Fannie Mae

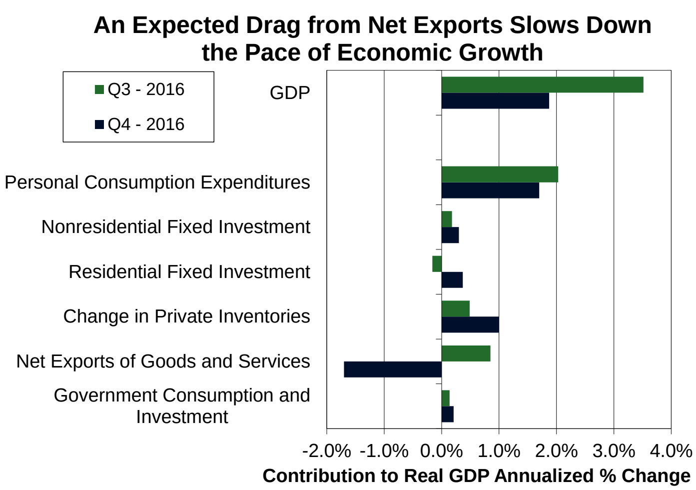
Economic and Strategic Research

Weekly Note – January 27, 2017

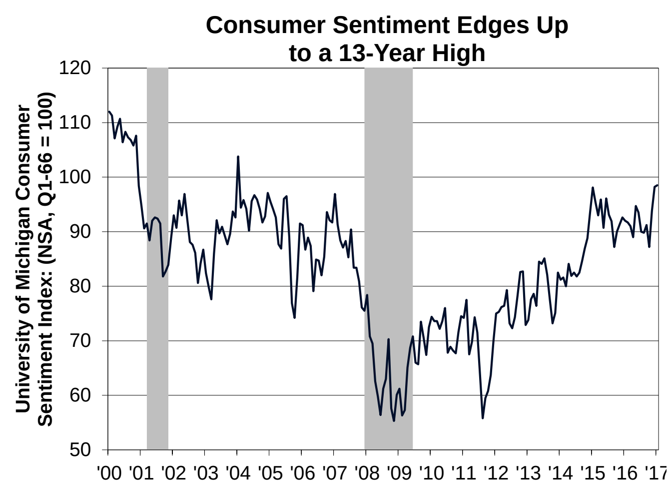
Economics: The Expansion Plods Along

The pace of economic growth slowed to 1.9 percent annualized in the fourth quarter in the initial estimate of gross domestic product (GDP). For the year, growth came in at the same pace, which is two-tenths percentage points below the expansion average of 2.1 percent. After an outsized rise in net exports in the third quarter due to a temporary surge in agricultural exports, net exports recorded the largest quarterly drop ever. The drag from net exports fully offset the contribution from consumer spending, which remains the largest contributor to growth. However, the pace of growth in spending has slowed in each of the past two quarters. Residential fixed investment contributed to growth for the first time in three quarters. Meanwhile, the volatile inventory investment component provided its largest addition since Q1 2015. Business fixed investment expanded modestly for the third consecutive quarter as the first expansion in equipment investment in five quarters and continued growth in intellectual property outweighed the drop in structures investment. Business investment in equipment looks set to continue its positive momentum in the first quarter, as core capital goods orders, a leading indicator for the GDP component, expanded for the third consecutive month in December. Durable goods orders in general fell due to a large drop in the volatile defense goods orders. The Conference Board's Leading Economic Index posted a large monthly jump in December, suggesting that the economy will continue to grow at a moderate pace in 2017. The increase was driven by improving sentiment about the economic outlook after the election. However, a post-presidential election rise in confidence is not unusual, and it is also not unusual for such measures to give back gains soon thereafter. However, so far, the boost in sentiment continued among consumers, as the University of Michigan index was revised upward in the final January reading to the highest level in 13 years, although the gain in January was much smaller than the large jumps from the previous two months.

- **Gross domestic product (GDP)**, adjusted for inflation, expanded at a 1.9 percent annualized pace in Q4 2016, according to the advance estimate from the Bureau of Economic Analysis (BEA), slowing from the 3.5 percent rate in the third quarter. Consumer spending added 1.7 percentage points but was countered by a 1.7 percentage point drag from net exports. Positive contributions from the other components led to the expansion in GDP during the quarter. For all of 2016, economic growth came in at 1.9 percent (Q4-over-Q4), tying 2015's pace of growth. The chained personal consumption expenditures (PCE) index rose 1.5 percent from a year ago, marking the fastest pace since Q3 2014, but the increase is still half of a percentage point below the Federal Reserve's target.
- **The University of Michigan Consumer Sentiment Index** edged up 0.3 points to 98.5 in the final January reading, A rise in the expectations component outweighed a drop in the current conditions component.
- **Durable goods orders** declined 0.4 percent in December, according to the Census Bureau. A large drop in defense aircraft orders drove the fall. Core capital goods orders, which exclude defense and aircraft items, rose 0.8 percent.
- **The Conference Board Leading Economic Index (LEI),** a gauge of the economic outlook over the next three to six months, increased sharply by 0.5 percent in December, marking the fourth consecutive monthly increase. The improvement was fueled by positive contributions from the yield spread, stock prices, and average consumer expectations for business conditions.
- **Initial claims for unemployment insurance** increased by 22,000 to 259,000 in the week ending January 21, according to the Department of Labor. The four-week moving average decreased by 2,000 to 245,500.



