Freddie Mac
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Office of the Chief Economist

December 2013 U.S. Economic & Housing Market Outlook

Diverging Homebuyer Affordability

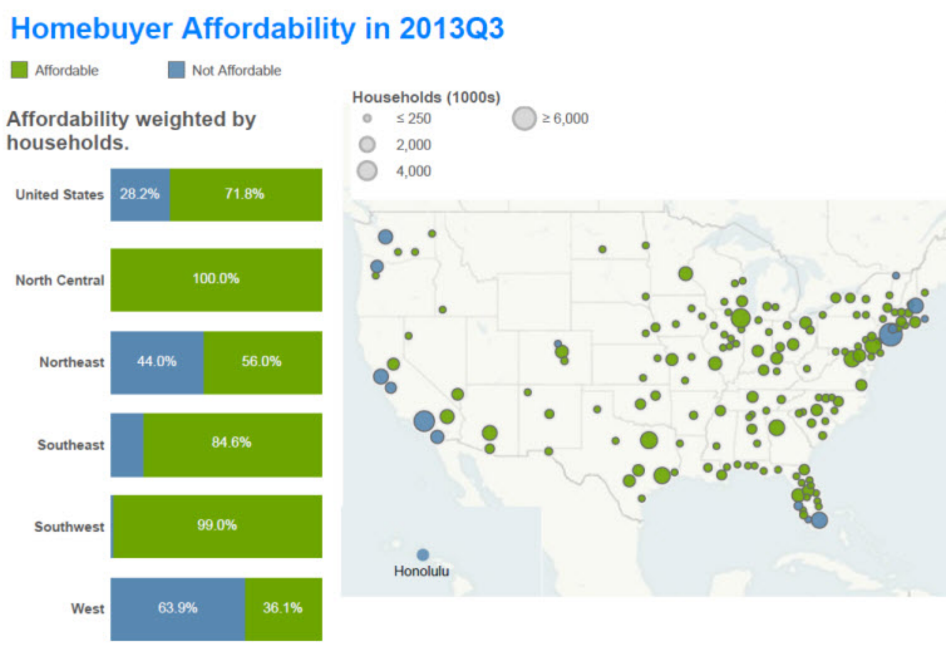
In the June 2013 'Outlook' we reported on how rising interest rates would affect homebuyer affordability and we found that most markets in the country were affordable and mortgage rates would have to rise to about 7 percent for them to become unaffordable to a typical family. After six months, interest rates are higher by about one half of a percentage point and prices have been rising across the country. In this Outlook we re-examine homebuyer affordability and ask: now that interest rates have moved higher and prices have sustained six months of gains, how does affordability look across the country now and what might it look like moving forward?

To assist us we've created an [interactive affordability map] by metro to explore the impact of mortgage rates, house prices and income.

Mortgage Rates Are Key

By the end of September, buyer affordability in many parts of the country had declined from what it was in March, with several of the largest markets on the coasts, representing about 28 percent of the households in our data, being 'unaffordable' by traditional housing payment-to-income guidelines. If mortgage rates increase to 5 percent, then two-fifths of the metro areas (weighted by households) would become 'unaffordable'. For much of the Midwest and South affordability would remain high.

At a 4.4 percent interest rate for a 30-year fixed that prevailed in the third quarter of 2013, all of the North Central region remained affordable, while just 36 percent of the West (based on an average of metros weighted by number of households) remained affordable. At a 5 percent rate (and no change in prices or income) approximately 63 percent of the country would be affordable; at 6 percent mortgage rates 55 percent would be affordable; and at 7 percent rates only 35 percent of the country (but 64 percent of the North Central region!) would be affordable.



