Fannie Mae

Economic and Strategic Research

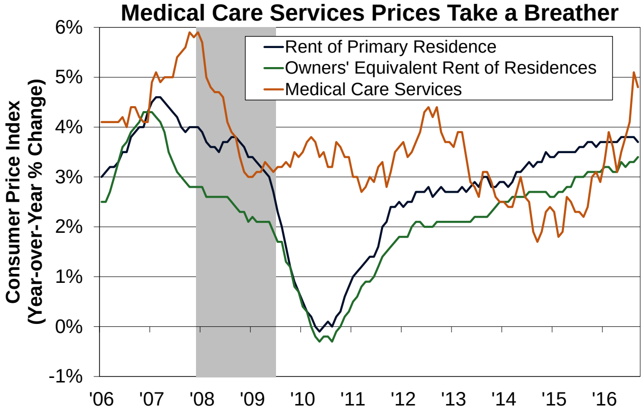
Weekly Note – October 21, 2016

Economics: Shelter Costs Continue to Boost Retail Prices

This week's inflation news echoed last week's pickup in wholesale inflation in September. Just as declining energy prices weighed on headline CPI for much of last year, rising energy prices drove the headline CPI higher in September. Meanwhile, core prices rose only slightly during the month, and the year-over-year gain remains within the narrow range between 2.1 percent and 2.3 percent witnessed since December 2015. Core goods deflation continued, with prices declining for the sixth time over the last seven months, while the gain in core services prices moderated, as medical care services prices were flat following strong increases in recent months. The annual increase in medical care service prices edged down from an expansion high in August. Meanwhile, shelter costs continued to firm in September, with the year-over-year gain in Owner's Equivalent Rent (estimated rents homeowners would get if they rented their homes in a competitive market) reaching an expansion high. Industrial production improved in September as the gains in manufacturing and mining output outweighed the drop in utility output. The increase in mining output showed that the sector is starting to recover in response to the recent rebound in energy prices and is consistent with data on active drilling rigs, which suggest that mining structures investment likely rebounded in the third quarter after dragging on economic growth over the past couple of years. Lastly, the Leading Economic Index, a gauge of the economic outlook over the next three to six months, rebounded in September, suggesting continued moderate growth through early next year.

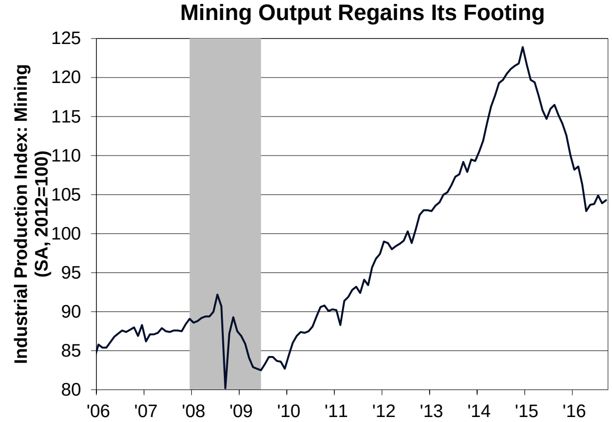
- **The Consumer Price Index (CPI)** rose 0.3 percent in September, driven by a jump in energy prices, according to the Bureau of Labor Statistics. The annual gain in the headline index picked up 0.4 percentage points to 1.5 percent, the biggest increase since October 2014. Excluding food and energy items, core prices edged up just 0.1 percent from August. From a year ago, the core CPI was up 2.2 percent, moderating from 2.3 percent in the prior month. Core goods prices fell 0.1 percent during the month, while core services prices rose 0.2 percent, moderating from their recent trends. Medical care services prices were unchanged after jumping 1.0 percent in the prior month, but are up 4.8 percent from a year ago. Owner's Equivalent Rent surged 0.4 percent, the biggest rise since 2006, and tenants' rent rose 0.3 percent. From a year ago, the former rose 3.4 percent, the biggest annual gain since May 2007, while the latter ticked down to 3.7 percent.
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, ticked up 0.1 percent in September, according to the Federal Reserve Board. Utility output fell 1.0 percent, the largest drop since March. Manufacturing output, which accounted for nearly 80 percent of the total output, rose 0.2 percent, partially reversing the 0.5 percent drop in the prior month. Mining output rose 0.4 percent.
- **The Conference Board Leading Economic Index (LEI)** rose 0.2 percent in September, reversing August's decline. Five out of ten components made positive contributions: Average weekly initial claims for unemployment insurance, building permits, interest rate spread, manufacturers' new orders of consumer goods and materials, and average consumer expectations for business conditions. Negative contributions came from the average workweek of production workers in manufacturing, the ISM new orders index, manufacturers' new orders of nondefense capital goods excluding aircraft, stock prices, and the leading credit index.
- **Initial claims for unemployment insurance** increased by 13,000 to 260,000 in the week ending October 15, according to the Department of Labor. The four-week moving average increased by 2,300 to 251,750.

