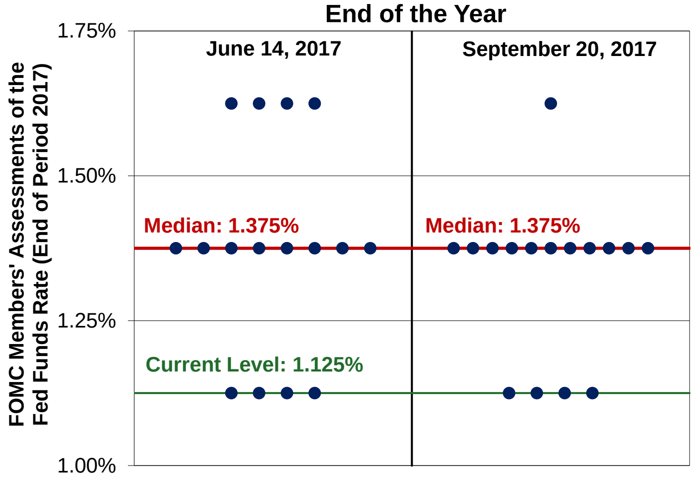
Weekly Note – September 22, 2017

Economics: Let the Balance Sheet Reduction Begin!

This week's key piece of news came with the release of the statement and updated economic projections following the Federal Open Market Committee (FOMC) meeting. As expected, the FOMC left the federal funds rate unchanged; however, the "dot plot" of Fed officials' assessment of the appropriate target level for the fed funds rate showed that the majority of officials still call for another rate hike by the end of 2017. The FOMC also announced a change in the balance sheet reinvestment policy, effective in October, to allow $6 billion of Treasury securities and $4 billion of agency debt and agency mortgage-backed securities to mature each month without being replaced. The cap on the monthly reduction will increase over time, reaching a maximum of $50 billion combined being allowed to roll off each month. The policy change has been well telegraphed through previous FOMC statements, meeting minutes, and Fed officials' speeches. The Fed's intention is to gradually shrink its balance sheet in the background and be as "exciting as watching paint dry", as Fed Chair Yellen noted in her press conference following the June FOMC meeting. The markets reacted relatively calmly to the tapering announcement and the dot plot, as the 10-year Treasury yield rose 4 basis points immediately following the release of the statement and implementation notice, but fell back 2 basis points to 2.26 percent at the time of this writing. In other news this week, The Conference Board Leading Economic Index increased in August for the 12th consecutive month to reach a new all-time high. According to the Conference Board, recent trends in the index suggest that the economy will continue to grow and perhaps improve at a moderately faster pace during the rest of the year. Positive contributions from building permits, the yield spread, and consumer expectations for business conditions more than offset the negative effect of initial claims for unemployment insurance. On the inflation front, import prices rose for the first time in four months in August, boosted by the strongest monthly gain in fuel prices since January, although nonfuel prices also posted a moderate gain during the month. Finally, initial claims for unemployment insurance fell last week for the second consecutive week as claims begin to normalize following a spike from Hurricane Harvey. However, claims could jump again when data reflecting the effects of Hurricane Irma are released next week.

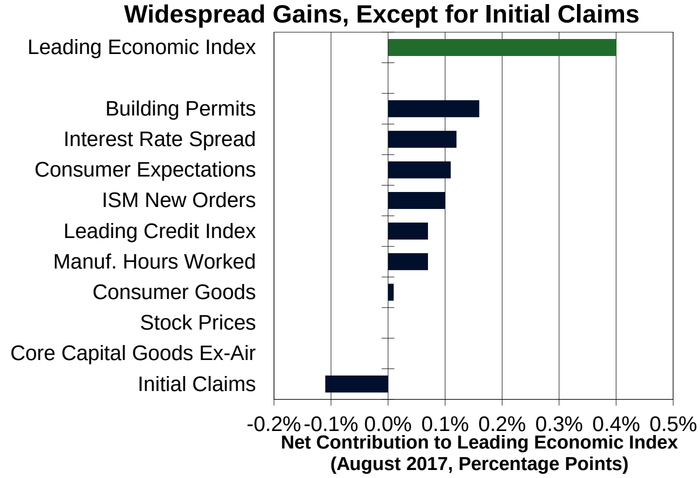
- **The Conference Board Leading Economic Index (LEI),** a gauge of the economic outlook over the next three to six months, increased 0.4 percent in August, following a 0.3 percent rise in July and a 0.6 percent gain in June. In the six-month period ending August 2017, the LEI increased 2.3 percent, an improvement from its growth of 2.0 percent during the previous six months.
- **Import prices** rose 0.6 percent in August, according to the Bureau of Labor Statistics. Nonfuel prices increased 0.3 percent from a month ago and 1.0 percent from a year ago. Petroleum and petroleum products rose 4.8 percent during the month and 15.8 percent year-over-year.
- **Initial claims for unemployment insurance** decreased by 23,000 to 259,000 in the week ending September 16, according to the Department of Labor. The four-week moving average increased by 6,000 to 268,750.

