Fannie Mae

Economic and Strategic Research

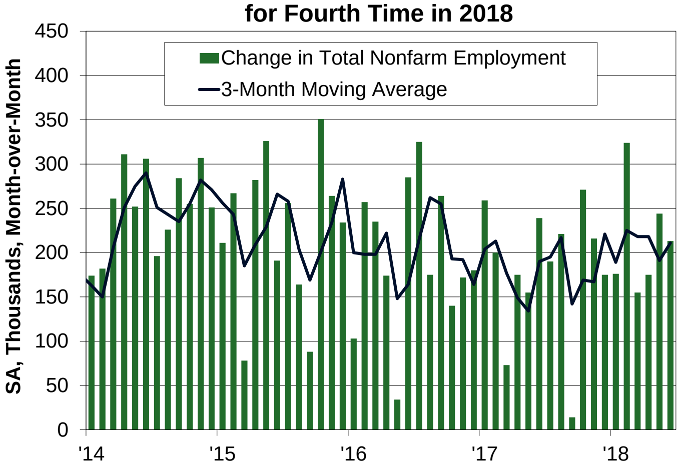
Weekly Note – July 6, 2018

Economics: Upbeat Hiring; Steady Annual Wage Gains

The week featured the June jobs report, which portrayed a strong labor market but also signaled that the Fed's gradual normalization of monetary policy remains appropriate. Along with a solid June payroll gain, upward revisions to the prior two months pushed the 3-month average job growth to over 200,000 for the fourth time this year. Annual wage gains held steady, staying within the tight range of 2.6 percent to 2.8 percent seen since December. While the unemployment rate moved up for the first time since August, the increase was accompanied by the first rise in the labor force participation rate in four months. The [minutes] from the June Federal Open Market Committee meeting suggested that the Fed is setting the stage for a September rate hike. With solid economic growth and a healthy labor market, participants agreed that even after the June rate hike, "the stance of monetary policy would remain accommodative." However, "a number" of participants noted that if gradual increases in the federal funds rate continue, the target rate "could be at or above their estimates of its neutral level sometime next year." Thus, if the economy progresses as anticipated, it may become necessary to modify the language in the post-meeting statement that policy "remains accommodative." In our view, the Fed could change the phrase to "remains slightly accommodative," perhaps as soon as the September meeting. Concerns about trade tensions are mounting in the Fed with many participants agreeing that the uncertainty around trade policy could eventually "have negative effects on business sentiment and investment spending." The day after the release of the June minutes, the U.S. imposed new tariffs on $34 billion of annual imports from China, prompting Beijing to respond with threats of retaliatory tariffs. While the possibility of a trade war grows, the trade deficit narrowed for the third straight month in May to its lowest level since October 2016, posting the best 3-month average since 2009. Exports rose to a fresh record high as imports edged up only slightly. In good news for the manufacturing sector, factory orders rose in May, boosted by a jump in nondurable goods orders. Core capital goods orders were revised higher to show a slight gain from a decline in the advance estimate. Additionally, a June survey of manufacturing purchasing managers showed the fastest pace of expansion since last September. A similar survey for the service sector reported faster expansion for the second consecutive month in June. Finally, light vehicle sales rose the most in nine months in June, but after two consecutive drops in April and May, average monthly sales for the second quarter declined from the first quarter.

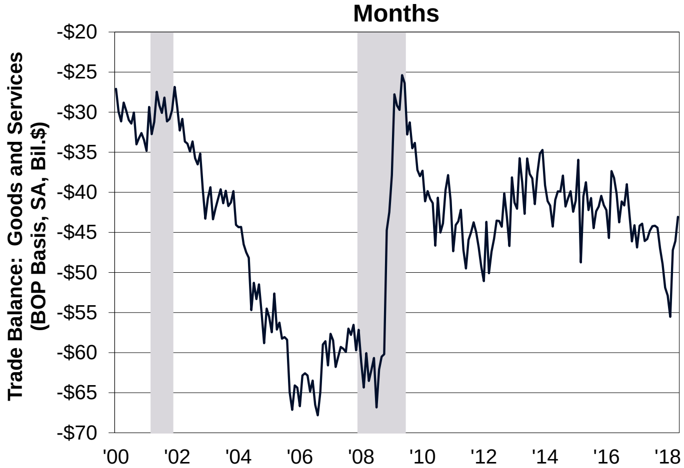
- **Nonfarm payroll employment** expanded by 213,000 in June, according to the Bureau of Labor Statistics. The prior two months were revised upward 37,000, on net, pushing the 3-month average gain to 211,000. The average workweek was flat at 34.5 hours. Average hourly earnings increased 0.2 percent during the month and 2.7 percent annually. The unemployment rate and the labor force participation rate both rose two-tenths to 4.0 percent and 62.9 percent, respectively. The broadest measure of labor underutilization, the U-6 rate, rose to 7.8 percent.
- **The U.S. trade deficit** narrowed $3.0 billion to $43.1 billion in May, according to the Census Bureau. The inflation-adjusted goods deficit, used to calculate net exports in the GDP estimate, narrowed by $2.2 billion to $75.3 billion.
- **The ISM Manufacturing Index** rose 1.5 points in June to 60.2. (Any reading above 50 indicates expansion). **The ISM Nonmanufacturing Index**, a gauge of service sector activity, increased 0.5 points in June to 59.1.
- **Factory orders** rose 0.4 percent in May, while factory shipments rose 0.6 percent, according to the Census Bureau. New orders for nondurable goods, the new piece of data in the report, increased 1.1 percent.
- **Light vehicle sales** posted a 3.3 percent gain to 17.5 million annualized units in June, according to Autodata.

