A Slow Start to the New Year, But Better News Ahead

The New Year got off to a slow start, with a labor market report indicating some forward progress that was helpful but not exciting. Nonfarm payrolls rose 103,000 in December, weaker than expected and barely enough to keep pace with a growing population, let alone make a dent in high rates of unemployment. An upward revision to October and November of 70,000 jobs sweetened the news somewhat, but the overall flavor was little changed: a jobs recovery that continues to move forward, but at such a sluggish pace that it has done little to date to help the housing market.

The unemployment number is calculated from a separate survey of households, but tells a similar story. The drop in the rate from 9.8 percent in November to 9.4 percent in December, lowest since May 2009, is encouraging. About half the decline, however, was due to people who stopped looking for work and were no longer counted as part of the labor force. Many of them are likely to return to the labor force in coming months, so a reversal of part of the December drop is expected to occur. The rest of the decline in the unemployment rate, however, reflects real improvements in joblessness due to an increased pace in hiring toward the end of last year.

This less-than-exuberant opening to 2011, though, does little to dampen our expectations that the recovery will continue to gather strength as the year goes on. This is likely to include more rapid job growth and some decline in unemployment rates, as well as a modest improvement in housing markets. There are several reasons for this outlook:

Near-term noise obscures the longer-term trend. The monthly growth of private payrolls has been choppy and remains sub-par, especially during the “soft patch” in hiring (and overall economic growth) that occurred late spring and in the summer. Initial claims for unemployment insurance, another important indicator of the health of the labor market, tell a similar story for much of 2010. Jobless claims fell from a peak of 650,000 in early 2009 but then flattened out in January 2010 at around 450,000 a week, where they more or less remained until early fall. Since then, however, claims have resumed their downward trend, dropping to 400,000 (and briefly below that threshold) late last year. This recent improvement, combined with the other developments discussed below, signals that jobs and incomes are set to begin rising again.

Consumers are coming back. The initial stages of the economic recovery were driven by inventory investment and a rebound in manufacturing, while consumers were hesitant to step up spending until the job market and home values showed signs of stabilizing. In recent months, however, consumers have come back. Real consumer spending (that is, controlling for inflation) grew at nearly a 4 percent annualized pace in the three months through November, roughly double the growth rate in the summer months. The early readings on spending in December were also encouraging, with auto sales rising to the highest rate (other than the “cash for clunkers” month) since September 2008. Surveys of consumer confidence consistently show that current conditions have gotten better and expectations are for further improvements over the rest of this year.

Macroeconomic policies support future growth. The recent tax deal reduced payroll taxes by 2 percentage points for low- and middle-income workers. Together with the extension of earlier tax cuts, lower payroll deductions will bolster take-home pay in the months ahead, which is expected to support the upward trend in consumer spending. Monetary policy remains firmly committed to supporting the economic recovery, with the Federal Reserve recently keeping its target for overnight interest rates at 25 basis points or less and reaffirming its plan to purchase $600 billion of Treasury securities by the end of June. Treasury bond yields did rise in December, but remain quite low by any measure, and financial market conditions remain conducive to stronger growth.

The back-up in Treasury rates prompted a similar rise in mortgage rates, from a low of 4.19 percent for 30-year fixed-rate mortgages in October to around 4.80 percent in late December and early January, according to Freddie Mac's Primary Mortgage Market Survey® (PMMS®). The main impact of these higher rates will be to slow the pace of mortgage refinancings. Indeed, according to the Mortgage Bankers Association, refinancing applications in recent weeks were less than half the pace seen in September and October. The increase in mortgage rates, however, still leaves them near the bottom end of historical experience – in the PMMS, which began tracking 30-year fixed mortgage rates in 1971, our current forecast of a 5.2 percent average over 2011 is the third lowest annual average in the survey behind only 2010 and 2009. Low mortgage rates combined with the house price declines experienced over recent years mean that homebuyer affordability is still very high. Although home sales may rise less than previously anticipated as a result of higher mortgage rates, sales are expected to be the best in at least three years, increasing about 10 percent above 2010 levels. More robust growth of jobs and incomes should offset much of the impact of the rise in rates, and help make 2011 a year of recovery for the housing market, as well as the economy overall.

