



July 2014 U.S. Economic & Housing Market Outlook

The Bitter and the Sweet

Economic news for the first half of 2014 has been bittersweet. The first quarter news was lackluster. While the second quarter provided better news, the economy is still operating far below potential. It begs the question: Are we at risk of entering another recession?

While it's always possible for the economic data to surprise us, the likelihood of another recession at this point is quite low. By most metrics the economy has not yet fully recovered from the Great Recession and is still operating well below potential. [Monetary policy](#) remains accommodative and it's unlikely that short term interest rates will spike any time soon. This means upside potential for improved economic activity is substantial.

Among the various sectors of the economy, housing has been particularly slow to recover from the Great Recession. The latest news has been quite 'bitter': In the first quarter of 2014 residential fixed investment fell 4 percent. Housing starts for June fell by 9.3 percent from the May pace (9.0 percent for 1-unit starts). After adding to economic growth in 2012 through mid-2013, housing activity has slowed and is no longer driving the economic recovery as we thought it might.

As long as the housing sector continues to operate well below potential, we should not expect to see robust economic growth. To a large extent, the recent lull in residential investment is a function of a weak labor market and below average household formations – both dragging down the housing market. If vigorous economic growth is unlikely without housing, and housing cannot take off without stronger economic growth, how do we foresee moving forward?

Home Sales and New Construction

The ongoing low-interest rate policy of the Federal Reserve has helped to fuel a turnaround in housing related activity from its cyclic trough. Even with the increases in mortgage rates last summer, financing costs remain well below historical averages, with the 30-year fixed-rate mortgage averaging 4.2 percent in the second quarter. These low rates have helped to sustain high levels of [homebuyer affordability](#) in most parts of the country. Yet, even with these favorable forces, home sales and housing construction remain well below normal levels.

Home sales dropped off considerably following the interest rate spike last year, but have started to recover. Home sales also took a particularly hard blow in the first quarter due to an abnormally severe winter in much of the country. Now that the severe weather is behind us and rates have eased – during the first three weeks of July, 30-year fixed-rates were about a quarter percentage point lower than the same time last year – we expect to see home sales pick up for the remainder of the year, ending 2014 down about 2 percent from last year's level (with existing sales down about 3 percent and new-home sales up 10 to 15 percent). While the improvement in sales will not be

enough to offset the weak first quarter this year, we expect 2015 to see home sales up about 7 percent over this year.

Despite the disappointing June reading, we expect to see housing construction continue to improve – up about 14 percent in 2014 relative to 2013 with larger percentage gains for multifamily than for single-family – but at a level well below long-term demographic trends.

The Jobs Outlook

The path to recovery is sustained job growth, and recent news has been ‘sweet’. The labor market is beginning to accelerate, with job growth averaging 231,000 net non-farm jobs a month for the first half of 2014. As the millennial generation gets back to work (or works for the first time as many recent graduates have had a hard time in the labor market) and move out of their parent’s basements, they won’t immediately become homeowners. The usual transition from dependent-to-renter-to-homeowner will likely be pushed out several years later than typical. Good news in the labor market should translate first to more tenant households (and increasing demand for rental apartments) before a pickup in the single-family owner-occupied market will be felt. Even with the sustained good news in the labor market, single-family housing is a couple of years away from full recovery and a stable level of activity.

With household formations centered on the rental housing market, the multifamily rental component of housing starts has rebounded sharply since bottoming in 2009. Multifamily rental construction accounted for almost one-third of housing starts during the first quarter (not seasonally adjusted). This reflects the strong fundamentals (low vacancy rates, inflation-adjusted rent growth, positive demographics) for rental housing. (See our [Executive Perspectives feature by David Brickman](#)).