* Reflects 28 percent of monthly median household income. Affordability is defined as 100 x 0.28 x Gross Monthly Income / PITI. PITI is calculated as the payments for Principal, Interest, Taxes and Insurance associated with a 30-year fixed-rate mortgage with a rate of 4.4% and a downpayment of 10%. **Sources:** National Association of Realtors (Median Sales Price), Moody's Analytics (Median Household Income Estimates). Mortgage Rates, (Freddie Mac Primary Mortgage Market Survey http://www.freddiemac.com/pmms/)

Job & Income Growth A Partial Offset

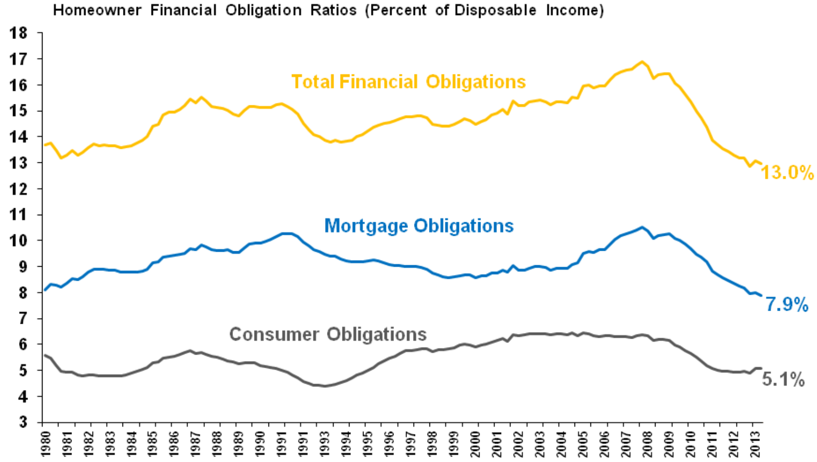
A partial offset to a rise in mortgage payments is income growth. Recently we've received some good news on the jobs front with October and November beating the consensus forecast. Job growth has increased at a monthly pace of 193,000 over the past 3 months and we're seeing better paying job growth as well. This has helped to bring the unemployment rate to 7 percent. Equally encouraging was an increase in job openings.

Housing Payments Fall

Relatively low payment-to-income ratios not only are good for potential homebuyers, they are important for sustaining homeownership for existing owners. Housing payment-to-income ratios have moved sharply lower over the past few years, and currently are at the lowest level since 1980, when the Federal Reserve began to keep track of the ratio. Relatively low, manageable ratios are critical for homeowners to have a successful, sustained homeownership experience.

Homeowners' Housing Payment-to-Income Ratio Has Fallen to Lowest Since 1980

Homeowner Financial Obligation Ratios (Percent of Disposable Income)



Source: Federal Reserve Board (the mortgage financial obligations ratio includes payments on mortgage debt, homeowners' insurance, and property taxes, while the consumer financial obligations ratio includes payments on consumer debt and automobile leases). Expressed quarterly.

When we look at household balance sheets there is additional good news for the economy and homeowners. The Federal Reserve's Flow of Funds data for the third quarter of 2013 shows that household wealth is increasing, due to gains in both the stock market and house prices. Household net worth was up $1.9 trillion in the third quarter of 2013 from the second quarter of 2012. Residential real estate holdings increased by $428 billion in the third quarter, while equities and mutual funds added $917 billion. Moreover, home mortgage debt rose about 1 percent in the third quarter, the first expansion in home mortgage debt since the first quarter of 2008 and a positive sign that new mortgage loans are exceeding charge-offs on defaulted debt.

The Harbinger

All eyes will be on the 'Taper' in the coming months of 2014. Without a doubt it will be the quintessential factor in mortgage rate swings as the speculation ensues, much like we saw last summer. But mortgage rates are just one factor in the affordability equation, and other fundamentals, such as income growth, will be those that help create a stable and sustainable environment for attaining homeownership.

So here's to sustained housing affordability and a healthy, prosperous and a truly new year!

