



Economic Developments – September 2017

Hurricanes Cloud Outlook

For the first time this year we changed our full-year 2017 growth forecast, revising it two-tenths higher to 2.2 percent, as upward revisions in previously released data increased momentum into the current quarter. However, the devastating Harvey and Irma hurricanes will distort economic activity in coming months. It is too soon to estimate the negative impact they will have on current quarter growth, which might be severe. Historically, natural disasters that hit heavily populated areas led to substantial declines in economic activity in the near term but meaningful rebounds over subsequent quarters due to rebuilding efforts. We will continue to monitor closely the extent and the duration of the disruptions over the next several months. To the extent that we overstate growth in the third quarter in this forecast, we will likely understate it in the fourth quarter. Needless to say, there is a great deal of uncertainty surrounding the forecast as we approach the end of 2017.

President Trump signed legislation to extend government spending authority and suspend the debt limit through December 8, which essentially pushes fiscal risks to later this year or the first quarter of 2018. On the monetary policy front, the unexpected resignation announcement of Federal Reserve Vice Chair Stanley Fischer added greater uncertainty on Fed leadership and monetary policy. Meanwhile, geopolitical risks remain heightened. While the decline in the dollar is a positive for net exports, its impact will lag substantially. Finally, a series of negotiations on trade agreements generates uncertainty to the outlook for the sector, both due to the potential effects on exports and, just as importantly, on business confidence.

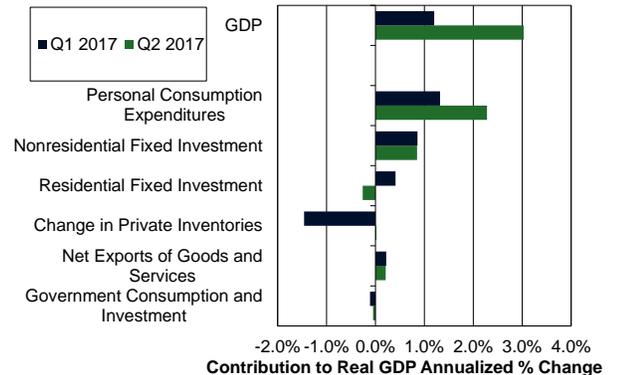
Consumers Step Up

Real gross domestic product (GDP) growth received a 0.4 percentage point upgrade to 3.0 percent annualized in the second quarter in the government's second estimate, thanks to stronger consumer spending and nonresidential investment. Monthly data showed that real consumer spending grew 0.2 percent in July, following upward revisions in the prior three months. The saving rate, which has resumed its downtrend since February, ticked down further in July to 3.5 percent, the lowest rate this year. Consumers apparently drew down their savings during the second quarter to support spending, which grew at a strong 3.3 percent annualized and contributed 2.3 percentage points to GDP.

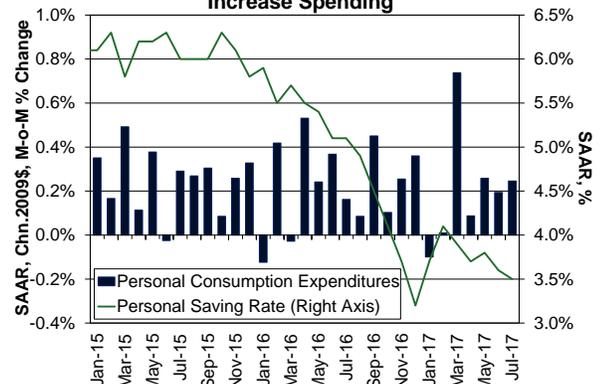
We do not expect the strength in second quarter consumer spending to persist. So far, August data point to some softening. Auto sales fell 3.7 percent, the biggest monthly drop since January, to 16.1 million annualized units, the weakest sales pace since February 2014. The large drop may have reflected the impact of Hurricane Harvey. We continue to expect that auto production and sales will drag on the economy going forward. However, replacement demand for vehicles damaged during the hurricanes could help boost the sector in the near term.

