Freddie Mac

U.S. Economic, Housing and Mortgage Market Outlook

OCTOBER 2023 IN THIS ISSUE:

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SPOTLIGHT: MILLENNIALS

Millennials are not forming households at the same rate and age as Boomers and Gen Xers. If they had, there would be an additional 2 million households in the U.S. today. **MORE →**

Recent developments in the U.S. economy

The U.S. economy continues to expand, according to the latest estimates by the Bureau of Economic Analysis (BEA). Real Gross Domestic Product (GDP) growth for 2Q 2023 was 2.1%, while first quarter growth was revised upwards to 2.2%. The growth rate of personal consumption expenditures fell from 3.8% in the first quarter to 0.8% in the second quarter. This decline in consumption expenditures was offset by an increase in investment expenditures, which increased from -9.0% in the first quarter to 5.2% in the second quarter. Topline real GDP growth of over 2% is above the Congressional Budget Office's estimate of real potential GDP growth, which was 1.8% for 2023 as of the latest estimate.[1]

The labor market continues to remain strong with the U.S. economy adding 336,000 jobs in September 2023, according to the latest report from the Bureau of Labor Statistics (BLS). September's monthly gains were above the prior 12-month average of 267,000. Job growth was led by leisure and hospitality; government; health care; professional, scientific, and technical services; and social assistance. Non-farm payroll growth for July and August was revised up by a combined 119,000 with July job growth revised up by 79,000 and August up by 40,000. As we noted in last month's Outlook, payroll growth revisions were negative for each of the first six months of 2023. The reversal of the trend of negative payroll revisions is another sign of the resilience of the U.S. labor market.

The unemployment rate remained unchanged at 3.8% in September, as did the number of unemployed persons at 6.4 million. The labor force participation rate as well as employment-population ratio were unchanged at 62.8% and 60.4%, respectively. Job openings have risen to their highest level since mid-2021 at 690,000 openings in August, as per the BLS. The ratio of job openings to unemployed continues to remain high at 1.5 as of August 2023.

1 See June 2023 Long-Term Economic Projections at https://www.cbo.gov/data/budget-economic-data.

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On the inflation front, price pressures are showing signs of abating with the August reading coming in below expectations. While overall inflation has come down, energy prices have been on the rise again presenting upside risks to the course of future inflation. Core inflation, excluding food and energy, ticked up 0.1% month-over-month as measured by the BEA's price index for Personal Consumption Expenditures (PCE). Even with the recent uptick in prices, the year-over-year core PCE price inflation was 3.9%, the lowest annual increase since mid-2021. Both prices for goods and services increased over the month with goods inflation increasing at 0.8% and services increasing more modestly at 0.2%. Services excluding energy and housing—the "super core" inflation measure that the Federal Reserve has been closely tracking—remained flat in August and was up 4.2% year-over-year.

Recent developments in the U.S. housing market

Interest rates have been above the 7% mark since August of this year, the highest level since the early 2000s. Elevated rates are pushing more homebuyers to delay their home purchase and wait for a more opportune time. Existing home sales, as reported by the National Association of Realtors (NAR), were down 15.3% from August 2022, but the median sale price of existing homes was up 3.9% over the same period. The lack of inventory of existing homes is pushing more homebuyers to consider new homes. New home sales for August were up 5.8% from last year as reported by the U.S. Census Bureau. The median sale price of new homes has decreased 2.3% from August 2022 to $430,000 in August 2023. Combining new and existing home sales, total home sales were down 12.8% from last August.

Home builders are becoming less confident, as measured by the National Association of Home Builders' (NAHB) Housing Market Index. Higher interest rates and supply side constraints are putting pressure on suppliers' ability to build new homes. All three components of the Housing Market Index fell, indicating the weaker demand from homebuyers and confidence from sellers. To drive more sales, an increasing number of home builders are adding incentives and decreasing the prices of new homes. This decline in sentiment is also reflected in the fewer number of housing starts in August, which fell 14.8% from last August and are down 4.3% from the start of this year. NAR's Pending Home Sales Index, another forward-looking measure of home purchases, is also down 18.7% year over year.

While both housing demand and supply measures have been declining, the tighter level of supply outweighs the decrease in demand, which translates to upward pressure on house prices. House prices were up 4.6% in July according to the FHFA Purchase Only House Price Index.