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January 2011 Economic and Housing Market Outlook

Office of the Chief Economist

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Major Economic Indicators

	2009		2010				2011				2012		Annual Totals					
Indicator	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Real GDP (%)	1.6	5.0	3.7	1.7	2.6	**3.0**	**3.2**	**3.5**	**4.1**	**4.1**	**4.0**	**4.0**	2.3	-2.8	0.2	**2.8**	**3.7**	**4.0**
Consumer Prices (%) a.	3.7	2.6	1.5	-0.7	1.5	**2.0**	**1.2**	**1.2**	**1.2**	**1.2**	**1.3**	**1.4**	4.0	1.6	1.5	**1.1**	**1.2**	**1.5**
Unemployment Rate (%) b.	9.6	10.0	9.7	9.7	9.6	9.6	**9.6**	**9.5**	**9.3**	**9.1**	**8.8**	**8.6**	4.6	5.8	9.3	9.7	**9.4**	**8.5**
30-Year Fixed Mtg. Rate (%) b.	5.2	4.9	5.0	4.9	4.4	4.4	**5.0**	**5.1**	**5.3**	**5.5**	**5.7**	**5.8**	6.3	6.0	5.0	4.7	**5.2**	**5.8**
1-Year Treas. Indexed ARM Rate (%) b.	4.7	4.4	4.3	4.0	3.5	3.3	**3.3**	**3.4**	**3.5**	**3.6**	**3.7**	**3.8**	5.6	5.2	4.7	3.8	**3.5**	**3.9**
10-Year Const. Mat. Treas. Rate (%) b.	3.5	3.5	3.7	3.5	2.8	2.9	**3.5**	**3.7**	**3.8**	**4.0**	**4.2**	**4.4**	4.6	3.7	3.3	3.2	**3.7**	**4.3**
1-Year Const. Mat. Treas. Rate (%) b.	0.5	0.4	0.4	0.4	0.3	0.3	**0.3**	**0.4**	**0.5**	**0.6**	**0.7**	**0.8**	4.5	1.8	0.5	0.3	**0.4**	**0.8**

Housing and Mortgage Markets

	2009		2010				2011				2012		Annual Totals					
Indicator	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Housing Starts c.	0.59	0.57	0.62	0.60	0.59	**0.55**	**0.60**	**0.70**	**0.80**	**0.90**	**1.10**	**1.20**	1.36	0.91	0.55	**0.59**	**0.75**	**1.20**
Total Home Sales d.	5.05	5.61	4.86	5.22	3.94	**4.30**	**4.50**	**4.70**	**5.30**	**5.70**	**5.60**	**5.60**	5.72	4.84	4.94	**4.58**	**5.05**	**5.56**
Conventional Mtg. Home Price Index (%) e.	-8.3	-2.2	-5.4	-1.5	5.6	**-1.0**	**0.0**	**1.0**	**1.5**	**1.5**	**2.0**	**2.5**	-0.4	-5.7	-4.0	**-0.6**	**1.0**	**2.5**
S&P/Case-Shiller® Home Price Index (%) f.	13.7	-4.3	-11.0	20.0	-7.9	**-4.0**	**-0.5**	**0.5**	**1.5**	**2.0**	**2.0**	**2.5**	-8.4	-18.3	-2.4	**-0.7**	**0.9**	**2.5**
1-4 Family Mortgage Originations g.																		
Conventional	$343	$319	**$243**	**$280**	**$330**	**$327**	**$175**	**$195**	**$205**	**$160**	**$180**	**$200**	$2,312	$1,310	$1,549	**$1,180**	**$735**	**$800**
FHA & VA	$119	$111	$92	$90	$95	**$93**	**$70**	**$80**	**$90**	**$75**	**$75**	**$80**	$120	$290	$451	**$370**	**$315**	**$350**
Total	$462	$430	**$335**	**$370**	**$425**	**$420**	**$245**	**$275**	**$295**	**$235**	**$255**	**$280**	$2,432	$1,600	$2,000	**$1,550**	**$1,050**	**$1,150**
ARM Share (%) h.	4	5	4	6	5	**6**	**7**	**8**	**9**	**10**	**10**	**11**	10	7	3	**5**	**9**	**12**
Refinancing Share - Applications (%) i.	59	74	70	72	81	**77**	**55**	**40**	**35**	**30**	**30**	**30**	42	48	70	**75**	**40**	**30**
Refinancing Share - Originations (%) j.	58	61	**70**	**58**	**75**	**71**	**55**	**40**	**35**	**35**	**35**	**35**	49	50	68	**69**	**41**	**35**
Residential Mortgage Debt (%) k.	-2.8	-2.4	-3.8	-2.4	-2.4	-2.0	0.0	**1.0**	**2.0**	**3.0**	**4.0**	**5.0**	7.1	-0.4	-1.7	**-2.7**	**1.5**	**6.0**

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 Conventional Mortgage Home Price Index (CMHPI); 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 1/11/2011 (MAS); Send comments and questions to chief_economist@freddiemac.com.

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