Labor market conditions showed broad-based softening in August following strong results in recent months. Nonfarm payrolls increased 156,000, with a downward revision of 41,000 jobs in the prior two months. The average workweek edged down, and annual growth in average hourly earnings remained stuck at 2.5 percent for the fifth consecutive month. Other key labor market metrics also disappointed, as the unemployment rate ticked up to 4.4 percent amid a flat labor force participation rate. However, the three-month average monthly job gain of 185,000 still points to a solid job market.

Inventory Swing and Consumer Spending Boost Second Quarter Growth



Consumers Lean on Their Savings to Increase Spending

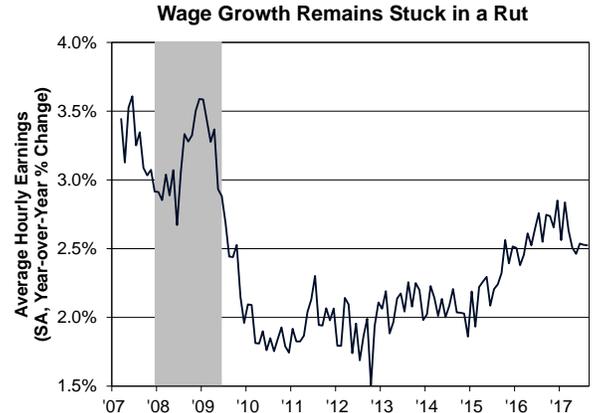
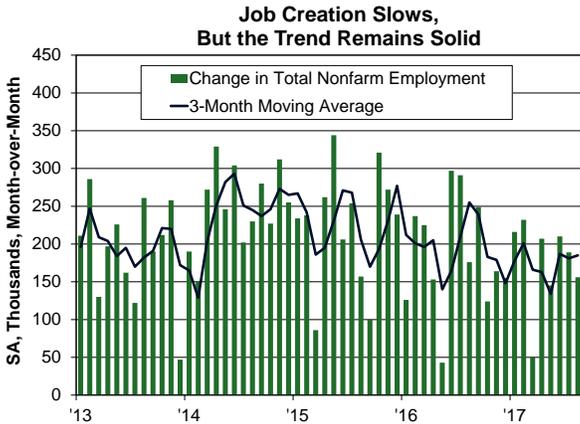


Auto Sales Peak and Will Drag on Consumer Spending





Initial jobless claims data are already reflecting the impact of Hurricane Harvey, which contributed to a 62,000 jump in claims for the week ending September 2. We expect incoming jobs reports to reflect the disruptions from the hurricanes and believe the labor market will take time to recover. Following Hurricane Katrina, nonfarm payrolls fell in September 2005 before upward revisions showed a moderate gain. It wasn't until November of that year that payrolls showed a significant rebound, gaining nearly 350,000 jobs.



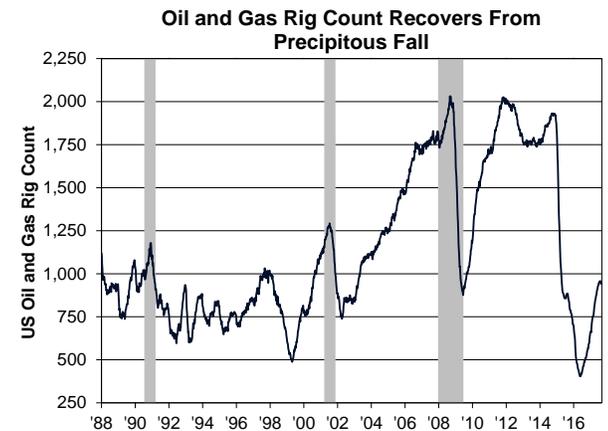
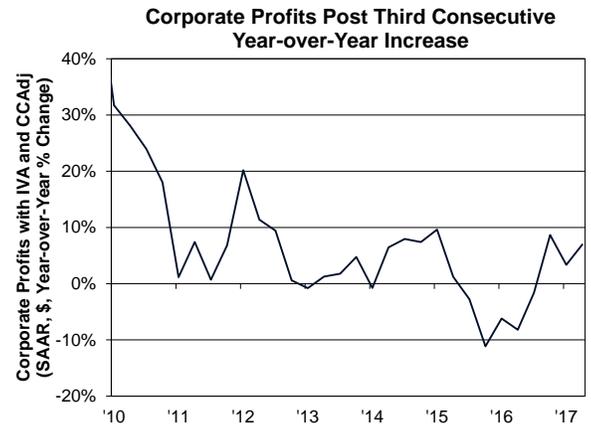
Business Equipment Investment Should Continue to be a Tailwind

