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July 2011 Economic Outlook | **Office of the Chief Economist**

Soft Patch or Double Dip?

As if any confirmation was needed, the June labor market report made it clear that economic growth had definitely slowed during the first half of 2011. Nonfarm payroll employment rose a scant 18,000, following a downward-revised 25,000 in May. In June, private sector job growth had slowed to a 57,000 gain for the month, largely offset by the continued downsizing of state and local payrolls. The unemployment rate ticked up for the third consecutive month to 9.2 percent, the highest in six months. The number of job seekers out of work for more than six months remained troublingly high: These unemployed workers are finding it increasingly difficult to land a new job as skills and labor market attachment gradually erode.

The labor market update did help to alleviate immediate concerns in the market that inflation may pick up in the intermediate term, thus helping to coax long-term interest rates lower. Thirty-year fixed-rate mortgages followed 10-year Treasury and long-term corporate bond yields lower after the report, and these mortgage rates continue to hover near 4.5 percent. Rates on 15-year fixed-rate, a product particularly popular for refinance, remain about three-fourths to seven-eighths of a percentage point below 30-year rates, and at this level should encourage a high refinance share of loan closings.

The sluggish job update likely reflects a temporary “soft patch” in the economy rather than foreshadowing an inflection point in gross domestic product (GDP) growth. Relatively high energy costs, supply disruptions related to natural disasters, and a foreboding mood among consumers and business owners continue to drag down economic performance. But these effects are likely short-lived, as energy costs have already retreated some from their recent peaks: The average price of a gallon of regular gasoline dropped about 10 percent from early May to the end of June, bringing some relief to consumer and business pocketbooks. And the additional capital market liquidity provided by the Federal Reserve’s “Quantitative Easing 2”, or QE2, should prime the economic pump over the next several months. Further, vehicle manufacturing should perk up in the third quarter, as the effects dissipate from supply disruptions in Japan earlier this year.

The macroeconomic sluggishness is reflected in the housing market. Home-buyer affordability remains near its 40-year zenith which should be boosting home sales (“ceteris paribus,” as economists like to say). But all other things in the market are not the same and other factors are dampening home sales, despite record levels of affordability. Households remain concerned over their financial futures and are holding off on major purchases, particularly homes. Credit underwriting has returned to more traditional and sustainable practices that had been downplayed during the height of the housing boom at the middle of the last decade. And expected home-value appreciation remains modest in many markets, encouraging potential first-time buyers to stay in rental housing.

The rental housing market, in contrast, has continued to show the clearest signs of a turnaround, with financing increasingly available and strong price appreciation. The National Multi Housing Council reported a tightening of rental market conditions in most metropolitan areas, and debt and equity financing is more available than three or six months ago. The

Apartment Property Price Index constructed by the National Council of Real Estate Investment Fiduciaries has shown a 15 percent gain over the year through the first quarter of 2011.

Single-family home sales will likely improve over the balance of 2011, in keeping with positive GDP forecasts for the United States. Home sales are expected to be up over 2010's pace, perhaps by 3 to 5 percent. And after clear weakness in national price metrics through the first quarter, there are glimmers that the second quarter may be markedly better: The FHFA Purchase-Only House Price Index for the U.S. was up 0.8 percent in April compared with March, and the S&P/Case-Shiller 20-city composite index registered a monthly gain of 0.7 percent (not seasonally adjusted) in April, the first positive monthly sign in eight months. However, monthly price metrics tend to be volatile, especially with high levels of distressed home sales, and will likely experience some decline in the second half of 2011. Overall, the home sales and apartment rental markets are unlikely to experience a "double dip", and will likely have gradual improvement over time.

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Chief Economist
July 18, 2011

July 2011 Economic and Housing Market Outlook

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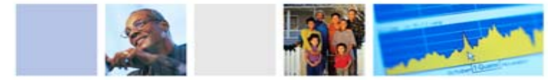