Source: Bureau of Economic Analysis



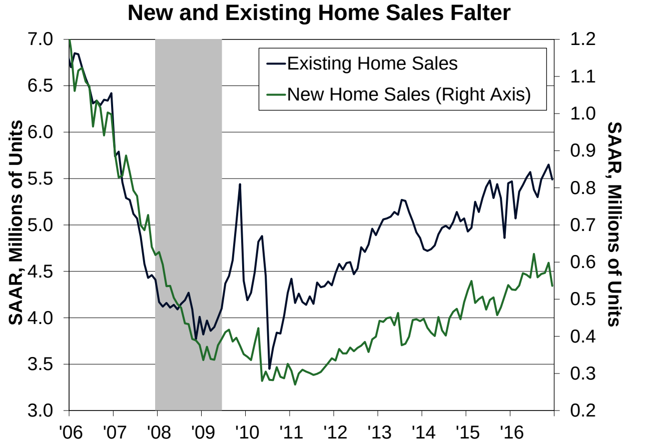
Source: University of Michigan

Housing: Sales Stumble into an Expansion Best in 2016

Housing data this week allowed for a full-year review of the home sales market in 2016. Existing homes sales posted the best annual performance since 2006. However, existing sales declined in December from a monthly expansion high in November. Inventory, on the other hand, continues to be a pain point for the market. The number of homes for sale has fallen year-over-year for 19 straight months and ended the year at the lowest level since 1999. The depressed level of inventory has maintained upward pressure on home prices, as the FHFA House Price Index, a repeat transaction index, has recorded four straight months of greater than six percent annual growth. The new home sales market has followed a similar path to the existing market in 2016, with the exception of inventory. On an annual basis, new homes sales also reached an expansion best but fell in December by a double digit percentage for only the second time in 2016. In contrast to December sales, the number of new homes for sale posted the largest monthly increase in over three years. The months' supply ratio rose to a 15-month high as a result of the drop in sales and the rise in inventory. The fall in sales for both the new and existing home markets during the month of December was in part a reaction to the post-election run up in mortgage rates, as dramatic increases in rates can act as an affordability shock and dampen home sales. After three weeks of declines, mortgage rates resumed an upward trend this week, rising 10 basis points to 4.19 percent. Mortgage demand reacted positively last week to the temporary respite from rising mortgage rates, as purchase applications jumped to a seven-month high and refinancing applications edged up, marking the fourth consecutive week of increases.

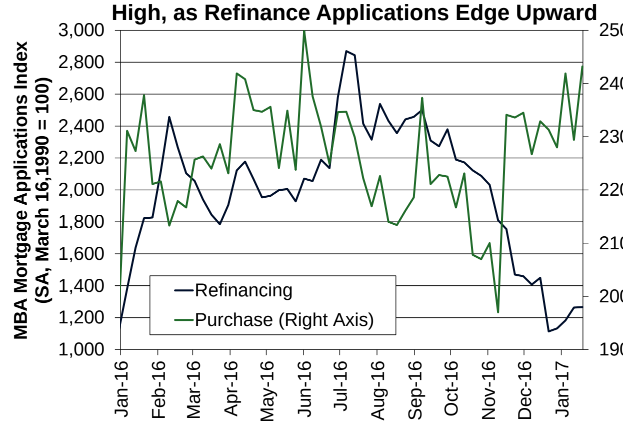
- **Existing home sales** fell 2.8 percent in December to a seasonally-adjusted annualized rate (SAAR) of 5.49 million units, according to the National Association of REALTORS®. Single-family sales fell 1.8 percent and condo/co-op sales dropped 10.3 percent. For all of 2016, home sales totaled 5.45 million, a 3.8 percent rise from 2015. The number of homes for sale, which is not seasonally adjusted, fell 6.3 percent year-over-year. The months' supply (inventory-to-sales ratio) dropped to 3.6 months, tying the lowest recorded level. The median existing home price, unadjusted for the composition of sales, rose 4.0 percent from a year ago.
- **New single-family home sales** declined 10.4 percent in December to a SAAR of 536,000 units, according to the Census Bureau. In 2016, new home sales rose 12.4 percent from the prior year to 563,000. New home sales in the prior three months were revised downward 11,000 on net. In December, sales fell in the Midwest, the South, and the West, outweighing the increase in the North, which hit a new expansion best for the region. The number of homes for sale jumped 4.0 percent from November and rose 10.2 percent from December 2015. The months' supply rose to 5.8 months, sixth-tenths above the level a year ago. The median sales price rose 7.9 percent year-over-year after falling 2.5 percent annually in November.
- **The FHFA Purchase-Only House Price Index**, reported on a seasonally-adjusted basis, edged up 0.5 percent in November. From a year ago, home prices rose 6.1 percent, moderating slightly from the 6.2 percent gain in October. Annual home price growth in New England and the Middle Atlantic reached new expansion highs.
- **Mortgage applications** improved 4.0 percent in the week ending January 20, according to the Mortgage Bankers Association. A 6.0 percent rise in purchase applications drove the gain, as refinance applications edged up 0.2 percent. The average 30-year fixed mortgage rate rose eight basis points to 4.35 percent.

New and Existing Home Sales Falter



Source: National Association of Realtors, Census Bureau

Purchase Applications Jump to a Seven-Month High, as Refinance Applications Edge Upward



Source: Mortgage Bankers Association

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