



Economic Developments – November 2017

Economy Remains Resilient Despite Hurricanes

The expected economic hit from the recent hurricanes did not materialize or was drowned out by growth in business optimism. The pickup in business fixed investment and inventory building has the economy growing at a 3 percent pace currently. The impact of the significant decline in the pace of regulatory growth combined with the expectation of tax cuts (or reform) and the high level of auto sales has the economy humming along.

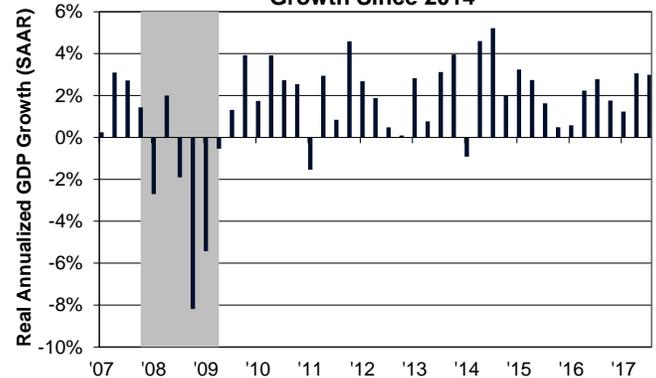
The first print of third quarter real gross domestic product (GDP) showed that economic growth slowed by only one-tenth from the second quarter to 3.0 percent annualized despite hurricane-related disruptions, marking the first back-to-back quarters of at least 3 percent growth since 2014. The third quarter estimate was six-tenths stronger than our forecast. Incoming data over the past month generally showed a pickup in domestic demand at the end of last quarter, leading us to revise slightly higher our forecast of fourth quarter growth. For all of 2017, we expect growth of 2.4 percent, two-tenths higher than in the prior forecast. We forecast that growth will moderate to 2.0 percent in 2018. A tax cut, if enacted, presents some upside risk to growth in 2018.

Strong headline third quarter growth masked weaker domestic demand, which softened in part because of the hurricanes. Consumer spending growth slowed nearly 1 percentage point from the prior quarter to 2.4 percent annualized, contributing 1.6 percentage points to GDP growth. While business investment in equipment increased strongly for the second consecutive quarter, the first decline in three quarters of nonresidential investment in structures caused overall nonresidential fixed investment growth to slow between the second and third quarters. Housing remained a soft spot, as the residential investment component dragged on the economy for the second consecutive quarter, subtracting 0.2 percentage points from growth.

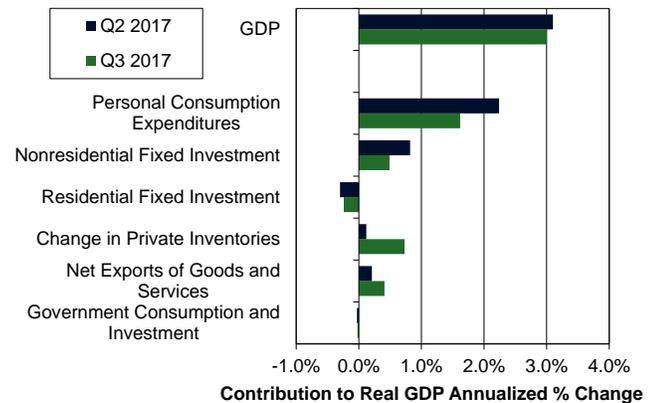
Inventory investment and net exports were the two main components of GDP that added more to growth in the third quarter than in the second quarter. As a result, final sales to domestic purchasers—GDP excluding the impact from net exports and inventories—grew just 1.8 percent annualized versus a 2.7 percent rise in the prior quarter, pointing to weakening underlying domestic demand. Net exports have contributed to growth in every quarter so far this year, thanks to the declining dollar and a pickup in growth abroad.

The dollar fell around 10 percent against major currencies between December 2016 and September 2017 but has strengthened since, perhaps due to renewed optimism over the potential passage of tax cut legislation. The rising trend in the dollar is unlikely to last if major central banks abroad further remove monetary policy accommodation. The Bank of Canada and the Bank of England have started to raise interest rates and the European Central Bank is expected to wind down its quantitative easing program next year.