Mortgage Originations

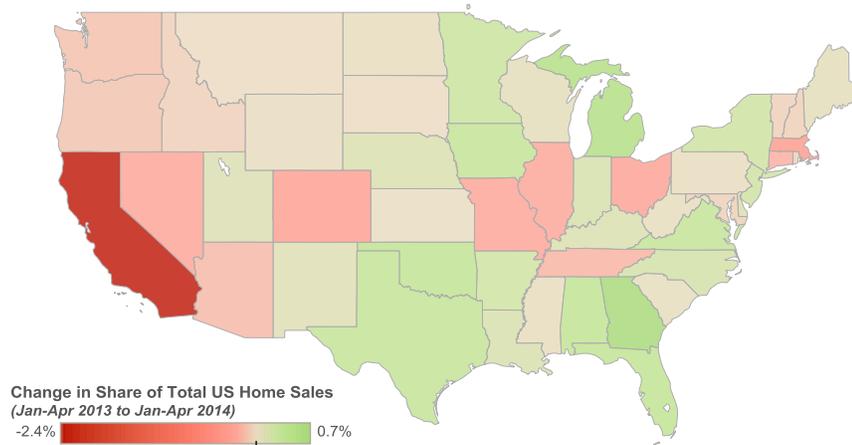
Based on estimates of mortgage origination volume in the first five months of 2014, we have revised down our 2014 forecast for mortgage originations by \$75 billion (6 percent).

Although mortgage rates are still near historical lows, they are not nearly as low as they were two years ago when refinance activity hit its peak – and that is weighing heavily against current mortgage origination volume. Mortgage refinance activity has fallen precipitously and we expect that to continue for some time. As mortgage rates gradually increase there will be fewer borrowers who can lower their payments through a refinance. Rising rates is a trend that we expect to continue: Our latest forecast has mortgage rates rising to 5 percent by the middle of 2015. The gradual rise in mortgage rates will lead to a large reduction in refinance mortgage originations: down about 60 percent from 2013 to 2014, and down an additional 47 percent from 2014 to 2015 in our latest forecast.

For home-purchase originations, home sales, house prices and mortgage utilization are the key drivers. During the first four months of this year, home sales were down 6 percent from one year ago, but home prices were up quite a bit, around 6 to 8 percent in various national indices. The all-cash share of existing sales edged up, from 31 percent to 33 percent, according to the National Association of Realtors.

Purchase originations were down during January-to-April compared to a year ago, even though the sum of house price appreciation and the change in home sales was flat-to-up 2 percent because the composition of home sales had shifted and mortgage utilization lessened. According to data on total home sales from CoreLogic, sales in 2014 have shifted away from California and the West coast toward Texas and the Southeast. Because the average sales price of a home in Texas and the Southeast is lower than the average sales price in California and the West, the shift in sales distribution lowers the average sales price. Therefore with roughly the same number of home sales, you can get lower purchase originations even after accounting for general increases in house prices.

Change of Home Sales Composition



Source: CoreLogic Total Home Sales (New and Existing). Difference in the share of total U.S. sales in 2014 relative to 2013 (January - April Sales Only).

Whither the Recovery?

Putting it all together we have a cautiously optimistic view for economic growth in the next few years. With the exception of multifamily rentals, the housing sector remains well below potential and will likely persist in that state for a couple of years, but continue to doggedly improve. That means construction, new home sales, and purchase mortgage originations will likely continue to increase year-over-year for the next few years, but remain below their long-run sustainable levels during that time. For single-family mortgage originations, the recovery in the purchase market will not offset the decline in refinance volume, particularly when rates resume their upward trend. Good news in the labor market will translate into a rise in household formations. The immediate impact of increased household formations will be felt in the rental market, but eventually over the next few years will lead to more single-family home sales.

The odds of recession are low, but the odds of below potential growth for single-family housing remain high.

Frank E. Nothaft
Chief Economist
July 21, 2014

Leonard Kiefer
Deputy Chief Economist

www.freddiemac.com/news/finance

chief_economist@freddiemac.com

Opinions, estimates, forecasts and other views contained in this document are those of Freddie Mac's Office of the Chief Economist, do not necessarily represent the views of Freddie Mac or its management, should not be construed as indicating Freddie Mac's business prospects or expected results, and are subject to change without notice. Although the Office of the Chief Economist attempts to provide reliable, useful information, it does not guarantee that the information is accurate, current or suitable for any particular purpose. The information is therefore provided on an "as is" basis, with no warranties of any kind whatsoever. Information from this document may be used with proper attribution. Alteration of this document is strictly prohibited. © 2014 by Freddie Mac

