HaMMR Digest

Stay current with economic and mortgage market trends.

October 17, 2022

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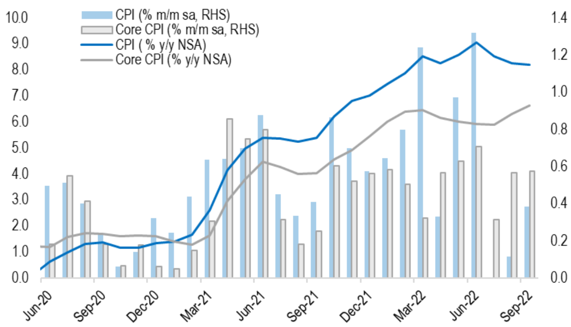
Weekly Wrap – Missing the Mark

- Inflation data keep surprising to the upside as hot and sticky services prices have more than offset goods weakness
- A 75bps hike in November is all but guaranteed and a 4.5% policy rate, at a minimum, highly likely by year-end
- Weaker labor market conditions are needed to ease price pressures and we still have a bit to go to achieve that

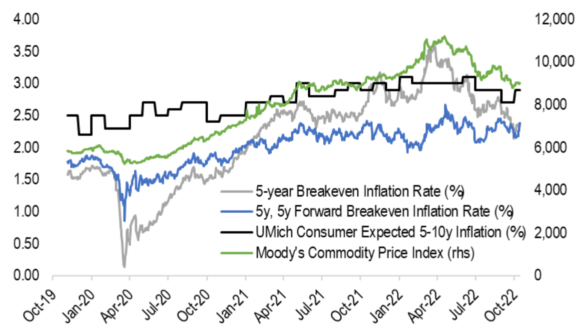
Consensus forecasters continue to undershoot on inflation data, expecting price pressures to cool much quicker than what has been realized. Analysts may be putting too much stock in private real-time price measures that have yet to feed through into the government data, which has been leading to large swings in bond yields and rate expectations upon release of official data with last week being no exception. Headline CPI climbed 0.4% (cons. 0.2%) in September, or 8.2% y/y, while core CPI (excluding food and energy) remained strong at 0.6% m/m (cons. 0.4%) for the second month in a row, lifting the annual pace to 6.6%, a new cycle peak (Figure 1) and the highest since 1982. September producer prices also rose 0.4% (cons. 0.2%) reflecting a reacceleration in energy and core prices. On the back of the upside inflation surprises, 10-year US Treasury yields rose to end the week near 4% while markets priced in more front-loaded rate hikes.

Figure 1: Headline and Core CPI Inflation



Sources: BLS, Arch MI

Figure 2: Inflation Monitor



Sources: Moody's, University of Michigan, FRB, Arch MI

The main message from the inflation data bonanza was that hot core services more than offset slowing in core goods prices. Survey measures of supply constraints are falling close to pre-pandemic levels as inventory-to-sales ratios are rising rapidly across several sectors. Add in falling freight costs, dampened consumer goods spending, and declining import prices, which fell -1.2% m/m (cons. -1.1%) in September and for the third month in a row, core goods disinflation has arrived. Services inflation, which accounts for over half of the consumer spending basket, firmed in September, rising 0.8% m/m. Energy services prices remained robust with electricity costs up 0.4% and natural gas utility costs up 2.9%, highlighting that household budgets could be haunted by more than just prices at the gas pump this winter. Indeed, the EIA estimated that households are facing 28% higher heating bills this winter compared to last year. Travel services strengthened across the board, suggesting that a post-COVID easing, should it materialize, will not be smooth while shelter costs accelerated to their fastest pace since 1990. Altogether, core services surged 0.8% m/m or 9.9% annualized, a significantly discouraging sign for the Fed.

Minutes from the September FOMC meeting showed policymakers remain steadfast in the battle to keep inflation expectations well-anchored. On that front, the Fed will likely be at least moderately worried about year-ahead inflation expectations rising to a three-month high of 5.1% in the preliminary University of Michigan consumer sentiment survey while longer-run expectations also climbed to 2.9% (Figure 2). A 75bps rate hike in November is all but guaranteed and there is also a decent chance the Fed maintains the 75bps pace in December, which would push the policy rate to 4.75% by year-end. September's inflation data confirm that the Fed still has its work cut out and will need much weaker labor market conditions, which we expect to get underway in earnest in the first half of 2023, to bring demand down to supply. Tighter financial conditions have thus far made minimal headway cooling the labor market and consumer spending. September core control group retail sales, which feed into the 3Q22 GDP report, rose a robust 0.4% m/m (cons. 0.2%) on top of a 20bps upward revision to the August figure. With households still flush with cash, a meaningful rise in unemployment is likely necessary to curtail spending more forcefully, which the Fed has been more explicit about recently.

