



MAY 2016

Low mortgage rates keep housing on track

Housing remains on track for the best year in a decade despite tepid economic growth and a labor market that’s throttling back. Low mortgage interest rates are supporting affordability in the face of rapidly rising house prices. And lower mortgage rates are providing additional opportunity for current homeowners to refinance. Housing remains a bright spot in the economic outlook and should propel the U.S. economy forward for the balance of this year.

Economy expected to pick up after weak first quarter

For a third consecutive year, the economy has sputtered out of the gate. According to the [BEA's initial estimate](#), first quarter gross domestic product (GDP) grew at a seasonally-adjusted annual rate of 0.5 percent. The weakness in growth can be attributed to nonresidential fixed investment, trade and inventory corrections, which together subtracted 1.4 percentage points from GDP growth. Specifically, nonresidential fixed investment fell 5.9 percent on a seasonally-adjusted annual rate, the biggest drop since 2009. The contraction can be traced to lower energy prices and their impact on equipment spending and business structure investment by energy companies. Conversely, consumers keep pushing the economy forward as residential investment for the first quarter grew at an annual rate of 14.8 percent and personal consumption expenditures grew 1.9 percent with services being the primary driver, growing at 2.7 percent.

The impact of falling energy prices in the first quarter was even more apparent in the consumer price index (CPI) contraction of -0.3 percent. Unseasonably warm weather during the first quarter depressed demand for energy and while energy prices have turned around in March, they still are [down more than 12 percent since last year](#). Another measure of inflation that is closely watched by the Fed, core personal consumption

Forecast Snapshot (May 2016)

Summary (annualized)	2015	2016	2017
30-year PMMS (%)	3.9	3.9	4.5
Total home sales (M)	5.75	5.92	6.16
House price growth (%)	6.0	4.8	3.5
Total originations (\$B)	1,750	1,725	1,460



expenditures (PCE), rose 1.6 percent year-over-year in March—still below the Fed's target of 2 percent. Nonetheless, consumers are optimistic that inflation will get back on track. The [New York Fed's Survey of Consumer Expectations](#) for April shows expectations of a 2.6 percent inflation rate one year from now. We don't forecast inflation to rise that rapidly, but do expect recovering gasoline prices should put upward pressure on CPI the rest of this year. We expect CPI to reach 2.0 percent in the fourth quarter of 2016 and average 1.9 percent for 2017.

Given the latest developments, we have reduced our 2016 outlook for GDP growth by 0.2 percentage points to 1.8 percent. However, if the past two years are any indication of how this year will turn out, expect a strong rebound in the remainder of 2016. As energy prices continue to slowly turnaround, and real wage growth continues to promote consumption, we expect the economy to pick up steam. We are currently forecasting second quarter GDP growth to bounce back up to 2.1 percent, followed by 2.3 and 2.4 percent in the third and fourth quarters of 2016, respectively.

Soft economic growth affecting labor market

In the [April Employment Situation release](#) we saw a small slowdown in the labor markets. While the unemployment rate stayed at 5 percent, nonfarm payrolls increased only 160,000 in April. This follows downward revisions for February and March, which came in at 215,000 and 208,000, respectively. This drop partly reflects growing apprehension felt by employers about the state of the economy in the short-term. As a result, many of these employers are scaling back their demand for labor. The labor force participation rate also was down 0.2 percentage points to 62.8 percent. A bright spot in the report was that average hourly earnings are rising as the labor market tightens. The latest report shows average wages were up 0.3 percent in April and 2.5 percent over the last 12 months. Given this latest report, we expect the unemployment rate to fall to 4.9 percent in the second and third quarters and 4.8 percent for the fourth quarter. For 2017 we predict the unemployment rate to average 4.8 percent.

Low mortgage rates support refinance activity

A variety of factors, have led investors to continue to flock to the safety of the government, thus keeping Treasury yields and mortgage rates low. Specifically, slowing domestic and global growth and foreign central banks implementing monetary policies to foster economic activity, have caused Treasury rates to oscillate within a 1.65 percent to 2.0 percent range since February. Furthermore, the FOMC meeting in April left even more doubt as to when the Fed will once again raise the benchmark rate, creating more demand for safer investments and keeping Treasury rates low. Consequently, mortgage rates have remained low throughout 2016, reaching a 3-year low in the week of May 12, 2016.

After falling almost 40 basis points from the end of 2015 to the end of February, the 30-year mortgage rate rose 11 basis points in March only to fall again in April to its lowest point since May 2013. In fact,



mortgage rates have been near historic lows for most of April, floating between 3.57 and 3.66 percent. We have tempered our expectations on mortgage rates for the rest of 2016, reducing second quarter rates by 10 basis points and every quarter thereafter by 20 basis points.

The adjustment to our long-term interest rate projections also has affected our single-family mortgage originations forecast for 2016. A lower rate environment should continue to promote origination activity, especially refinancing. Based on recent data, we estimate first quarter refinance share of originations was 52 percent, 4 percentage points above last month's forecast. This translates to about \$25 billion more in originations, bringing the total for 2016 to \$1,725 billion.

