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Office of the Chief Economist

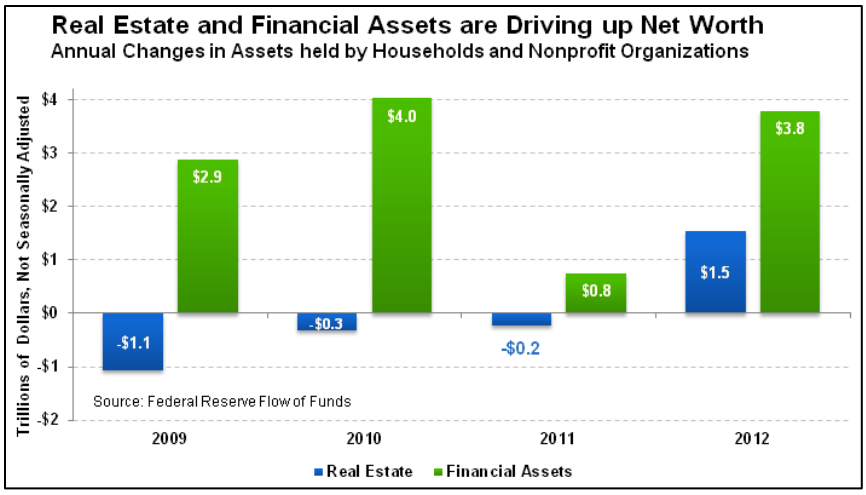
March 2013 U.S. Economic & Housing Market Outlook

From Gloom to Bloom

The economy is showing signs of continued strengthening and has brought good news for housing and mortgage markets so far this year. The employment report for February showed strong job growth with nonfarm payrolls increasing by 236,000 which helped to reduce the unemployment rate from 7.9 percent to 7.7 percent. Digging deeper into the jobs report reveals more good news. Overall construction added 48,000 jobs, with 17,000 in residential construction. Moreover, the average workweek increased 0.1 hours for all non-farm workers and 0.3 hours in construction. The increase in average hours worked is another sign of an improving labor market. While the unemployment rate remains well above what we would expect in a healthy economy, it's moving in the right direction.

Near record-low mortgage rates are contributing to near record-high homebuyer affordability. Housing is increasingly becoming a major contributor to an economic recovery that is poised to turn this year's spring homebuying season from gloom to bloom. Can we be optimistic that we have finally turned the corner and economic growth will continue?

Favorable developments in the stock market, housing, and on the jobs front appear to have offset the hit to disposable income from the expiration of the payroll tax holiday in January 2013. According to the Flow of Funds Accounts from the Federal Reserve, household and non-profit total assets increased by 7.4 percent in 2012, with the value of owner-occupied real estate, including vacant land and mobile homes, increasing by 8.7 percent. Through the end of February, the S&P 500 index was up 6 percent, following a 13 percent increase in the index for 2012. In 2009, real estate reduced household assets by $1.1 trillion in value, largely due to the fall in house prices. In 2012, real estate added $1.5 trillion to household and nonprofit balance sheets, while financial assets added $3.8 trillion. On the liability side, outstanding residential mortgage debt increased by 0.1 percent in the fourth quarter of 2012. This is the first quarter since 2008 where mortgage debt has



increased, indicating that household deleveraging might be drawing to a close. In fact, February saw retail sales up 1.1 percent, above the consensus forecast, a sign consumers are willing to spend.

Nationally house prices were up by 6.4 percent on an annual basis in December according to the Freddie Mac House Price Index (FMHPI), with the housing markets hardest hit by the Great Recession posting the strongest gains. For instance, Arizona, which had price declines of 49 percent peak-to-trough, posted a 26 percent year over year increase in the FMHPI from December 2011 to December 2012. While the price increases are significant, it is *important* to remember these gains are off a deep bottom and in some markets prices overshot the bottom. Our February Economic and Housing Market Outlook addressed the "bubbler's anxiety" reaction, for lack of a better term, to help explain the reason around the significant gains.

The positive momentum for housing markets from 2012 appears to be carrying over into 2013. As we head into the spring homebuying season, continued low mortgage rates, increasing house prices, and gradually improving consumer confidence will help support increased home sales. Compared to 2012, we expect home sales to be up 8 to 10 percent for 2013. With inventories tightening and home sales picking up in many markets, the demand for new housing (both multifamily and single-family) will result in more construction, higher new home sales and greater construction employment. We are forecasting that housing starts will increase to 950,000 units for 2013, compared to 780,000 in 2012.

