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Office of the Chief Economist

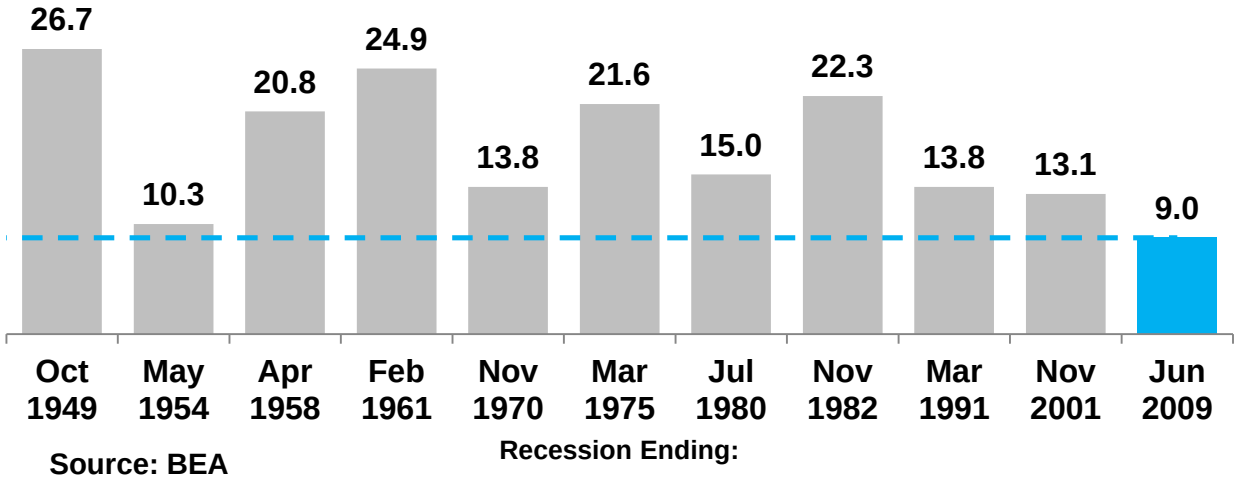
August 2013 U.S. Economic & Housing Market Outlook

Growing Pains as the Recovery Turns Four

The Great Recession officially ended in June 2009 and, with the release of the second quarter GDP, we now have data on four full years of economic recovery. The data release confirmed what many have felt: four years of recovery have only brought lackluster growth. Compared to all prior postwar recoveries, this expansion has been the weakest. Real GDP has risen by only 9 percent since the recession officially ended, while it grew an average of 17.4 percent in the four years following the end of the previous ten recessions. In terms of GDP growth, the current recovery most closely matches the one beginning in May of 1954, but during that four year period the economy also experienced another recession.

Four Years Into Recovery, How Much Has Real GDP Grown?

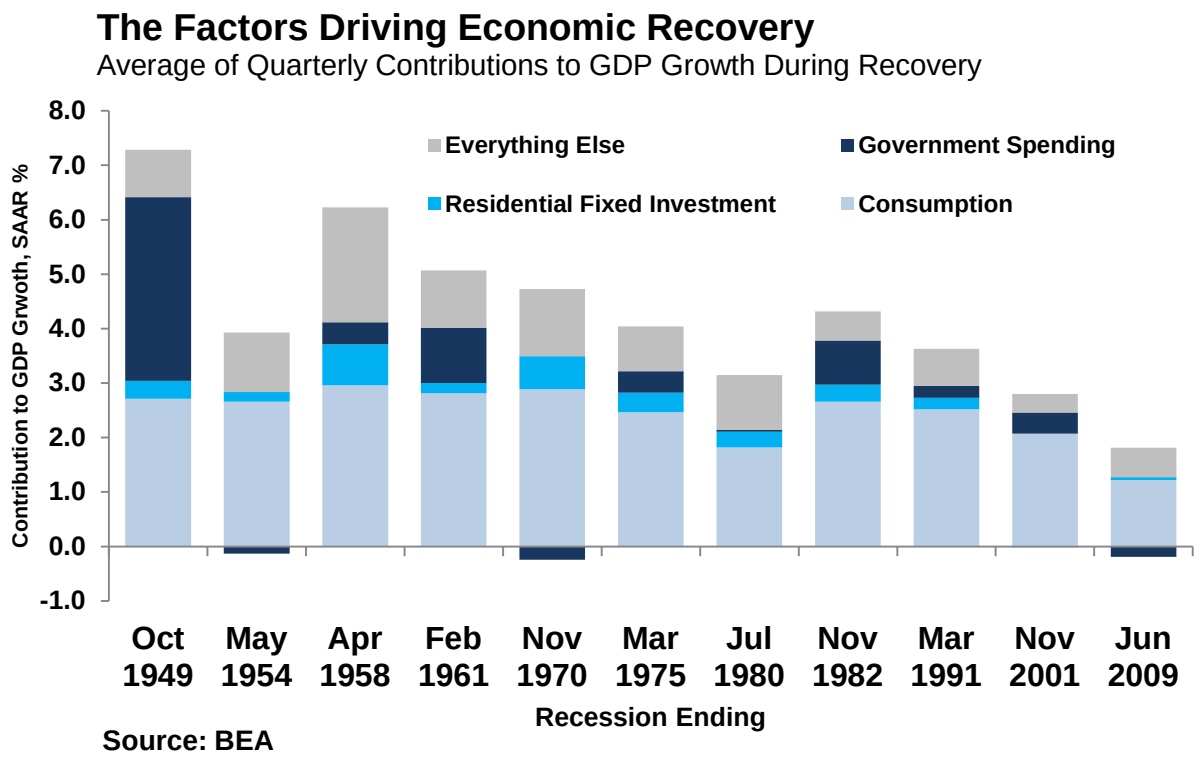
Percent Change in GDP from Recession End to Four Years Later