Frank E. Nothaft — Leonard Kiefer
Chief Economist — Deputy Chief Economist
December 19, 2013

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Revised 12/18/2013

	2012		2013				2014				Annual Totals						
Indicator	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012	2013	2014	2015
Real GDP (%)	2.8	0.1	1.1	2.5	3.6	**2.0**	**2.6**	**2.8**	**3.0**	**3.2**	-0.2	2.8	2.0	2.0	**2.3**	**2.9**	**3.2**
Consumer Prices (%) a.	2.1	2.2	1.4	0.0	2.6	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	1.5	1.4	3.0	1.8	**1.5**	**2.0**	**2.0**
Unemployment Rate (%) b.	8.0	7.8	7.7	7.6	7.3	**7.1**	**7.0**	**6.9**	**6.8**	**6.7**	9.3	9.6	8.9	8.1	**7.4**	**6.9**	**6.5**
30-Year Fixed Mtg. Rate (%) b.	3.6	3.4	3.5	3.7	4.4	**4.3**	**4.4**	**4.6**	**4.8**	**5.0**	5.0	4.7	4.5	3.7	**4.0**	**4.7**	**5.5**
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	2.6	2.6	2.7	**2.7**	**2.7**	**2.8**	**2.8**	**2.9**	4.7	3.8	3.0	2.7	**2.7**	**2.8**	**3.1**
10-Year Const. Mat. Treas. Rate (%) b.	1.6	1.7	2.0	2.0	2.7	**2.6**	**2.8**	**3.0**	**3.2**	**3.4**	3.3	3.2	2.8	1.8	**2.3**	**3.1**	**3.9**
1-Year Const. Mat. Treas. Rate (%) b.	0.2	0.2	0.2	0.1	0.1	**0.1**	**0.1**	**0.2**	**0.2**	**0.3**	0.5	0.3	0.2	0.2	**0.1**	**0.2**	**0.5**

	2012		2013				2014				Annual Totals						
Indicator	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012	2013	2014	2015
Housing Starts c.	0.78	0.90	0.96	0.87	0.88	**0.95**	**1.00**	**1.05**	**1.15**	**1.20**	0.55	0.59	0.61	0.78	**0.92**	**1.10**	**1.35**
Total Home Sales d.	5.12	5.28	5.39	5.50	5.73	**5.50**	**5.80**	**5.90**	**5.90**	**6.00**	4.72	4.51	4.57	5.03	**5.53**	**5.90**	**6.10**
FMHPI House Price Appreciation (%) e.	1.1	0.1	2.7	5.4	2.2	**-0.1**	**1.0**	**2.5**	**2.0**	**0.4**	-2.3	-4.9	-3.2	5.8	**10.5**	**6.0**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	2.0	-0.5	1.1	7.1	3.2	**-0.4**	**1.1**	**3.1**	**1.5**	**0.2**	-2.5	-3.8	-3.7	7.2	**11.3**	**6.0**	**3.0**
1-4 Family Mortgage Originations g.																	
Conventional	$471	$495	**$435**	**$456**	**$359**	**$280**	**$306**	**$362**	**$266**	**$194**	$1,549	$1,300	$1,206	$1,750	**$1,530**	**$1,128**	**$952**
FHA & VA	$97	$105	$105	$104	$91	**$70**	**$77**	**$91**	**$66**	**$48**	$451	$377	$294	$380	**$370**	**$282**	**$238**
Total	$568	$600	**$540**	**$560**	**$450**	**$350**	**$383**	**$453**	**$332**	**$242**	$2,000	$1,677	$1,500	$2,130	**$1,900**	**$1,410**	**$1,190**
ARM Share (%) h.	8	7	8	9	9	**9**	**10**	**11**	**12**	**13**	3	5	11	10	**9**	**12**	**15**
Refinancing Share - Applications (%) i.	82	83	79	73	64	**57**	**50**	**46**	**43**	**40**	70	76	75	81	**70**	**45**	**20**
Refinancing Share - Originations (%) j.	69	73	**71**	**65**	**56**	**49**	**44**	**40**	**39**	**35**	68	67	64	70	**62**	**40**	**20**
Residential Mortgage Debt (%) k.	-3.0	-0.1	-1.7	-0.5	0.9	**0.0**	**0.0**	**1.0**	**2.0**	**3.0**	-1.6	-4.3	-2.2	-2.1	**-0.3**	**1.5**	**4.0**

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.

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 12/18/2013 (PTT); Send comments and questions to chief_economist@freddiemac.com.