Fannie Mae

Economic and Strategic Research

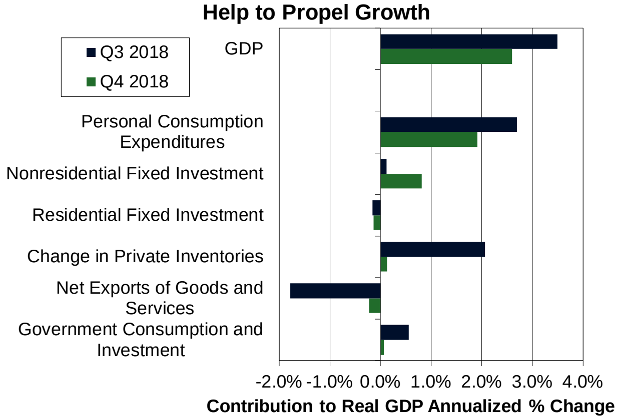
Weekly Note – March 1, 2019

Economics: Consumer Spending Loses Steam at Year End

This week featured the first look at fourth quarter real gross domestic product (GDP) growth, which slowed for the second straight quarter, albeit to a still solid pace of 2.6 percent annualized. The headline growth figure was two-tenths below our February estimate. Personal consumption expenditures (PCE) were the largest contributor, adding 1.9 percentage points to growth, followed by nonresidential fixed investment, which surprised to the upside. Despite a decline in structures spending for the second consecutive quarter, nonresidential fixed investment growth accelerated, thanks to the strength in intellectual property products and equipment segments. Both inventory investment and government spending added slightly to growth. Net exports dragged on growth for the third time in four quarters driven entirely by imports while exports rebounded from the prior quarter's decline. Lastly, housing dragged on growth for the fourth straight quarter. While real PCE posted a healthy gain in the fourth quarter, December data showed weakening momentum into this quarter as they declined the most since September 2009. The monthly trajectory suggests a downside risk to our real PCE forecast this quarter of 1.8 percent annualized. Real personal income posted the largest monthly gain in December in seven years, boosted largely by special factors, including subsidy payments to farmers hurt by Chinese tariffs. As a result, the saving rate jumped to the highest level in almost three years. On the inflation front, the annual increase in the Fed's preferred measure of inflation, the PCE deflator, decelerated further from the Fed's 2.0 percent target in December, falling to the slowest pace since October 2017. Core inflation (excluding food and energy) held steady just below 2.0 percent. Two measures of consumer confidence rebounded in February after significant declines to start the year: Factory orders barely moved in December and nondurable goods orders fell for the second straight month. Finally, a survey of purchasing managers indicated the slowest pace of expansion of manufacturing activity in February since the presidential election.

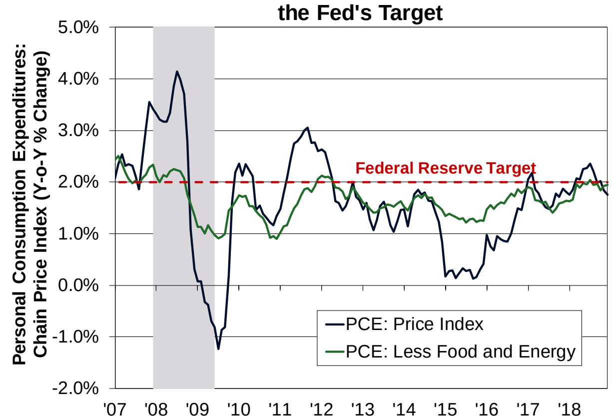
- **Gross domestic product**, adjusted for inflation, rose by 2.6 percent annualized in Q4 2018, decelerating from an increase of 3.4 percent in the prior quarter, according to the Bureau of Economic Analysis. Real PCE rose by 2.8 percent. Real business fixed investment rose 6.2 percent as equipment investment and intellectual property spending rose 6.7 percent and 13.1 percent, respectively. Structures investment fell 4.2 percent, the largest decline since Q3 2017. Real government spending edged up 0.4 percent while residential fixed investment fell 3.5 percent. Net exports detracted 0.2 percentage point from growth and inventories added one-tenth of a percentage point. The GDP price index rose 1.8 percent annualized, the PCE deflator increased 1.5 percent, and core prices rose 1.7 percent.
- **Personal income**, adjusted for inflation, rose 0.9 percent in December, according to the Bureau of Economic Analysis. Real PCE plunged 0.6 percent from November but rose 2.2 percent from a year ago. The personal saving rate jumped 1.5 percentage points to 7.6 percent. The PCE deflator increased 0.1 percent from November and 1.7 percent annually. The core deflator rose 0.2 percent during the month and 1.9 percent year over year.
- **Factory orders** edged up 0.1 percent in December, while factory shipments fell 0.2 percent, according to the Census Bureau. Nondurable goods orders declined 1.0 percent to the lowest level in nine months.
- **The ISM Manufacturing Index** fell 2.4 points to 54.2 in February (any reading above 50 indicates expansion).
- **The Univ. of Michigan Consumer Sentiment Index** rose 2.6 points to 93.8 in the February final reading driven by a 4.5-point increase in consumer expectations. The current economic conditions component edged down 0.3 points.
- **The Conference Board Consumer Confidence Index** improved for the first time in four months, rising 9.7 points to 131.4 in February. Of the components, present situation increased 3.3 points to an 18-year high and expectations rose 14.0 points, the largest monthly gain since November 2011 though it remains below October's expansion high.