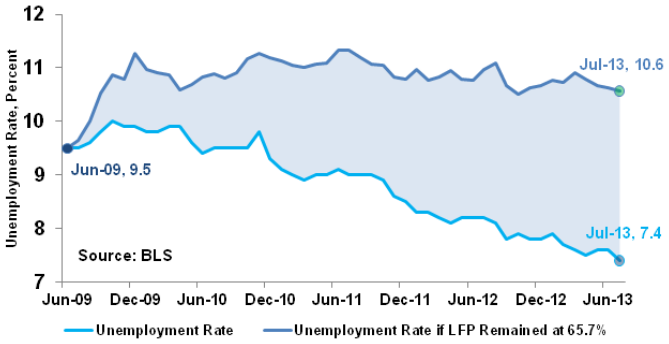
Source: BEA

Why is this economic recovery frustratingly slow? The chart below shows the contribution of four components of GDP to overall growth: Consumption, Residential Fixed Investment, Government Spending, and Everything Else (Non-residential Fixed Investment, Inventories, and Net Exports). The chart illustrates the average quarterly contribution to growth during each expansion and there are three points to note. First, during this recovery government spending has been a net drag on economic growth for the first time since the expansion that began at the end of 1970. The American Reinvestment and Recovery Act (the Stimulus) helped government spending add 2 percentage points to real GDP growth in 2009, but the subsequent wind down of the stimulus, spending cutbacks by state and local governments, and further contractionary fiscal policy subtracted over 5 percent from real GDP growth following 2009. Second, residential fixed investment has not been adding to GDP growth until recently. In past recoveries, the housing

sector was generally at the forefront of the expansion, helping to pull other sectors into recovery. On average, during recoveries, residential fixed investment adds about one quarter of a percentage point to real GDP growth per quarter, but during the most recent recovery, residential fixed investment has added just 0.05 percent to GDP growth per quarter. Third, consumption spending has improved very slowly. Historically, consumption spending adds about 2.5 percentage points to real GDP growth each quarter on average, but since the second quarter of 2009 it has only added about 1.2 percentage points in real GDP growth each quarter. Contractionary fiscal policy, moribund residential construction (until recently) and slow consumption growth have kept the economic recovery near stall speed.



While the economy is expanding right now, economic growth is not as robust as it needs to be to get the labor market back to health. The July employment report indicated the U.S. economy added 165,000 jobs, and the unemployment rate ticked down to 7.4 percent, the lowest level since December 2008. However, the entire decline in the unemployment rate since June 2009 is due to falling labor force participation rather than robust job growth. To be sure, demographic factors account for some of the decline in the labor force participation rate, but a large portion of the declining participation rate is due to dim job prospects and potential workers bowing out of the labor force.



Can we hope to see the recovery speed up anytime soon? Good news in the housing sector bodes well for future economic growth. Recently housing markets have shown solid growth. Housing starts were up 18 percent, home sales gained 13 percent, and U.S. house price indexes

increased about 10 percent over the past year. Plus serious delinquency rates have declined to their lowest level since the third quarter of 2008.[i] A rapidly improving housing market will help the economic recovery in at least three ways.

