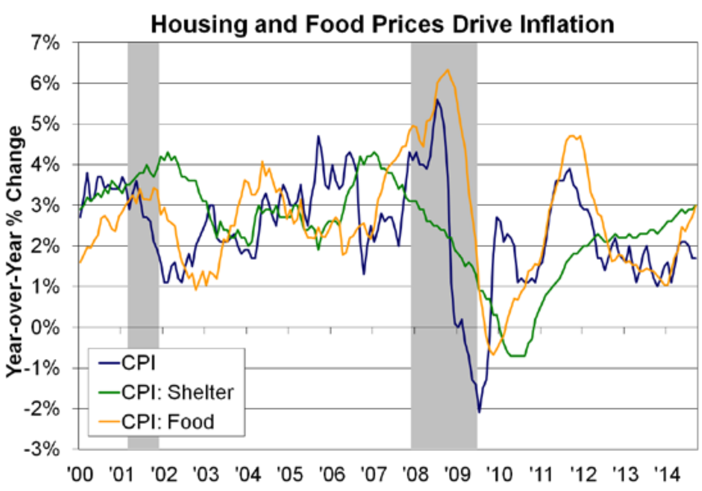
Economics: Markets Take a Breather Ahead of Next Week's FOMC Meeting

One week before the Federal Open Market Committee (FOMC) delivers its October 29th policy statement, in which we expect it to announce the conclusion of QE3 and perhaps provide further hints regarding the timing of the first rate hike since 2004, data on September retail prices depicted a dormant inflationary trend. The recent strengthening of the dollar and decline in global oil prices have no doubt contributed to the subdued inflation outlook, and with crude oil prices down more than 10 percent from the average September price at the time of this writing, a further moderation in headline inflation in the near-term seems likely. The Fed will have to balance a tepid inflation outlook with increasing evidence of a stronger trend in U.S. growth and employment. Strength in the Conference Board index of leading indicators in September suggested that the flat reading in August 2014 was likely a fluke, while layoffs as measured by initial jobless claims continue to hover near 14-year lows. Markets settled down this week after a volatile two-week stretch in global financial markets, with a rebound in domestic and European equities and a modest rally in Eurozone sovereign debt, though yields in Spain, Italy, and others remained elevated compared to earlier this month. The 10-year Treasury yield opened Friday morning near 2.25 percent, a bit higher than last week's close of 2.22 percent.

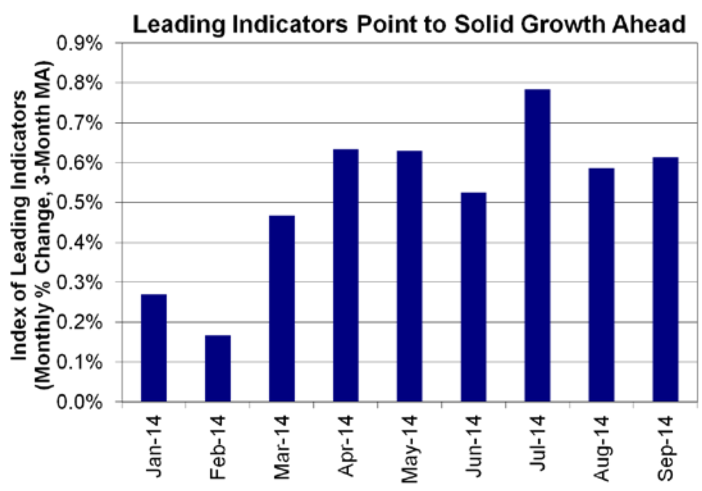
- **The Consumer Price Index (CPI)** increased 0.1 percent in September after a 0.2 percent drop in the prior month as increases in food and other prices offset a 0.7 percent drop in energy prices. Core CPI, which excludes the volatile food and energy categories, edged up 0.1 percent largely due to rising shelter costs, as rent increases accelerated amid moderating home price growth. Over the past 12 months, both headline CPI and core CPI are up 1.7 percent for the second consecutive month.

- **The Conference Board Index of Leading Indicators**, a gauge of economic growth in the next three to six months, rebounded in September, increasing 0.8 percent after a flat reading in August. Nine of the 10 components of the index improved on the month, with a small decline in consumer expectations acting as the lone drag. The three-month moving average was unchanged at 0.6 percent in September, suggesting continued solid growth to round out 2014.

- **Initial claims for unemployment insurance** increased 17,000 to 283,000 in the week ending October 18, according to the Department of Labor. However, the four-week moving average fell 3,000 to 281,000—the lowest since May 2000. Continuing claims also have trended lower this year, with the four-week moving average falling to the lowest level since May 2006 at 2.38 million in the week ending October 11.



