# HaMMR Digest

**Stay current with economic and mortgage market trends.**

## May 15, 2023

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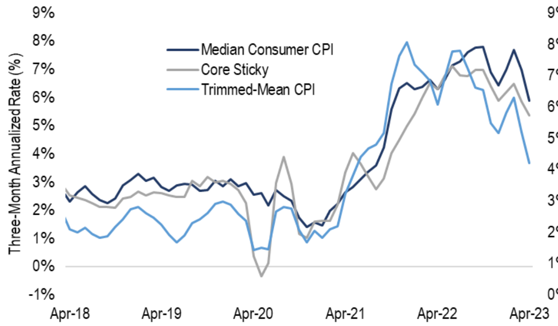
## Weekly Wrap — Tidal Wave or Rough Chop?

- Inflation is trending in the right direction with reduced credit flows adding further downward pressure ahead.
- First read on post-banking-squall lending standards not reflective of a severe credit crunch.
- Recent data strengthens the case for the Fed to pause. We still do not expect any rate cuts this year.

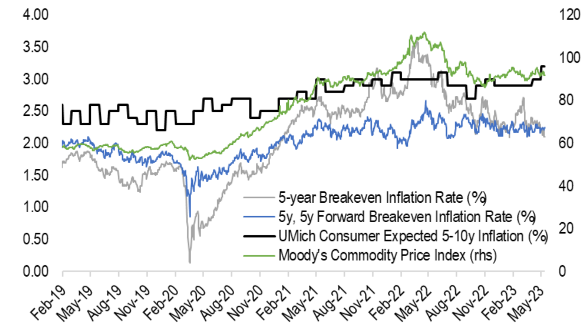
Inflation was the headline-grabbing macro news last week. Consumer Price Index (CPI) inflation rose 0.4% m/m (cons. 0.4%) in April from 0.1% last month. Core CPI (excluding food and energy) also rose 0.4% (cons. 0.4%), with the three-month annualized rate holding steady at 5.0% for the third straight month. Energy costs bolstered the headline rate as gasoline prices climbed while grocery prices declined for the second straight month. April Producer Price Index (PPI) inflation increased by 0.2% m/m (cons. 0.2%), up from a -0.5% decline last month but was still a disinflationary print given the downtrend in the annual rate of PPI inflation to 2.4% from 8.7% in August. In addition, core PPI excluding trade services has averaged 0.2% for the last three months, half the rate of the prior 12 months.

**Figure 1: Consumer Inflation**




*Sources: Federal Reserve Bank (FRB) of Atlanta, FRB Cleveland, Arch MI*

**Figure 2: Inflation Monitor**




*Sources: Moody's, University of Michigan, Federal Reserve Board, Arch MI*

The first read on the impact of the banking squall on lending conditions came from the Senior Loan Officer Opinion Survey (SLOOS), conducted after the failure of Silicon Valley Bank (SVB) but before First Republic Bank's resolution. The report showed a continuation of tightening in credit conditions across all types of lending. However, the magnitude of the change was less than anticipated. Loan standards for businesses were mostly unchanged from the prior quarter with only 3.2% of banks tightening credit "considerably." In addition, the main reason behind the tightening was precautionary as opposed to realized credit deterioration, industry specific issues or worsening bank capital positions. The bulk of loan demand was "moderately" instead of "substantially" weaker compared to the prior release, as well. The topline view of the details implies that credit tightness feeding through the system will be more of an incremental slog instead of an immediate credit crunch. Supporting that notion, while overall sentiment in the NFIB Small Business Optimism Index weakened in April (89.0 vs cons. 89.7), the net share of firms reporting credit being harder to obtain fell 3%-pts m/m to 6%, par with pre-SVB trends.

