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Office of the Chief Economist

December 2012 U.S. Economic & Housing Market Outlook

# Peering Into 2013

The last few months have brought a spate of favorable news on the U.S. housing market: construction up, more home sales, and home value growth turning positive. This has been a big change from a year ago, when some analysts worried that the looming 'shadow inventory' would keep the housing sector mired in an economic depression. Indeed, more than three million single-family loans remain at least 90 days delinquent or in the process of foreclosure as of September and will continue to weigh on the market. But this stock of seriously delinquent loans has fallen by about 600,000 over the past year, and the improving housing demand allows distressed sales to be better absorbed in local housing markets with less adverse consequences on property values. According to CoreLogic's Market Trends data, REO sales and short sales combined represented 21 percent of sales during the third quarter, the smallest share since the third quarter of 2008. Thus, while distressed sales are a big part of some local markets, they represent a smaller share than in recent years.

So what will be some of the market features for 2013? We peered into our crystal ball and identified the following:

***One: Mortgage Rates Stay Low.*** Mortgage rates fell to 65-year lows after the Federal Reserve began its third round of quantitative easing in September, "QE3". Look for fixed-rate mortgage rates to remain near record lows for the first half of 2013 for both single-family and for apartment-building loans. While rates may rise a bit in the tail end of next year, long-term fixed-rate mortgage rates are expected to remain below 4 percent. In the single-family market, this means homebuyer affordability should remain very high in 2013 for those potential buyers with good credit history, stable income and sufficient savings.

***Two: Home Values Rise.*** All major house price indexes (HPI) showed an annual gain in values for the U.S. in the most recent data. For example, over the twelve months ending September, the Federal Housing Finance Agency Purchase-Only HPI was up 4.5 percent and the Freddie Mac HPI was up 4.3 percent (not seasonally adjusted). Likewise, apartment building values rose, with the National Council of Real Estate Investment Fiduciaries reporting a four-quarter rise of 6.3 percent through the third quarter. Look for property values to continue to strengthen in 2013: most U.S. house price indexes will likely rise by 2 to 3 percent in 2013. Like always, national statistics mask the differential price performance in the myriad of local neighborhoods as some will post faster gains, while some will be stagnant or see value loss in 2013.

***Three: Household Formations Up.*** The past year saw net household formations pick up, and 2013 appears ripe for formations to step up further. Unemployment, while still high, will

likely drift down toward 7.5 percent; the resulting job and income gains will facilitate household formations. Look for net growth of 1.20 to 1.25 million households in 2013. These gains will help drive more housing construction and reduce vacancy rates further. Housing starts should be up around the 1.0 million pace (seasonally adjusted annual rate) by the fourth quarter of 2013.

***Four: Vacancy Rates Down.*** Vacancy rates in both the apartment rental market and the single-family for-sale market have been trending lower for much of the past three years. An important reason why vacancies have lessened is because household formations have outpaced new construction. To illustrate, over the year through the third quarter, net household formations totaled 1.15 million but completions of newly built homes (both rental and for sale) were just under 700,000; the difference is made up by a reduction in vacancies. This trend will continue in 2013 and could bring aggregate vacancy rates down to levels last seen a decade ago. While this is good news for property owners, tenants will likely see rents rise a bit faster than overall consumer-price inflation.

***Five: Less Refinancing, More Apartment Funding.*** Refinance activity accounts for the bulk of the current residential mortgage market, and this will continue into 2013. But compared with the refinance boom in 2012, next year will likely have less refinance activity for two reasons: first, many homeowners have locked in low rates in recent months and will have little financial incentive to refinance again; and, second, interest rates will likely be a bit higher a year from now than they are today, further reducing the financial incentive to refinance. In the single-family market, the bulk of 2013 originations will continue to be for refinance, but less so than in 2012; a pickup in purchase-money lending will probably be insufficient to offset the dip in refinance, thus reducing single-family originations by about 15 percent. Multifamily lending is a different story, as permanent financing on new completions, property transactions, and refinance of loans exiting from “lockout” or “yield maintenance” periods is expected to translate into a rise of 5 percent or so in dollar originations.

Best wishes for a healthy and prosperous 2013!

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## Major Economic Indicators