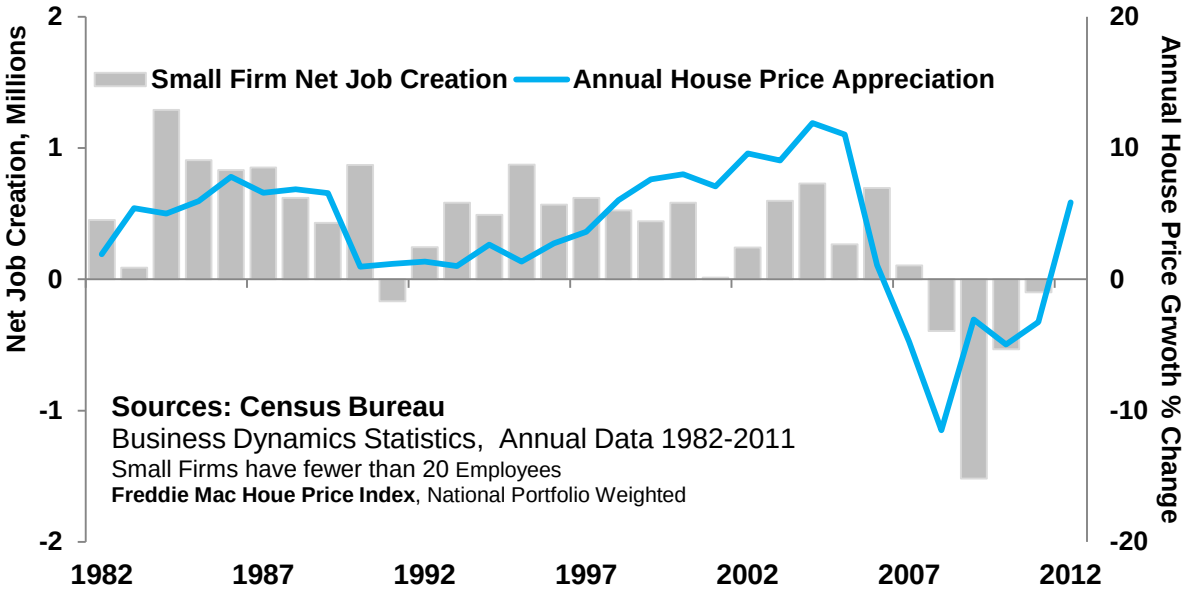
First, increased demand for housing will help stimulate new single-family and multifamily construction and boost home sales. We expect starts to hover just below one million (SAAR) over the second half of the year, the best six-month building pace since the first half of 2008. This increased building and sales will add approximately three-eighths of a percentage point directly to GDP growth through residential fixed investment and will employ many more workers in construction and at other housing related firms.

Second, through the housing wealth effect, rising home prices should help to spur consumption spending. With housing being the biggest asset of most American households, rising house prices directly affect the balance sheet of homeowners. Home equity is the largest component of net wealth for many families. As wealth rises, households generally increase their consumption spending. They may even tap into their equity through a home-equity loan, using the proceeds for either consumption or investment spending. Some evidence that home equity lending has picked up was found in Freddie Mac's Refinance Report for the second quarter, which saw $9.5 billion in home-equity cashed-out as part of a refinance, up from a year ago.

Finally, rising house prices will help the economic recovery by spurring small business formation, as a business owner's home often serves as collateral for a start-up. Small business growth has been very weak during the recovery. In fact, according to data reported in the Business Dynamics Statistics from the Census Bureau, Small Businesses (defined as firms with fewer than 20 employees) subtracted from net job creation from 2008 through 2011. Recent research by analysts at the U.S. Census Bureau and University of Maryland[ii] indicated that slow house price growth has been a key contributing factor to anemic small business growth. According to their analysis 42 percent of the decline in the performance of young firms (relative to mature firms) is due to declines in home prices.

Small Firms are adding far fewer jobs than in previous years, at least partially due to falling house prices.

Net Job Creation by Small Firms in the US 1982-2011
and Annual House Price Growth 1982-2012.



As the recovery passes its fourth birthday, it has yet to show maturity but may be ripe for a growth spurt. And that economic growth will be fed by a continued rise in housing demand and property values, which in turn will stimulate job gains, consumption spending, and investment, some of the latter in small businesses.

