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The Doughnut or the Hole?

Homebuyer affordability remains very high, driven by the twin forces of low financing costs and a buyer's market. Mortgage interest rates have gradually moved lower for most of the spring, with fixed-rate loans just slightly above the half-century nadir attained last fall, and initial interest rates on adjustable-rate product are at or near record lows. Likewise, U.S. house price indexes moved lower during the first quarter, helping set the stage for a high-degree of purchasing power for home seekers.

With that as a backdrop, why aren't home sales more vigorous? Part of the reason is because consumers are currently a worried group. The latest Conference Board measure of consumer confidence declined in May, in part reflecting concerns over waning job creation and rising energy costs. Consumers who feel heightened uncertainty over their economic well-being and future prospects are more likely to be cautious when considering purchases of big-ticket items, such as cars or homes. Further, the first-quarter data on U.S. house-price softness has removed a catalyst to immediate action: Some potential buyers who have the means to buy are awaiting clearer signs that home values have firmed.

The consumer is not the only economic agent brooding over the uncertain outlook. Small businesses are also concerned about the vitality of future demand for their products. The National Federation of Independent Businesses' economic confidence index declined for the third consecutive month in May and remains at levels reflecting a bearish near-term outlook. Firms will be hesitant to add workers if worried about prospects for sales growth. One industry that remains particularly depressed is home building. The National Association of Home Builders/Wells Fargo Housing Market Index of builder sentiment remains mired at historically low levels; the May value was 17 for an index where values below 50 indicate a negative assessment of demand.

The sullen vibes may account for part of the lackluster jobs update for May released by the Bureau of Labor Statistics. Net job creation was a mere 54,000 – less than one-third the average pace for the first four months of 2011 – and the unemployment rate ticked up for the second straight month to 9.1 percent, the highest this year.

Sluggishness in payroll jobs was broad based. The private sector added 83,000 to the payroll roster, the fewest since last June. Government continued to cut payrolls and eliminated 29,000 jobs, led by layoffs in local-government education. Employment for residential building construction was down 6,000 from already depressed levels. Manufacturing, which had been leading the recovery, lost 5,000 jobs, led by a deceleration in the durable goods sector. Apart from healthcare and some professional services, there was little or no net job gain in service-producing sectors of the economy. Retail employment edged down after a strong 64,000 gain in April.

On a positive note, though, wage growth improved in May, as average hourly earnings rose 0.3 percent, following a 0.1 percent uptick in April. The average workweek for all workers held steady at 34.4 hours, and the manufacturing workweek increased to 40.6 hours. Further, special factors like supply chain interruptions related to the earthquake and tsunami in Japan and severe weather-related disruptions reduced employment gains and will likely be reversed in the coming months.

The economic soft patch is expected to be temporary, with more robust economic growth returning during the second half of the year. This projected resurgence will be supported by the accommodative monetary policy pursued by the Federal Reserve Board. Based on trading prices for federal funds futures contracts, the market does not expect any change in the target for the balance of this year. And there are early signs that home values have stabilized in national metrics during the spring, and prices are up in stronger local markets. This, in combination with a bottoming of mortgage rates and a pick-up in economic growth, should channel through to more home sales. During the first four months of 2011, average monthly sales of existing homes were up about 5 percent from the average pace of 2010, and that pattern should hold for the rest of this year.

A bright sign in today’s housing market is the rental sector. The National Multi Housing Council reported that property managers in most local markets have found a tightening in rental markets and greater availability of equity and debt financing, and released an upbeat Market Tightness Index of 90 – the highest recorded in the 12-year index history (values above 50 represent a tightening of the market in recent months). Consistent with this evaluation, rental vacancy rates in buildings with at least five apartments have steadily drifted lower over the past year, and monthly rents have risen over the past year.

Thus, even though near-term concerns over income and sales growth are restraining consumer spending, business hiring, and new building, there have been a number of positive signs in the economy that growth will continue and is likely to accelerate in the second half of this year. And while parts of the housing industry remain weak, the rental market has clearly strengthened and homes sales are above last year’s pace. Look for a gradual but substantive improvement in housing activity in the coming year.

