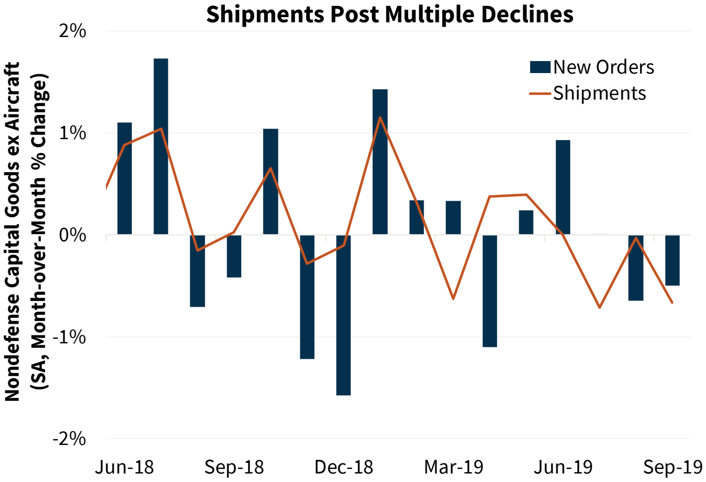
Economics: Equipment Spending Likely to Take a Hit in Q3

Consumer sentiment remained resilient this week but the manufacturing sector continued to show signs of erosion. Headline durable goods orders declined in September for the first time in four months, driven mainly by the volatile transportation equipment orders component. Orders for both motor vehicles and nondefense aircraft fell for the second straight month and details of the report showed weakness elsewhere as well. Excluding transportation, durable goods orders have moved largely sideways over the past year, staying within the tight range of $163 billion to $165 billion since April 2018. Durable goods shipments also dropped, falling to the lowest level in more than a year. Core capital goods shipments, which are an input to estimate business equipment spending, fell for the third straight month in September, making it likely that business equipment spending will be a drag on third quarter growth in gross domestic product (GDP). Core orders, the forward-looking indicator, posted the second consecutive month of significant declines, signaling poor capital expenditures momentum heading into 2020. In addition to weak September data, estimates for both core shipments and core orders for August were revised lower. While weakness in the durable goods report was expected, the broad-based losses may suggest that business investment in equipment dragged on GDP growth more than expected in the third quarter and that the return to positive territory we are predicting in the fourth quarter may be weaker than previously anticipated. On two brighter notes, initial claims for unemployment insurance declined this week, remaining near the 50-year low experienced earlier this year in April, and consumer sentiment increased in October, though the improvement shown over the past two months has yet to make up fully for the massive drop seen during August. Consumers' confidence in the current economic climate rose strongly, posting a seven-month best, while consumer expectations edged up modestly. According to the University of Michigan's press release, references to the negative impact of tariffs plummeted from 36 percent of respondents in September to 27 percent of respondents in October. Perhaps the most significant portion of the report, however, was the long-run inflation expectation component, which declined to 2.3 percent and tied the all-time low. Inflation expectations have declined steadily during this expansion, and we believe this latest drop likely increases support at the Fed for an October rate cut next week.

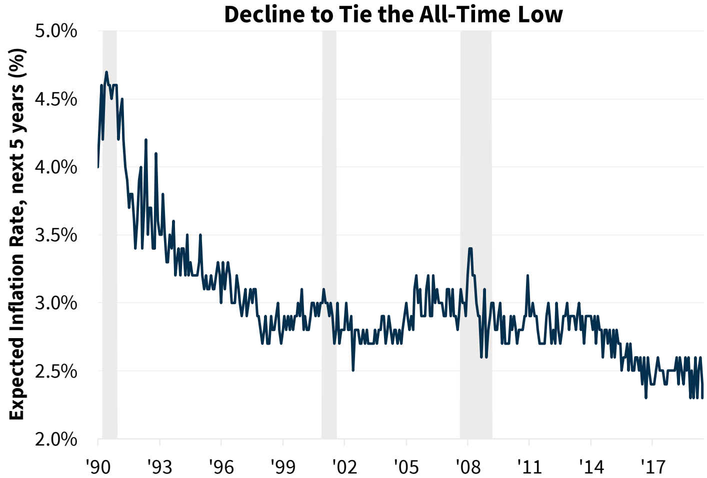
- **Durable goods orders** fell 1.1 percent in September, driven by transportation equipment orders, according to the Census Bureau. Excluding transportation, durable orders declined only 0.3 percent. Durable goods shipments dropped 0.4 percent while inventories were a bright spot, rising 0.5 percent. Orders and shipments of core capital goods (nondefense excluding aircraft) fell 0.5 percent and 0.7 percent, respectively.
- **The University of Michigan Consumer Sentiment Index** rose 2.3 points to 95.5 in the final October reading. Confidence in current economic conditions and future expectations both rose, increasing 4.7 points and 0.8 points, respectively. Both near-term and long-run inflation expectations declined.
- **Initial claims for unemployment insurance** fell by 6,000 to 212,000 in the week ending with October 19, according to the Department of Labor. The four-week moving average edged down by 750 to 215,000.

