-tenth downgrade to 3.1 percent annualized. Corporate profits, the new piece of data in the report, fell for the second straight quarter and posted the largest decline since the end of 2015. Similarly, annual growth in after-tax profits decelerated to 1.9 percent, the slowest pace since the third quarter of 2016. Declining corporate profits, increased volatility in the stock market, and growing concerns over trade tensions pose downside risks to our business fixed investment forecast of 3.4 percent.

- **Personal income**, adjusted for inflation, rose 0.2 percent in April, one-tenth more than the gain in real disposable income, according to the Bureau of Economic Analysis. Real PCE was flat from March but increased 2.7 percent annually. The personal saving rate edged up a tick to 6.2 percent. The PCE deflator rose 0.3 percent in April and 1.5 percent from a year ago. The core deflator rose 0.2 percent during the month and 1.6 percent year over year.
- **The Conference Board Consumer Confidence Index** improved 4.9 points in May to 134.1. The present situation component rose 6.2 points to 175.2, the highest level since the end of 2000, and the expectations component increased to 106.6, a six-month high. **The University of Michigan Consumer Sentiment Index** rose 2.8 points to 100.0 in the May final reading driven by a 6.1-point rise in the consumer expectations component while the current conditions component fell 2.3 points.
- **Gross domestic product**, adjusted for inflation, expanded 3.1 percent annualized in Q1 2019, according to the second estimate from the Bureau of Economic Analysis. Personal consumption expenditures were revised upward one-tenth to contribute 0.9 percentage point to the headline gain but remained the second largest driver of growth after net exports, which were unchanged. Nonresidential fixed investment and business inventories were both revised down a tenth to contribute 0.3 percent and 0.6 percent, respectively. Corporate profits (before taxes) fell 2.8 percent from the prior quarter (not annualized) as profits for both domestic and international firms declined. From a year ago, however, profits rose 3.1 percent. After-tax profit dropped 3.5 percent, the first decline since the end of 2015.
- **Initial claims for unemployment insurance** increased by 3,000 to 215,000 in the week ending May 25, according to the Department of Labor. The four-week moving average declined 3,750 to 216,750.



Source: Bureau of Economic Analysis



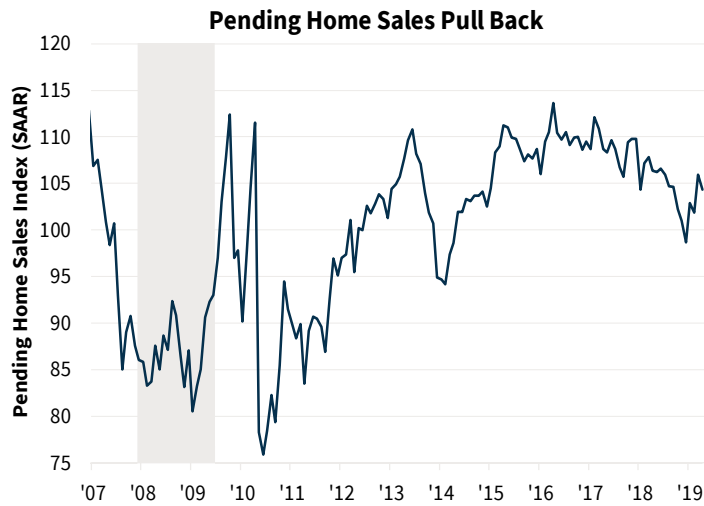
Source: Bureau of Economic Analysis



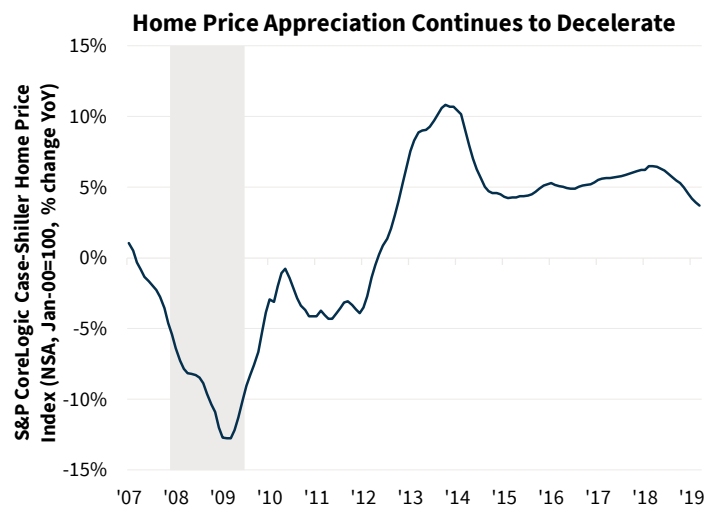
Housing: Pending Home Sales Pull Back

In this week's housing news, pending home sales dropped, two indices of home price appreciation continued to decelerate, and mortgage applications fell. Pending home sales, a leading indicator of sales activity, fell in April, partially reversing the strong increase in March. This was the sixteenth straight month during which year-over-year change was negative. Despite the decline in pending sales, we continue to expect home sales to strengthen somewhat in the coming months, driven partly by the continued decline in mortgage rates. Persistent supply constraints at the lower end of the market may, however, be restricting the responsiveness of homebuyers to improvements in affordability. The months' supply of existing homes priced under \$250,000 was 3.3 in April, a level well below the historical norm, while the months' supply of homes priced at or above \$1 million was much higher at 8.9. Regarding home price growth, two measures showed continued deceleration in March. On an annual basis, the FHFA Purchase-Only House Price Index decelerated for the ninth consecutive month and fourth straight quarter to the slowest pace of home price growth in four years, while the S&P CoreLogic Case-Shiller National Home Price Index showed annual home price growth decelerating for the eleventh consecutive month in March to the slowest pace since 2012. The deceleration in home price appreciation is a boon for potential homebuyers and affordability as the gap between the growth rates of home prices and labor earnings continues to shrink. Lower mortgage rates have also contributed to the recent improvement in affordability: The average yield on 30-year fixed-rate mortgages fell seven basis points this week to 3.99 percent, according to Freddie Mac. This is the fifth straight week of declines, leaving mortgage rates at the lowest level since January 2018. For the entire month of May, mortgage rates averaged 4.07 percent, slowing for the sixth straight month and now 80 basis points below the most recent peak in November. Nevertheless, both purchase and refinance mortgage applications fell last week, with the large decline in refinance applications nearly reversing the increase seen two weeks earlier. Purchase applications fell modestly for the third week in a row but remain at a level well above the past winter's lows. While the recent decline in mortgage rates and continued slowdown in home price growth help affordability, home prices remain elevated and housing supply continues to be constrained, which could dampen future sales.

- **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, fell 1.5 percent in April. The index was down 2.0 percent from a year ago. Pending home sales fell in every region except the Midwest, where pending sales increased 1.3 percent.
- **The FHFA Purchase-Only House Price Index**, reported on a seasonally adjusted basis, grew 0.1 percent in March and 5.0 percent from a year earlier, while the quarterly index value was up 5.2 percent from a year ago. **The S&P CoreLogic Case-Shiller National Home Price Index** (not seasonally adjusted) rose 0.6 percent in March and was up 3.7 percent from a year earlier, while the quarterly index was 3.9 percent higher than a year ago.
- **Mortgage applications** fell 3.3 percent for the week ending May 24, according to the Mortgage Bankers Association. Refinance applications and purchase applications fell 6.0 percent and 1.4 percent, respectively.



Source: National Association of REALTORS®



Source: Standard & Poor's

Ricky Goyette and Rebecca Meeker
 Economic and Strategic Research Group
 May 31, 2019



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