Demand for housing should overcome market constraints

Despite low mortgage rates, rapidly rising house prices and tight inventory make affordability and availability major challenges for would-be homebuyers. The latest [Freddie Mac House Price Index](#) shows first quarter house price appreciation at 1.4 percent. Over the past 12 months, house prices have increased nationally by 5.8 percent, with Washington (12.6 percent), Oregon (11.4 percent), Florida (10.7 percent), Colorado (9.7 percent), and Nevada (9.3 percent) leading the way. As a result, we are forecasting house prices to appreciate 4.8 percent in 2016, and 3.5 percent in 2017.

Additionally, [privately-owned housing starts](#) disappointed in March where the majority of housing starts occurred in the Northeast, while the Midwest, South, and West all saw declines. March's seasonally-adjusted annual rate of 1.09 million units marks an 8.8 percent drop from February's estimate of 1.19 million starts, further signaling softening growth in residential construction. Despite housing starts only averaging 1.13 million units in the first quarter, we expect starts to pick up during subsequent quarters raising 2016 to 1.27 million units and 2017 to 1.51 million units.

Notwithstanding, demand continues to surge as [existing-homes sales in March](#) increased 5.1 percent to an annual rate of 5.33 million units. [New residential sales](#), however, fell 1.5 percent in March to an annual rate of 511,000 units. This drop is understandable given the slowing rate of new home construction. Furthermore, sales of new homes were up 5.4 percent over 12 months with the Northeast increasing 30 percent. The West on the other hand, has decreased almost 21 percent over that same time period, suggesting that supply constraints and price appreciation are taking a toll on homebuyers in that region.

Even with tight inventories and rising house prices, we still forecast 2016 to be the best year for home sales in a decade. Our [latest housing tracker](#)—which compares non-seasonally-adjusted year-to-date home sales across years—shows that the first quarter of 2016 was the second fastest first quarter pace of home sales in the past decade, narrowly edging 2015. Home sales typically rise in the spring and summer months, and we anticipate an acceleration in home sales that will surpass 2007's pace by late summer.



May 2016 Economic & Housing Market Forecast

Forecasted Figures

Historical Data

As of 5/4/2016

2016
2017
Annual Totals

INDICATOR	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2015	2016	2017
Real GDP (%)	0.5	2.1	2.3	2.4	2.3	2.3	2.3	2.3	2.0	1.8	2.3
Consumer Prices (%) a.	-0.3	1.9	1.9	2.0	1.9	1.9	1.9	1.9	0.4	1.4	1.9
Unemployment Rate (%) b.	4.9	4.9	4.9	4.8	4.8	4.8	4.7	4.7	5.3	4.9	4.8
30-Year Fixed Mtg. Rate (%) b.	3.7	3.7	3.9	4.1	4.2	4.4	4.6	4.8	3.9	3.9	4.5
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	2.9	2.9	3.2	3.5	3.7	3.9	4.1	4.3	2.9	3.1	4.0
10-Year Const. Mat. Treas. Rate (%) b.	1.9	1.9	2.1	2.3	2.4	2.6	2.8	3.0	2.2	2.1	2.7
1-Year Const. Mat. Treas. Rate (%) b.	0.6	0.6	0.9	1.1	1.3	1.5	1.7	1.9	0.3	0.8	1.6
Housing Starts c.	1.13	1.25	1.33	1.38	1.43	1.48	1.53	1.58	1.11	1.27	1.51
Total Home Sales d.	5.81	5.91	5.91	6.06	6.11	6.16	6.16	6.21	5.75	5.92	6.16
FMHPI House Price Appreciation (%) e.	1.4	1.2	1.0	1.1	0.9	0.9	0.9	0.8	6.0	4.8	3.5
1-4 Family Mortgage Originations f.											
- Conventional	\$273	\$396	\$347	\$316	\$285	\$299	\$261	\$246	\$1,344	\$1,332	\$1,091
- FHA & VA	\$87	\$109	\$103	\$94	\$95	\$101	\$89	\$84	\$406	\$393	\$369
- Total	\$360	\$505	\$450	\$410	\$380	\$400	\$350	\$330	\$1,750	\$1,725	\$1,460
Refinancing Share - Originations (%) g.	52	42	38	35	27	25	23	22	48	41	24
Residential Mortgage Debt (%) h.	2.7	3.5	3.7	4.0	4.0	4.0	4.0	4.0	1.3	3.5	4.0

Note: Quarterly and annual forecasts are shown in shaded areas; totals may not add due to rounding; quarterly data expressed as annual rates. Annual forecast data are averages of quarterly values; annual historical data are reported as Q4 over Q4.

- a. Calculations based on quarterly average of monthly index levels; index levels based on the seasonally-adjusted, all-urban consumer price index.
- b. Quarterly average of monthly unemployment rates (seasonally-adjusted); Quarterly average of monthly interest rates (not seasonally-adjusted).
- c. Millions of housing units; quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).
- d. Millions of housing units; total sales are the sum of new and existing single-family homes; quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).
- e. Quarterly growth rate of Freddie Mac's House Price Index; seasonally-adjusted; annual rates for yearly data.
- f. Billions of dollars (not seasonally-adjusted); conventional for 2014 are Freddie Mac estimates.
- g. Home Mortgage Disclosure Act for all single-family mortgages (not seasonally-adjusted); annual share is dollar-weighted average of quarterly shares (2014 estimated).
- h. Federal Reserve Board; growth rate of residential mortgage debt, the sum of single-family and multifamily mortgages (not seasonally-adjusted, annual rate).



Economic & Housing Research **Outlook**

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