“Between the optimist and the pessimist, the difference is droll. The optimist sees the doughnut, the pessimist the hole!” – McLandburgh Wilson

Frank E. Nothaft
Chief Economist
June 15, 2011

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June 2011 Economic and Housing Market Outlook

Office of the Chief Economist

__Revised 6/15/2011__

Major Economic Indicators

Indicator	2010				2011				2012				Annual Totals						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008	2009	2010	2011	2012	2013
Real GDP (%)	3.7	1.7	2.6	3.1	1.8	**2.8**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**	2.3	-2.8	0.2	2.8	**3.2**	**4.0**	**4.0**
Consumer Prices (%) a.	1.3	-0.5	1.4	2.6	5.2	**4.0**	**1.5**	**1.5**	**2.0**	**2.0**	**2.0**	**2.0**	4.0	1.6	1.5	1.2	**3.1**	**2.0**	**2.0**
Unemployment Rate (%) b.	9.7	9.7	9.6	9.6	8.9	**9.0**	**8.9**	**8.8**	**8.7**	**8.6**	**8.5**	**8.3**	4.6	5.8	9.3	9.7	**8.9**	**8.5**	**7.6**
30-Year Fixed Mtg. Rate (%) b.	5.0	4.9	4.4	4.4	4.9	**4.7**	**4.7**	**4.9**	**5.1**	**5.3**	**5.5**	**5.7**	6.3	6.0	5.0	4.7	**4.8**	**5.4**	**6.1**
1-Year Treas. Indexed ARM Rate (%) b.	4.3	4.0	3.5	3.3	3.3	**3.2**	**3.2**	**3.3**	**3.4**	**3.5**	**3.6**	**3.7**	5.6	5.2	4.7	3.8	**3.2**	**3.6**	**4.0**
10-Year Const. Mat. Treas. Rate (%) b.	3.7	3.5	2.8	2.9	3.5	**3.2**	**3.2**	**3.2**	**3.3**	**3.4**	**3.5**	**3.6**	4.6	3.7	3.3	3.2	**3.3**	**3.5**	**3.9**
1-Year Const. Mat. Treas. Rate (%) b.	0.4	0.4	0.3	0.3	0.3	**0.2**	**0.2**	**0.2**	**0.3**	**0.4**	**0.5**	**0.6**	4.5	1.8	0.5	0.3	**0.2**	**0.5**	**0.9**

Housing and Mortgage Markets

Indicator	2010				2011				2012				Annual Totals						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008	2009	2010	2011	2012	2013
Housing Starts c.	0.62	0.60	0.58	0.54	0.58	**0.57**	**0.60**	**0.65**	**0.65**	**0.75**	**0.85**	**0.95**	1.36	0.91	0.55	0.59	**0.60**	**0.80**	**1.20**
Total Home Sales d.	4.89	5.22	3.95	4.47	4.77	**4.86**	**5.00**	**5.15**	**5.40**	**5.40**	**5.40**	**5.40**	5.72	4.84	4.94	4.63	**4.95**	**5.40**	**5.90**
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**	-5.0	-11.7	-2.3	-6.2	**-2.2**	**1.1**	**4.0**
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**	-8.4	-18.4	-2.5	-3.8	**-4.3**	**2.5**	**4.4**
1-4 Family Mortgage Originations g.																			
Conventional	**$243**	**$226**	**$309**	**$396**	**$264**	**$263**	**$210**	**$149**	**$142**	**$176**	**$178**	**$142**	$2,312	$1,310	$1,549	**$1,173**	**$886**	**$638**	**$781**
FHA & VA	$92	$90	$95	$100	$76	**$87**	**$90**	**$61**	**$58**	**$74**	**$72**	**$58**	$120	$290	$451	$377	**$314**	**$262**	**$319**
Total	**$335**	**$316**	**$404**	**$496**	**$340**	**$350**	**$300**	**$210**	**$200**	**$250**	**$250**	**$200**	$2,432	$1,600	$2,000	**$1,550**	**$1,200**	**$900**	**$1,100**
ARM Share (%) h.	4	6	5	4	8	**11**	**11**	**10**	**12**	**12**	**12**	**13**	10	7	3	5	**10**	**12**	**14**
Refinancing Share - Applications (%) i.	70	72	81	82	69	**63**	**55**	**50**	**35**	**35**	**35**	**35**	42	48	70	76	**59**	**35**	**35**
Refinancing Share - Originations (%) j.	**70**	**58**	**75**	**79**	**69**	**63**	**55**	**50**	**35**	**35**	**35**	**35**	49	50	68	**71**	**59**	**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**	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 6/15/2011 (MAS); Send comments and questions to chief_economist@freddiemac.com.