The recent trend in consumer inflation has been choppy but nonetheless trending down. The trimmed-mean measure, which excludes the most volatile components every month to give a cleaner read of price pressures, is trending in the right direction (Figure 1) but still well above the Fed's 2% average inflation target. Meanwhile, medium-term consumer inflation expectations unexpectedly rose to 3.2% (cons. 2.9%) in the University of Michigan preliminary reading (Figure 2). Moreover, consumer sentiment tumbled to a six-month low of 57.7 (cons. 63.0) driven by weakening expectations, likely influenced by press coverage of the debt ceiling and banking sector stress. Overall, recent data should be just enough for the Fed to hold rates unchanged at the upcoming June meeting. Banking risks are not fully behind us, debt ceiling risks are coming to the fore and tighter credit will quicken labor market normalization while also weighing on demand — all of which will help alleviate capacity constraints and alleviate price pressures. However, a pause in the hiking cycle does not imply rate cuts are in the near-term future. Despite encouraging inflation trends, the rate of inflation remains far too elevated and, thus, we expect the Fed to keep rates at the current level through year-end to ensure inflation fully normalizes.

## Recent Data Releases

Key economic and housing data releases over the last week:

| Date | Indicator | Period | Actual | Consensus | Previous | Note |
|---|---|---|---|---|---|---|
| 5/8/23 | Wholesale Inventories m/m | Mar F | 0.0% | 0.1% | 0.1% | sa |
| 5/9/23 | NFIB Small Business Optimism | Apr | 89.0 | 89.7 | 90.1 | index, sa |
| 5/10/23 | MBA Mortgage Applications | 5/5/23 | 6.3% | -- | -1.2% | w/w, sa |
| 5/10/23 | CPI m/m | Apr | 0.4% | 0.4% | 0.1% | sa |
| 5/10/23 | CPI Core (ex Food and Energy) m/m | Apr | 0.4% | 0.4% | 0.4% | sa |
| 5/10/23 | CPI y/y | Apr | 4.9% | 5.0% | 5.0% | nsa |
| 5/10/23 | CPI Core (ex Food and Energy) y/y | Apr | 5.5% | 5.5% | 5.6% | nsa |
| 5/11/23 | Initial Jobless Claims | 5/6/23 | 264 | 245 | 242 | k, sa |
| 5/11/23 | Continuing Claims | 4/29/23 | 1,813 | 1,820 | 1,801 | k, sa |
| 5/11/23 | PPI Final Demand m/m | Apr | 0.2% | 0.3% | -0.4% | sa |
| 5/11/23 | PPI Core (ex Food and Energy) m/m | Apr | 0.2% | 0.2% | 0.0% | sa |
| 5/11/23 | PPI Final Demand y/y | Apr | 2.3% | 2.5% | 2.7% | nsa |
| 5/11/23 | PPI Core (ex Food and Energy) y/y | Apr | 3.2% | 3.3% | 3.4% | nsa |
| 5/12/23 | Import Price Index y/y | Apr | -4.8% | -4.8% | -4.8% | nsa |
| 5/12/23 | U. of Mich. Sentiment | May P | 57.7 | 63.0 | 63.5 | index, nsa |
| 5/12/23 | U. of Mich. 1 Yr Inflation | May P | 4.5% | 4.4% | 4.6% | nsa |
| 5/12/23 | U. of Mich. 5-10 Yr Inflation | May P | 3.2% | 2.9% | 3.0% | nsa |

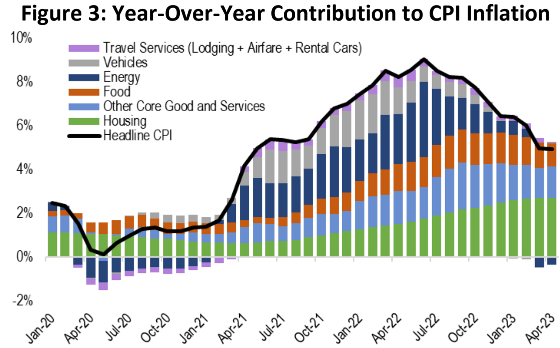
*Sources: Bloomberg Consensus Survey of Economists, Arch MI*

**Green** = beat expectations; **Red** = worse than expectations; (compared vs. prior if no consensus estimates available)