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August 14, 2013

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[i] Housing starts and new and existing home sales were measured as growth from second quarter of 2012 to the second quarter of 2013. The Freddie Mac House Price Index for the U.S. was up 9.3 percent and the CoreLogic National House Price Index gained 11.9 percent over the 12 months through June (excluding distressed sales, the CoreLogic index was up 11.0 percent over that period).
[ii] Haltiwanger, John, Ron Jarmin, and Javier Miranda. 2013. "Anemic Job Creation and Growth in the Aftermath of the Great Recession: Are Home Prices to Blame?" http://www.census.gov/ces/dataproducts/bds/publications.html

August 2013 Economic and Housing Market Outlook

Revised 8/9/2013

Indicator	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	Annual Totals 2009	2010	2011	2012	2013	2014
Real GDP (%)	2.8	0.1	1.1	1.7	**2.4**	**2.8**	**3.0**	**3.0**	**3.5**	**3.5**	-0.2	2.8	2.0	2.0	**2.0**	**3.3**
Consumer Prices (%) a.	2.1	2.2	1.4	0.0	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	1.5	1.4	3.0	1.8	**1.4**	**2.0**
Unemployment Rate (%) b.	8.0	7.8	7.7	7.6	**7.4**	**7.4**	**7.3**	**7.2**	**7.0**	**6.9**	9.3	9.6	8.9	8.1	**7.5**	**7.1**
30-Year Fixed Mtg. Rate (%) b.	3.6	3.4	3.5	3.7	**4.4**	**4.5**	**4.7**	**4.9**	**5.1**	**5.3**	5.0	4.7	4.5	3.7	**4.0**	**5.0**
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	2.6	2.6	**2.6**	**2.6**	**2.7**	**2.8**	**2.8**	**2.9**	4.7	3.8	3.0	2.7	**2.6**	**2.8**
10-Year Const. Mat. Treas. Rate (%) b.	1.6	1.7	2.0	2.0	**2.6**	**2.7**	**2.9**	**3.1**	**3.3**	**3.5**	3.3	3.2	2.8	1.8	**2.3**	**3.2**
1-Year Const. Mat. Treas. Rate (%) b.	0.2	0.2	0.2	0.1	**0.1**	**0.1**	**0.2**	**0.3**	**0.3**	**0.4**	0.5	0.3	0.2	0.2	**0.1**	**0.3**

Indicator	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	Annual Totals 2009	2010	2011	2012	2013	2014
Housing Starts c.	0.78	0.90	0.96	0.87	**0.95**	**1.00**	**1.10**	**1.15**	**1.25**	**1.30**	0.55	0.59	0.61	0.78	**0.95**	**1.20**
Total Home Sales d.	5.12	5.28	5.39	5.53	**5.55**	**5.65**	**5.75**	**5.85**	**5.95**	**6.05**	4.72	4.51	4.57	5.03	**5.53**	**5.90**
FMHPI House Price Appreciation (%) e.	1.1	0.1	2.7	5.2	**0.9**	**0.0**	**1.0**	**1.5**	**2.0**	**0.4**	-2.3	-5.0	-3.3	5.9	**9.0**	**5.0**
S&P/Case-Shiller® Home Price Index (%) f.	2.1	-0.4	1.2	**6.1**	**1.5**	**0.0**	**1.1**	**2.1**	**1.5**	**0.2**	-2.5	-3.8	-3.7	7.3	**9.0**	**5.0**
1-4 Family Mortgage Originations g.																
Conventional	**$463**	**$475**	**$440**	**$455**	**$320**	**$235**	**$280**	**$340**	**$245**	**$185**	$1,549	$1,300	$1,206	**$1,720**	**$1,450**	**$1,050**
FHA & VA	$97	$105	$100	**$105**	**$80**	**$65**	**$50**	**$80**	**$65**	**$55**	$451	$377	$294	$380	**$350**	**$250**
Total	**$560**	**$580**	**$540**	**$560**	**$400**	**$300**	**$330**	**$420**	**$310**	**$240**	$2,000	$1,677	$1,500	**$2,100**	**$1,800**	**$1,300**
ARM Share (%) h.	8	7	8	9	**10**	**11**	**12**	**13**	**14**	**15**	3	5	11	10	**10**	**14**
Refinancing Share - Applications (%) i.	82	83	79	73	**55**	**45**	**45**	**40**	**40**	**35**	70	76	75	81	**66**	**40**
Refinancing Share - Originations (%) j.	**76**	**76**	**75**	**70**	**50**	**40**	**45**	**40**	**40**	**35**	68	67	64	**71**	**62**	**40**
Residential Mortgage Debt (%) k.	-2.9	0.0	-1.9	**1.5**	**1.5**	**0.5**	**1.0**	**2.0**	**3.0**	**4.0**	-1.6	-4.1	-2.2	-2.1	**0.4**	**2.5**

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.
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 (FMHPI); not seasonally-adjusted; Dec.to-Dec. for yearly data.
f. National composite index (quarterly growth rate); not seasonally-adjusted; Q4-to-Q4 for yearly data.
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 8/9/2013 (MAS); Send comments and questions to chief_economist@freddiemac.com.

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