FOMC Still Projects One More Rate Hike by the End of the Year



Source: Federal Reserve Board

Leading Economic Index Improves Again After Widespread Gains, Except for Initial Claims



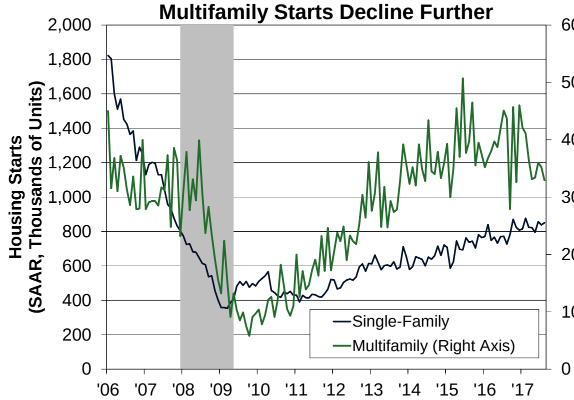
Source: Conference Board

Housing: Net Worth Rises, Starts and Existing Sales Falter

Housing data featured good news for households and disappointing news for home construction and existing home sales. The Federal Reserve reported household net worth reached a new record high in the second quarter, boosted by gains in home prices and stocks. Homeowners' equity as a share of real estate value reached the highest level since the first quarter of 2006. Total housing starts declined in August for the fifth time in six months. Multifamily starts continued to struggle, falling to a nine-month low. However, a recent rebound in multifamily permits, which reached the highest level since October 2016, suggests the recent slide in multifamily building might reverse in the near-term. Single-family starts, in contrast, edged up during the month, but permits slipped. The sluggishness of home construction seems to be taking its toll on builders' confidence, as the National Association of Home Builders Housing Market Index fell year-over-year for the first time in over a year in September. Existing home sales fell in August for the third consecutive month to hit a 12-month low. Existing home sales have been constrained by the continued decline in home inventory, as the number of homes for sale declined year-over-year for the 27th straight month in August. The National Association of REALTORS noted that some of the drop in sales in the South reflected the impact of Hurricane Harvey. Mortgage demand fell sharply last week, reversing much of the gain from the prior week. Purchase applications returned to a level just above the six-month low hit three weeks ago, while refinance applications fell from the prior week's 10-month high. Finally, the average 30-year fixed mortgage rate rose 5 basis points to 3.83 percent this week, ending a nearly two-month long stretch of declines.

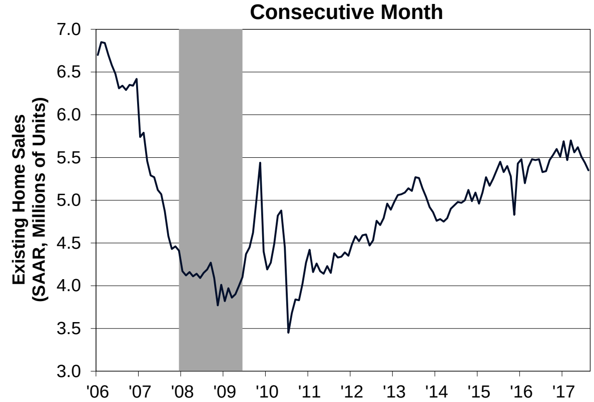
- **The net worth of U.S. households and nonprofit organizations**—the value of assets minus liabilities—rose $1.7 trillion in the second quarter to $96.2 trillion, according to the Federal Reserve. **The owners' equity in real estate as a percentage of household real estate** rose 0.5 percentage points to 58.4 percent. **Single-family mortgage debt outstanding** rose 2.9 percent annualized.
- **Housing starts** fell 0.8 percent in August to a 1.18 million seasonally-adjusted annualized rate (SAAR), according to the Census Bureau. Single-family starts rose 1.6 percent to 851,000 units, while multifamily starts fell 6.5 percent to 329,000 units. Year-to-date, single-family starts are 8.9 percent higher than the same period a year ago, while multifamily starts are 9.9 percent lower. New residential permits increased 5.7 percent to 1.30 million annualized units. Single-family permits fell 1.5 percent to 800,000 units, while multifamily permits rose 19.6 percent to 500,000 units. On a year-to-date basis, single-family permits are 9.5 percent higher and multifamily permits are up 0.4 percent.
- **Existing home sales** fell 1.7 percent to 5.35 million units (SAAR) in August, according to the National Association of REALTORS®. On a year-to-date basis, sales are 2.0 percent higher than a year ago. Single-family sales fell 2.1 percent, while condo/co-op sales rose 1.7 percent. The number of homes for sale, which is not seasonally adjusted, fell 6.5 percent from August 2016. The months' supply (inventory-to-sales ratio) was 4.2 months.
- **The National Association of Home Builders/Wells Fargo Housing Market Index** fell 3 points in September to 64. A reading above 50 indicates more builders view the single-family market as "good" rather than "poor". All three components, current sales, sales expectations, and foot traffic of prospective buyers, fell during the month.
- **Mortgage applications** fell sharply by 9.7 percent for the week ending September 15, according to the Mortgage Bankers Association. Purchase applications fell 10.8 percent, and refinance applications fell 8.5 percent. The survey's average 30-year fixed mortgage rate ticked up 1 basis point to 4.04 percent.

Single-Family Starts Edge Up, While Multifamily Starts Decline Further



Source: Census Bureau

Existing Home Sales Decline for the Third Consecutive Month



Source: National Association of REALTORS®

Frank Shaw
Economic and Strategic Research Group
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