| *Indicator* | 2011 Q1 | 2011 Q2 | 2011 Q3 | 2011 Q4 | 2012 Q1 | 2012 Q2 | 2012 Q3 | 2012 Q4 | 2013 Q1 | 2013 Q2 | 2013 Q3 | 2013 Q4 | Annual Totals 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Real GDP (%)** | 0.1 | 2.5 | 1.3 | 4.1 | 2.0 | 1.3 | 2.7 | **1.2** | **1.5** | **2.8** | **3.2** | **3.5** | -3.3 | -0.1 | 2.4 | 2.0 | **1.8** | **2.8** | **3.5** |
| **Consumer Prices (%) a.** | 4.5 | 4.4 | 3.1 | 1.3 | 2.5 | 0.8 | 2.3 | **2.5** | **1.5** | **2.0** | **2.0** | **2.0** | 1.6 | 1.5 | 1.2 | 3.3 | **2.0** | **1.9** | **2.0** |
| **Unemployment Rate (%) b.** | 9.0 | 9.0 | 9.1 | 8.7 | 8.3 | 8.2 | 8.1 | **7.8** | **7.7** | **7.6** | **7.5** | **7.4** | 5.8 | 9.3 | 9.6 | 9.0 | **8.1** | **7.6** | **7.1** |
| **30-Year Fixed Mtg. Rate (%) b.** | 4.9 | 4.7 | 4.3 | 4.0 | 3.9 | 3.8 | 3.6 | **3.4** | **3.4** | **3.5** | **3.6** | **3.7** | 6.0 | 5.0 | 4.7 | 4.5 | **3.7** | **3.6** | **4.1** |
| **1-Year Treas. Indexed ARM Rate (%) b.** | 3.3 | 3.1 | 2.9 | 2.9 | 2.8 | 2.8 | 2.7 | **2.6** | **2.7** | **2.7** | **2.8** | **2.8** | 5.2 | 4.7 | 3.8 | 3.0 | **2.7** | **2.8** | **3.6** |
| **10-Year Const. Mat. Treas. Rate (%) b.** | 3.5 | 3.2 | 2.4 | 2.1 | 2.0 | 1.8 | 1.6 | **1.7** | **1.7** | **1.8** | **1.9** | **2.0** | 3.7 | 3.3 | 3.2 | 2.8 | **1.8** | **1.9** | **2.4** |
| **1-Year Const. Mat. Treas. Rate (%) b.** | 0.3 | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | **0.2** | **0.2** | **0.2** | **0.3** | **0.3** | 1.8 | 0.5 | 0.3 | 0.2 | **0.2** | **0.3** | **0.5** |

## Housing and Mortgage Markets

| *Indicator* | 2011 Q1 | 2011 Q2 | 2011 Q3 | 2011 Q4 | 2012 Q1 | 2012 Q2 | 2012 Q3 | 2012 Q4 | 2013 Q1 | 2013 Q2 | 2013 Q3 | 2013 Q4 | Annual Totals 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Housing Starts c.** | 0.58 | 0.57 | 0.61 | 0.68 | 0.72 | 0.74 | 0.78 | **0.82** | **0.85** | **0.90** | **0.95** | **1.00** | 0.91 | 0.55 | 0.59 | 0.61 | **0.77** | **0.93** | **1.20** |
| **Total Home Sales d.** | 4.63 | 4.48 | 4.55 | 4.69 | 4.92 | 4.90 | 5.03 | **5.15** | **5.20** | **5.30** | **5.50** | **5.60** | 4.59 | 4.72 | 4.51 | 4.57 | **5.00** | **5.40** | **5.80** |
| **FMHPI House Price Appreciation (%) e.** | -1.3 | 1.5 | -1.8 | -2.4 | 0.6 | 4.9 | 1.3 | **-1.5** | **0.6** | **3.3** | **0.0** | **-1.4** | -11.7 | -2.3 | -5.5 | -3.9 | **5.3** | **2.5** | **3.0** |
| **S&P/Case-Shiller® Home Price Index (%) f.** | -4.0 | 4.1 | 0.1 | -3.8 | -1.6 | 7.1 | 2.2 | **-2.0** | **0.0** | **3.5** | **1.0** | **-2.0** | -18.4 | -2.5 | -3.8 | -3.7 | **5.6** | **2.5** | **3.0** |
| **1-4 Family Mortgage Originations g.** | | | | | | | | | | | | | | | | | | | |
| **Conventional** | $269 | $226 | $311 | $400 | **$367** | **$377** | **$450** | **$426** | **$377** | **$385** | **$318** | **$280** | $1,310 | $1,549 | $1,300 | $1,208 | **$1,620** | **$1,360** | **$1,000** |
| **FHA & VA** | $77 | $70 | $73 | $74 | $83 | $93 | $100 | **$104** | **$83** | **$95** | **$92** | **$70** | $290 | $451 | $377 | $292 | **$380** | **$340** | **$250** |
| **Total** | $346 | $296 | $384 | $474 | **$450** | **$470** | **$550** | **$530** | **$460** | **$480** | **$410** | **$350** | $1,600 | $2,000 | $1,677 | $1,500 | **$2,000** | **$1,700** | **$1,250** |
| **ARM Share (%) h.** | 8 | 11 | 12 | 14 | 12 | 11 | 8 | **8** | **10** | **11** | **12** | **13** | 7 | 3 | 5 | 11 | **10** | **12** | **15** |
| **Refinancing Share - Applications (%) i.** | 69 | 70 | 78 | 81 | 81 | 77 | 82 | **80** | **75** | **65** | **60** | **50** | 48 | 70 | 76 | 75 | **80** | **63** | **40** |
| **Refinancing Share - Originations (%) j.** | 69 | 51 | 61 | 73 | **75** | **71** | **76** | **76** | **70** | **65** | **55** | **50** | 50 | 68 | 67 | 64 | **75** | **60** | **40** |
| **Residential Mortgage Debt (%) k.** | -3.0 | -2.4 | -2.0 | -1.8 | -3.1 | -1.9 | -2.8 | **-2.0** | **-1.0** | **0.0** | **0.0** | **1.0** | -0.5 | -1.6 | -4.1 | -2.3 | **-2.5** | **0.0** | **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 (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 (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 12/7/2012 (MAS); Send comments and questions to chief_economist@freddiemac.com.

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