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Office of the Chief Economist

January 2013 U.S. Economic & Housing Market Outlook

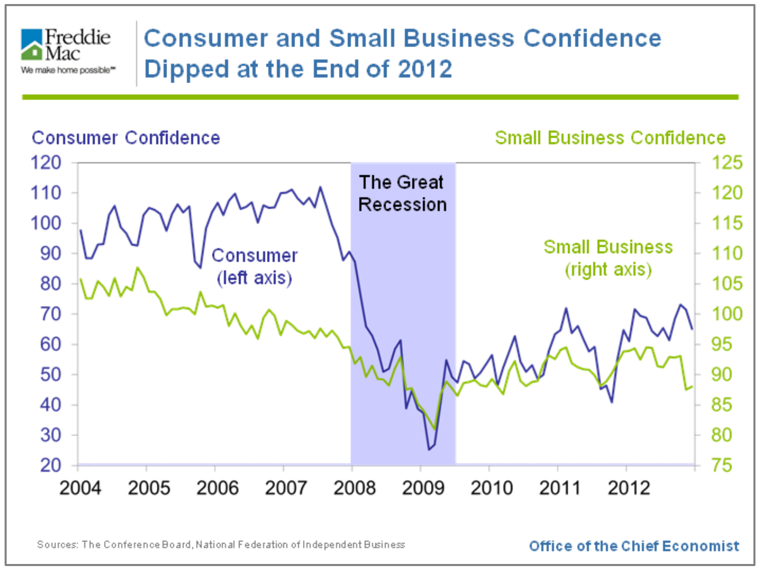
Fiscal Uncertainty

The new year was greeted with the passage of the American Taxpayer Relief Act of 2012, preserving the marginal tax rates for most of America's taxpayers, raising marginal rates for those with high income (above $400,000 for single filers, $450,000 for joint filers), and avoiding the negative macroeconomic consequences of the so-called "fiscal cliff". Importantly for some mortgage borrowers, the Act also extended through 2013 a provision that allows individuals to exclude from taxable income up to $2 million of cancelled or forgiven principal residence debt. The Act also allows borrowers to deduct the insurance premiums they paid on their qualified residence during 2012 along with their mortgage interest, provided their adjusted gross income does not exceed certain thresholds, $110,000 for married couples filing jointly. While the Act provided certainty for the tax rate structure, a compromise on federal spending reductions and a lifting of the national debt limit eluded lawmakers. Consequently, further debates on spending "sequestration" and debt will create fiscal policy uncertainty during the first quarter of 2013.

Consumer attitudes on the economy have so far remained fairly resilient despite the "fiscal cliff" drama that has played out. Helping to buoy consumers' views has been improving news on the labor market and the housing market. Earlier this month, the Bureau of Labor Statistics reported that December registered 155,000 job gains and November's payrolls were revised up by 24,000, bringing the employment increase for 2012 to 1.86 million, the best since 2006. Assuming the uncertainty of the fiscal policy debates during the first quarter fails to derail the economic expansion, the U.S. will likely see about two million new jobs created in 2013, gradually nudging the unemployment rate lower.

Consumer confidence has been slow to rebuild during the macroeconomic expansion and still remains historically low three-and-a-half years into the economic recovery. The Conference Board's consumer confidence index had been gradually edging higher in recent months. By October the index attained its highest level since early 2008, only to then dip in December's reading; possibly, a jolt from the fiscal cliff drama. Regardless, consumer confidence is up from its Great Recession low, and as consumer attitudes on the economic outlook improve, more potential homebuyers will emerge and feel financially secure in making an offer to purchase a home. Over the first 11 months of 2012, home sales were up 9 percent from the same period of the prior year, and we project a similar gain in sales for 2013.

Unfortunately, business owners and managers are more sanguine about the nation's business outlook than consumers seem to be. The National Federation of Independent Businesses reported deterioration in its business optimism index at the end of 2012, with the November and December index levels the lowest since 2009, highlighting worries among small and mid-sized business owners about the health of the economy. Such concerns may retard hiring in the first part of 2013 until the uncertainties of the fiscal debates are behind us.



Just how much does policy uncertainty weigh down the economy? Recent research by economists from Stanford University and the University of Chicago[1] attempts to quantify the impact of policy uncertainty on the economy. The Economic Policy Uncertainty Index is constructed using estimates of news coverage about policy uncertainty, provisions in the tax code set to expire, and dispersion across professional economists' forecasts of economic conditions. They estimate that increases in policy uncertainty precede declines in economic growth and employment. For instance, increases in policy uncertainty equal to the increase observed from 2006-2011 could cost the US economy up to 2.3 percent in lost GDP and 2.3 million fewer jobs.

The uncertainty surrounding fiscal policy is in stark contrast to steps the Federal Reserve has taken on monetary policy. The most recent Federal Open Market Committee (FOMC) statement, issued December 12, announced that the FOMC believed the "exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent…", as long as inflation remains close to the long-term target and inflationary expectations are "well anchored."[2] With the unemployment rate in December holding at an elevated 7.8 percent, this statement likely assures a continuation of an accommodative policy stance by the Federal Reserve through the coming year. In other words, relatively low interest rates will continue to be a feature of mortgage lending and the broader capital markets in 2013.

