FannieMae ECONOMIC AND STRATEGIC RESEARCH

ESR Economic and Housing Weekly Note *June 6, 2014*

Economics: May Indicators Support Outlook for a Rebound in Growth

Economic growth, viewed in the rearview mirror, continued to soften as the April trade report revised up imports in March, suggesting that last week's downward revision to Q1 2014 GDP (from a 0.1 percent increase to a 1.0 percent decline) was likely not enough. However, our expectation for a sharp rebound in the current quarter was bolstered this week by a flurry of upbeat May data, including continued strength in employment growth (four consecutive months of more than 200,000 job gains for the first time since 2000), surging leading indicators of manufacturing and service sector activity, and the fastest pace of auto sales since February 2007. Still, the worsening picture of Q1 2014 economic activity suggests that even with significant catch-up through the remainder of 2014 our May forecast for 2.4 percent annual growth for 2014 may be too optimistic.

- **Nonfarm payroll employment** rose 217,000 in May leaving the average monthly gain over the past three months at 234,000—near the highest level witnessed in more than two years. The average workweek held steady at 34.5 hours, while average hourly earnings edged up 0.2 percent for the month and 2.1 percent for the year. In the separate survey of households, household employment and the civilian labor force were little changed—leaving the unemployment rate and the participation rate unchanged at 6.3 percent and 62.8 percent, respectively.

- **The Institute for Supply Management (ISM) Manufacturing Index** increased 0.5 points in May to a four-month high of 55.4 (any reading above 50 indicates expansion in the sector). Current production and new orders both reached new highs for the year, though the employment index dipped 1.9 points, reversing more than half of the large jump witnessed in April. **The ISM Nonmanufacturing Index**, which measures the service sector, rose 1.1 points to 56.3 in May—the highest reading since last August. The business activity and new orders subcomponents both reached the highest level since Q1 2011, while the employment index rose a more modest 1.1 points to 52.4—firmly in expansion territory.

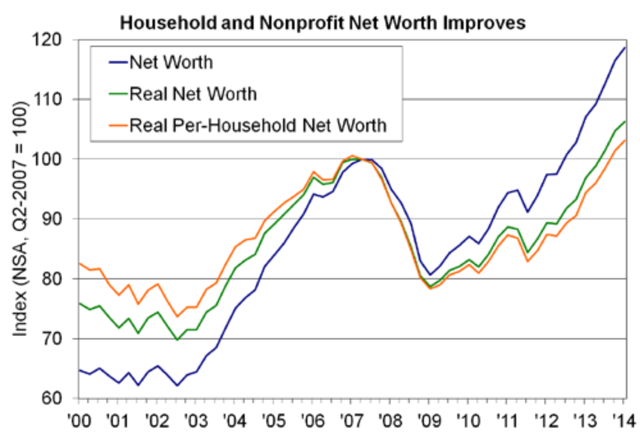
- **Factory orders** rose 0.7 percent in April following a 1.5 percent increase in March. Core capital goods—a leading indicator of business investment—declined 1.2 percent in April (unrevised from last week's advance estimate) after a 4.7 percent jump in March.

- **The U.S. trade deficit** widened for the fifth consecutive month—$3.1 billion in April—to $47.2 billion. Sharply increasing imports of goods and services so far in 2014 after three years of essentially flat growth, combined with the sideways trend in exports over the past six months, drove the widest trade deficit in two years. The inflation-adjusted goods deficit, an input into the estimation of GDP, increased $3.0 billion in April to $53.8 billion—the largest deficit since October 2008.

- **Nonfarm business productivity** was revised down to show a 3.2 percent seasonally adjusted annualized decline in Q1 2014 compared to the previously reported 1.7 percent drop—due to the downward revision to Q1 2014 economic output and an upward revision to hours worked. Unit labor costs rose at a 5.7 percent clip—the largest gain in over a year.

