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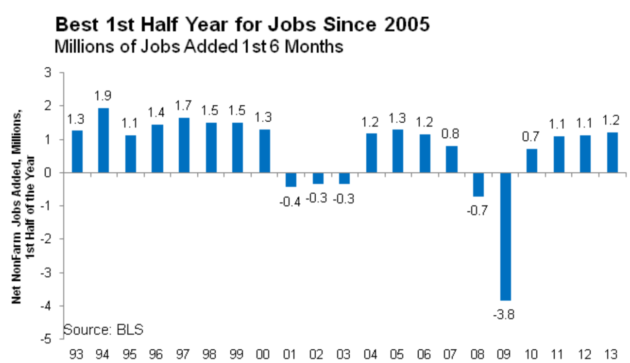
Office of the Chief Economist

July 2013 U.S. Economic & Housing Market Outlook

TAPER TALK TRUMPS

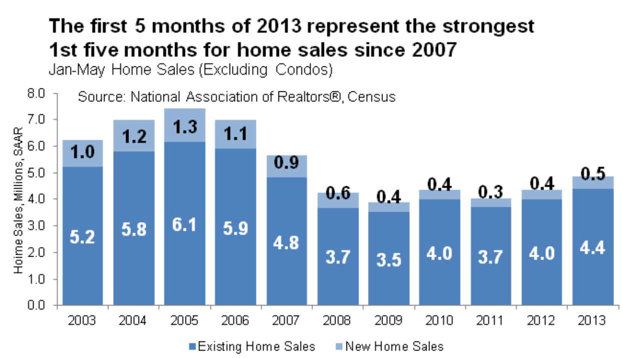
At the midpoint of the year a central topic has become the timing and speed of the Fed's scaling back of its long-term Treasury bond and MBS purchases: that is, the 'Taper Talk'. This speculation has prompted the recent roller coaster in interest rates and a ride where the exit will be at a higher rate level than the entrance. While higher interest rates on mortgages will slow the housing recovery, they are unlikely to stop it in its tracks. Here's our take on the first half of the year, and our expectation for the second half.

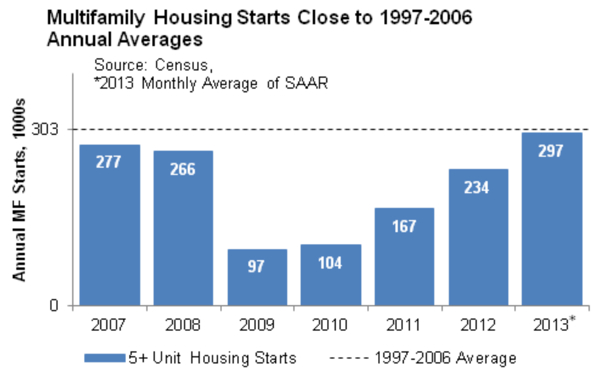
Labor Market Improves. From January through June of this year the economy added 1.2 million net jobs to nonfarm payrolls, the best first half of the year since 2005. The pick-up in housing starts contributed more than 100,000 construction jobs during this six-month period. Better job growth also means that more families have the financial resources to form separate households, thus bolstering housing demand. We expect job growth to maintain this pace in the second half, making 2013 the best calendar year for job growth since 2005.



House Prices Increase. Single-family house prices have been posting near double-digit percentage point annual gains in recent months. Seasonally adjusted, values were likely up about 5 percent in national indexes in just the first half of 2013. The blistering pace in house price appreciation is unlikely to continue, but rather moderate and grow at a seasonally adjusted rate closer to 3 to 4 percent in the second half, for a total gain of 8 to 9 percent for the calendar year. Over the next couple of years house price growth should gradually ease until settling in at around 3 percent a year. Three percent annual house price growth with a 2 to 2.5 percent inflation rate corresponds to a real house price pick-up of 0.5 to 1 percent per year, about in line with historic averages.

Home Sales Strengthen. Through May, home sales were on their best first-half pace since 2007. Existing home sales were up over 10 percent compared with the first five months of 2012, and new home sales were up 29 percent. The latter gain is the reason single-family starts are up 24 percent since last year, averaging 631,000 homes through May (SAAR) and boosting construction employment. In the second half of the year, we anticipate more modest growth with sales (new and existing) up an additional 2 percent and starts up 12 percent relative to the first half.





Apartment Market Healthy. Apartment building values recovered earlier and faster than house prices, but are likely to experience little, if any, further appreciation this year. Rent growth is expected to outpace inflation in 2013 as apartment vacancies in professionally managed buildings remain low; while higher rents will grow net operating income, higher expected cap rates will keep building valuations largely unchanged in national metrics. In the first quarter of 2013 about 65 percent of newly completed apartments were rented within three months, up substantially from 2009 when absorption rates were about 50 percent. Good fundamentals have driven the renaissance in apartment construction: Through the first five months of 2013 multifamily housing starts were near a 300,000 annual pace, about the same as the average pace during 1997-2006.