**CONSUMER PRICE PRESSURES MAKING CHOPPY PROGRESS**

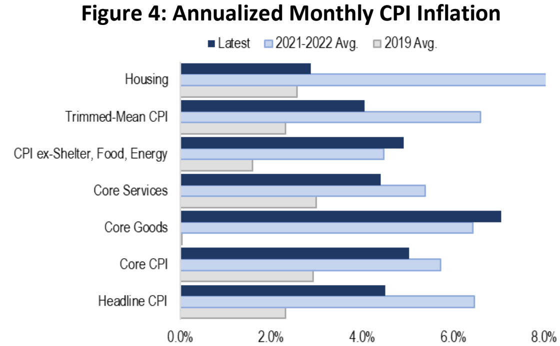
The April Consumer Price Index (CPI) inflation report was in line with consensus expectations with the headline index rebounding from 0.1% last month to 0.4% m/m (cons. 0.4%) or 4.9% y/y, a step down from 5.0% y/y in March (Figure 3). The rebound was led by a 0.6% m/m gain in energy prices, driven by a 3.0% increase in gasoline prices, which more than offset the drag from the second consecutive month of unchanged consumer food prices. Despite announced OPEC production cuts, benchmark oil prices have declined over the past month and retail gasoline prices have accordingly turned lower in early May as well. Natural gas prices have also declined back toward the level that prevailed prior to the pandemic. Altogether, energy prices should flip from a tailwind to a headwind for inflation in the May report. Households are also getting respite at the grocery story with food at home prices declining for the second straight month while food away from (i.e., dining out), remained firm at 0.4% m/m. Producer prices for finished consumer foods has declined by 4% since December, suggesting that cooling grocery bills could persist for some time.

**Figure 3: Year-Over-Year Contribution to CPI Inflation**




*Sources: Bureau of Labor Statistics, Arch MI*

**Figure 4: Annualized Monthly CPI Inflation**



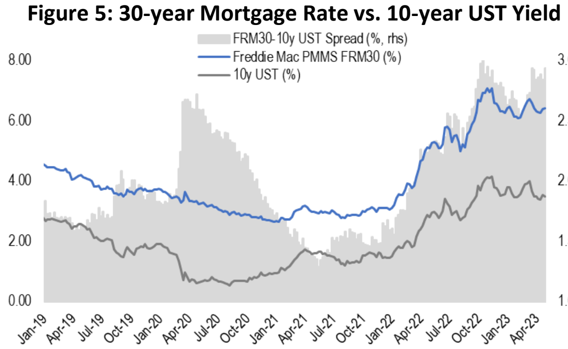

*Sources: Bureau of Labor Statistics, Arch MI*

Core inflation (excluding food and energy) remained rather muddled, rising in line with consensus expectations at 0.4% m/m, or 5.0% annualized (Figure 4). Core goods prices accelerated to 0.6% m/m, the fastest pace since last May, mostly due to a 4.5% jump in used vehicles. We had been expecting used vehicles to rebound given the recent firming in wholesale car prices. On top of still-tight auto supply and pent-up consumer demand, vehicle prices could stay firm in the months ahead. Other core goods prices eased but were still strong, namely apparel (0.3%), medical commodities (0.5%) and recreation goods (0.3%). Core services inflation slowed 9bps to 0.4% m/m, a tenth below its three-month average with the bulk of weakness coming from hotels (-3.0%) and airfares (-2.6%). Rent ticked up to 0.6% m/m from 0.5% in March while owners' equivalent rent held at 0.5% for the second straight month — both measures of housing inflation are a step down from the strong 0.7-0.8% monthly prints that prevailed over the second half of 2022. The cooldown in housing inflation roughly coincides with our expectations, based on the roughly 12-month lag between home price and rent growth (which both have been slowing or declining since 2Q22) and the CPI measures. We expect housing inflation to continue to cool as the year progresses based on this lagged relationship.

