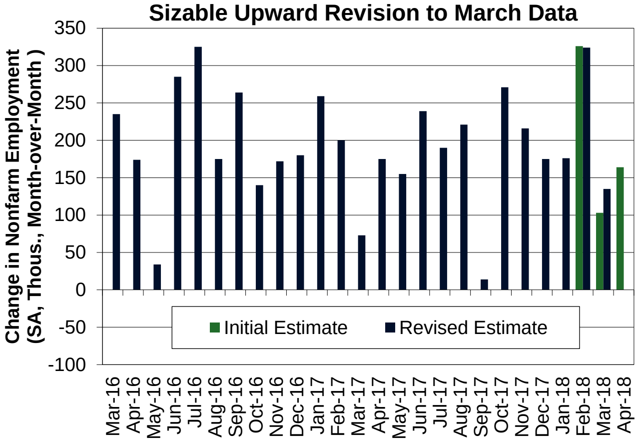
Weekly Note – May 4, 2018

Economics: Low Unemployment Doesn't Lift Wage Gains

A lukewarm April jobs report took center stage for a busy week of economic news. Job gains came in on the soft side, but upward revisions on net in the prior two months helped to keep the three-month average gain above 200,000. The annual increase in average hourly earnings held steady for the third consecutive month. The first drop in the unemployment rate in six months was the result of the second straight drop in the labor force participation rate. One bright spot was the decrease in the broadest measure of labor underutilization (U-6) to the lowest level in nearly 17 years. While wage pressures continued to be muted, inflation picked up. The Fed's preferred measure of inflation, the personal consumption expenditures (PCE) deflator, rose 2.0 percent annually in March after four consecutive months of 1.7 percent gains. The statement following the May Federal Open Market Committee meeting reflected the acceleration, noting that inflation "moved close to" the 2 percent target, a change from "continued to run below" in the prior statement. Another notable modification in the statement was that inflation is "expected to run near the Committee's symmetric 2 percent objective over the medium term." The introduction of the word "symmetric" could be a signal that the Fed will tolerate inflation temporarily moving above the target. The Committee also dropped the language that it is "monitoring inflation developments closely," hinting that it is more confident in the near-term inflation outlook. The statement's somewhat dovish tone and the April jobs report support our view of a June rate hike followed by only one more increase this year. In other news, real consumer spending rebounded in March from the first back-to-back drops since 2009. Spending increases outpaced a rise in disposable personal income, pushing down the saving rate. Turning to second quarter consumer spending, auto sales fell in April, continuing the downward trend which began last September. Productivity rose on a quarterly basis and posted modest annual growth of slightly more than 1 percent, similar to the pace seen over the past year. The trade deficit narrowed sharply in March, recovering from February's widest level of the expansion. Finally, factory orders increased in March and nondurable goods orders reached the highest level since October 2014.

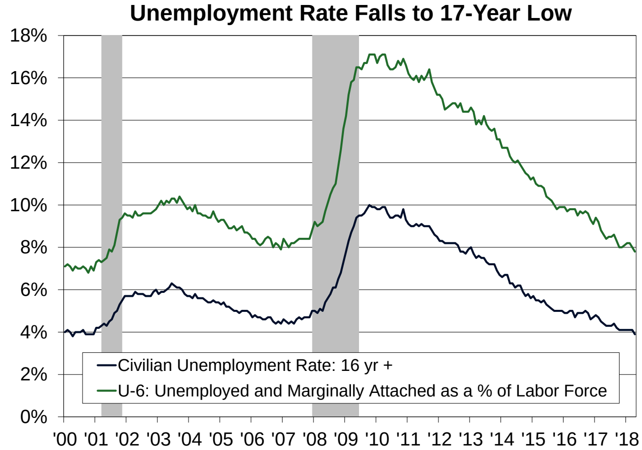
- **Nonfarm payroll employment** expanded by 164,000 in April, according to the Bureau of Labor Statistics. The three-month average gain slowed to 208,000 from 212,000 in March. Job gains the prior two months were revised up 30,000 on net. The unemployment rate and the labor force participation rate fell to 3.9 percent and 62.8 percent, respectively. The U-6 rate fell two-tenths to 7.8 percent. The average workweek was flat at 34.5 hours. Average hourly earnings increased 0.1 percent in April and 2.6 percent from a year ago.
- **Personal income**, adjusted for inflation, improved 0.3 percent in March, according to the Bureau of Economic Analysis. Real PCE rose 0.4 percent and the saving rate decreased two-tenths to 3.1 percent. The PCE deflator was flat from February, with core PCE rising 0.2 percent from February and 1.9 percent from a year ago.
- **The U.S. trade deficit** narrowed $8.8 billion to $49.0 billion in March, according to the Census Bureau. The inflation-adjusted goods deficit, used to calculate net exports in the GDP estimate, narrowed by $6.9 billion to $62.1 billion.
- **Nonfarm business productivity** rose 0.7 percent annualized in Q1 2018 and 1.3 percent year over year, according to preliminary estimates by the Bureau of Labor Statistics. Annually, unit labor costs rose 1.1 percent.
- **The ISM Manufacturing Index** fell 2.0 points to 57.3 in April (any reading above 50 indicates expansion). **The ISM Nonmanufacturing Index**, a gauge of service sector activity, also fell 2.0 points in April to 56.8.
- **Factory orders** rose 1.6 percent and factory shipments increased 0.4 percent in March, according to the Census Bureau. Nondurable goods orders, the new piece of data in the report, rose 0.5 percent.
- **Light vehicle sales** fell 1.8 percent to 17.2 million annualized units in April, according to Autodata.