Both Core Capital Goods Orders and Shipments Post Multiple Declines



Source: Census Bureau

Long-Term Inflation Expectations Decline to Tie the All-Time Low



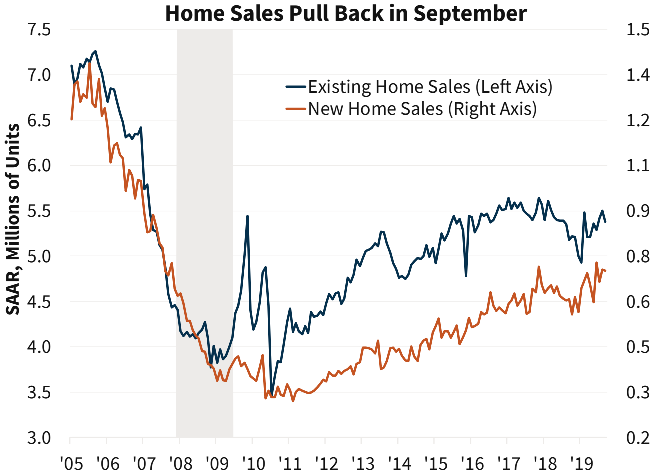
Source: University of Michigan

Housing: Home Sales Rise in the Third Quarter

Home sales activity adds to evidence that residential fixed investment will show a rebound in the third quarter. While sales of both new and existing single-family homes pulled back in September as we expected, home sales increased during the third quarter as a whole, in line with our outlook. On a quarterly basis, Q3 sales of new single-family homes rose to the highest annualized level since Q3 2007, while sales of existing homes rose to the highest annualized level since Q1 2018. The increase in sales implies an increase in broker commissions, which are a component of residential fixed investment. Inventories for both new and existing homes were essentially unchanged in September, but existing homes for sale fell on a year-over-year basis for the fourth straight month while new single-family homes for sale fell on a year-over-year basis for the first time since December 2012. The shortage of for-sale inventory is expected to continue to weigh on future home sales growth until there is a sustained increase in either new construction or household mobility. The annual growth in the median sales price for existing homes rose in September, while growth of the median sales price of new homes posted the largest decline this year, falling to the lowest level since February 2017. While the median sales price of new homes remains well above the median price of existing homes, the gap between the two has narrowed recently, likely reflecting a decline in median square footage of new construction as homebuilders respond to unmet demand for more modestly priced homes. The FHFA Purchase-Only House Price Index showed that annual home price appreciation slowed in August, reversing the slight acceleration from July and decelerating to the slowest pace since October 2014. The average rate on 30-year fixed-rate mortgages rose 6 basis points to 3.75 percent this week, according to Freddie Mac, the highest level since August 1, though still a full percentage point below year-ago levels. Despite relatively low mortgage rates, both purchase and refinance mortgage applications dropped sharply last week. Purchase applications have fallen for three straight weeks, suggesting another potential pullback in sales in the coming months.

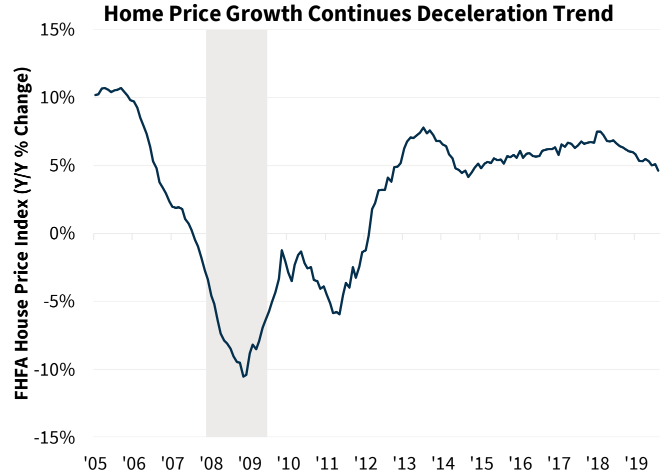
- **New single-family home sales** pulled back slightly in September, falling by 0.7 percent to a seasonally adjusted annualized rate (SAAR) of 701,000, according to the Census Bureau. Sales fell in every region except the Midwest. The months' supply was unchanged at 5.5 months, as the number of new single-family homes for sale declined by just 2,000. From a year-ago, new home sales rose 17.4 percent, while the median sales price fell 8.8 percent to $299,400. On a quarterly basis, Q3 new home sales rose for the second time in three quarters to 691,000 (SAAR).
- **Existing home sales** fell 2.2 percent in September to 5.38 million (SAAR), according to the National Association of REALTORS®. Sales fell in every region. The number of existing homes for sale was unchanged from August at 1.83 million, while the months' supply rose one-tenth to 4.1 (not seasonally adjusted). From a year ago, existing home sales rose 3.9 percent while the median sales price rose 5.9 percent. On a quarterly basis, Q3 existing home sales rose for the third straight quarter.
- **The FHFA Purchase-Only House Price Index**, reported on a seasonally adjusted basis, rose 0.2 percent in August and 4.6 percent from a year-ago.
- **Mortgage applications** plunged by 11.9 percent in the week ending October 18, according to the Mortgage Bankers Association. Refinance applications and purchase applications both fell, dropping 17.1 percent and 3.6 percent respectively.

Home Sales Pull Back in September



Source: Census Bureau, National Association of REALTORS®

Home Price Growth Continues Deceleration Trend



Source: Federal Housing Finance Agency

Ricky Goyette and Rebecca Meeker
Economic and Strategic Research Group
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