Economics: Inflation Remains Tame as Fed Prepares Exit Strategy

Economic data released this week were muted. Industrial production declined, but manufacturing production improved, inching towards its all-time peak reached in December 2007. Consumer prices continued to reflect a modest inflation outlook, weighed down by falling energy prices, but supported by steadily rising shelter costs. An index of leading indicators suggested that our forecast for steady, if unspectacular, growth next year remains well-founded. While jobless claims data have worsened a bit over the past few weeks, the level of new claims remains quite low, and has held below 300,000 for 10 consecutive weeks—a feat unseen since 2000. The minutes of the October 28-29 Federal Open Market Committee (FOMC) meeting showed a general consensus around the conclusion of the Fed's asset-purchase program in October. More debate centered on the Fed's decision to maintain its commitment to keep interest rates low for a "considerable time", a phrase we expect to be removed in subsequent statements in preparation for an eventual interest rate hike. The minutes also showed considerable discussion over the current low rate of inflation, with most participants agreeing it was largely transitory. We continue to expect the Fed to begin hiking interest rates in Q3 2015. The 10-year U.S. Treasury yield was little changed on the week, hovering around 2.33 percent on Friday morning.

- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, edged down 0.1 percent in October following a 0.8 percent jump in the prior month, according to the Federal Reserve. Headline production was weighed down by declines in the mining and utilities sectors, while manufacturing production increased 0.2 percent for the second consecutive month.

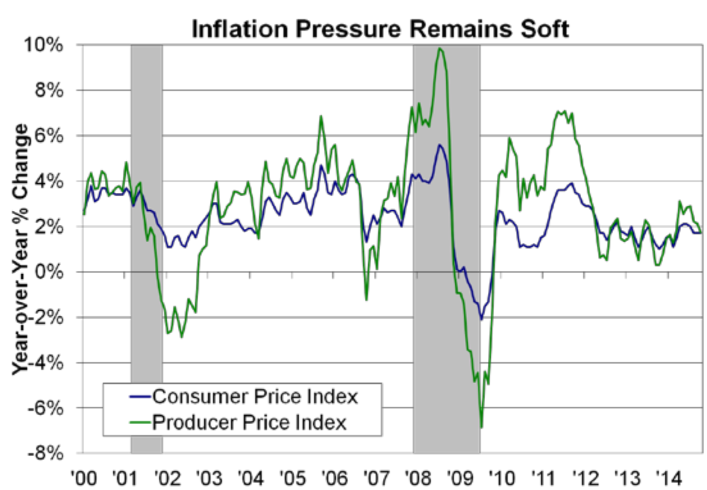
- **The Consumer Price Index (CPI)** was unchanged in October following a 0.1 percent increase in September, according to the Bureau of Labor Statistics. A 1.0 percent decline in energy prices (the fourth consecutive monthly decline) weighed on the index, while food prices edged up just 0.1 percent—the smallest gain since June. Excluding food and energy prices, core CPI increased 0.2 percent, boosted by rising shelter costs and a jump in transportation service costs. The CPI is up 1.7 percent over the past year, the same annual increase witnessed over the past three months, while core CPI increased 1.8 percent.

- **The Producer Price Index (PPI)** fell for a third straight month in October, declining 0.3 percent on the month and increasing 1.7 percent over the past 12 months—the smallest annual increase since February, according to the Bureau of Labor Statistics. Excluding food and energy, core PPI rose 0.1 percent on the month and 2.1 percent on the year.

- **The Conference Board Index of Leading Economic Indicators**, a gauge of the economic outlook over the next three to six months, increased 0.9 percent in October following a 0.7 percent jump in September. Gains were broad-based, as eight of the 10 subcomponents improved on the month, with strong growth in the Institute of Supply Management (ISM) new orders index leading the way.

- **Initial claims for unemployment insurance** declined 2,000 to 291,000 in the week ending November 15, according to the Department of Labor. The four-week moving average increased 1,750 to 287,500.

