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August 2011 Economic Outlook | Office of the Chief Economist

Whipsaw

The Coney Island Cyclone is one of the classic roller coasters in the U.S. and claimed to be the world's fastest when it opened in 1927. In sharp contrast to the thrills provided by the Cyclone, those who rode the capital markets in recent weeks have had a far more shrilling cry.

The release of multi-year Gross Domestic Product (GDP) revisions along with an advanced look into second-quarter growth as of the end of July was discouraging news. The Bureau of Economic Analysis (BEA) increased the estimated severity of the Great Recession by a full percentage point, to a peak-to-trough drop of 5.1 percent. In turn, growth was estimated to have been slightly better in the first half of 2010, but the shocker was the significant downward revision to growth at the beginning of this year. Over the first half of 2011, growth was figured to be about 0.8 percent at an annual rate, far too weak to generate enough jobs to keep pace with labor force growth.

Much of the downward revision during the Recession was because of far weaker overall consumption expenditures; weaker personal consumption, less inventories and more imports all contributed to a substantial growth reversion in early 2011. An interesting sidebar to the myriad of these revisions was an improved methodology for estimating mortgage interest payments; the BEA estimated that the average interest rate on single-family mortgages outstanding in the first half of this year was 5.3 percent, and had dropped nearly a percentage point since the onset of the Recession. Compared with the first quarter of 2008, borrowers are paying about $130 billion less in mortgage interest today, at an annual rate. That also means that borrowers have that much additional cash to either save or use for additional spending purposes.

The downward GDP revisions helped rationalize the tepid pace of employment gains during the second quarter. After this dismal GDP report, the July employment report from the Bureau of Labor Statistics was a hopeful sign. Employment was up 117,000, the best showing since April, and the unemployment rate edged down a tenth to 9.1 percent. State and local governments continued to reduce payrolls by roughly 30,000 a month, while private-sector job growth accelerated in July. Though the improvement was encouraging, the labor market needs to sport more job creation to keep up with labor force growth and make a substantive dent in the unemployment rolls.

The capital markets barely had time to savor the July payrolls when Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the United States of America to 'AA+' from 'AAA'. That release coupled with renewed concerns over the Eurozone's ability to manage its debt crisis precipitated a roller coaster ride for the capital markets. An upshot of the heightened degree of market uncertainty is that it may have encouraged the Federal Reserve's Federal Open Market Committee (FOMC) to be more specific regarding the length of time it will preserve a low (near zero) federal funds target: On August 9th, the FOMC issued a statement that, in light of these economic conditions, it likely will maintain "exceptionally low levels for the federal funds rate at least through mid-2013." Further, the Federal Reserve will continue to reinvest principal repayments in additional security investments; which will likely help promote low long-term bond yields in the capital markets as well. The FOMC's announcement is important at this time because it clearly articulates its medium-term plans for even more accommodative monetary policy, reducing some of the uncertainty that had whipsawed the capital markets in recent weeks.

The likelihood of an extended period of both relatively low short- and long-term interest rates is helpful news for the housing market's recovery. Interest rates on new mortgage commitments have continued to gradually drift lower over the last several weeks. Thirty-year fixed-rate mortgage rates are hovering slightly above levels seen in the early 1950s. And the Freddie Mac House Price Index(SM) for the U.S. shows that prices are down 25 percent, on average, as of June 2011 compared with their peak obtained five years ago. With interest rates and house prices low, home buyer affordability over the first half of this year is higher than any other half-year interval over the past four decades, according to the National Association of Realtors' Affordability Index.

Interest rates on 15-year fixed-rate loans – always popular for borrowers considering to refinance – reached about 3.5 percent in early August, the lowest recorded in the 20 years that Freddie Mac has surveyed primary market rates for this product. This should assure that the refinance boom continues. In the second quarter, Freddie Mac found that nearly two-in-five borrowers refinancing out of their 30-year fixed-rate mortgage chose a 15- or 20-year fixed-rate loan, thus locking in even greater interest-rate savings because of the lower rates on these products and their shorter term. Thus, the average rate on single-family mortgages outstanding is likely to continue to trend lower, allowing households to deploy their payment savings toward other consumption or investment purposes.

Roller coaster riders occasionally experience injury as a result. While the capital markets have experienced sizeable movements up and down in recent weeks, these swings are unlikely to lead to whiplash or hospitalization for individual investors. Heightened uncertainty, unfortunately, can be harmful to the overall economy. Perhaps it's best not to look up nor down, but keep one's eyes on the track ahead.

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Chief Economist
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August 2011 Economic and Housing Market Outlook