Office of the Chief Economist

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Major Economic Indicators

Indicator	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4
Real GDP (%)	3.7	1.7	2.6	3.1	1.9	2.0	3.5	3.5	3.5	3.5	3.5	4.0
Consumer Prices (%) a.	1.3	-0.5	1.4	2.5	5.2	4.1	1.5	1.5	2.0	2.0	2.0	2.0
Unemployment Rate (%) b.	9.7	9.7	9.6	9.6	8.9	9.1	9.0	8.9	8.7	8.5	8.3	8.0
30-Year Fixed Mtg. Rate (%) b.	5.0	4.9	4.4	4.4	4.9	4.7	4.7	5.0	5.3	5.5	5.8	6.0
1-Year Treas. Indexed ARM Rate (%) b.	4.3	4.0	3.3	3.3	3.3	3.1	3.1	3.2	3.3	3.4	3.5	3.7
10-Year Const. Mat. Treas. Rate (%) b.	3.7	3.5	2.8	2.9	3.5	3.2	3.2	3.4	3.7	3.9	4.2	4.4
1-Year Const. Mat. Treas. Rate (%) b.	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.3	0.4	0.5	0.6	0.8

Indicator (Annual Totals)	2007	2008	2009	2010	2011	2012	2013
Real GDP (%)	2.3	-2.8	0.2	2.8	2.7	3.6	4.0
Consumer Prices (%) a.	4.0	1.6	1.5	1.2	3.1	2.0	2.0
Unemployment Rate (%) b.	4.6	5.8	9.3	9.7	9.0	8.4	7.6
30-Year Fixed Mtg. Rate (%) b.	6.3	6.0	5.0	4.7	4.8	5.7	6.6
1-Year Treas. Indexed ARM Rate (%) b.	5.6	5.2	4.7	3.8	3.2	3.5	4.2
10-Year Const. Mat. Treas. Rate (%) b.	4.6	3.7	3.3	3.2	3.3	4.1	5.0
1-Year Const. Mat. Treas. Rate (%) b.	4.5	1.8	0.5	0.3	0.2	0.6	1.3

Housing and Mortgage Markets

Indicator	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4
Housing Starts c.	0.62	0.60	0.58	0.54	0.58	0.58	0.60	0.65	0.65	0.75	0.85	0.95
Total Home Sales d.	4.89	5.22	3.95	4.47	4.77	4.61	5.00	5.15	5.40	5.40	5.40	5.40
FMHPI House Price Appreciation (%) e.	-1.4	4.0	-12.8	-13.4	-10.8	2.0	1.0	-1.0	0.0	1.0	1.5	2.0
S&P/Case-Shiller® Home Price Index (%) f.	-11.0	19.9	-7.2	-13.5	-15.6	0.5	0.0	-2.0	1.0	2.0	3.0	4.0
1-4 Family Mortgage Originations g.												
Conventional	$243	$226	$309	$396	$264	$263	$210	$149	$137	$176	$178	$140
FHA & VA	$92	$90	$95	$100	$76	$87	$90	$61	$51	$62	$59	$47
Total	$335	$316	$404	$496	$340	$350	$300	$210	$188	$238	$237	$187
ARM Share (%) h.	4	6	5	4	8	11	11	10	12	12	12	13
Refinancing Share - Applications (%) i.	70	72	81	82	69	70	55	45	35	35	35	35
Refinancing Share - Originations (%) j.	70	58	75	79	70	68	55	45	35	35	35	35
Residential Mortgage Debt (%) k.	-4.7	-2.3	-2.6	-2.0	-2.6	0.0	0.0	-2.0	0.0	2.0	2.0	4.0

Indicator (Annual Totals)	2007	2008	2009	2010	2011	2012	2013
Housing Starts c.	1.36	0.91	0.55	0.59	0.60	0.80	1.20
Total Home Sales d.	5.72	4.84	4.94	4.63	4.89	5.40	5.90
FMHPI House Price Appreciation (%) e.	-5.0	-11.7	-2.3	-6.2	-2.2	1.1	4.0
S&P/Case-Shiller® Home Price Index (%) f.	-8.4	-18.4	-2.5	-3.8	-4.3	2.5	4.4
1-4 Family Mortgage Originations g.							
Conventional	$2,312	$1,310	$1,549	$1,173	$886	$631	$740
FHA & VA	$120	$290	$451	$377	$314	$219	$260
Total	$2,432	$1,600	$2,000	$1,550	$1,200	$850	$1,000
ARM Share (%) h.	10	7	3	5	10	12	14
Refinancing Share - Applications (%) i.	42	48	70	76	60	35	35
Refinancing Share - Originations (%) j.	49	50	68	71	60	35	35
Residential Mortgage Debt (%) k.	7.1	-0.4	-1.6	-2.9	-1.2	2.0	5.0

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 Hpouse Price Index (FMHPI); 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 7/21/2011 (MAS); Send comments and questions to chief_economist@freddiemac.com.