Recent developments in the U.S. mortgage market

Treasury yields rose to the highest levels in 16 years with the yield on 10-year Treasuries hitting a high of 4.8% on October 17, 2023. Higher 10-year yields have also pushed up mortgage rates to 23-year highs. The U.S. average 30-year fixed-rate mortgage as measured by Freddie Mac's Primary Mortgage Market Survey® increased in August, reaching a high of 7.49% during the first week of October, a level not seen since December 2000. Higher rates have reduced mortgage demand. According to the Mortgage Bankers Association's Weekly Applications Survey, the total mortgage application index was down 25% and the purchase index was down 27% over the year during the third week of September, while the refinance index was down 21% over the year. As compared to the pre-pandemic average of 2016-2019, purchase originations were down 41% during the third week of September and were down 58% as compared to the peak in early 2021.

While mortgage delinquencies have remained low so far, there was a slight uptick in delinquencies across the spectrum as per Transunion's August 2023 report. Loans which were 30 or more days past due increased to 2.04% in August 2023 from 2% in July 2023. On the other hand, loans which were 60 or more days past due increased to 0.94% in August 2023 from 0.91% in July 2023. Serious delinquencies increased to 0.59% during August 2023 from 0.58% in July 2023 and 0.55% in August 2022.

The outlook

While current conditions in the economy remain strong and have been exceeding expectations so far this year, the outlook remains clouded. The rise in interest rates in September combined with higher gasoline prices have sapped consumer confidence and have likely contributed to a slowdown in consumer spending in the second half of the year. Recent geopolitical developments have added to the uncertainty and could potentially further slow growth. But U.S. consumers have weathered considerable shocks over the past 2 years and in aggregate have strong balance sheets even if they have nearly exhausted their excess pandemic related savings. Our baseline view is one of a slowing economy that avoids tipping into recession.

We expect U.S. economic growth to slow at the end of this year and remain muted in 2024. Inflation will continue to moderate, but the reduction will be gradual so policymakers will hold rates higher for longer. In this environment, mortgage rates will remain elevated, though a reduction in bond market volatility will allow the spread between Treasuries and mortgage rates to narrow back towards historical averages.

Mortgage rates hitting new highs has presented many challenges, particularly for homebuyers. Given elevated interest rates, fewer buyers and sellers are likely to step into the housing market, affecting both the demand and supply. The combination of high mortgage rates dragging demand down and tight supply driven by the rate-lock-in effect will keep sales volume low through the rest of the year.

Mortgage origination volume is expected to remain muted through the rest of the year. Although we forecast home prices to rise for the next twelve months, the positive impact of prices on origination volumes is offset by low sale volumes. We expect the refinance market to be impacted significantly by rising rates which would keep refinance volumes near historical lows. Together, we expect total mortgage originations to remain flat for the rest of the year with modest growth in 2024.

OCTOBER 2023 SPOTLIGHT:

Millennial household formation — potential for another 2 million households

Where does the Millennial generation stand in forming households? And how many more households can this generation form?

There are 72 million Millennials in the United States, which makes them the largest cohort in history. You may recall articles from the mid-2010s about how some Millennials were living in their parents' basement and achieving life stages at a slower rate than previous generations.[2] In 2018, Freddie Mac published research on young adult household formation and the reasons why this generation has lower rates of household formation

