Fannie Mae

Economic and Strategic Research

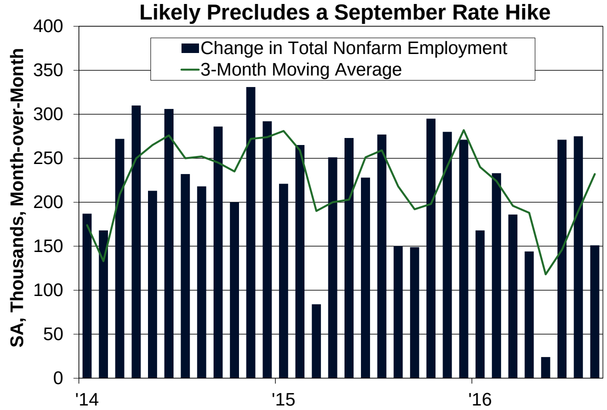
Weekly Note – September 2, 2016

Economics: Job Growth Comes Up Short for the Fed

Despite recent attempts by Fed officials to convince the market that economic conditions are ripe for a rate hike, we believe that the August jobs report did not pass the high bar needed for a fed funds rate increase this month. Headline hiring slowed markedly from the prior two months amid weakening earnings growth and a declining workweek. However, by itself this is not a weak report given that only about 100,000 jobs need to be added monthly to hold the unemployment rate, which has not changed in three months, constant. Fed funds futures' odds of a September rate hike fell by more than half immediately following the report to 12 percent, but later rebounded to the low 20 percent range. Other data suggest caution for the Fed. The Fed's preferred measure of inflation—annual growth in the personal consumption expenditures deflator—slipped in July to the slowest pace since March. A survey of purchasing managers showed the manufacturing sector surprisingly contracted in August after expanding for the previous five months. Vehicle sales also pulled back sharply in August. Productivity growth continues to struggle, falling year-over-year in the second quarter for the first time in three years. However, news on the consumer front was positive. Real personal income posted the largest increase of the year in July amid a solid rise in real consumer spending and the first increase in the saving rate in four months. Consumer confidence hit an 11-month high in August. The trade picture also brightened, with the trade deficit narrowing in July, driven by the largest increase in exports since March 2014 and the first drop in imports in four months.

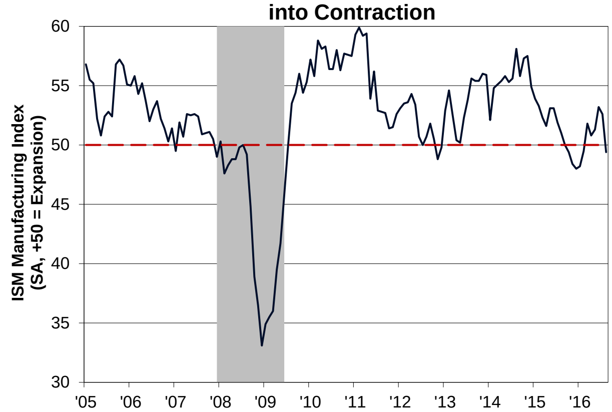
- **Nonfarm payroll employment** expanded by 151,000 in August, according to the Bureau of Labor Statistics. The three-month average change rose to 232,000 from 190,000 in June. The unemployment rate was flat at 4.9 percent, as the participation rate was also unchanged at 62.8 percent. Average hourly earnings edged up 0.1 percent from the prior month, and rose 2.4 percent from a year ago. The average workweek slipped one-tenth to 34.3 hours. The broadest measure of the unemployment rate (U-6) remained at 9.7 percent.
- **Personal income**, adjusted for inflation, increased 0.4 percent in July, according to the Bureau of Economic Analysis. Real personal consumption expenditures (PCE) rose 0.3 percent. The personal saving rate ticked up two-tenths to 5.7 percent. The PCE deflator was flat during the month and increased 0.8 percent year-over-year. Excluding food and energy, the core PCE deflator edged up 0.1 percent from June, and 1.6 percent from a year ago.
- **Nonfarm business productivity** declined 0.6 percent in Q2 2016, according to the Bureau of Labor Statistics, a one-tenth downward revision from the initial estimate. On an annual basis, productivity decreased 0.4 percent. With compensation rising 2.2 percent from a year ago, unit labor costs rose 2.6 percent.
- **The Institute for Supply Management (ISM) Manufacturing Index** dropped 3.2 points in August to hit 49.4 (any reading above 50 indicates expansion). The decline was widespread as every component fell during the month.
- **The Conference Board Consumer Confidence Index** rose 4.4 points to 101.1 in August. Both the present situation and expectations components rose, with the former climbing to a nine-year high.
- **Light vehicle sales** fell 5.0 percent to a 17.0 million annualized rate in August, according to Autodata.
- **The U.S. trade deficit** narrowed $5.2 billion in July to $39.5 billion, according to the Census Bureau. Exports rose for a second straight month while imports fell. The inflation-adjusted goods deficit, used in the calculation of net exports in the GDP estimate, narrowed $6.3 billion to $58.2 billion.
- **Factory orders** improved 1.9 percent in July, according to the Census Bureau. Nondurable goods, the new piece of news in the report, fell 0.5 percent. Both core capital goods orders and shipments saw negligible revisions.