Mortgage Rates Rise. Much attention over the past few weeks has focused on the recent run up in interest rates. Our Primary Mortgage Market Survey® shows the rate on 30-year fixed mortgages was up a full percentage point between the start of this year and the middle of May, and it's likely to rise further in the coming year. The increases in rates have come about largely due to speculation around the timing and speed at which the Federal Reserve may taper its bond and MBS purchases – that is, the pulling away of the proverbial punch bowl. The taper talk leads to increased rates for two reasons, first because market participants anticipate that Fed tapering will increase interest rates in the near future, and second, they see the Fed taper talk as being indicative of a strengthening economy. The real question is not what effect rising mortgage rates will have on the housing recovery – there's sure to be an impact – but will it be enough to stall the recovery? We don't think so. Demand is strong, supply is limited, and for most families in most markets, housing affordability is still strong. But we do expect a substantial change in single-family originations as we transition from a refinance-dominated market to a much smaller purchase-money market by year-end.

So for those who like the punch bowl analogy around tapering, there's plenty of time to drink, but do us all a favor, and drink responsibly so the housing market can avoid the roller coaster ride with mortgage rates.

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	2012		2013				2014				Annual Totals					
Indicator	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Real GDP (%)	3.1	0.4	1.8	**1.7**	**2.4**	**2.8**	**3.3**	**3.5**	**3.6**	**3.5**	-0.1	2.4	2.0	1.7	**2.2**	**3.5**
Consumer Prices (%) a.	2.1	2.2	1.4	**0.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	1.5	1.4	3.0	1.8	**1.4**	**2.0**
Unemployment Rate (%) b.	8.0	7.8	7.7	7.6	**7.5**	**7.4**	**7.3**	**7.2**	**7.0**	**6.9**	9.3	9.6	8.9	8.1	**7.6**	**7.1**
30-Year Fixed Mtg. Rate (%) b.	3.6	3.4	3.5	3.7	**4.5**	**4.6**	**4.7**	**4.9**	**5.1**	**5.3**	5.0	4.7	4.5	3.7	**4.1**	**5.0**
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	2.6	2.6	**2.6**	**2.6**	**2.7**	**2.7**	**2.8**	**2.9**	4.7	3.8	3.0	2.7	**2.6**	**2.8**
10-Year Const. Mat. Treas. Rate (%) b.	1.6	1.7	2.0	2.0	**2.6**	**2.8**	**2.9**	**3.1**	**3.3**	**3.5**	3.3	3.2	2.8	1.8	**2.4**	**3.2**
1-Year Const. Mat. Treas. Rate (%) b.	0.2	0.2	0.2	0.1	**0.2**	**0.2**	**0.3**	**0.3**	**0.4**	**0.5**	0.5	0.3	0.2	0.2	**0.2**	**0.4**

	2012		2013				2014				Annual Totals					
Indicator	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Housing Starts c.	0.78	0.90	0.96	**0.92**	**1.03**	**1.07**	**1.10**	**1.15**	**1.25**	**1.30**	0.55	0.59	0.61	0.78	**1.00**	**1.20**
Total Home Sales d.	5.12	5.28	5.39	**5.55**	**5.50**	**5.65**	**5.75**	**5.85**	**5.95**	**6.05**	4.72	4.51	4.57	5.03	**5.52**	**5.90**
FMHPI House Price Appreciation (%) e.	0.6	0.0	1.4	**4.0**	**2.0**	**0.4**	**1.0**	**1.5**	**2.0**	**0.4**	-2.3	-5.3	-3.6	6.0	**8.0**	**5.0**
S&P/Case-Shiller® Home Price Index (%) f.	2.1	-0.4	1.2	**4.0**	**2.0**	**0.5**	**1.1**	**2.1**	**1.5**	**0.2**	-2.5	-3.8	-3.7	7.3	**8.0**	**5.0**
1-4 Family Mortgage Originations g.																
Conventional	**$463**	**$475**	**$440**	**$455**	**$320**	**$235**	**$280**	**$340**	**$245**	**$185**	$1,549	$1,300	$1,206	**$1,720**	**$1,450**	**$1,050**
FHA & VA	$97	$105	$100	**$105**	**$80**	**$65**	**$50**	**$80**	**$65**	**$55**	$451	$377	$294	$380	**$350**	**$250**
Total	**$560**	**$580**	**$540**	**$560**	**$400**	**$300**	**$330**	**$420**	**$310**	**$240**	$2,000	$1,677	$1,500	**$2,100**	**$1,800**	**$1,300**
ARM Share (%) h.	8	7	8	**9**	**10**	**11**	**12**	**13**	**14**	**15**	3	5	11	10	**10**	**14**
Refinancing Share - Applications (%) i.	82	83	79	**75**	**55**	**45**	**45**	**40**	**40**	**35**	70	76	75	81	**67**	**40**
Refinancing Share - Originations (%) j.	**76**	**76**	**75**	**70**	**50**	**40**	**45**	**40**	**40**	**35**	68	67	64	**71**	**62**	**40**
Residential Mortgage Debt (%) k.	-2.9	0.0	-1.9	**1.5**	**1.5**	**0.5**	**1.0**	**2.0**	**3.0**	**4.0**	-1.6	-4.1	-2.2	-2.1	**0.4**	**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.
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 7/8/2013 (MAS); Send comments and questions to chief_economist@freddiemac.com.