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Office of the Chief Economist

November 2012 U.S. Economic & Housing Market Outlook

98.6°

The U.S. housing market is healing, but how will we know when it's actually "healthy"? Let's use an analogy and say the patient – in this case, the housing market – was running an alarmingly high fever of 103 degrees in 2006, at the height of the boom. The patient collapsed and, after a difficult period of convalescence, now seems to be getting better. Housing starts, sales and prices are rising, delinquencies and foreclosure inventories are trending down. The question is: What does a national housing market look like at a healthy 98.6 degrees?

To deliver the right prognosis, we need to compare the current housing market to the years before the housing peak, but not the peak itself. Let's start by reviewing the latest data on the market's condition.

Both the S&P/Case-Shiller 20-city and Federal Housing Finance Agency's purchase-only house price indexes have shown seven consecutive months of positive gains through August on a seasonally-adjusted basis. Freddie Mac's own house price index was up 4 percent in September over the same month in 2011; further, increases were geographically broad based, with an annual rise found in 44 states and the District of Columbia. Residential construction was up 26 percent in the first nine months of this year compared to the same time last year. Home sales were at a rate of almost five million units for the first nine months of 2012, a 9 percent increase from the same period a year ago, and the homeowner and rental vacancy rates have declined to 1.9 percent and 8.6 percent, respectively, in the third quarter of his year. On the surface, the housing numbers are looking better and trending in a healing direction.

Nonetheless, with the unemployment rate remaining in the high 7-percent area and family-income growth modest, housing demand has remained subdued, as has a principal driver: the pace of household formations. Household growth was running at an annual rate of 0.5 percent over 2007-2011, which was less than one-half the 1990-2006 average of 1.2 percent per year. However, over the past four quarters, it has returned to a 1 percent growth rate, or an increase of about 1.15 million households over the past year.

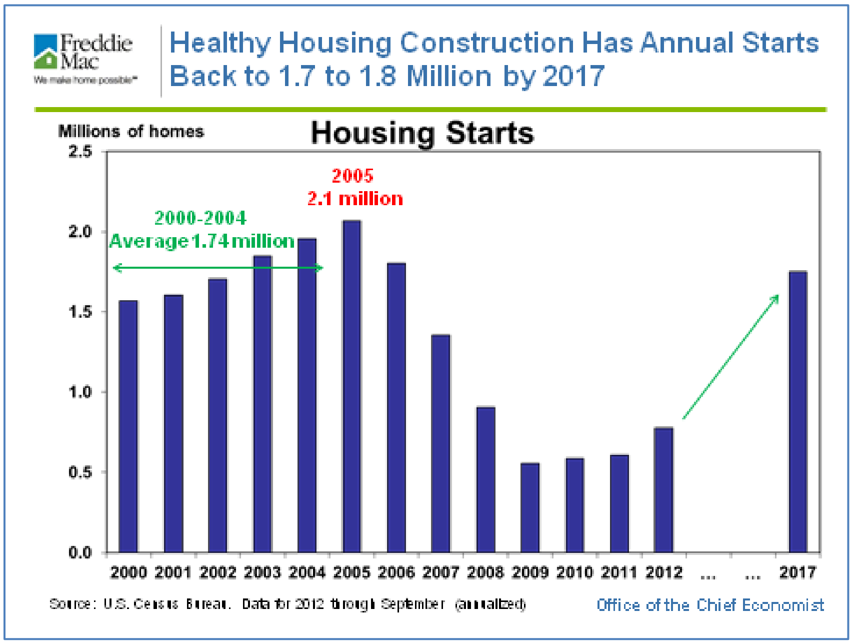
Our diagnosis of a healthy market will also have to take into account demographic shifts among both "Generation Y" and the "Baby Boomers" that are having a profound impact on the housing market. Generation Y's appear to be staying at their parents' home longer and delaying both household formation and home purchase based on a recent study by the Federal Reserve Bank of Cleveland.[1] Baby Boomers are now looking at not only the younger generation living with them, but also their own retirement. Fewer are likely to be move-up buyers and may delay a move to a retirement home. Additionally, while the number of foreclosures continues to decline year over

[1] "Household Formation and the Great Recession," Timothy Dunne, August 23, 2012, Federal Reserve Bank of Cleveland (http://www.clevelandfed.org/research/commentary/2012/2012-12.cfm)

year, and the industry's seriously delinquent rate is down to 7.3 percent, both still remain elevated. If we put these additional factors into play, what a healthy housing market should look like will dismay those who keep comparing housing to its peak years of 2004-2006.