Consumer Spending and Business Investment Help to Propel Growth



Source: Bureau of Economic Analysis

Headline Inflation Decelerates Further From the Fed's Target



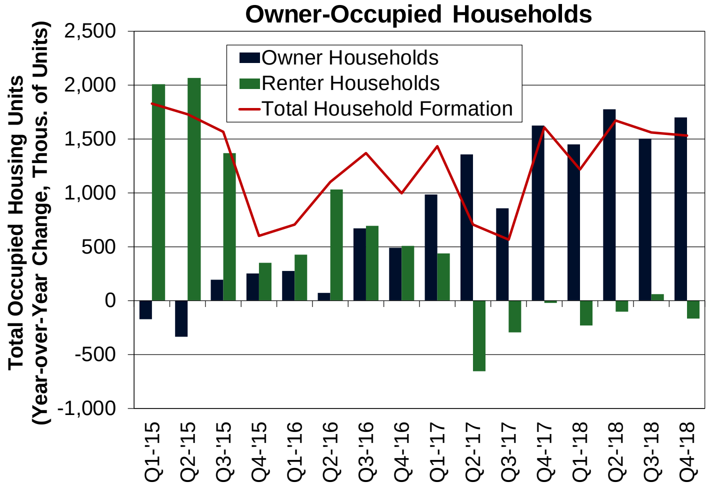
Source: Bureau of Economic Analysis

Housing: Homeownership Rate Hits Four-Year High

It was a busy week for housing releases. The FHFA Purchase-Only House Price Index and the S&P Case-Shiller National Home Price Index both indicated that house prices continued to lose momentum in December as both measures showed a deceleration in house price appreciation nationwide. This week, contract rates on 30-year fixed-rate mortgages held steady at a level last recorded a year ago, but average mortgage rates over the month of February fell for the third consecutive month. Amid reports of slower house price growth and falling mortgage rates, the National Association of REALTORS' Pending Home Sales Index, which measures contract signings on existing home sales, rose in January for the first time since June 2018, suggesting more closings of existing home sales in the coming months. In addition, mortgage applications for purchase – a timelier forward-looking indictor of home sales – rose for the second consecutive week, but average purchase mortgage originations for the month of February posted the largest monthly decline in five years, which may constrain home sales in the near term. The Housing Vacancy Survey offered some good news in the owner-occupied sector. The homeownership rate rose in the fourth quarter of 2018 to the highest level since the start of 2014, as a sharp expansion in the number of owner-occupied households over the quarter offset a small contraction in renter households. However, residential construction ended the year on a soft note as housing starts fell over the month of December to the lowest level since September 2016. Single-family starts declined for the fourth consecutive month, falling to a level below 800,000 annualized for the first time since May 2017. Multifamily starts, which tend to be more volatile, also fell over the month, driven by a steep decline in starts of 5+ unit buildings to its lowest level since August 2017. The outlook for multifamily construction is encouraging as multifamily permits rose in December, but the decline in single-family permits could weigh on the extent of growth of single-family construction in the coming months.

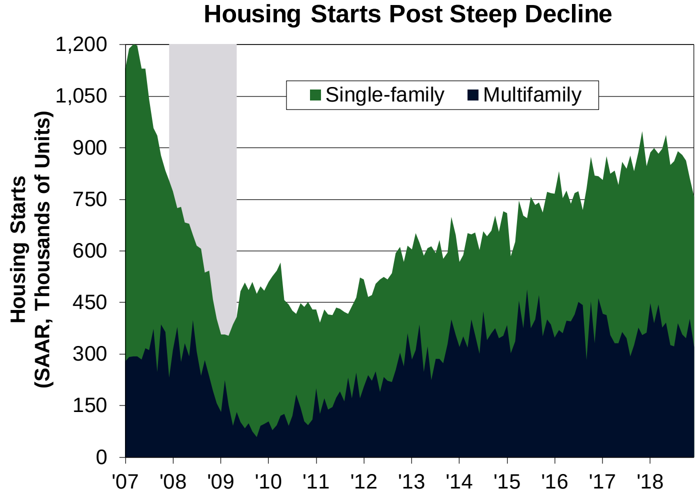
- **Housing starts** fell 11.2 percent in December to 1.08 million annualized units, according to the Census Bureau. Single-family starts fell 6.7 percent to 758,000 units. Multifamily starts declined 20.4 percent to 320,000. Single-family permits dropped 2.2 percent to 829,000 while multifamily permits rose 4.9 percent to 497,000.
- **The National Association of REALTORS® Pending Home Sales Index**, which typically leads closings by one to two months, rose 4.6 percent in January but fell 2.3 percent annually.
- **The FHFA Purchase-Only House Price Index**, reported on a seasonally adjusted basis, increased 0.3 percent in December. From a year ago, the index rose 5.6 percent. **S&P CoreLogic Case-Shiller National Home Price Index** (not seasonally adjusted) declined 0.1 percent in December but rose 4.7 percent from a year ago.
- **The Housing Vacancy Survey** for Q4 2018 (not seasonally adjusted) showed that the homeownership rate reached 64.8 percent, according to the Census Bureau. The rate was 0.6 percentage point higher than in Q4 2017. The number of owner-occupied households climbed by 1.7 million over the past year while the number of renter-occupied households fell by 0.2 million.
- **Mortgage applications** rose 5.3 percent for the week ending February 22, according to the Mortgage Bankers Association. Purchase applications increased 6.1 percent and refinance applications climbed 4.6 percent. On average over the month of February, mortgage applications fell 5.3 percent – average monthly purchase mortgage applications declined 10.3 percent while average monthly refinance mortgage applications slipped 0.7 percent.

Household Formation Driven Entirely By Owner-Occupied Households



Source: Census Bureau

Housing Starts Post Steep Decline



Source: Census Bureau

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