A More Measured Pace of Job Creation Most Likely Precludes a September Rate Hike



Source: Bureau of Labor Statistics

Manufacturing Sector Surprisingly Falls Back into Contraction



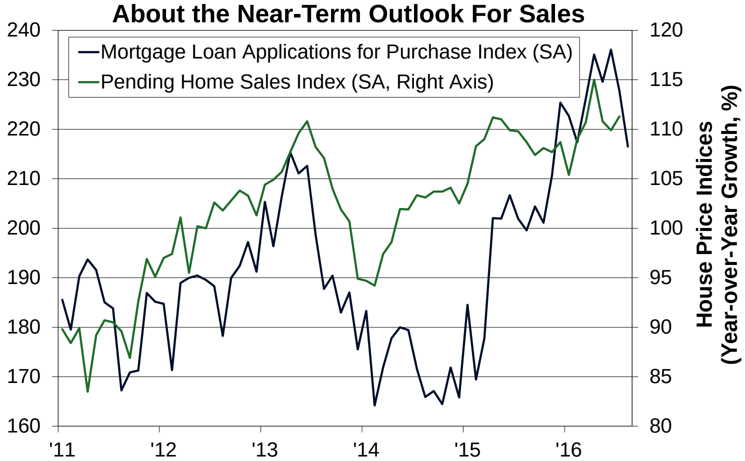
Source: Institute for Supply Management

Housing: Mixed Messages on Future Home Sales

The week's housing news was on the bearish side. The pending home sales index increased in July, marking the first gain in three months; however, the June figure was revised down from a slight gain to a modest decline. Separate data on mortgage purchase applications fell in July and August, pointing to some weakening in home sales in coming months. The S&P/Case Shiller national house price index showed continued strong annual gains, thanks to lean inventory. The annual gain in the index held at 5.1 percent in June for the fourth consecutive month, consistent with other home price measures including the FHFA and CoreLogic House Price Indices. Last but not least, the construction spending report points to downbeat residential investment for the current quarter, as spending for both new single-family and multifamily structures declined at the start of the third quarter. This bodes poorly for residential investment this quarter, and is particularly discouraging given that residential investment subtracted 0.3 percentage points from economic growth last quarter. Mortgage rates ticked up this week in response to hawkish speeches from Fed officials, including the remark from Chair Yellen calling for a rate hike sometime this year. Freddie Mac's survey showed that the rate on the 30-year fixed-rate mortgage rose three basis points to 3.46 percent, staying within the narrow range of 3.41 to 3.48 percent observed over the past 10 weeks.

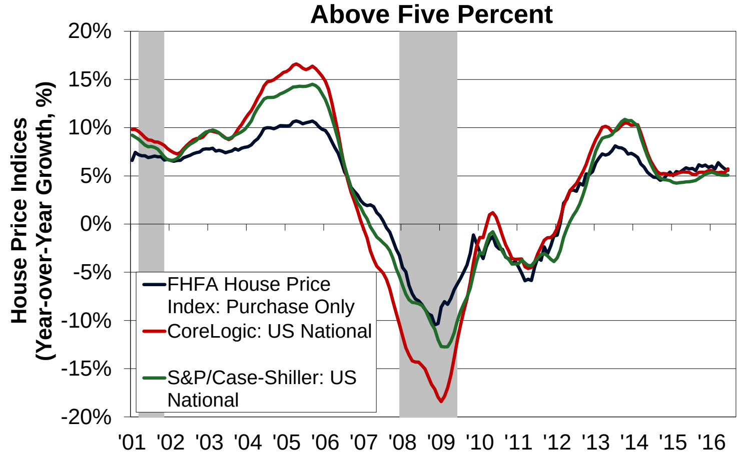
- **Private residential construction spending** rose 0.3 percent in July, according to the Census Bureau. This marks the first rise in four months, solely because of the increase in the home improvement component. Spending on new single-family construction ticked down 0.2 percent, the fifth consecutive monthly decrease. Spending on multifamily structures fell for the second straight month and the third time over the last four months, declining 0.6 percent.
- **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, rose 1.3 percent in July, sending the index to the second highest level of the expansion. The increase was concentrated in the West, where sales jumped 7.3 percent. Sales edged up 0.8 percent in the South and Northeast and fell 2.9 percent in the Midwest.
- **The S&P/Case-Schiller National Home Price Index** (not seasonally adjusted) rose 1.0 percent in June. From a year ago, the index increased 5.1 percent for the fourth consecutive month. Annual home price appreciation has been greater than 5.0 percent since last November. Annual price gains decelerated slightly to 4.3 percent and 5.1 percent, respectively, for the 10-city and 20-city composite indices. Home price appreciation was the fastest in Portland and Seattle and the slowest in New York and Washington, D.C.
- **Mortgage applications** increased 2.8 percent for the week ending August 26, according to the Mortgage Bankers Association. Purchase mortgage originations rose 1.3 percent while refinance applications increased 3.7 percent. The average contract interest rate for 30-year fixed-rate mortgages remained unchanged at 3.67 percent.

Leading Indicators Send Mixed Messages About the Near-Term Outlook For Sales



Source: Mortgage Bankers Association, National Association of REALTORS®

Annual House Price Growth Hovers Slightly Above Five Percent



Source: CoreLogic, FHFA, and S&P

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