Consumer confidence has been the one indicator that has remained stubbornly low throughout the recovery. The Thomson Reuters/University of Michigan sentiment index shows consumer confidence taking a hit following deliberations around the sequestration. The preliminary sentiment index for March came in at 71.8, well below the consensus expectations of 78.0. The March consumer sentiment index was at the lowest level since December 2011. However, consumer confidence appears to be drawn along income lines. According to the Conference Board, households with incomes greater than $50,000 have seen a big rebound in confidence, but households with less income feel less optimistic. Stock market values and the unemployment rate—two broad measures of the health of the macroeconomy—affect overall confidence for both higher-and lower-income families; but the bar chart below shows that the stock market (and recent news has been quite bullish) is a relatively more important driver of confidence for higher-income households while the unemployment rate has a more influential effect on the confidence of lower-income households.

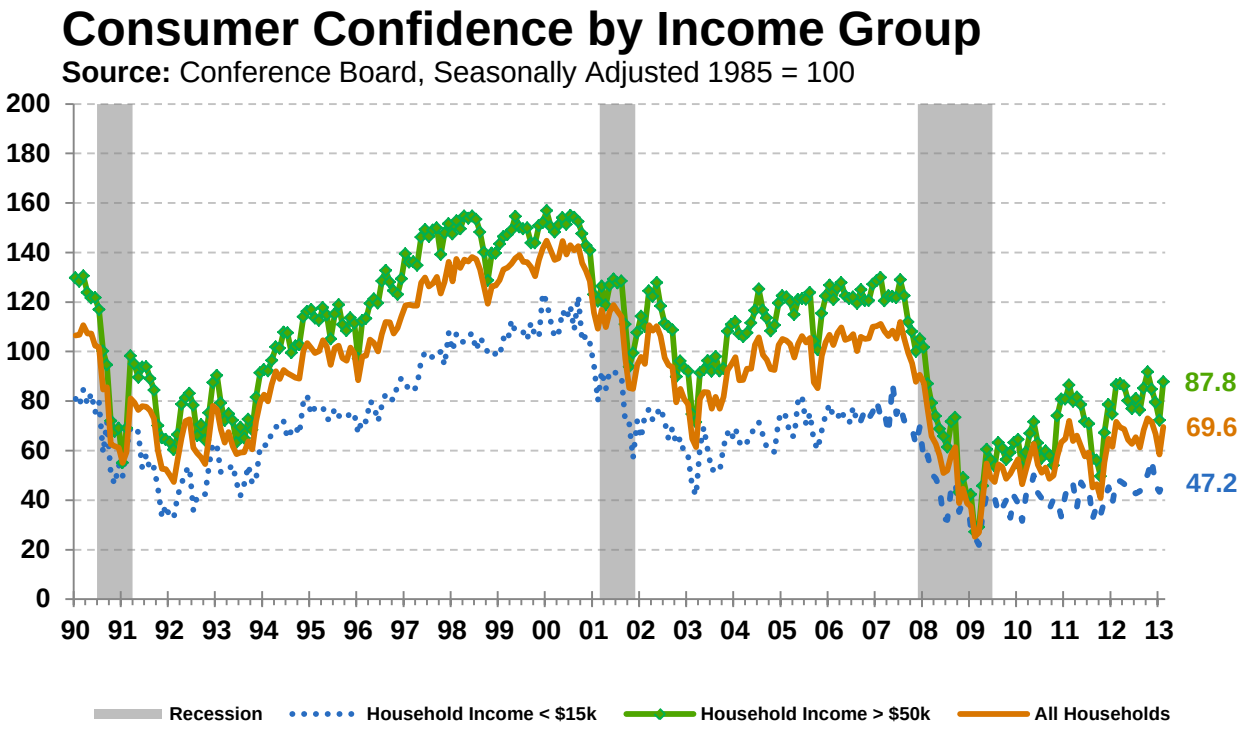
There are two potential stumbling blocks for the recovery that could slow or reverse the building momentum in the economy and housing market. Internationally, the situation in Europe could deteriorate, weakening foreign demand and potentially disrupting financial markets. Domestically, fiscal policy could be a drag on economic growth. The sequester that went into effect on March 1, is estimated by the Congressional Budget Office, International Monetary Fund, Macroeconomic Advisers, and Moody's Analytics to reduce economic growth by about 0.5 of a percentage point in 2013. That means the fiscal drag will just about offset

the positive contribution residential construction is poised to make to GDP in economic growth.

Following the enactment of the sequester we revised down our projection for economic growth by 0.5 percentage points for 2013. Sequestration cuts will also likely result in lower employment growth, which should have a dampening effect on housing. We expect that as the sequestration spending reductions go into effect throughout the year; the unemployment rate will be about 0.25 percentage points higher than it otherwise would have been. On net, we expect the unemployment rate in 2013 will average about 7.8 percent, essentially flat for the year. With modest growth and stubbornly high unemployment, long term interest rates, such as for the 30-year fixed-rate mortgage, will only gradually creep up and likely remain below 4 percent throughout 2013.