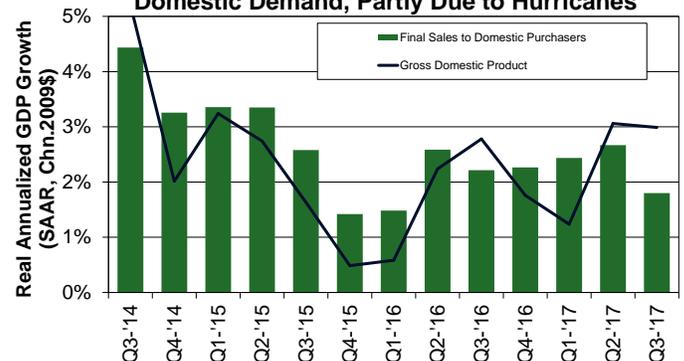
Economy Posts Strongest Back-to-Back Growth Since 2014



Housing Drags on Economic Growth Again



Strong Headline Growth Masks Weaker Domestic Demand, Partly Due to Hurricanes



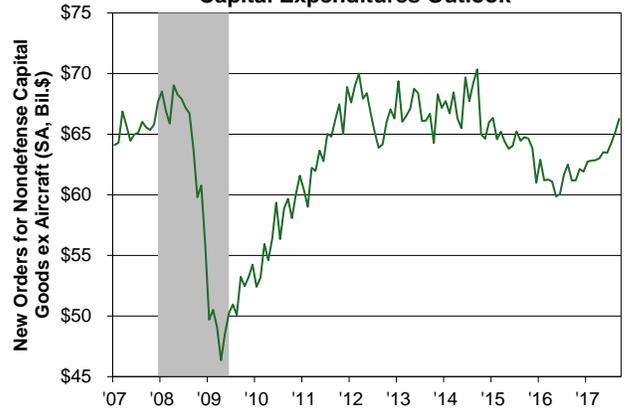
Note: Final sales to domestic purchasers is gross domestic product less net exports and change in private inventories



The Dollar Has Recently Moved Up



Core Capital Goods Orders Bode Well for Capital Expenditures Outlook

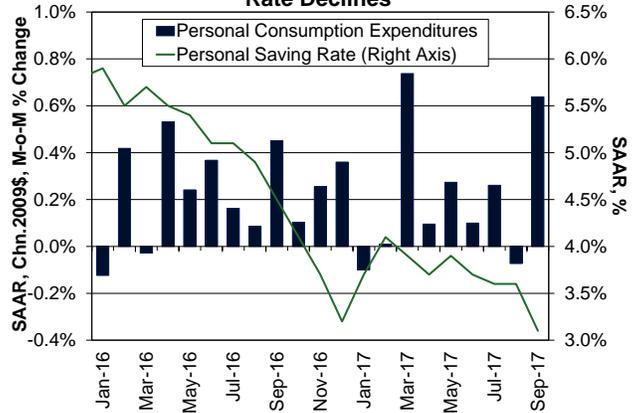


Despite the recent weakness, we expect domestic demand growth to pick up in the current quarter. Core capital goods orders (nondefense durable goods orders excluding aircraft), which are a forward-looking indicator for business investment in equipment, rose in September for the third straight month and the fifth time in six months. A rollback in regulation, rising energy prices that have boosted mining machinery orders and related energy exploration activity, the decline in the dollar, and a pickup in economic growth abroad have helped spur business capital expenditures.

Consumer spending should pick up and contribute more to growth this quarter. Despite softening in the third quarter, consumer spending gained momentum at the end of the quarter. Real consumer spending jumped 0.6 percent in September after declining in the prior month for the first time since January amid real personal income that was flat for the second consecutive month. Part of the increase in spending came from robust replacement demand for vehicles damaged during the hurricanes. However, spending on nondurable goods and services also posted solid gains in September. Auto sales cooled only slightly in October, pointing to continued robust replacement sales. We expect real consumer spending growth to rebound to 3.0 percent annualized this quarter.

