FannieMae ECONOMIC AND STRATEGIC RESEARCH

ESR Economic and Housing Weekly Note *May 1, 2015*

Economics: Economy Sings the Winter Blues

Fears of a brutal winter for the economy were realized with GDP data released this week, as economic growth ground to a halt during Q1 2015. Consumer spending drove what little growth there was, overcoming the large drag from net exports. The winter weather, the West Coast port strikes, declining energy-related capital expenditures, and the strong dollar were largely responsible for the first quarter slump, and we believe the latter two factors will likely linger in coming quarters. The statement following the April Federal Open Market Committee meeting partly attributed transitory factors for the sputtering economic growth, and the committee "continues to expect" growth to pick up. We agree. Despite the weak March jobs report, initial jobless claims trended down last week to the lowest level in 15 years. Though real personal income dropped in March, the 6.1 percent annualized gain for the quarter marks the strongest quarterly growth since Q4 2012. Given incoming data, we continue to hold our call for a September liftoff in the fed funds rate; however, we see risks skewed toward a later hike as fed funds futures now point to a year-end hike.

- **Gross Domestic Product (GDP),** adjusted for inflation, grew by a disappointing 0.2 percent annual rate in the first quarter of 2015, according to the first estimate from the Bureau of Economic Analysis. Personal consumption expenditures drove the meek growth, contributing 1.3 percent to GDP, but its growth decelerated to 1.9 percent in Q1 after robust 4.4 percent growth in Q4 2014. Inventory investment was the only other component that contributed positively to GDP, while fixed investment, net exports, and government spending were all drags on growth. Specifically, net exports acted as the largest drag to growth in a year, subtracting 1.25 percentage points. Housing failed to boost the economy, as residential fixed investment contributed a negligible amount to GDP.

- **Personal Income,** adjusted for inflation, fell 0.1 percent in March, the first drop since December 2013, according to the Bureau of Economic Analysis. Real personal consumption expenditures (PCE), on the other hand, grew 0.3 percent—the biggest gain in four months—driven by a surge in durable goods spending. The saving rate edged down four-tenths to 5.3 percent from a two-year high in February. The PCE chained price index rose 0.2 percent from February and 0.3 percent from last year for the second month running. Core PCE prices, which exclude food and energy, ticked up 0.1 percent in March and increased 1.3 percent year-over-year for the fourth month in a row.

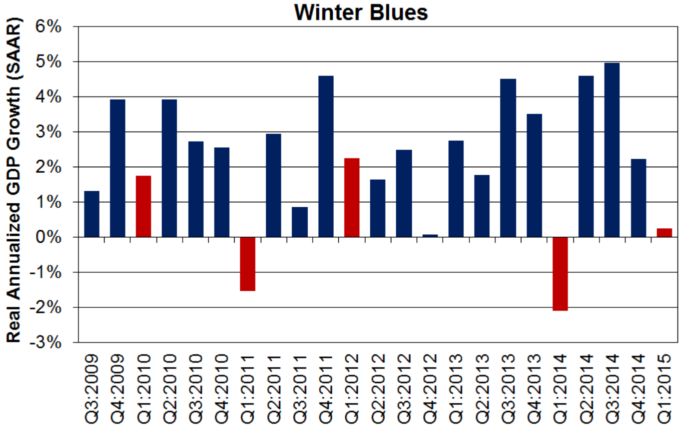
- **The Conference Board Consumer Confidence Index** tumbled 6.2 points in April to 95.2, the largest drop since October 2013, as both the present situation and consumer expectations components fell. By contrast, the **Reuters/University of Michigan Consumer Sentiment Index** rose 2.9 points in April to 95.9 after two months of decline.

- **The Institute for Supply Management (ISM) Manufacturing Index** was unchanged in April at 51.5, holding just above the threshold of 50, which indicates expansion in the sector. Improvement in the new orders and production indices were offset by deterioration in the supplier deliveries and employment indices—the latter of which fell into contraction territory for the first time since May 2013.

- **The Employment Cost Index (ECI)** rose 0.7 percent in Q1 2015 for the third time in the past four quarters. The year-over-year gain of 2.6 percent marks the fastest growth since Q4 2008.

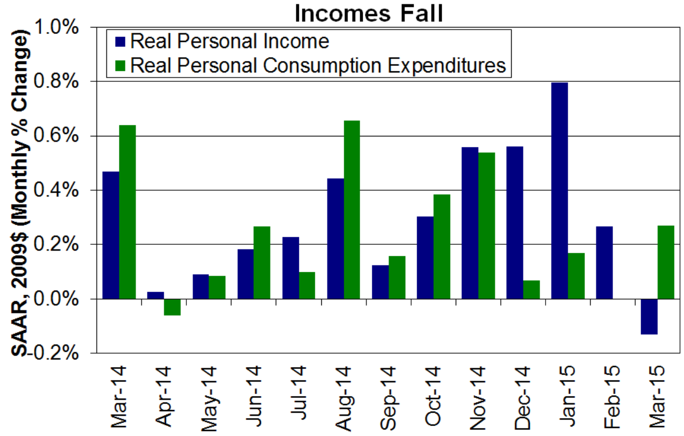
- **Initial claims for unemployment insurance** plunged 34,000 to 262,000 in the week ending April 25, according to the Department of Labor. The four-week moving average decreased by 1,250 to 283,750.