Nonresidential fixed investment also received an upgrade in the second estimate of GDP last quarter across the structures, equipment, and intellectual property components. Business conditions improved in the second quarter as corporate profits rebounded, rising 1.3 percent (not annualized) and partially recovering the 2.1 percent drop in the prior quarter. While the quarterly increase was on the weak side, the year-over-year gain of 7.0 percent augurs well for business investment.

Nonresidential investment in both structures and equipment was a strong driver of growth in the first half of this year. The rebound in energy extraction activity spurred surges in investment in mining and oilfield machinery and in petroleum and natural gas structures. The strength in energy extraction correlates with the steep rise in the rig count from the depressed levels reached after energy-related investment declined sharply following the oil price collapse in late 2014.

However, the rig count fell in August, marking the first monthly drop since May 2016. In addition, Hurricane Harvey will also likely cause disruptions in energy production in the near term.

Core capital goods (nondefense capital goods excluding aircraft) shipments—a key source of data used to estimate equipment spending—posted the strongest monthly increase in July since February. In addition, core capital goods orders, a forward-looking indicator, showed the biggest rise since January, continuing an upward trend that started a year ago after a protracted downturn triggered by the plunge in oil prices and the sharp rise in the dollar in 2014. Notably, core capital goods orders have trended up steadily following the presidential election, which has triggered a series of business deregulations, including the reversal of some existing federal regulation, and a slowdown in the issuance of new regulation. We expect that business equipment investment will increase solidly this quarter despite softening energy-related activity.





After dragging sizably on growth in the first quarter before stabilizing in the second quarter, we expect inventory investment to help drive growth in the second half of this year. For the trade sector, the real trade deficit widened only slightly in July, as the drop in real goods exports outweighed the decline in real goods imports. In the near term, Hurricane Harvey might cause a large temporary drag on energy exports. We expect that net exports will subtract from growth in the second half after supporting growth in the first half. Finally, residential investment should be neutral to growth for the last half of 2017.

Nothing Should Deter the Fed from Tapering the Balance Sheet

The minutes from the last Federal Open Market Committee meeting in July showed that the Committee expressed concerns about recent declines in inflation trends and saw downside risk to its near-term outlook. The Fed's favored measure of inflation tied to consumer spending—the Personal Consumption Expenditures (PCE) Deflator—ticked up 0.1 percent in July while the annual increase remained at 1.4 percent, well below the Fed's two-percent target. Since February, PCE inflation has declined by 0.8 percentage points. Excluding food and energy items, the annual increase in core PCE fell one-tenth to 1.4 percent. Rising gasoline prices from Harvey should temporarily increase headline inflation. However, the next increase in the fed funds rate, which we currently believe will occur in December, could be delayed until next year if core inflation fails to firm. The disruptions from the hurricanes will also muddy the employment picture. Despite rising uncertainty surrounding the timing of the next rate hike, we continue to expect the Fed to announce a tapering of its balance sheet at its next meeting on September 19-20.

Housing Roundup

Real residential investment fell 6.5 percent annualized in the second quarter, the biggest drop since the third quarter of 2010. We expect it to drop again this quarter, albeit more moderately. Housing indicators started off the third quarter on a soft note. Single-family starts fell slightly in July while multifamily starts dropped sharply. Year-to-date, single-family starts were up about 9 percent; however, the current level remains near those witnessed in recessions prior to the last downturn. Through July, multifamily starts were approximately 10 percent below the level during the same period last year.

Existing home sales fell in July to the slowest pace since August 2016, while new home sales plummeted to the weakest pace since December 2016. The number of existing homes for sale remains significantly below last year's level, extending a streak of annual declines to more than two years. Homes are selling fast, with existing homes staying on the market for 30 days or less for the fourth consecutive month. Data from CoreLogic show that the annual decline in inventory is most severe for lower-priced homes, presenting a challenge for potential first-time homebuyers.