Source: Bureau of Labor Statistics



Source: Conference Board

Housing: Home Sales Recovery Interrupted but not Derailed

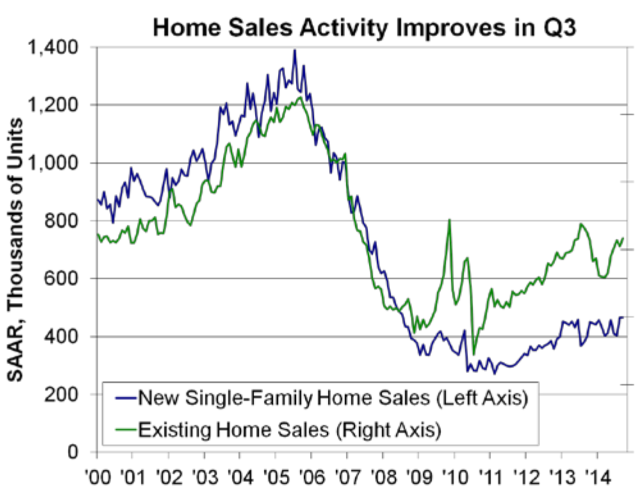
This week's housing and mortgage indicators are in line with our forecast, calling for a decline in total home sales of roughly 3.0 percent in 2014, marking the first annual drop in five years. While existing home sales increased in September for the fifth time over the last six months to the strongest pace in a year, they likely can't overcome the steep drop witnessed during the first quarter. Meanwhile, new home sales have bounced around from month to month this year without showing a meaningful upward trend. Through the first three quarters of 2014, existing home sales were 4.8 percent below the level during the same period last year, compared with a 2.4 percent gain for new home sales, the latter of which accounts for a small fraction of total home sales. Declining mortgage rates, with Freddie Mac's average yield on the 30-year fixed mortgage rate remaining at sub-4.0 percent for the second consecutive week, should provide a catalyst for increased home sales and purchase mortgage demand going into 2015. Combined with our expectations of continued improving labor market conditions, rising inventories, and some easing of lending standards, we expect home sales to rise roughly 5.0 percent in 2015, which would be the highest turnover since 2007. Recent declines in rates already have revived refinance mortgage demand, providing an upside to the outlook for the mortgage industry in late 2014 and early 2015.

➢ **Existing home sales** rose 2.4 percent in September to 5.17 million annualized, more than offsetting the 1.8 percent drop in August, according to the National Association of REALTORS®. For the third quarter, their data show total home sales increased 5.2 percent from the prior quarter. The months' supply (not seasonally adjusted) fell to 5.3 in September, the lowest reading in six months. Median home prices in September, which can be biased from the mix of sales, were 5.6 percent higher than a year ago. Sales increased during the month in all regions except the Midwest, with the South the only region to post a year-over-year gain.

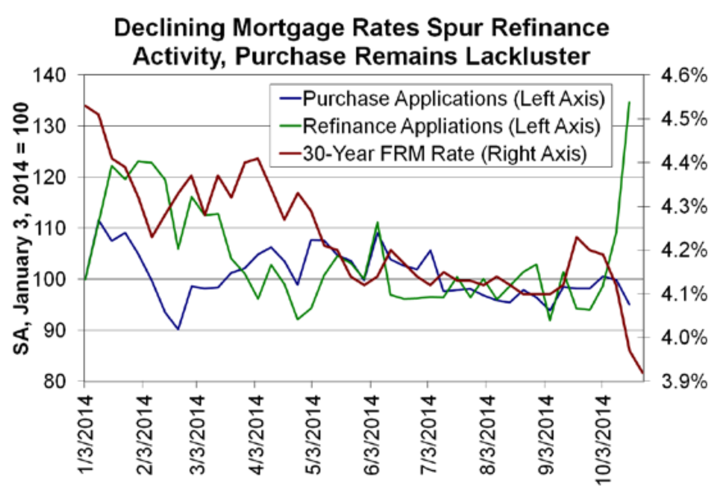
➢ **New single-family home sales** edged up 0.2 percent in September to 467,000 units annualized, according to the Census Bureau. The August sales total was revised down sharply from 504,000 to 466,000, leaving the September sales pace at the highest level since July 2008. Even with downward revisions, average sales for the third quarter rose 4.5 percent—the first quarterly gain this year. Regionally, the Midwest and the South showed monthly increases, while all four showed year-over-year gains. The months' supply (seasonally adjusted) was 5.3 in September, unchanged from August but down slightly from a year ago. The median sales price was down 4.0 percent from last September.

➢ **The FHFA purchase-only home price index** (reported by FHFA on a seasonally adjusted basis) increased 0.5 percent in August from July and 4.8 percent from August 2013. Year-over-year gains have moderated from 7.4 percent at the start of the year, similar to trends in other home price measures. Prices posted month-to-month gains in seven of nine Census divisions, with New England and the South Atlantic recording declines. From a year ago, prices rose in all nine divisions, ranging from 2.0 percent in the Middle Atlantic to 7.9 percent in the Pacific.

➢ **Mortgage applications** jumped 11.6 percent for the week ending October 17, boosted by refinance activity as the average contract rate for 30-year fixed-rate mortgages decreased 10 basis points to 4.10 percent, the lowest level since May 2013, according to the Mortgage Bankers Association. The refinance index increased 23.3 percent to the highest level since November 2013, with the average loan balance rising to a record high. The purchase index decreased 4.8 percent, pushing the refinance share of mortgage activity up to 65 percent of total applications, the highest since last December.



Source: Census Bureau, National Association of REALTORS®



Source: Mortgage Bankers Association, Freddie Mac

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