**MORTGAGE APPLICATION ACTIVITY BOUNCED BACK BUT REMAINED WELL BELOW PRE-COVID LEVELS**

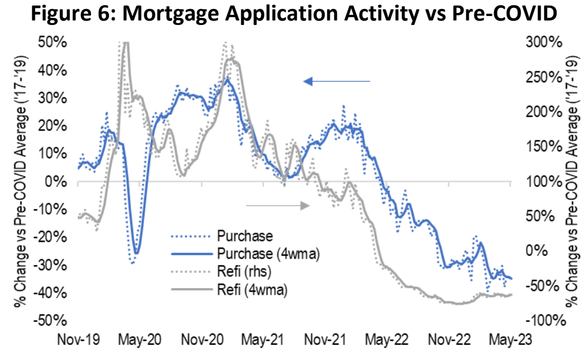
According to the MBA Weekly Applications Survey, the average contract conventional mortgage rate declined -2bps to 6.48% during the week ending May 5 while the FHA contract mortgage rate also declined -2bps to 6.41%, resulting in an unchanged spread (-0.07%) between the FHA and conventional mortgage rate. Freddie Mac's more recent Primary Mortgage Market Survey (PMMS) for the week ending May 10 indicated that the FRM30 declined -4bps w/w to 6.35% (Figure 5) as 10-year UST yields declined -2bps to an average of 3.46% over the same period. Accordingly, the spread between the PMMS FRM30 and the 10-year UST narrowed -2bps to 2.89%, about 120bps wider than its typical non-stressed level prior to the pandemic and still close to the peak of 300bps reached last October. We expect rate volatility and mortgage spreads to remain wide until more clarity is gained around the path of inflation and monetary policy, which is not likely to occur before mid-year.

**Figure 5: 30-year Mortgage Rate vs. 10-year UST Yield**




*Sources: Freddie Mac Primary Mortgage Market Survey, Federal Reserve Board, Arch MI*

**Figure 6: Mortgage Application Activity vs Pre-COVID**




*Sources: Mortgage Bankers Association, Arch MI*

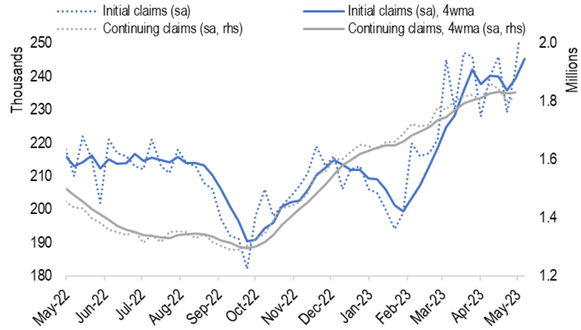
The MBA Weekly Applications Survey for the week ending May 5 increased 6.3% w/w, leaving the index down -37% year-over-year and down -44% compared with pre-pandemic levels (i.e., the average of the same week in 2017, 2018 and 2019). The weekly increase was driven primarily by a 10% increase in refinancing applications, which remained down -44% y/y despite the weekly increase, and -59% below the pre-pandemic level (Figure 6). Purchase applications increased 4.8% w/w but remained down -32% y/y and -33% relative to pre-pandemic levels.

**JOBLESS CLAIMS CONTINUED TO MOVE SIDEWAYS**

Initial jobless claims rose by 22k to a seasonally adjusted 264k (cons. 245k) during the week ending May 6, moving the four-week average up to 245k from 239k (Figure 7). The non-seasonally adjusted level of initial claims moved up to 19% above its pre-COVID average (i.e., 2018 to 2019) from 13% the week before and up from -17% below in mid-January (Figure 8). Meanwhile, continuing claims for regular state programs (i.e., repeat filers for unemployment insurance) climbed by 12k during the week ending April 29 to a seasonally adjusted 1,813k (cons. 1,820k), moving the four-week average up to 1,830k from 1,827k. The non-seasonally adjusted level of continuing claims moved down to -1% below its pre-COVID average from 0% the week before and up from -17% below in mid-January.