Shelter Costs Boost Core Inflation While Medical Care Services Prices Take a Breather



Source: Bureau of Labor Statistics

Mining Output Regains Its Footing

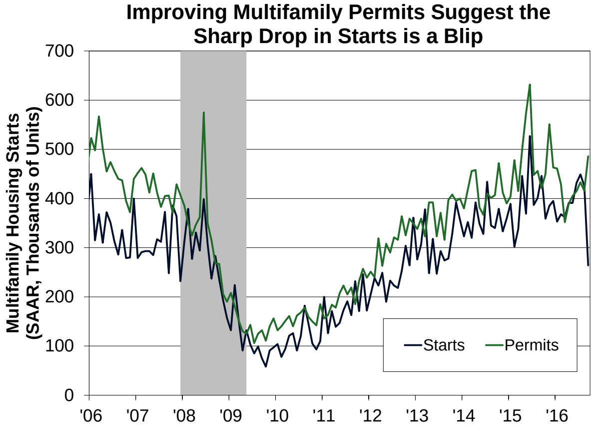


Source: Federal Reserve Board

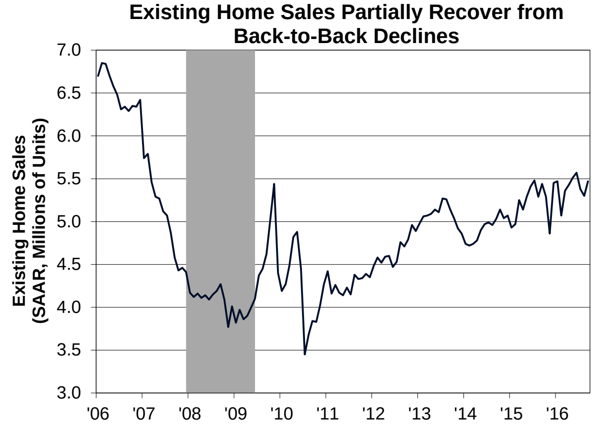
Housing: Good News Hides Beneath the Surface

The housing market took a step toward steadying the ship this week, as volatile multifamily data tempered good news for the single-family sector. Total housing starts declined for the second consecutive month, driven entirely by the largest drop in multifamily starts since April 2009. The multifamily sector has suffered from a backlog of building, as the gap between multifamily units under construction and units completed is at its widest level on record. However, multifamily permits rose for the fifth time over the past six months to reach a 10-month high, suggesting improvement for the sector in coming months. The good news in the report came from single-family starts, which rose to a seven-month high after increasing in three of the past four months. During the third quarter, single-family starts edged up 0.5 percent after falling 4.5 percent in the second quarter. Home builders' confidence fell slightly, weighed down by assessments of current sales and of prospective buyer traffic. However, expectations for sales over the next six-months reached a 12-month high. Housing also received another dose of good news from the existing home sales market, as total existing home sales bounced back in September from back-to-back declines. The gain was nationwide, with sales in all four census regions rising for the first time since March. For the third quarter, sales dropped slightly from the expansion high reached in the second quarter. Lean inventory remains a thorn in the side of the existing home market, as the number of homes available for sale fell year-over-year for the 16th consecutive month. Mortgage demand was relatively unchanged last week, as purchase applications rose for the first time in three weeks and refinancing applications declined for a second straight week. Refinancing demand remains under pressure, as the average 30-year fixed mortgage rate rose five basis points for the second consecutive week to reach 3.52 percent, marking the highest level since the end of June.

- **Housing starts** fell 9.0 percent in September to 1.05 million annualized units, according to the Census Bureau. Multifamily starts dropped 38.0 percent to 264,000 units, while single-family starts rose 8.1 percent to 783,000 units. Through the first nine months of the year, single-family starts are 8.6 percent higher than the same period a year ago, while multifamily starts are 5.2 percent lower. New residential permits increased 6.3 percent to 1.23 million annualized units. Single-family permits edged up 0.4 percent, while multifamily permits jumped 16.8 percent. On a year-to-date basis, single-family permits are up 7.4 percent and multifamily permits are down 12.4 percent.
- **Existing home sales** rose 3.2 percent to 5.47 million annualized units in September, according to the National Association of REALTORS®. Year-to-date sales are 3.2 percent higher than the same period a year ago. The number of homes for sale (not seasonally adjusted) fell 6.8 percent from a year ago. The months' supply of homes (inventory to sales ratio) was 4.5 months, down three-tenths from September 2015. The median price, which does not control for changes in the mix of sales, rose 5.6 percent year-over-year.
- **The National Association of Home Builders/Wells Fargo Housing Market Index** slipped two points to 63 in October. A reading above 50 indicates more builders view the single-family market as "good" rather than "poor". The present sales and traffic of prospective buyers components fell, while sales expectations rose for a second month.
- **Mortgage applications** edged up 0.6 percent for the week ending October 14 after dropping sharply the prior week, according to the Mortgage Bankers Association. Purchase applications rose 3.0 percent, more than offsetting the prior week's fall. Refinancing applications slipped 0.8 percent, as the average 30-year fixed mortgage rate rose five basis points to 3.73 percent.



Source: Census Bureau



Source: National Association of REALTORS®

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