Source: Federal Reserve Board



Source: Bureau of Labor Statistics

Housing: Momentum Building

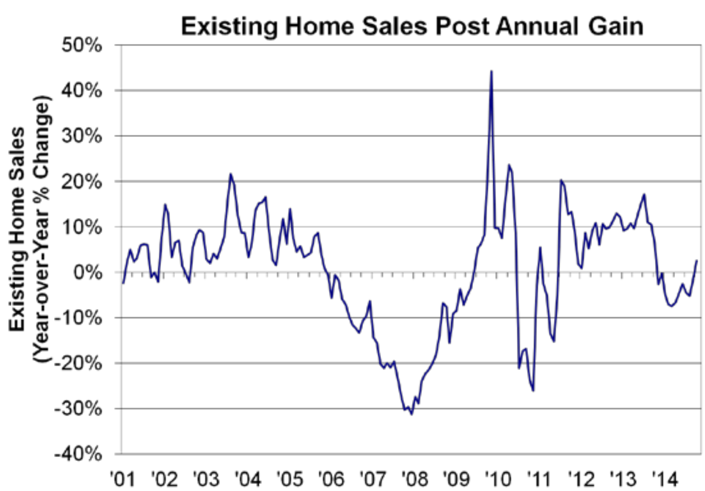
This week's housing data were largely upbeat. Home sales edged higher in October and have increased in six of the last seven months. Though the cumulative year-to-date total of home sales is down from the same period last year, October was the first month in the last 12 with a seasonally adjusted sales pace higher than the prior year. However, we continue to expect full-year 2014 sales to come in below the 2013 sales pace given the weak start to the year. Data on October residential construction was also positive on balance. Single-family housing starts and single-family building permits moved higher during the month and have trended up over the past four to six months, although both remain below their recovery peaks reached in November 2013. The upward movement has been modest but is still an improvement from the flat-lining we've witnessed for the better part of two years. Mortgage applications broke a stretch of three consecutive weekly declines, moving higher last week due to a surge in purchase demand—a welcome sign in light of the persistent downward trend in purchase mortgage applications witnessed over the past year and a half. According to Freddie Mac, the 30-year fixed mortgage rate ticked down 2 basis points to 3.99 percent.

- **Existing home sales** increased 1.5 percent in October to a seasonally adjusted annual rate of 5.26 million units, according to the National Association of REALTORS®. Homes available for sale declined for a third consecutive month, as is typical in the fall months following the summer selling season. The months' supply, or inventory/sales ratio, followed suit, edging down to a seven-month low of 5.1. Through the first 10 months of the year, existing home sales were down 3.8 percent compared to the same period last year. The median existing home price, unadjusted for sales composition, increased 5.5 percent on the year—the 32nd consecutive month of annual price growth. The cash sales share of home sales was 27 percent in October, down only modestly from the 31 percent reported for October 2013.

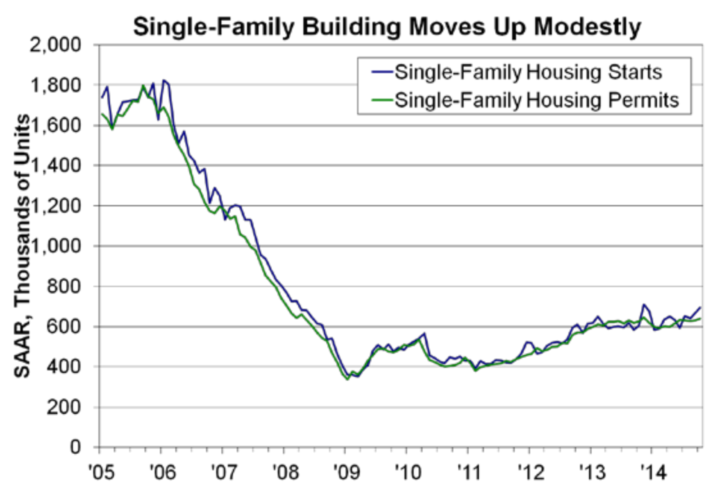
- **Housing starts** edged lower in October, falling 2.8 percent to a seasonally adjusted annual rate of 1.01 million units according to the Census Bureau. Multifamily housing starts declined 15.4 percent, driving the overall decline, while single-family starts increased by 4.2 percent for the second consecutive month. Through the first 10 months of the year, single-family housing starts were up 5.3 percent and multifamily starts were up 18.7 percent from the same period last year. Residential building permits increased 4.8 percent in October, due to a 1.4 percent gain in single-family and a 10.0 percent jump in multifamily permits.

- **The National Association of Home Builders (NAHB)/Wells Fargo Housing Market Index** increased 4 points in November to a reading of 58, following a 5 point decline the prior month. (A reading above 50 indicates more builders view the market as good than poor.) All three sub-components (current sales, sales expectations over the next six months, and buyer traffic) rebounded but failed to recover fully from the declines in October. Buyer traffic is the only component that remains below the threshold reading of 50, with a post-recession peak of 47 reached in September.

- **Mortgage applications** rose 4.9 percent in the week ending November 14, according to the Mortgage Bankers Association (MBA), boosted by the largest weekly gain in purchase mortgage applications in more than a year. Purchase applications jumped 11.7 percent to the highest level since early July. Refinance applications ticked up 0.9 percent while the average contract 30-year mortgage rate measured in the MBA survey ticked down one basis point to 4.18 percent.



Source: National Association of REALTORS®



Source: Census Bureau

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November 21, 2014