3-Month Moving Average Rises Above 200,000 for Fourth Time in 2018



Source: Bureau of Labor Statistics

Trade Deficit Narrows to Lowest Level in 19 Months



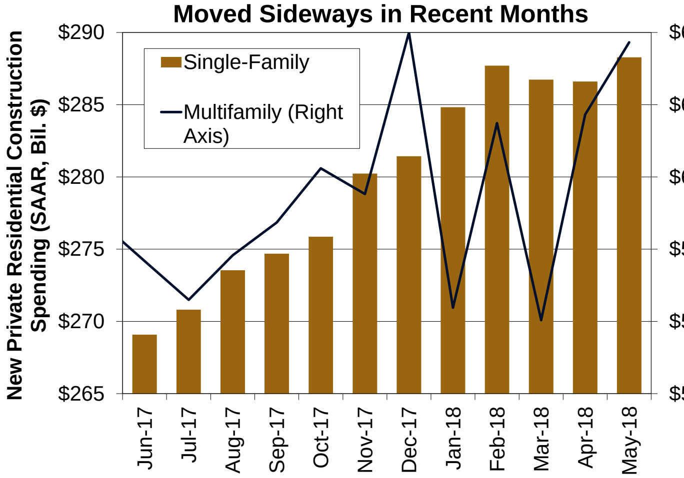
Source: Census Bureau

Housing: Construction Spending Is Consistent with a Modest Rebound in Residential Investment

A slow week for housing data revealed a slight improvement for private residential construction spending and continued lackluster mortgage demand. Total residential construction spending (not adjusted for inflation) increased modestly in May for the second consecutive month following the second largest decline of the expansion in March. Spending on new single-family construction ticked up, marking the first rise in three months, while spending on new multifamily building increased for the second consecutive month. The gradual improvement in total construction spending in April and May suggests that real residential investment likely rebounded in the second quarter following the drop in the prior quarter. However, combined with declining year-to-date total home sales through May, the gain in second quarter real residential investment was likely modest. The news remained bearish this week on the mortgage demand front. Total mortgage demand fell during the last week of June as the decline in refinance mortgage applications outweighed an increase in purchase applications. Monthly average purchase mortgage applications were virtually flat in June after declining in May for the first time in three months. Refinance applications declined in June for the fifth straight month and the eighth time in nine months. Mortgage demand was lackluster during June despite the slight drop in the average 30-year fixed mortgage rate to 4.57 percent from 4.59 percent in May, marking the first monthly decline since last September, according to Freddie Mac. Rates dropped this week for the third consecutive week, declining 3 basis points to 4.52 percent. Given the recent trends in purchase mortgage applications, we expect home sales, especially of existing homes, to remain sluggish in the near term, as strong home price appreciation amid a shortage of homes for sale will continue to restrain affordability and sales.

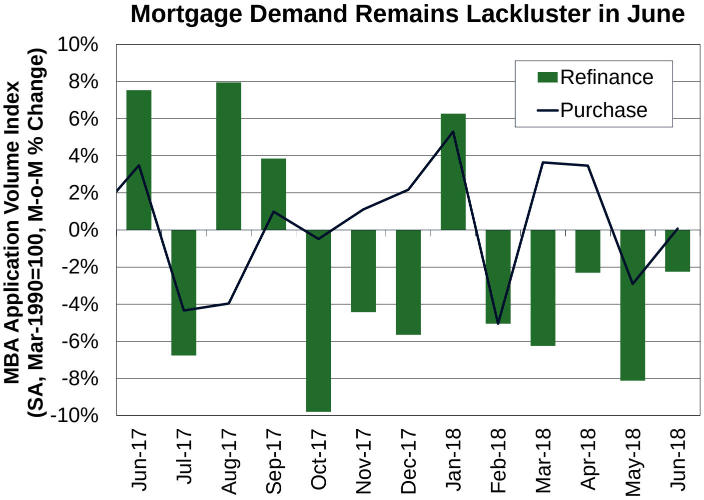
- **Private residential construction spending** edged up 0.8 percent in May following a 0.5 percent rise in April, according to the Census Bureau. Spending on new single-family building and new multifamily building increased 0.6 percent and 1.6 percent, respectively, while home improvement spending increased 0.9 percent. From a year ago, single-family construction spending rose 8.1 percent, compared with a 2018-best 3.6 percent annual gain for multifamily.
- **Mortgage applications** edged down 0.5 percent for the week ending June 29, according to the Mortgage Bankers Association (MBA). Purchase applications rose 0.5 percent, while refinance applications dropped 2.0 percent. Conventional applications increased for purchase and decreased for refinance. Government applications increased for both loan types. The MBA survey's average 30-year fixed mortgage rate slipped 5 basis points to 4.79 percent.

Single-Family Construction Spending Has Moved Sideways in Recent Months



Source: Census Bureau

Mortgage Demand Remains Lackluster in June



Source: Mortgage Bankers Association

Orawin Velz and Rebecca Meeker
Economic and Strategic Research Group
July 6, 2018

different results. The analyses, opinions, estimates, forecasts and other views published by the ESR group represent the views of that group as of the date indicated and do not necessarily represent the views of Fannie Mae or its management.