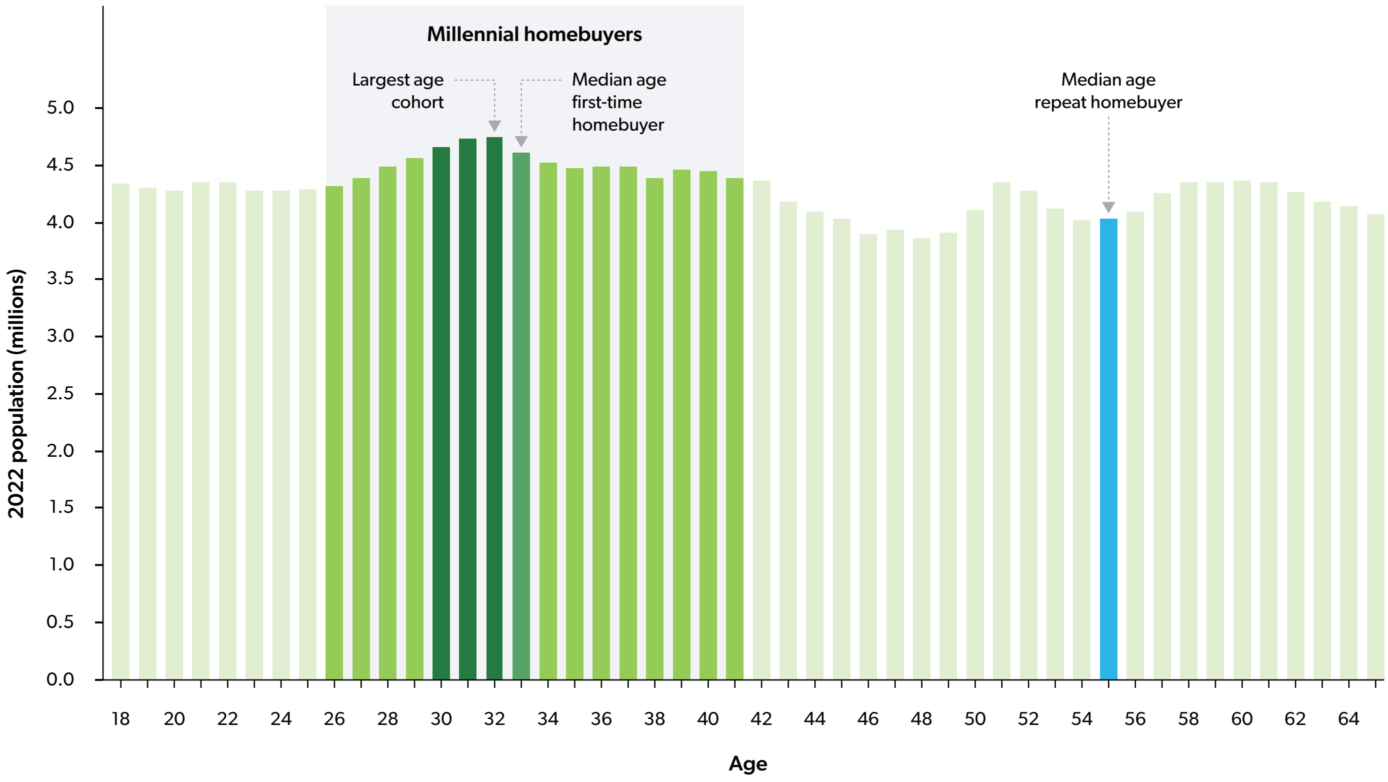
2 We define Millennials as those between 26 and 41 years of age as of Dec 2022.

in comparison to previous generations. In the five years since we wrote that article, Millennials have aged to the point where previous generations reached their peak of new household formation. The oldest Millennial is now 41 years old, while the youngest Millennial is about 26 years old. Age demographics have been favorable with the number of people near the peak first-time homebuyer age ramping up for the last 15 years and with more potential left.

EXHIBIT 1

U.S. population by age, 2022

Peak purchase demand is found between 30 to 40 year old homebuyers



Source: U.S. Census Bureau

For Millennials who want to form independent households and buy a house, they face many challenges. The biggest among them are housing costs, as discussed in our previous research. Income and employment also contributed to the gap compared to prior generations, followed by a delay in marriage. Yet despite these challenges, Millennial household formations have increased, and the largest generation is now driving housing demand. Household formation of this generation got a push during the pandemic from the need for more space combined with the low interest rate environment. In fact, Millennial household formation has increased by 7.4 million since 2018.

One way to estimate it would be to compare the headship rate (rate of heading a household or the share of population that is head of a household) of Millennials to Gen Xers and Baby Boomers when they were 26-41 years old. Boomers were between the ages of 26 and 41 in 1987 and Gen Xers in 2006. The headship rate of both Boomers and Gen Xers was 51% at that point in their lives. If Millennials had formed households at the same rate as Boomers and Gen Xers when they were the same age, then there would be an additional 2 million households in the U.S. today, as shown in **Exhibit 2**.

EXHIBIT 2

Millennial households: actual vs. estimates based on trends from prior generations

	Number of Households
Millennial households if they achieve previous generations' headship rate (51%)	37 million
Current number of Millennial households	35 million
Potential for Millennial household formation	2 million

Source: U.S. Census Bureau and Freddie Mac estimates

The preceding analysis suggests that not only is there potential for new households to form, but for these younger households that have formed to move into homeownership, as the homeownership rates of young adults is low. This implies that there are two main drivers of future housing demand: those that form new households and those that become homeowners. At Freddie Mac, we offer a variety of customized loan products to help Millennials overcome housing challenges and become homeowners. In the second quarter of 2023 alone, we helped 372,000 families buy, refinance, or rent a home. This was more than a 40% increase over the first quarter and includes 102,000 first-time homebuyers (many of whom are Millennials). That represents more than 51% of the owner-occupied homes we helped finance, a historic high.

Note: On October 27, 2023, estimated potential Millennial household formation was revised down from a previous version of this Spotlight.

Prepared by the Economic & Housing Research group

Sam Khater, Chief Economist
Len Kiefer, Deputy Chief Economist
Ajita Atreya, Macro & Housing Economics Manager
Rama Yanamandra, Macro & Housing Economics Manager
Penka Trentcheva, Macro & Housing Economics Senior
Genaro Villa, Macro & Housing Economics Senior
Lalith Manukonda, Finance Analyst

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