GDP Growth Again Sings the Old Tune of the Winter Blues



Source: Bureau of Economic Analysis

Consumers Open the Piggy Bank Even as Incomes Fall



Source: Bureau of Economic Analysis

Housing: Spring Momentum Builds

Housing data released this week had two distinct themes. The first, and more upbeat, is the early formation of one of the strongest spring/summer selling seasons in years. On the heels of the surge in existing home sales in March reported last week, pending home sales in March increased for a third consecutive month amid upward revisions to an already strong increase in February. Another leading indicator of home sales, purchase mortgage applications, held steady last week at the highest level since June 2013, when a sharp spike in mortgage rates prompted by the "Taper Tantrum" choked off budding housing market activity. The purchase applications index is now up 34.7 percent since the start of the year and 20.8 percent from a year ago. The contract interest rate for 30-year fixed-rate mortgages edged up three basis points this week according to Freddie Mac, but remains quite low at 3.68 percent and continues to support demand. Furthermore, home prices not only continue to rise at a healthy clip, but annual appreciation actually accelerated in the first two months of the year according to S&P/Case-Shiller. The second, more concerning theme, was persistent structural weakness in single-family homebuilding and homeownership. After nearly six years of recovery, spending on private single-family construction remains stuck near 1998 levels, while the homeownership rate declined a remarkable 1.1 percentage points over the past year to the lowest level in Q1 2015 since the early 1990s—fully erasing the gains witnessed in the decade from 1995 through 2005.

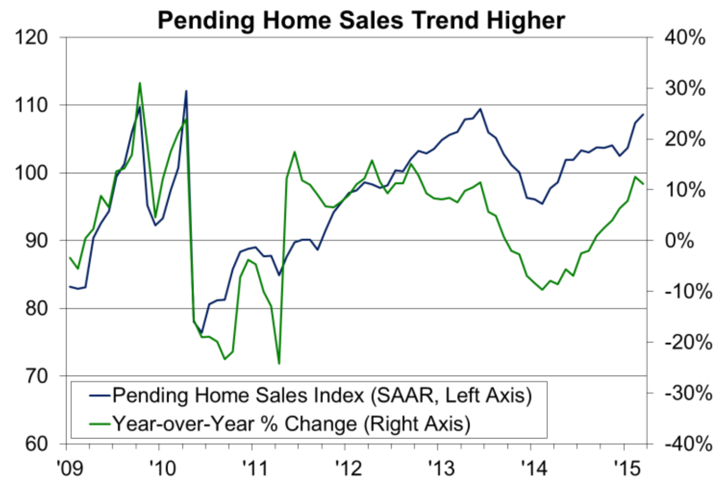
- **The National Association of REALTORS® pending home sales index,** which records contract signings of existing homes and typically leads closings by one to two months, rose 1.1 percent in March to the highest level since June 2013. From a year ago, pending home sales are up 11.1 percent.

- **The Housing Vacancy Survey (HVS)** for Q1 2015 (not seasonally adjusted) released by the Census Bureau showed a 0.3 percentage point decline in the homeownership rate to 63.7 percent—the lowest since Q1 1993. The rental vacancy rate ticked up 0.1 percentage points to 7.1 percent from a two-decade low in Q4. The homeowner vacancy rate held steady at 1.9 percent. The average number of households in Q1 declined 407,000 after a jump of 1.34 million in Q4. The year-over-year gain in households of 1.48 million was down from 1.66 million in Q4, but much higher than any previous period since 2006.

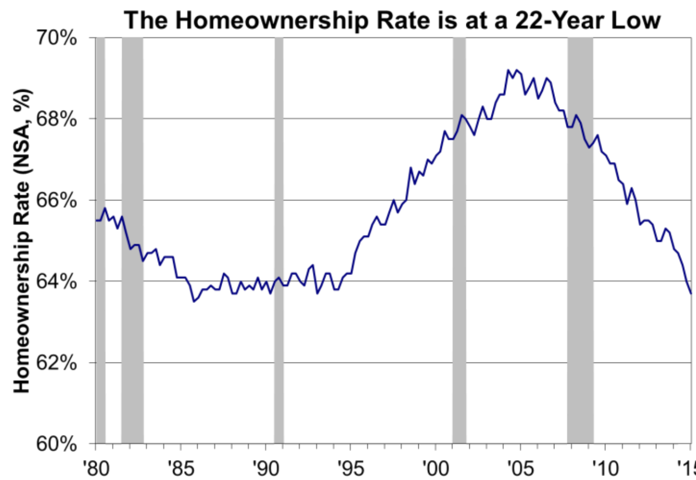
- **Private residential construction spending** declined 1.6 percent in March following a tepid gain in February, according to the Census Bureau. Spending on single-family and multifamily private construction sank 1.8 and 2.1 percent, respectively in March, but increased 7.8 and 23.4 percent, respectively, over the past 12 months.

- **The S&P/Case-Schiller composite 20-city home price index** (not seasonally adjusted) jumped 0.5 percent in the three months ending in February. From a year ago, the index is up 5.0 percent—the fastest annual appreciation since last August. All 20 cities measured registered annual price growth.

- **Mortgage applications** edged down 2.3 percent in the week ending April 24, according to the Mortgage Bankers Association. Refinance applications declined for the third time in four weeks, falling 3.7 percent amid a two-basis-point increase in the survey's contract interest rate for 30-year fixed mortgages to 3.85 percent. Purchase applications were unchanged on the week, holding at the highest level since June 2013.



Source: National Association of REALTORS®



Source: Census Bureau, Housing Vacancy Survey

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