July 2014 Economic and Housing Market Outlook

Revised 7/18/2014

Indicator	2013		2014				2015				Annual Totals						
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012	2013	2014	2015
Real GDP (%)	4.1	2.6	-2.9	3.2	3.0	3.2	3.3	3.3	3.3	3.3	-0.2	2.8	2.0	2.0	2.6	1.6	3.3
Consumer Prices (%) a.	2.2	1.1	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0	1.5	1.2	3.3	1.9	1.2	2.0	2.0
Unemployment Rate (%) b.	7.2	7.0	6.7	6.2	6.2	6.1	6.1	6.0	5.9	5.8	9.3	9.6	8.9	8.1	7.4	6.3	6.0
30-Year Fixed Mtg. Rate (%) b.	4.4	4.3	4.4	4.2	4.3	4.5	4.8	5.0	5.2	5.4	5.0	4.7	4.5	3.7	4.0	4.4	5.1
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	3.2	3.0	3.1	3.0	3.3	3.6	3.8	4.0	4.3	4.5	4.8	3.8	3.3	2.8	2.9	3.3	4.2
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	2.5	2.4	2.5	2.6	2.6	2.7	2.7	2.8	4.7	3.8	3.0	2.7	2.6	2.5	2.7
10-Year Const. Mat. Treas. Rate (%) b.	2.7	2.7	2.8	2.6	2.7	3.0	3.2	3.4	3.6	3.9	3.3	3.2	2.8	1.8	2.4	2.8	3.5
1-Year Const. Mat. Treas. Rate (%) b.	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.4	0.4	0.5	0.3	0.2	0.2	0.1	0.1	0.3

Indicator	2013		2014				2015				Annual Totals						
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012	2013	2014	2015
Housing Starts c.	0.88	1.03	0.93	0.98	1.10	1.20	1.30	1.40	1.40	1.50	0.55	0.59	0.61	0.78	0.92	1.05	1.40
Total Home Sales d.	5.71	5.39	5.04	5.27	5.60	5.70	5.75	5.75	5.80	5.90	4.72	4.51	4.57	5.03	5.51	5.40	5.80
FMHPI House Price Appreciation (%) e.	1.6	-0.7	1.2	2.5	1.5	-0.3	0.0	2.0	1.0	0.0	-3.1	-4.9	-3.3	6.1	9.3	5.0	3.0
S&P/Case-Shiller® Home Price Index (%) f.	3.1	-0.3	0.2	4.4	1.0	-0.6	0.0	2.0	1.0	0.0	-2.5	-3.8	-3.7	7.2	11.4	5.0	3.0
1-4 Family Mortgage Originations g.																	
Conventional	\$363	\$291	\$198	\$276	\$256	\$208	\$220	\$280	\$216	\$152	\$1,549	\$1,300	\$1,206	\$1,750	\$1,570	\$938	\$868
FHA & VA	\$87	\$59	\$52	\$69	\$64	\$52	\$55	\$70	\$54	\$38	\$451	\$367	\$286	\$372	\$355	\$237	\$217
Total	\$450	\$350	\$250	\$345	\$320	\$260	\$275	\$350	\$270	\$190	\$2,000	\$1,667	\$1,492	\$2,122	\$1,925	\$1,175	\$1,085
ARM Share (%) h.	9	10	11	10	12	13	14	15	15	15	3	5	11	10	9	12	15
Refinancing Share - Applications (%) i.	54	59	52	45	35	34	32	22	18	17	68	73	71	77	63	41	23
Refinancing Share - Originations (%) j.	52	51	48	41	31	30	30	22	18	17	68	67	64	70	61	37	22
Residential Mortgage Debt (%) k.	0.8	-0.7	-1.0	0.0	1.0	2.0	2.5	3.0	3.0	3.5	-1.7	-4.2	-2.1	-1.7	-0.5	0.5	3.0

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. MBA Applications Survey; activity by dollars, total market refi share percent for United States (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 7/18/2014 (GTW); Send comments and questions to chief_economist@freddiemac.com.

Opinions, estimates, forecasts and other views contained in this document are those of Freddie Mac's Office of the Chief Economist, do not necessarily represent the views of Freddie Mac or its management, should not be construed as indicating Freddie Mac's business prospects or expected results, and are subject to change without notice. Although the Office of the Chief Economist attempts to provide reliable, useful information, it does not guarantee that the information is accurate, current or suitable for any particular purpose. The information is therefore provided on an "as is" basis, with no warranties of any kind whatsoever.

Information from this document may be used with proper attribution. Alteration of this document is strictly prohibited. © 2014 by Freddie Mac.