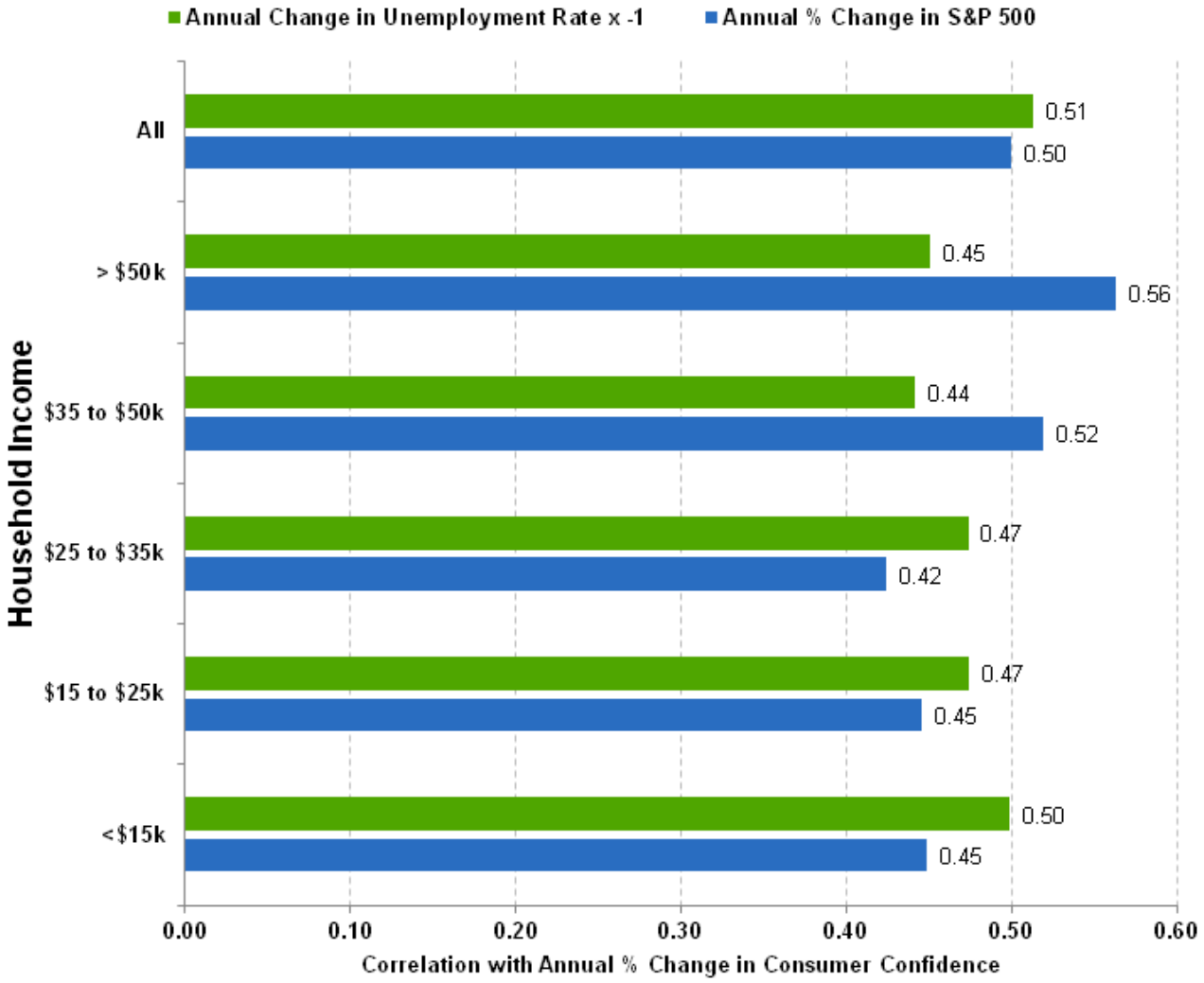
However, the long term picture is brighter. As the economic recovery spreads across more industries and regions of the U.S., led by a housing market that continues to heal, we project that economic growth in 2014 will come in around 3.5 percent. After absorbing the fiscal drag from the sequestration cuts, the unemployment rate should begin to come down in 2014, but not crossing below 7 percent until 2015. As long as inflation remains contained, and the Federal Reserve continues its accommodative policies, mortgage rates should remain low, and this should continue to help fuel the housing recovery.

Regardless, we are already beginning to see the housing wealth effect take hold in the broader market which should translate into the healthiest spring homebuying season we have seen since 2007.