Through the first seven months of this year, total home sales were about 3 percent higher than sales during the same period in 2016. The near-term outlook for home sales is bearish, as pending home sales fell in July and posted annual drops in three of the past four months. In addition, another leading indicator of home sales, purchase mortgage applications, fell 4.0 percent in August after declining 4.3 percent in July.

Core Capital Goods Orders Have Gradually Recovered



New and Existing Home Sales Drop to the Lowest Levels of 2017



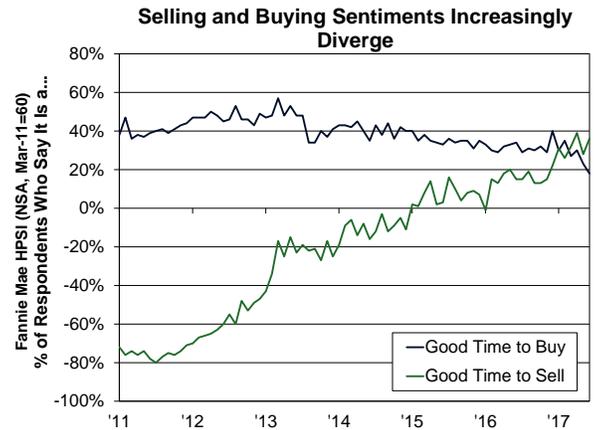
Pending Home Sales Fall Year-over-Year For the Third Time in the Past Four Months





Extremely lean inventory continues to fuel home price appreciation and pressure affordability. Main measures of home prices, including the Case-Shiller, the Federal Housing Finance Agency (FHFA) Purchase-only, and the CoreLogic indices, showed annual gains of between 5.8 percent and 6.5 percent in June.

The August Fannie Mae National Housing Survey® showed that high home prices led to increasingly divergent home buying and selling sentiments. In the early stages of the economic expansion, home selling sentiment trailed home buying sentiment by a significant margin. However, the situation is now reversed. The net share of consumers saying it is a good time to sell is double the net share indicating it is a good time to buy, with record high percentages of consumers citing home prices as the primary reason for both perceptions. We believe that lean inventory and strong home price appreciation will continue to weigh on home sales through the rest of the year.



Mortgage rates have averaged below 4.0 percent over the past three months, and we expect them to move sideways for the balance of the year, averaging 3.9 percent in the fourth quarter. Despite continued low mortgage rates, we expect total home sales to be flat during the second half of the year compared with the first half. For all of 2017, we expect total home sale to rise about 3 percent, the same as in the prior forecast. Our projection for total single-family mortgage originations is little changed from the prior forecast at \$1.68 trillion in 2017, a drop of about 18 percent from 2016. The refinance share is expected to decline to around 36 percent in 2017 from 48 percent in 2016.

Economic & Strategic Research (ESR) Group

September 11, 2017

For a snapshot of macroeconomic and housing data between the monthly forecasts, please read ESR's [Economic and Housing Weekly Notes](#).

Data source for charts: Bureau of Economic Analysis, Autodata, Bureau of Labor Statistics, Baker Hughes, Census Bureau, National Association of REALTORS®, Fannie Mae.

Opinions, analyses, estimates, forecasts and other views of Fannie Mae's Economic & Strategic Research (ESR) Group included in these materials should not be construed as indicating Fannie Mae's business prospects or expected results, are based on a number of assumptions, and are subject to change without notice. How this information affects Fannie Mae will depend on many factors. Although the ESR group bases its opinions, analyses, estimates, forecasts and other views on information it considers reliable, it does not guarantee that the information provided in these materials is accurate, current or suitable for any particular purpose. Changes in the assumptions or the information underlying these views could produce materially 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.

ESR Macroeconomic Forecast Team

Doug Duncan, SVP and Chief Economist
 Orawin T. Velz, Director
 Hamilton Fout, Director

Mark Palim, VP and Deputy Chief Economist
 Frank Shaw, Economist
 Michael T. Vangeloff, Strategic Planning Analyst III