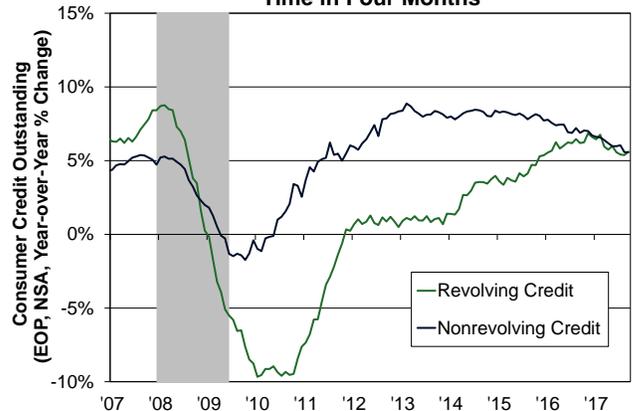
One concern related to recent income and spending trends is the decline in the saving rate to an expansion low of 3.1 percent in September. After stabilizing in late 2016, the saving rate resumed its downward trend in February of this year, suggesting that consumers will have less cushion from savings to support near-term spending.

Consumer Spending Jumps, as the Saving Rate Declines



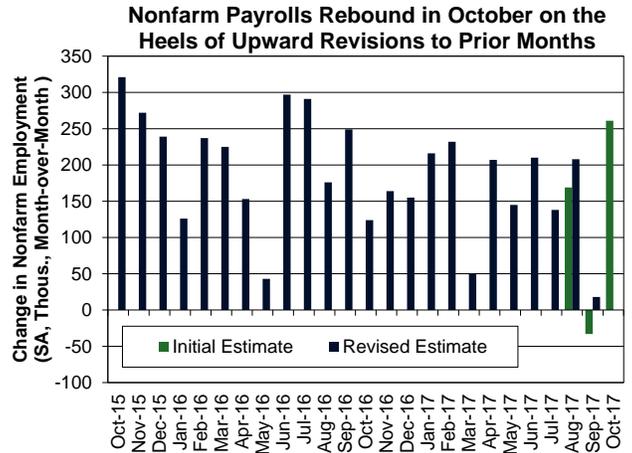
Meanwhile, consumer credit outstanding posted the biggest monthly jump in September since last November, with strong increases in both revolving (largely credit card) and nonrevolving (largely auto and student loans) debt. Notably, the annual increase in revolving debt accelerated in September for the first time in four months. One headwind for consumer credit is continued tightening of lending standards for auto loans and credit cards, according to the Federal Reserve Senior Loan Officer Opinion Survey for the three months ending in October.

Revolving Credit Growth Picks Up for the First Time in Four Months

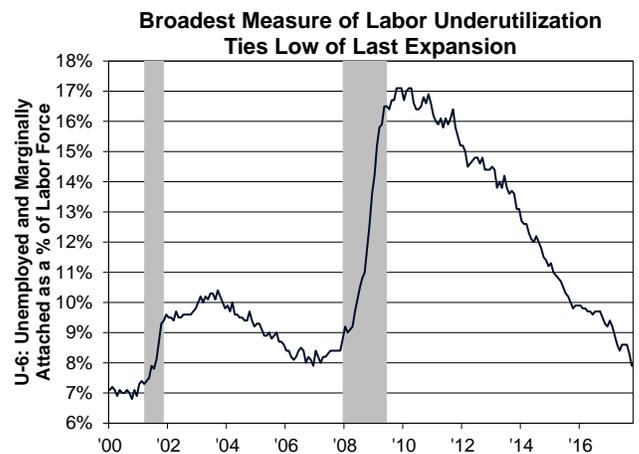
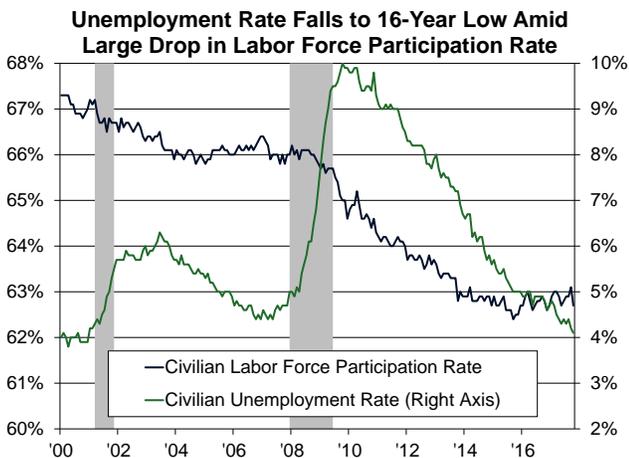