Recent Data Releases

Key economic and housing data releases over the last week:

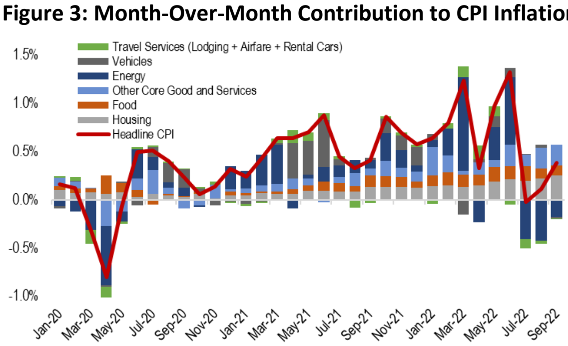
Date	Indicator	Period	Actual	Consensus	Previous	Note
10/11/22	NFIB Small Business Optimism	Sep	92.1	91.6	91.8	index, sa
10/12/22	MBA Mortgage Applications	10/7/22	-2.0%	--	-14.2%	w/w, sa
10/12/22	PPI Final Demand m/m	Sep	0.4%	0.2%	-0.2%	sa
10/12/22	PPI Final Demand y/y	Sep	8.5%	8.4%	8.7%	nsa
10/12/22	PPI Core (ex Food and Energy) m/m	Sep	0.3%	0.3%	0.3%	sa
10/12/22	PPI Core (ex Food and Energy) y/y	Sep	7.2%	7.3%	7.2%	nsa
10/12/22	FOMC Meeting Minutes	9/21/22	--	--	--	
10/13/22	CPI m/m	Sep	0.4%	0.2%	0.1%	sa
10/13/22	CPI y/y	Sep	8.2%	8.1%	8.3%	nsa
10/13/22	CPI Core (ex Food and Energy) m/m	Sep	0.6%	0.4%	0.6%	sa
10/13/22	CPI Core (ex Food and Energy) y/y	Sep	6.6%	6.5%	6.3%	nsa
10/13/22	Initial Jobless Claims	10/8/22	228	225	219	k, sa
10/13/22	Continuing Claims	10/1/22	1,368	1,365	1,365	k, sa
10/14/22	Advance Retail Sales m/m	Sep	0.0%	0.2%	0.4%	sa
10/14/22	Retail Sales Control Group m/m	Sep	0.4%	0.3%	0.2%	sa
10/14/22	Import Price Index y/y	Sep	6.0%	6.2%	7.8%	nsa
10/14/22	Business Inventories m/m	Aug	0.8%	0.9%	0.5%	sa
10/14/22	U. of Mich. Sentiment	Oct P	59.8	58.8	58.6	index, nsa
10/14/22	U. of Mich. 1 Yr Inflation	Oct P	5.1%	4.6%	4.7%	nsa
10/14/22	U. of Mich. 5-10 Yr Inflation	Oct P	2.9%	2.8%	2.7%	nsa

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

RECENT CORE CPI COOLING APPEARS TO HAVE BEEN A HEAD FAKE

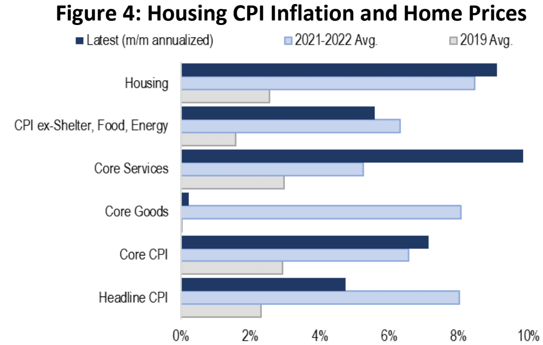
September consumer price inflation came in hotter than consensus forecasters expected. Headline consumer price inflation rose 0.4% m/m on a seasonally adjusted basis (Figure 3), 20bps above consensus expectations despite energy prices subtracting 17bps from monthly headline inflation. The correction in gasoline prices continued over the month, falling by 4.9% on top of the 10.6% decline in August. However, retail gasoline prices have begun to rise once again, suggesting that gasoline will be a contributor to headline prices in October. Core inflation (excluding food and energy) remained firm at 0.6% m/m, or 7% annualized (Figure 4), 20bps higher than consensus expectations.