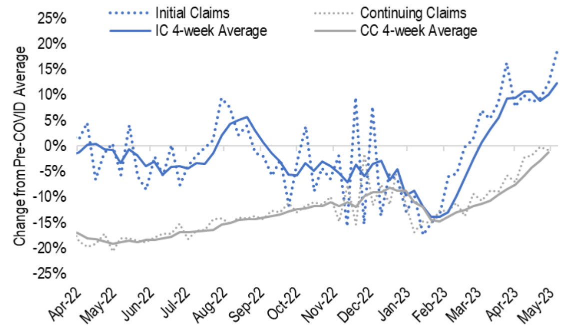
 

**Figure 7: Initial and Continuing Jobless Claims (SA)**




*Source: U.S. Department of Labor, Arch MI*

**Figure 8: Claims (NSA) vs Pre-COVID Average**




*Source: U.S. Department of Labor, Arch Global Economics*

Although claims had generally trended sideways over the past month or so, the series has been very noisy, in part due to the difficulty in seasonally adjusting weekly data around holidays. The jump last week was notable, although more than half of the increase came from a single state: Massachusetts. According to the state, “the increase seen in initial weekly unemployment claims is not reflective of individuals filing for unemployment insurance but rather fraudulent attempts on the system.” While claims data has certainly trended higher in recent months, last week’s jump undoubtedly overstated the cooling in labor market conditions.

## The Week Ahead

This week’s data releases will be concentrated in the housing and manufacturing sectors. May National Association of Home Builders (NAHB) Housing Market Index is expected to remain unchanged relative to April, according to the Bloomberg Consensus Survey of Economists. Housing construction activity is expected to have remained choppy in April, with housing starts down -1.4% m/m and building permits up 0.2% compared with respective declines of -0.8% and -7.7% in March. April existing home sales are expected to have declined by -3.2%, which would be an acceleration relative to the -2.4% decline in March. Manufacturing activity is expected to have cooled slightly in April, while retail sales are expected to have bounced back last month (0.8% m/m vs -0.6% in March).

### UPCOMING DATA RELEASES

Key economic and housing data releases for the coming week:

| Date | Indicator | Period | Actual | Consensus | Previous | Note |
|---|---|---|---|---|---|---|
| 5/15/23 | Empire Manufacturing | May | -- | -3.9 | 10.8 | index, sa |
| 5/16/23 | Advance Retail Sales m/m | Apr | -- | 0.8% | -0.6% | sa |
| 5/16/23 | Retail Sales Control Group m/m | Apr | -- | 0.3% | -0.3% | sa |
| 5/16/23 | Industrial Production m/m | Apr | -- | 0.0% | 0.4% | sa |
| 5/16/23 | Capacity Utilization | Apr | -- | 79.7% | 79.8% | sa |
| 5/16/23 | Business Inventories m/m | Mar | -- | 0.0% | 0.2% | sa |
| 5/16/23 | NAHB Housing Market Index | May | -- | 45 | 45 | index, sa |
| 5/17/23 | MBA Mortgage Applications | 5/12/23 | -- | -- | 0.1 | w/w, sa |
| 5/17/23 | Housing Starts | Apr | -- | 1,400 | 1,420 | k, saar |
| 5/17/23 | Housing Starts m/m | Apr | -- | -1.4% | -0.8% | sa |
| 5/17/23 | Building Permits | Apr | -- | 1,434 | 1,430 | k, saar |
| 5/17/23 | Building Permits m/m | Apr | -- | 0.2% | -7.7% | sa |
| 5/18/23 | Initial Jobless Claims | 5/13/23 | -- | 252 | 264 | k, sa |
| 5/18/23 | Continuing Claims | 5/6/23 | -- | 1,819 | 1,813 | k, sa |
| 5/18/23 | Philadelphia Fed Business Outlook | May | -- | -19.8 | -31.3 | index, sa |
| 5/18/23 | Existing Home Sales | Apr | -- | 4,300 | 4,440 | k, saar |
| 5/18/23 | Existing Home Sales m/m | Apr | -- | -3.2% | -2.4% | sa |
| 5/18/23 | Conference Board Leading Index | Apr | -- | -0.6% | -1.2% | m/m, sa |

*Sources: Bloomberg Consensus Survey of Economists, Arch MI*