ESR Economic and Housing Weekly Note ***February 19, 2016***

Economics: Inflation Firms as Fed Waits for More Data before Further Tightening

This week's economic reports showed positive developments at the start of the year. Industrial production rebounded strongly in January, ending a four-month string of declines. The biggest jump in utility output in almost nine years drove the increase, as the weather turned more seasonal following the record warm December. It wasn't all about the weather, however. Manufacturing output, which accounts for about two-thirds of overall industrial production, also recovered after back-to-back drops. The January gain sent manufacturing output to tie for an expansion high, although it remains about 3.0 percent below its pre-recession peak. Underlying, or core, inflation jumped in January for both the retail and wholesale segments. Notably, the year-over-year change in core retail prices has trended up in recent months, reaching the highest level in three and a half years. The firming of underlying price trends supports the Fed's notion that inflation would gradually return to the target once the impacts of declining energy prices and the strong dollar dissipate. The minutes from the January Federal Open Market Committee meeting showed that Fed officials were concerned with increased downside risks associated with the recent tightening in financial conditions and the possibility of slower global growth. Overall, the minutes suggested that before the Fed tightens further, it would like to see more information to assess the impact of recent developments on the growth and inflation outlooks. We believe this week's reports are in line with our latest forecast that the Fed will stay on the sidelines at its March meeting before raising the fed funds rate twice by the end of 2016. Lastly, a gauge of near-term economic outlook from the Conference Board fell in January for the second consecutive month, pointing to continued modest economic expansion.

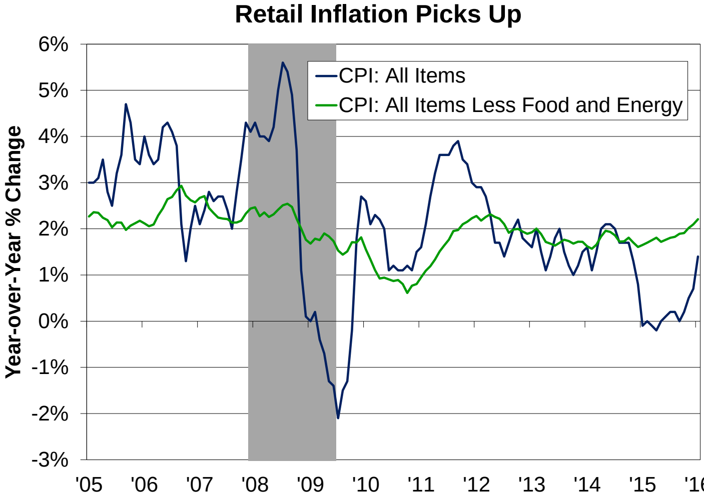
- **The Consumer Price Index (CPI)** was unchanged in January, weighed down by the drop in energy prices. The core index (excluding food and energy items) rose 0.3 percent, the biggest increase since August 2011. The gain was broad-based, with sharp increases in apparel and airfare. Shelter costs also accelerated. From a year ago, core prices rose 2.2 percent, the strongest increase since June 2012. **The Producer Price Index (PPI)** for final demand edged up 0.1 percent in January, only the second increase in the past six months. Goods prices fell 0.7 percent for the second consecutive month, while prices for services rose 0.5 percent. The core PPI moved up 0.4 percent from December and 0.6 percent from a year ago. The Bureau of Labor Statistics produces both series.

- **Industrial Production**, a gauge of output in the manufacturing, utility, and mining sectors, rose 1.1 percent in January, according to the Federal Reserve Board. Utility output surged 5.4 percent, while manufacturing output was up 0.5 percent, driven by an increase in motor vehicle assemblies. Mining output was flat after declining for four consecutive months.

- **The Conference Board Leading Economic Index (LEI)** declined for a second consecutive month in January, dropping 0.2 percent. Stock prices and weekly initial jobless claims led the drop. In the six months ended in January, the LEI increased 0.7 percent at an annualized rate, slowing slightly from December's gain.

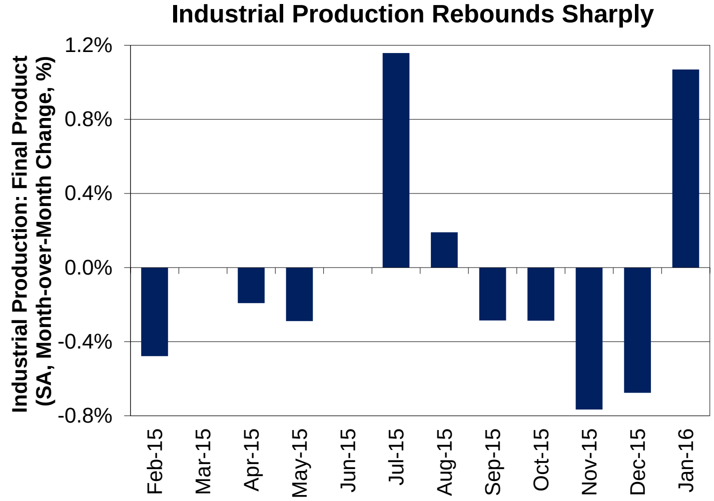
- **Initial claims for unemployment insurance** decreased by 7,000 to 262,000 in the week ending February 13, according to the Department of Labor. This marks the lowest level of claims since late November 2015. The four-week moving average decreased by 8,000 to 273,000, the best performance since mid-December.