Figure 3: Month-Over-Month Contribution to CPI Inflation



Sources: BLS, Arch MI

Figure 4: Housing CPI Inflation and Home Prices



Sources: BLS, Arch MI

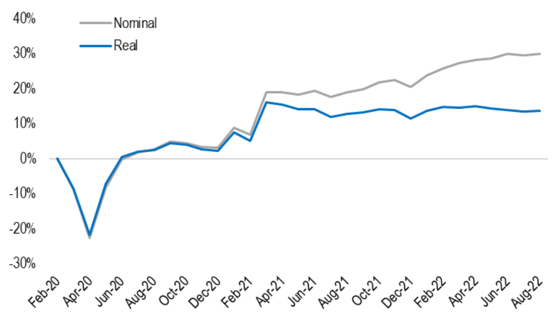
Core goods inflation remained volatile, rising just 0.02% m/m in September, much lower than August's print of 0.5% and the 2022 monthly average of 0.7%. For the most recent month, price declines in used vehicles (-1.1%), apparel (-0.3%), and appliances (-0.7%) helped to offset robust growth in new vehicles (+0.7%) and household furnishings (+0.6%). Meanwhile, core services inflation accelerated to 0.8% m/m from 0.6% prior, reflecting strong growth in medical services (1.0%), transportation services (1.9%), as well as rents (0.8%) and owners' equivalent rent (0.8%) – which all accelerated from the prior month. We expect housing inflation to remain elevated and keep upward pressure on core inflation well into early next year based on the historical lag between BLS data and real-time measures of rent growth and home prices.

RETAIL SALES FLATLINE

September nominal headline retail and food services sales were flat compared to the prior month, falling short of consensus expectations looking for a 0.2% m/m bump, reflecting softness in autos (-0.4%), gas (-1.4%), and building materials (-0.4%). The rest of the retail sales report showed solid breadth with seven of the thirteen major categories recording monthly increases, resulting in a 0.3% gain for total retail sales excluding auto and gas and 0.4% growth for the important control group (excluding auto, gas, building materials, and food services) which feeds into the GDP report.

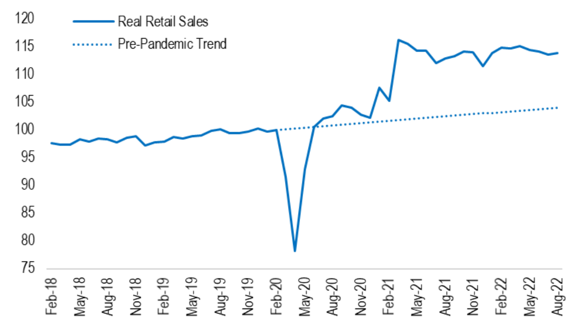
Adjusted for inflation, retail sales declined 0.4% m/m, the fifth monthly decline in the last seven months. Real retail sales have generally remained flat this year (Figure 5), a sign that consumers are simply maintaining their spending at elevated levels in the face of surging prices. Despite this year's lack of real spending growth, real retail sales remain 13% above their February 2020 level and 4% above their pre-COVID trend (Figure 6).

Figure 5: Retail & Food Services Sales (Change from Feb '20)



Sources: Census Bureau, Arch MI

Figure 6: Real Retail and Food Services Sales



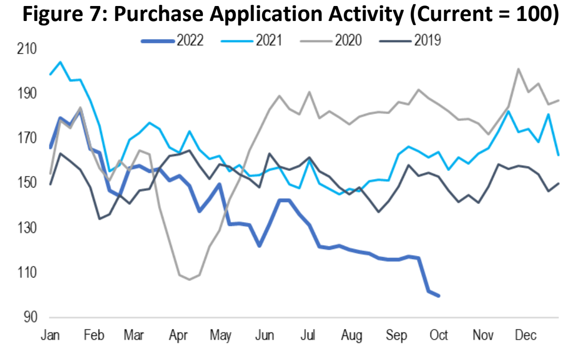
Sources: Census Bureau, Arch MI

The details of the report were somewhat mixed. Gas station sales were down for the third consecutive month, but they will likely reverse in October as gas prices have turned higher. Furniture and home furnishings fell -0.7% m/m, aligning with the slowdown in the housing market while food services sales rose 0.5% and on top of the 1.8% gain in August that was revised up from 1.1%.