Office of the Chief Economist

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Major Economic Indicators

Indicator	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	Annual Totals 2007	2008	2009	2010	2011	2012	2013
Real GDP (%)	2.5	2.3	0.4	1.3	**2.0**	**2.5**	**2.7**	**3.0**	**3.5**	**3.5**	**4.0**	**4.0**	2.2	-3.3	-0.5	3.1	**1.6**	**3.2**	**4.0**
Consumer Prices (%) a.	1.4	2.5	5.2	4.1	**1.5**	**1.5**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	4.0	1.6	1.5	1.2	**3.1**	**2.0**	**2.0**
Unemployment Rate (%) b.	9.6	9.6	8.9	9.1	**9.0**	**9.0**	**8.9**	**8.7**	**8.6**	**8.5**	**8.4**	**8.0**	4.6	5.8	9.3	9.7	**9.0**	**8.7**	**7.7**
30-Year Fixed Mtg. Rate (%) b.	4.4	4.4	4.9	4.7	**4.5**	**4.6**	**4.8**	**5.0**	**5.2**	**5.4**	**5.6**	**5.8**	6.3	6.0	5.0	4.7	**4.7**	**5.1**	**6.0**
1-Year Treas. Indexed ARM Rate (%) b.	3.3	3.3	3.3	3.1	**3.1**	**3.1**	**3.2**	**3.3**	**3.4**	**3.5**	**3.6**	**3.7**	5.6	5.2	4.7	3.8	**3.1**	**3.4**	**3.8**
10-Year Const. Mat. Treas. Rate (%) b.	2.8	2.9	3.5	3.2	**2.9**	**2.8**	**3.0**	**3.2**	**3.4**	**3.6**	**3.8**	**4.0**	4.6	3.7	3.3	3.2	**3.1**	**3.3**	**4.3**
1-Year Const. Mat. Treas. Rate (%) b.	0.3	0.3	0.3	0.2	**0.2**	**0.2**	**0.3**	**0.3**	**0.4**	**0.4**	**0.5**	**0.5**	4.5	1.8	0.5	0.3	**0.2**	**0.4**	**0.6**

Housing and Mortgage Markets

Indicator	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	Annual Totals 2007	2008	2009	2010	2011	2012	2013
Housing Starts c.	0.58	0.54	0.58	0.58	**0.60**	**0.60**	**0.65**	**0.75**	**0.85**	**0.95**	**1.05**	**1.15**	1.36	0.91	0.55	0.59	**0.59**	**0.80**	**1.20**
Total Home Sales d.	3.95	4.47	4.77	4.60	**4.92**	**4.92**	**5.00**	**5.10**	**5.20**	**5.30**	**5.60**	**5.80**	5.72	4.84	4.94	4.63	**4.80**	**5.15**	**5.90**
FMHPI House Price Appreciation (%) e.	-12.8	-13.5	-8.7	8.8	**-2.0**	**-6.0**	**-3.0**	**4.0**	**1.5**	**1.5**	**1.5**	**3.5**	-5.0	-11.7	-2.3	-6.2	**-2.0**	**1.0**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	-7.2	-13.5	-15.6	6.0	**-0.5**	**-6.0**	**-3.0**	**4.0**	**3.0**	**4.0**	**4.2**	**4.3**	-8.4	-18.4	-2.5	-3.8	**-4.0**	**2.0**	**4.4**
1-4 Family Mortgage Originations g.																			
Conventional	**$309**	**$396**	**$264**	**$263**	**$210**	**$163**	**$137**	**$176**	**$178**	**$140**	**$160**	**$195**	$2,312	$1,310	$1,549	**$1,173**	**$900**	**$631**	**$740**
FHA & VA	$95	$100	$76	$67	**$90**	**$67**	**$51**	**$62**	**$59**	**$47**	**$65**	**$80**	$120	$290	$451	$377	**$300**	**$219**	**$260**
Total	**$404**	**$496**	**$340**	**$330**	**$300**	**$230**	**$188**	**$238**	**$237**	**$187**	**$225**	**$275**	$2,432	$1,600	$2,000	**$1,550**	**$1,200**	**$850**	**$1,000**
ARM Share (%) h.	5	4	8	11	**11**	**10**	**12**	**12**	**12**	**13**	**13**	**13**	10	7	3	5	**10**	**12**	**14**
Refinancing Share - Applications (%) i.	81	82	69	70	**65**	**50**	**35**	**35**	**35**	**35**	**35**	**35**	42	48	70	76	**64**	**35**	**35**
Refinancing Share - Originations (%) j.	**75**	**79**	**70**	**68**	**65**	**50**	**35**	**35**	**35**	**35**	**35**	**35**	49	50	68	**71**	**63**	**35**	**35**
Residential Mortgage Debt (%) k.	-2.6	-2.0	-2.6	**-0.5**	**-0.5**	**-2.0**	**0.0**	**2.0**	**2.0**	**4.0**	**4.4**	**4.9**	7.1	-0.4	-1.6	-2.9	**-1.4**	**2.0**	**5.0**

Note: Quarterly and annual forecasts (or estimates) 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 detached single-family homes;quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).

e. Annualized growth rate of Freddie Mac's House Price Index (FMHPI); not seasonally-adjusted

f. National composite index (annualized growth rate), not seasonally-adjusted

g. Billions of dollars (not seasonally-adjusted).

h. Federal Housing Finance Agency (FHFA); quarterly averages of monthly shares of number of loans of conventional, home-purchase mortgage closings (not seasonally-adjusted).

i. Primary Mortgage Market Survey®; quarterly averages of monthly shares of all single-family mortgage applications (not seasonally-adjusted).

j. Home Mortgage Disclosure Act for all single-family mortgages (not seasonally-adjusted); Annual share is dollar-weighted average of quarterly shares.

k. Federal Reserve Board; growth rate of residential mortgage debt, the sum of single-family and multifamily mortgages(not seasonally-adjusted, annual rate)

Prepared by Office of the Chief Economist and reflects views as of 8/12/2011 (MAS); Send comments and questions to chief_economist@freddiemac.com.