Some of the uncertainty surrounding future mortgage lending guidelines may have been cleared up with the Consumer Financial Protection Board's release of a rule covering "qualified mortgages," which implements the Dodd-Frank legislation's "ability to repay" requirement. The

[1] http://www.policyuncertainty.com/index.html

[2] http://www.federalreserve.gov/newsevents/press/monetary/20121212a.htm

Final Rule will go into effect on January 10, 2014. Lenders must fully document a borrower's ability to repay for a loan to be a "qualified mortgage." Some other important provisions would cap payment-to-monthly income ratios at 43 percent for "qualified mortgages," exclude interest-only loans from the "qualified mortgage" definition, and provide a safe harbor from litigation for loans that meet the definition and are not "higher priced." Included in the regulation was a temporary provision, for up to seven years, permitting some lending at higher ratios if the mortgage satisfies the underwriting requirements of the GSEs (while in conservatorship) or the FHA, VA, or RHS. While it will take some time to review the rule the early views have been cautious yet positive. For example, the Mortgage Bankers Association's Chairman released a statement that was supportive but cautioned that the cap on points and fees and the definition's interest-rate threshold may be unnecessarily restrictive.[3] Removing some of the regulatory uncertainty that has hovered over mortgage lending may help lenders plan for new lending volumes going forward.

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[3] http://www.mortgagebankers.org/NewsandMedia/PressCenter/83091.htm

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Revised 1/8/2013

Indicator	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2009	2010	2011	2012	2013	2014
Real GDP (%)	2.0	1.3	3.1	**1.2**	**2.0**	**2.5**	**3.0**	**3.2**	-0.1	2.4	2.0	**1.9**	**2.7**	**3.5**
Consumer Prices (%) a.	2.5	0.8	2.3	**2.5**	**1.5**	**2.0**	**2.0**	**2.0**	1.5	1.2	3.3	**2.0**	**1.9**	**2.0**
Unemployment Rate (%) b.	8.3	8.2	8.0	7.8	**7.8**	**7.7**	**7.6**	**7.5**	9.3	9.6	8.9	8.1	**7.7**	**7.1**
30-Year Fixed Mtg. Rate (%) b.	3.9	3.8	3.6	3.4	**3.4**	**3.5**	**3.6**	**3.7**	5.0	4.7	4.5	3.7	**3.6**	**4.1**
1-Year Treas. Indexed ARM Rate (%) b.	2.8	2.8	2.7	2.6	**2.7**	**2.7**	**2.8**	**2.8**	4.7	3.8	3.0	2.7	**2.8**	**3.6**
10-Year Const. Mat. Treas. Rate (%) b.	2.0	1.8	1.6	1.7	**1.7**	**1.8**	**1.9**	**2.0**	3.3	3.2	2.8	1.8	**1.9**	**2.4**
1-Year Const. Mat. Treas. Rate (%) b.	0.2	0.2	0.2	0.2	**0.2**	**0.2**	**0.3**	**0.3**	0.5	0.3	0.2	0.2	**0.3**	**0.5**

Indicator	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2009	2010	2011	2012	2013	2014
Housing Starts c.	0.72	0.74	0.77	**0.88**	**0.88**	**0.90**	**0.95**	**1.00**	0.55	0.59	0.61	**0.78**	**0.93**	**1.20**
Total Home Sales d.	4.92	4.90	5.03	**5.27**	**5.20**	**5.30**	**5.50**	**5.60**	4.72	4.51	4.57	**5.03**	**5.40**	**5.80**
FMHPI House Price Appreciation (%) e.	0.6	4.9	1.3	**-1.5**	**0.6**	**3.3**	**0.0**	**-1.4**	-2.3	-5.5	-3.9	**5.3**	**2.5**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	-1.6	7.1	2.2	**-2.0**	**0.0**	**3.5**	**1.0**	**-2.0**	-2.5	-3.8	-3.7	**5.6**	**2.5**	**3.0**
1-4 Family Mortgage Originations g.														
Conventional	**$367**	**$377**	**$450**	**$426**	**$377**	**$385**	**$318**	**$280**	$1,549	$1,300	$1,208	**$1,620**	**$1,360**	**$1,000**
FHA & VA	$83	$93	$100	**$104**	**$83**	**$95**	**$92**	**$70**	$451	$377	$292	**$380**	**$340**	**$250**
Total	**$450**	**$470**	**$550**	**$530**	**$460**	**$480**	**$410**	**$350**	$2,000	$1,677	$1,500	**$2,000**	**$1,700**	**$1,250**
ARM Share (%) h.	12	11	8	**8**	**10**	**11**	**12**	**13**	3	5	11	**10**	**12**	**15**
Refinancing Share - Applications (%) i.	81	77	82	**80**	**75**	**70**	**65**	**50**	70	76	75	**80**	**65**	**45**
Refinancing Share - Originations (%) j.	**75**	**71**	**76**	**76**	**75**	**70**	**65**	**50**	68	67	64	**75**	**65**	**45**
Residential Mortgage Debt (%) k.	-3.1	-1.9	-2.8	**-2.0**	**-1.0**	**0.0**	**0.0**	**1.0**	-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

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

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.

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 1/8/2013 (MAS); Send comments and questions to chief_economist@freddiemac.com.