MORTGAGE ACTIVITY DECLINE AGAIN AS MORTGAGE RATES HOVER NEAR 7%

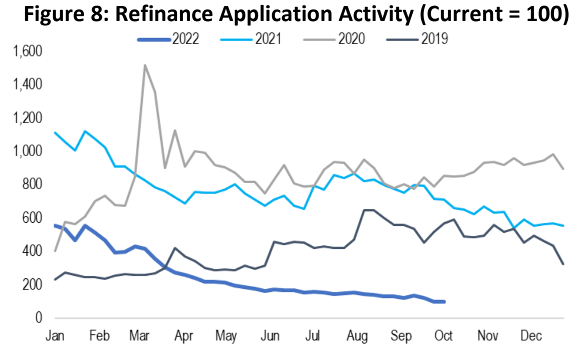
The MBA application survey for the week ending October 7th declined -2% w/w and the index is now down -69% year-over-year and -63% compared with pre-pandemic levels (i.e., 3 years ago). The weekly decline was driven primarily by a -2.1% decline in purchase applications, which remain down -39% y/y and -35% over 3 years (Figure 7). Refinancing applications declined -1.8% w/w and are down -86% y/y and -82% relative to 2019 levels (Figure 8).

Figure 7: Purchase Application Activity (Current = 100)



Sources: Mortgage Bankers Association, Arch MI

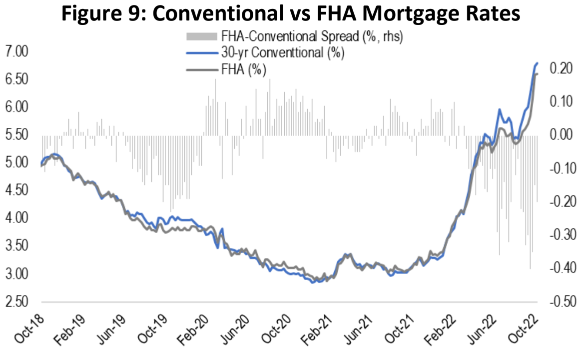
Figure 8: Refinance Application Activity (Current = 100)



Sources: Mortgage Bankers Association, Arch MI

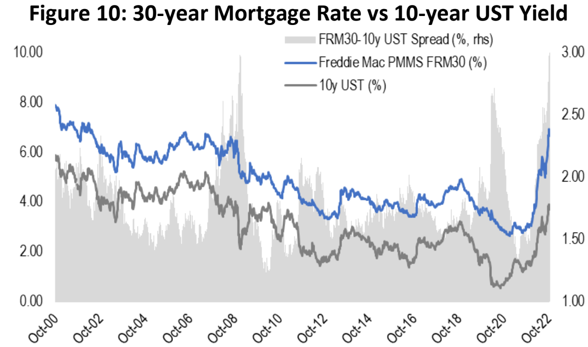
According to the MBA survey of lenders, the average contract conventional mortgage rate rose 6bps to 6.81% during the week ending October 7th while the FHA contract mortgage rate also rose 1bps to 6.61%, resulting in a -5bps contraction in the spread between the FHA and conventional mortgage rate to -0.2% (Figure 9). Freddie Mac's more recent Primary Mortgage Market Survey (PMMS) for the 3 days ending October 12th indicated that the FRM30 jumped 26bps w/w to 6.92% (Figure 10) as 10-year UST yields also jumped 23bps to an average of 3.92% over the same period. Accordingly, the spread between the PMMS FRM30 and the 10-year UST widened 3bps to 3.0%, a new record high surpassing even the peak of the global financial crisis. 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 until well into the first half of next year given the Fed's increasingly hawkish stance and the lag in official inflation data relative to more real-time measures.