The November jobs report showed that nonfarm payrolls rebounded in October by 261,000 on the heels of upward revisions that added 90,000 jobs to the hurricane-affected months. The average monthly job gain for the last three months was 162,000, compared with a year-to-date average monthly gain through July of 171,000. The slowdown in hiring is to be expected as the labor market inches closer to full employment. Leisure and hospitality payrolls, which shed 102,000 jobs in September, gained 106,000 jobs in November. The average workweek was unchanged at 34.4 hours for the fourth straight month. Average hourly earnings were flat, bringing annual wage growth down to 2.4 percent, a four-tenths decrease from the solid gain of the prior month, when the hurricanes prevented many low-wage employees from working.

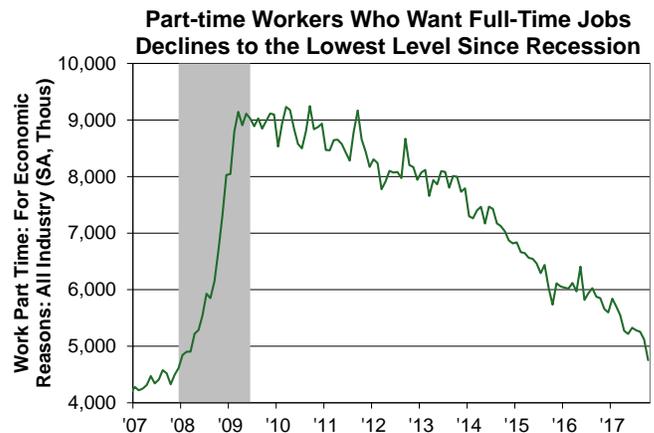


The household survey results were mixed. The unemployment rate fell one-tenth to 4.1 percent, reaching the lowest level since December 2000. However, the labor force participation rate plunged by 0.4 percentage points in October, the biggest monthly decline in four years, to 62.7 percent. In another sign of a tight labor market, the broadest measure of labor underutilization, which includes discouraged workers and part-time workers who want full-time jobs, fell to 7.9 percent, matching the lowest rate of the last expansion.



The number of part-time workers who want full-time jobs has trended down sharply over the past year. That number plunged 7.2 percent in November to the lowest level since December 2007, when the economy slipped into recession, underscoring receding slack in the labor market.

Earnings unadjusted for the composition of employment have shown lackluster growth. The Employment Cost Index (ECI), a gauge of labor compensation that includes wage and salaries, as well as benefits, has drifted higher. The ECI rose 0.7 percent during the third quarter and 2.5 percent from a year ago, the second strongest annual rise of this expansion. Recent acceleration in ECI growth suggests that tightening in the labor market has put upward pressure on compensation.





On the inflation front, the Fed's favored measure, the Personal Consumption Expenditures deflator, rose 0.4 percent in September, driven by supply disruptions in the energy sector following Hurricane Harvey. The annual increase picked up two-tenths to 1.6 percent. However, the annual rise in core prices was unchanged at 1.3 percent, the lowest reading since 2015.

As widely expected, the Federal Open Market Committee (FOMC) kept the fed funds rate unchanged at its November meeting. The statement following the meeting noted that core inflation "remained soft." Also expected was the nomination of Jerome Powell to replace Fed Chair Janet Yellen. It appears that the market expects continued gradual monetary policy normalization under the new Fed Chair. We continue to expect a rate hike at the December FOMC meeting, the third rate rise this year, followed by two rate increases in 2018.

The Annual Rise in the Employment Cost Index Climbs to Near Expansion High



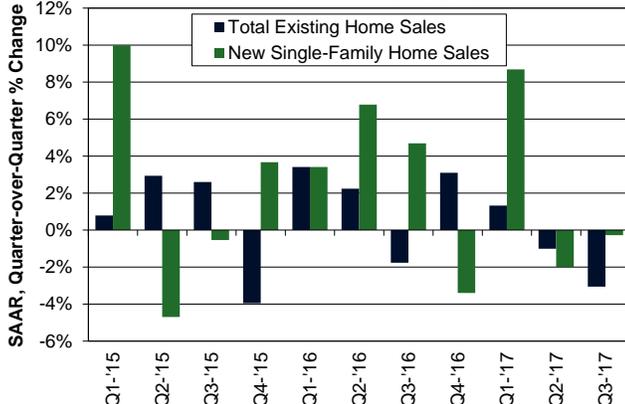
Housing Roundup

Housing activity continued its rough patch, pulling back across the board last quarter. Total housing starts fell for the third straight quarter, as a drop in multifamily starts outweighed an increase in the single-family segment. Despite an 18.9 percent surge in September to a fresh expansion high, new home sales fell during the third quarter. Existing home sales also declined last quarter, as sales recovered only modestly in September, marking the first rise in four months.