What's Driving Consumer Confidence?

The Stock Market among Higher Income Households, the Unemployment Rate for Lower Earning Households



Source: Conference Board, Labor Department, Standard & Poor's. Data are monthly from January 1990 to February 2012.

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March 20, 2013

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March 2013 Economic and Housing Market Outlook

Revised 3/8/2013

Indicator	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	Annual Totals 2009	2010	2011	2012	2013	2014
Real GDP (%)	3.1	0.1	**1.8**	**1.3**	**2.4**	**2.5**	**3.3**	**3.5**	**3.6**	**3.5**	-0.1	2.4	2.0	1.6	**2.0**	**3.5**
Consumer Prices (%) a.	2.3	2.1	**1.5**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	1.5	1.2	3.3	1.9	**1.9**	**2.0**
Unemployment Rate (%) b.	8.0	7.8	**7.8**	**7.8**	**7.8**	**7.8**	**7.7**	**7.6**	**7.4**	**7.3**	9.3	9.6	8.9	8.1	**7.8**	**7.5**
30-Year Fixed Mtg. Rate (%) b.	3.6	3.4	**3.5**	**3.6**	**3.7**	**3.8**	**3.9**	**4.1**	**4.2**	**4.4**	5.0	4.7	4.5	3.7	**3.7**	**4.2**
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	**2.6**	**2.6**	**2.6**	**2.7**	**2.8**	**2.8**	**2.9**	**3.0**	4.7	3.8	3.0	2.7	**2.6**	**2.9**
10-Year Const. Mat. Treas. Rate (%) b.	1.6	1.7	**2.0**	**2.1**	**2.2**	**2.3**	**2.4**	**2.6**	**2.7**	**2.9**	3.3	3.2	2.8	1.8	**2.2**	**2.7**
1-Year Const. Mat. Treas. Rate (%) b.	0.2	0.2	**0.2**	**0.2**	**0.2**	**0.3**	**0.4**	**0.4**	**0.5**	**0.6**	0.5	0.3	0.2	0.2	**0.2**	**0.5**

Indicator	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	Annual Totals 2009	2010	2011	2012	2013	2014
Housing Starts c.	0.77	0.90	**0.90**	**0.93**	**0.97**	**1.00**	**1.10**	**1.15**	**1.25**	**1.30**	0.55	0.59	0.61	0.78	**0.95**	**1.20**
Total Home Sales d.	5.11	5.28	**5.30**	**5.35**	**5.45**	**5.50**	**5.70**	**5.80**	**5.80**	**5.90**	4.72	4.51	4.57	5.03	**5.40**	**5.80**
FMHPI House Price Appreciation (%) e.	0.6	0.4	**0.8**	**2.0**	**2.0**	**-0.8**	**1.0**	**1.5**	**1.0**	**0.4**	-2.3	-5.4	-3.7	**6.4**	**4.0**	**3.5**
S&P/Case-Shiller® Home Price Index (%) f.	2.1	-0.3	**0.5**	**3.5**	**1.0**	**-1.0**	**0.5**	**2.0**	**0.7**	**0.3**	-2.5	-3.8	-3.7	**7.3**	**4.0**	**3.5**
1-4 Family Mortgage Originations g.																
Conventional	**$453**	**$425**	**$397**	**$405**	**$318**	**$290**	**$240**	**$335**	**$235**	**$190**	$1,549	$1,300	$1,208	**$1,627**	**$1,410**	**$1,000**
FHA & VA	$97	$105	**$83**	**$95**	**$92**	**$70**	**$50**	**$80**	**$65**	**$55**	$451	$377	$292	$373	**$340**	**$250**
Total	**$550**	**$530**	**$480**	**$500**	**$410**	**$360**	**$290**	**$415**	**$300**	**$245**	$2,000	$1,677	$1,500	**$2,000**	**$1,750**	**$1,250**
ARM Share (%) h.	8	7	**10**	**11**	**12**	**13**	**14**	**15**	**15**	**16**	3	5	11	10	**12**	**15**
Refinancing Share - Applications (%) i.	82	83	**77**	**70**	**65**	**60**	**50**	**45**	**45**	**40**	70	76	75	81	**68**	**45**
Refinancing Share - Originations (%) j.	**76**	**76**	**77**	**70**	**65**	**60**	**50**	**45**	**45**	**40**	68	67	64	**75**	**68**	**45**
Residential Mortgage Debt (%) k.	-3.0	0.1	**-1.0**	**0.0**	**0.0**	**1.0**	**1.0**	**2.0**	**3.0**	**4.0**	-1.6	-4.1	-2.2	-2.0	**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 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 3/8/2013 (MAS); Send comments and questions to chief_economist@freddiemac.com.

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