Figure 9: Conventional vs FHA Mortgage Rates



Sources: Mortgage Bankers Association, Arch MI

Figure 10: 30-year Mortgage Rate vs 10-year UST Yield

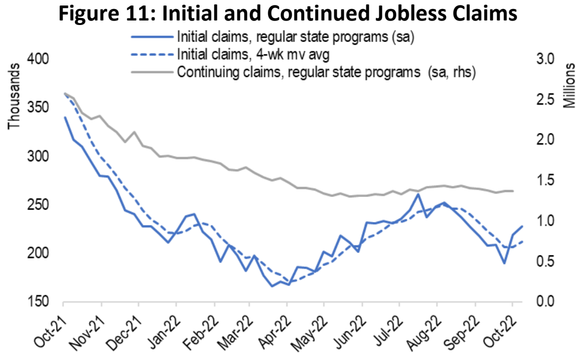


Sources: Freddie Mac PMMS, FRB, Arch MI

SEASONALLY ADJUSTED CLAIMS CLIMB AGAIN AS HURRICANE IAN IMPACT LINGERS

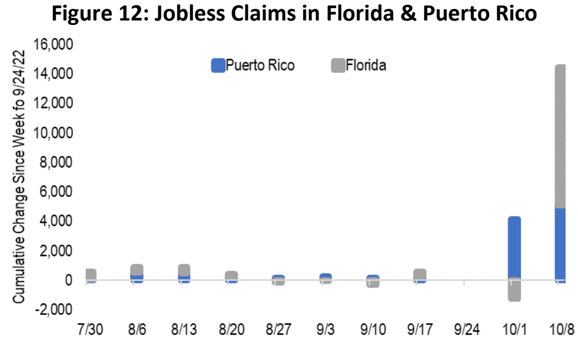
Initial jobless claims rose by 9k to 228k (consensus: 225k) during the week ending October 8th from 219k the previous week, moving the 4-week average up to 212k from 207k (Figure 11). Some of last week's increase was due to Hurricane Ian as claims jumped by 10,574 and 940 in Florida and Puerto Rico, respectively, bringing the combined cumulative increase to 14,436 over the last two weeks (Figure 12). Hurricane-related claims may impact claims data in the weeks ahead depending on the duration of disruptions in the impacted areas. Meanwhile, continuing claims for regular state programs (i.e., repeat filers for unemployment insurance) climbed by 3k to 1,368k (consensus: 1,365k) during the week ending October 1st.

Figure 11: Initial and Continued Jobless Claims



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

Figure 12: Jobless Claims in Florida & Puerto Rico



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

The Week Ahead

UPCOMING DATA RELEASES

This week brings a host of data with an emphasis on the housing sector. The mortgage shock that has dented buyer affordability also likely kept homebuyer traffic and closings suppressed and weighed on homebuilder sentiment and construction activity. Given the downtrodden homebuyer, the NAHB housing sentiment index is expected to remain below the “50” break-even threshold marker. Construction activity is also expected to reflect the dour mood with permits and starts both expected to trend lower as builders focus on completing a bloated pipeline of units under construction. On the housing demand front, weak pending sales and mortgage applications imply that existing sales will continue to face pressure in the near-term with a decent chance Friday’s print comes in even lower than an already-weak consensus forecast of 4,690k saar.

Aside from housing, this week will also provide a bevy of manufacturing data with sentiment figures from Fed regions in New York and Philadelphia continuing to show volatility from month-to-month, but the overall trend will likely point to a downshift in goods production. Lackluster global demand, tighter financial conditions, and a strong US dollar will limit how much industrial production can grow. The only bright spot in the industrial production report could be autos, a sector that is still struggling to shrink backlogs.

Key economic and housing data releases for the coming week:

Date	Indicator	Period	Actual	Consensus	Previous	Note
10/17/22	Empire Manufacturing	Oct	--	-4.3	-1.5	index, sa
10/18/22	Industrial Production m/m	Sep	--	0.1%	-0.2%	sa
10/18/22	Capacity Utilization	Sep	--	80.0%	80.0%	sa
10/18/22	NAHB Housing Market Index	Oct	--	43.0	46.0	index, sa
10/19/22	MBA Mortgage Applications	10/14/22	--	--	-2.0%	w/w, sa
10/19/22	Building Permits	Sep	--	1,530	1,542	k, saar
10/19/22	Building Permits m/m	Sep	--	-0.8%	-8.5%	sa
10/19/22	Housing Starts	Sep	--	1,463	1,575	k, saar
10/19/22	Housing Starts m/m	Sep	--	-7.0%	12.2%	sa
10/20/22	Philadelphia Fed Business Outlook	Oct	--	-5.0	-9.9	index, sa
10/20/22	Initial Jobless Claims	10/15/22	--	230	228	k, sa
10/20/22	Continuing Claims	10/8/22	--	1,378	1,368	k, sa
10/20/22	Existing Home Sales	Sep	--	4,690	4,800	k, saar
10/20/22	Existing Home Sales m/m	Sep	--	-2.3%	-0.4%	sa
10/20/22	Conference Board Leading Index	Sep	--	-0.3%	-0.3%	m/m, sa

Sources: Bloomberg Consensus Survey of Economists, Arch MI