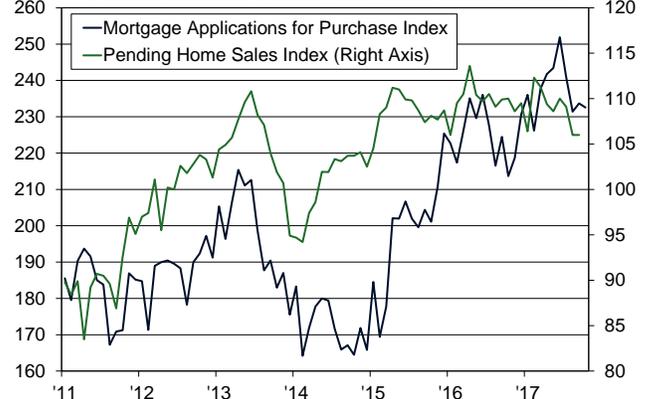
While the hurricanes disrupted activity in the South, housing weakness was present before the hurricanes and largely stems from the supply side. Shortages of labor and available lots have restrained building activity. In addition, building material prices have jumped, with framing and structural panel lumber prices rising 20 percent and 32 percent, respectively, from a year ago. The number of existing homes for sale has declined on an annual basis for more than two years, and conditions are unlikely to change in the near term. An extremely lean housing inventory, especially in the existing home market, continues to provide a tailwind to home prices, constraining affordability and sales. Main measures of home prices, including the Case-Shiller, the FHFA Purchase-only, and the CoreLogic indices, grew by more than 6 percent in August.

Leading indicators suggest that a meaningful rebound in sales is unlikely this quarter. Pending home sales, which record contract signings of existing homes and usually lead closings by one to two months, were flat in September at the lowest level since January 2016. Pending sales have declined on an annual basis in five of the past six months. In addition, average monthly purchase mortgage applications fell in October for the third time in four months.

New and Existing Home Sales Decline for the Second Consecutive Quarter



Leading Indicators Paint an Uninspiring Picture of Near-Term Outlook for Home Sales





One positive for the single-family housing market is that the homeownership rate increased in the third quarter on an annual basis for the third consecutive quarter, supporting our view that the rate has stabilized. The rental market, on the other hand, shows some signs of softening. The vacancy rate for all rental housing types rose on a year-over-year basis for the second consecutive quarter to reach 7.5 percent, the highest reading in more than three years. The rising rental vacancy rate was partly due to increased supply of apartment units, especially in the higher-end of the market and in large metropolitan areas.

Homeownership Rate Stabilizes Further



The Rental Market Shows Signs of Softening



We expect mortgage rates to remain low, with the yield on 30-year fixed-rate mortgages averaging 3.9 percent this quarter before gradually rising to 4.2 percent a year from now. Because of weaker-than-expected housing starts during the third quarter, we revised slightly lower our projections through 2018. At the same time, we revised higher near-term existing home sales. We expect total home sales to come in 1.4 percent higher this year than in 2016, with a similar increase anticipated for 2018. For all of 2017, total mortgage originations are expected to decline approximately 12 percent from 2016 to \$1.81 trillion, with a 12 percentage point drop in the refinance share to 37 percent. Mortgage originations are projected to fall further by about 5 percent to \$1.71 trillion in 2018, as a decline in refinance originations outweighs an increase in purchase originations, leading to a further drop in refinance share to 31 percent.

For information on multifamily market conditions, read the [November 2017 Multifamily Market Commentary](#).

Economic & Strategic Research (ESR) Group

November 13, 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, the Federal Reserve Board, Census Bureau, Bureau of Labor Statistics, National Association of REALTORS®, Mortgage Bankers Association.

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