Job Growth Accelerates in April Along With a Sizable Upward Revision to March Data



Source: Bureau of Labor Statistics

Unemployment Rate Falls to 17-Year Low



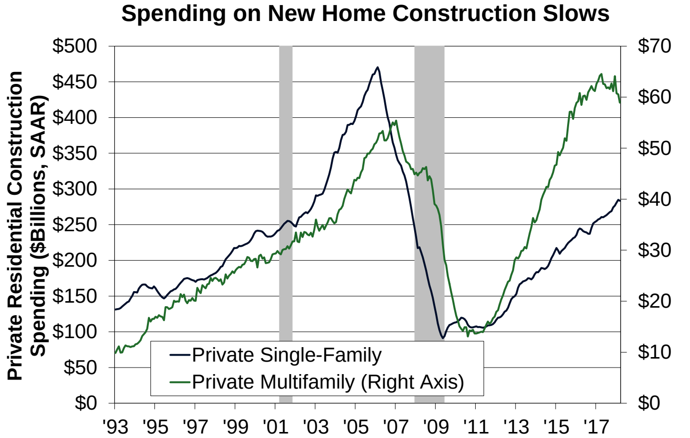
Source: Bureau of Labor Statistics

Housing: Market Tries to Shake Off the Winter Blues

This week's data suggested the housing market struggled to move past a sluggish first quarter. First, the March construction spending report pointed to a slight decline in real residential investment in the first quarter versus a flat reading reported in last week's first estimate of first quarter gross domestic product. Residential construction spending dropped during the month by the largest amount of the expansion, ending a four-month streak of increases. Single-family spending fell for the first time in 10 months but posted a 10 percent or greater annual gain for the third consecutive month. Spending on multifamily construction declined for the fourth time in five months and recorded the largest annual drop in seven years. Unseasonably bad weather weighed on building activity, and we expect to see some improvement this quarter. Second, two leading indicators for home sales painted an improving picture heading into the spring selling season. Pending home sales, which are contract signings of existing homes and typically lead closings by one to two months, rose for the second consecutive month in March. However, the year-over-year trend remains bearish, as sales fell for the third straight month. Purchase mortgage applications, another leading indicator, declined during the last week of April. However, the April average rose for the second consecutive month and the fifth time in six months, climbing to an eight-year high. Refinance applications fell last week to a new weekly expansion low, with the monthly average dropping for the third consecutive month. Potential home buyers continue to face headwinds from accelerating home price gains, as the CoreLogic National Home Price Index rose 7 percent annually in March, the biggest increase since May 2014. Homes priced below the median continued to appreciate faster than homes above the median, posing a particular challenge for first-time homebuyers. Regionally, four states showed double-digit annual appreciation, all of which were in the West (Washington, Nevada, Idaho, and Utah). Mortgage rates edged down this week from last week's four-year high, with the 30-year fixed mortgage rate slipping 3 basis points to 4.55 percent, according to Freddie Mac.

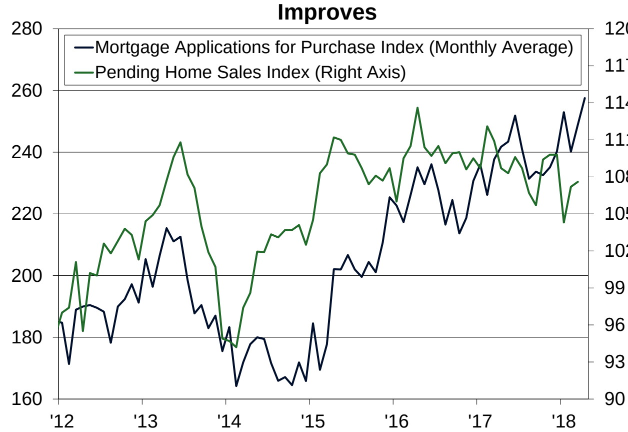
- **The National Association of REALTORS® (NAR) Pending Home Sales Index** edged up 0.4 percent in March. The February gain was revised downward slightly. The index declined 3.0 percent from March 2017.
- **Private residential construction spending** fell 3.5 percent in March, according to the Census Bureau. New single-family spending fell 0.4 percent, while multifamily spending dropped 2.7 percent. Home improvement spending fell 8.0 percent. From a year ago, single-family spending increased 10.0 percent, and multifamily spending fell 9.2 percent.
- **The CoreLogic National Home Price Index**, a repeat sales measure, rose 1.5 percent in March (not seasonally adjusted). On an annual basis, the index increased 7.0 percent. Prices in the lowest price tier (75 percent or less of the median) increased 9.6 percent year-over-year, while prices in the low-to-middle price tier (between 75 and 100 percent of the median) rose 8.6 percent annually. The middle-to-moderate price tier (between 100 and 125 percent of the median) and the high price tier (greater than 125 percent of the median) posted 7.2 percent and 5.8 percent annual gains, respectively. Regionally, the states of Washington and Nevada saw the strongest annual growth of 12.6 percent, followed by Idaho and Utah, with 12.3 percent and 11.2 percent annual gains, respectively.
- **Mortgage applications** declined 2.5 percent for the week ending April 27, according to the Mortgage Bankers Association (MBA). Purchase applications decreased 1.6 percent, and refinancing applications fell 3.5 percent. The MBA's survey average 30-year fixed mortgage rate jumped 7 basis points to 4.80 percent, a four-year high.

Spending on New Home Construction Slows



Source: Census Bureau

Near-Term Outlook for Home Sales Improves



Source: NAR, MBA

Rebecca Meeker and Frank Shaw
Economic and Strategic Research Group
May 4, 2018

Opinions, analyses, estimates, forecasts and other views of Fannie Mae's Economic and 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.