- **Net worth in the household and nonprofit sector** rose $1.5 trillion in Q1 2014 to an all-time high of $81.8 trillion. A healthy increase in assets, including both real estate and financial, drove the increase, while liabilities ticked up only modestly. Though nominal household net worth is now approximately 19 percent above the previous peak witnessed in Q2 2007, inflation and household adjusted net worth has risen a much more modest 3 percent over that span.

Source: Institute for Supply Management



Source: Federal Reserve Board

Housing: Purchase Demand Remains Low as Home Prices Continue to Rise

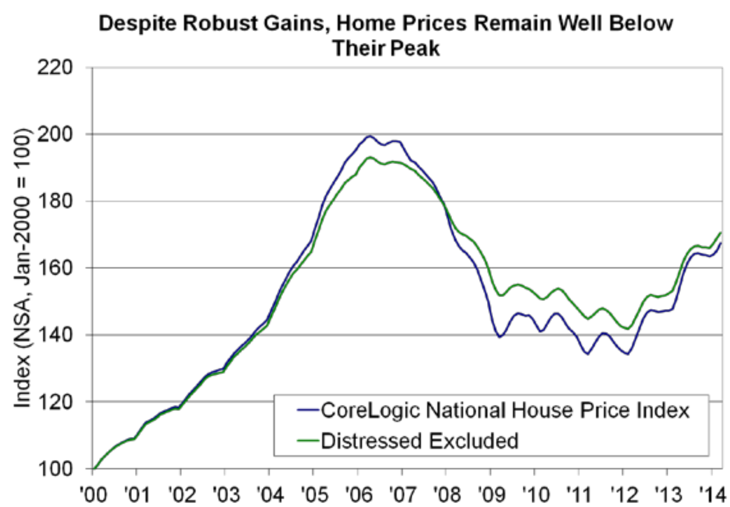
Purchase mortgage demand continued to pull back from last year's levels against a backdrop of robust year-over-year home price gains across the country. A drop in mortgage rates helped to boost refinance application volume in May, the first increase in three months. However, we believe this effect is temporary as rates are poised to rise through the second half of this year and a majority of eligible borrowers have already refinanced. Residential construction spending increased for the sixth straight month, led higher by spending increases in both new single-family and new multifamily construction, signaling that much needed housing supply is forthcoming.

- **Residential construction spending** increased to a seasonally adjusted annual rate of $379 billion in April, up 0.1 percent from March. Construction spending for new homes rose, with single-family and multifamily construction spending gaining 1.3 percent and 2.7 percent, respectively, while spending on improvements to existing homes fell. Residential construction spending was up 17.2 percent from April 2013, as spending for both new housing and improvements continued to show large year-over-year gains. However, residential construction spending remains over 40 percent below its record high witnessed in 2006.

- **The CoreLogic Home Price Index** (not seasonally adjusted) increased 2.1 percent in April, and is up 10.5 percent from April 2013. Year-over-year home price gains were seen in 95 of the top 100 metro areas by population and in all states. The index excluding distressed sales increased 1.1 percent in April 2014 and is up 8.3 percent compared to April 2013 as investors continued to fuel some of the gains seen in the overall index. Although the overall index has risen a cumulative 27 percent from the March 2011 trough, it remains 17 percent below the April 2006 peak.

- **The Mortgage Bankers Association Mortgage Applications Survey** showed that mortgage applications continued to slide last week, with purchase applications and refinance applications falling 3.6 percent and 2.9 percent, respectively. The average monthly purchase index increased 1.3 percent from April but fell 14.7 percent from a year ago. The refinance index rose 3.2 percent during the month but was 67.3 percent below May 2013 levels.

- **Single-family mortgage debt outstanding** (MDO) declined 0.4 percent in Q1 2014, as new mortgage origination volume failed to keep up with the combined pace of amortization, prepayments, and charge-offs. Excluding Q3 2013, mortgage debt outstanding has been declining since Q2 2008. It is worth noting, however, that the pace of MDO decline has been slowing year-over-year. We expect MDO to post a small gain this year—the first annual rise in seven years.



Source: CoreLogic

Source: Federal Reserve Board

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