Retail Inflation Picks Up



Source: The Bureau of Labor Statistics

Industrial Production Rebounds Sharply



Source: The Federal Reserve Board

Housing: Single-Family Building Activity and Builders' Sentiment Soften

This week's housing indicators showed that both single-family and multifamily starts declined in January for the third time over the last four months. Leading indicators were mixed: Single-family permits dropped while multifamily permits rose slightly. Builders' moods appeared to be consistent with the lackluster construction data, as a gauge of their confidence from the National Association of Home Builders has trended down since reaching its expansion-high last October, falling in February for the third time over the last four months to the lowest level since May 2015. Details showed that builders were less optimistic about present sales and potential buyer traffic, but were slightly more optimistic about sales over the next six months. Builders noted increased consumer concern over the price of new homes relative to existing homes and reported that they face higher costs for labor, land, and materials. The timely weekly mortgage applications showed cooling purchase mortgage demand, with applications falling last week to the lowest level since the start of 2016. By contrast, refinance applications rose for the sixth consecutive week to the highest level since January 2015 amid the lowest mortgage rates since last April. Rates held steady this week, with the average 30-year fixed mortgage rate in the Freddie Mac survey remaining at 3.65 percent. News was largely upbeat on the mortgage performance front. The Mortgage Bankers Association reported that both the overall delinquency rate and the serious delinquency rate for the overall mortgage market fell in the fourth quarter of 2015 to pre-recession levels, while the rate at which new foreclosures were started, which closely links to labor market conditions, decreased to the lowest reading since 2003. Notably, out of 12 states that posted an increase in foreclosure starts, five are oil-dependent economies — Oklahoma, North Dakota, Louisiana, Colorado, and Texas.

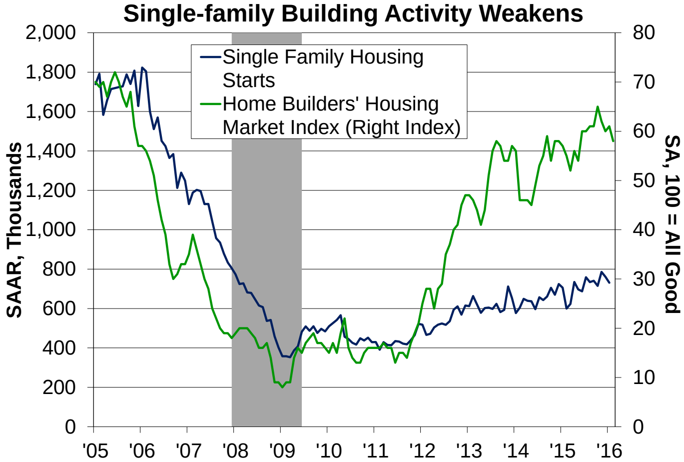
- **Housing starts** fell 3.8 percent in January, according to the Census Bureau. Single-family starts declined 3.9 percent to 731,000 units annualized, compared with a 3.7 percent drop in multifamily starts to 368,000 units. Single-family permits fell 1.6 percent to 720,000 units; multifamily permits rose 2.1 percent to 482,000 units.

- **The National Association of Home Builders (NAHB) / Wells Fargo Housing Market Index** fell three points in February to 58. (A reading of more than 50 indicates that more builders view housing market conditions as good rather than poor.) The component assessing prospective buyer traffic fell five points to 39, the lowest level since May 2015, while the present sales conditions component fell three points to 65. Future sales expectations edged up one point to 65.

- **The Mortgage Bankers Association National Delinquency Survey** showed that the overall mortgage market delinquency rate for mortgage loans on one-to-four-unit residential properties decreased to a seasonally adjusted rate of 4.77 percent of all loans outstanding at the end of Q4 2015, the lowest level since Q3 2006. The foreclosure starts rate dipped to 0.36 percent, only one-fourth of the record-high level set during the worst of the foreclosure crisis in Q2 2009.The serious delinquency rate, which includes the percentage of loans that are 90 days or more past due or in the process of foreclosure and is not seasonally adjusted, was 3.44 percent, the best reading since Q3 2007.

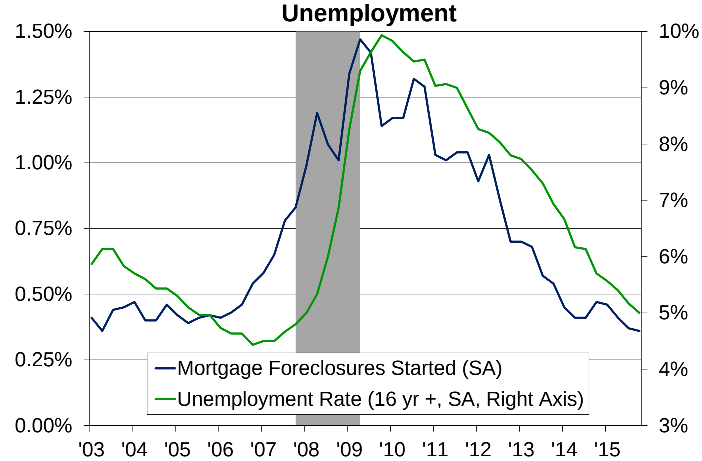
- **Mortgage applications** rose 8.2 percent in the week ending February 12, according to the Mortgage Bankers Association. Purchase applications fell 3.7 percent, the second drop in the last three weeks. Refinance applications rose 16 percent, the fifth double-digit increase over the past six weeks. The refinance share of the number of loan applications increased to 64.3 percent, the highest level since February 2015. The average contract interest rate for 30-year fixed-rate mortgages decreased eight basis points to 3.83 percent, the lowest level since April 2015.

Builders' Confidence Moves Lower as Single-family Building Activity Weakens



Source: Census Bureau, the National Association of Home Builders

New Foreclosures Trend Lower Amid Declining Unemployment



Source: The Mortgage Bankers Association, Bureau of Labor Statistics

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