Our most recent Economic and Housing Market Outlook provides a near-term view; however, if we look at long-term trends here's what a healthy housing market should look like in the next five years:

- Housing starts increasing to about 1.7 to 1.8 million dwellings per year (compared with 2.1 million in 2005)
- Home sales increasing to about 5 percent of the housing stock, or about 6.5 to 7.0 million homes per year (compared with sales of 7 percent of the stock in 2005)
- U.S. house price appreciation rising gradually to about 3 percent per year (compared to 11 percent of 2005)
- Vacancy rates easing further to about 1.7 percent on for-sale homes and 8 percent for rental homes (down from peaks of about 3 percent in 2008 and 11 percent in 2009, respectively)
- Serious delinquency rates nearing 2 percent (down from a peak of 9.5 percent in early 2010)



To sum up: taking into account recent trends, key housing indicators and the shifting demographic patterns that will define a new and realistic trajectory toward a healthy housing market, the long-term prognosis is promising. In the immediate future, however, the market's recovery will be tempered by continued high unemployment, modest income growth, and a subdued pace of household formations. In other words, the patient is on the way back to health, but don't expect the housing market to wake up at 98.6 degrees tomorrow morning.

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November 2012 Economic and Housing Market Outlook

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Major Economic Indicators

Indicator	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	Annual Totals 2008	2009	2010	2011	2012	2013	2014
Real GDP (%)	0.1	2.5	1.3	4.1	2.0	1.3	2.0	**1.7**	**2.0**	**2.8**	**3.2**	**3.5**	-3.3	-0.1	2.4	2.0	**1.8**	**2.9**	**3.5**
Consumer Prices (%) a.	4.5	4.4	3.1	1.3	2.5	0.8	2.3	**2.5**	**1.5**	**2.0**	**2.0**	**2.0**	1.6	1.5	1.2	3.3	**2.0**	**1.9**	**2.0**
Unemployment Rate (%) b.	9.0	9.0	9.1	8.7	8.3	8.2	8.1	**7.9**	**7.9**	**7.8**	**7.7**	**7.6**	5.8	9.3	9.6	9.0	**8.1**	**7.8**	**7.3**
30-Year Fixed Mtg. Rate (%) b.	4.9	4.7	4.3	4.0	3.9	3.8	3.6	**3.4**	**3.4**	**3.5**	**3.6**	**3.7**	6.0	5.0	4.7	4.5	**3.7**	**3.6**	**4.2**
1-Year Treas. Indexed ARM Rate (%) b.	3.3	3.1	2.9	2.9	2.8	2.8	2.7	**2.6**	**2.7**	**2.8**	**2.9**	**3.0**	5.2	4.7	3.8	3.0	**2.7**	**2.9**	**3.6**
10-Year Const. Mat. Treas. Rate (%) b.	3.5	3.2	2.4	2.1	2.0	1.8	1.6	**1.7**	**1.7**	**1.8**	**1.9**	**2.0**	3.7	3.3	3.2	2.8	**1.8**	**1.9**	**2.5**
1-Year Const. Mat. Treas. Rate (%) b.	0.3	0.2	0.1	0.1	0.2	0.2	0.2	**0.2**	**0.2**	**0.2**	**0.3**	**0.3**	1.8	0.5	0.3	0.2	**0.2**	**0.3**	**0.5**

Housing and Mortgage Markets

Indicator	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	Annual Totals 2008	2009	2010	2011	2012	2013	2014
Housing Starts c.	0.58	0.57	0.61	0.68	0.72	0.74	0.79	**0.80**	**0.85**	**0.90**	**0.95**	**1.00**	0.91	0.55	0.59	0.61	**0.76**	**0.93**	**1.20**
Total Home Sales d.	4.63	4.48	4.55	4.69	4.92	4.90	5.06	**5.10**	**5.20**	**5.30**	**5.50**	**5.60**	4.59	4.72	4.51	4.57	**5.00**	**5.40**	**5.80**
FMHPI House Price Appreciation (%) e.	-1.3	1.5	-1.8	-2.4	0.6	4.9	1.3	**-4.0**	**0.0**	**2.5**	**0.5**	**-1.0**	-11.7	-2.3	-5.5	-3.9	**2.8**	**2.0**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	-4.0	4.1	0.1	-3.8	-1.7	6.9	**0.5**	**-3.4**	**0.0**	**2.5**	**0.5**	**-1.0**	-18.4	-2.5	-3.7	-3.7	**2.0**	**2.0**	**3.0**
1-4 Family Mortgage Originations g.																			
Conventional	$269	$226	$311	$402	**$337**	**$375**	**$450**	**$424**	**$357**	**$355**	**$328**	**$280**	$1,310	$1,549	$1,300	$1,208	**$1,586**	**$1,320**	**$960**
FHA & VA	$77	$70	$73	$72	$83	$95	$100	**$106**	**$83**	**$95**	**$82**	**$70**	$290	$451	$377	$292	**$384**	**$330**	**$240**
Total	$346	$296	$384	$474	**$450**	**$470**	**$550**	**$530**	**$440**	**$450**	**$410**	**$350**	$1,600	$2,000	$1,677	$1,500	**$2,000**	**$1,650**	**$1,200**
ARM Share (%) h.	8	11	12	14	12	11	8	**11**	**12**	**13**	**14**	**15**	7	3	5	11	**11**	**14**	**15**
Refinancing Share - Applications (%) i.	69	70	78	81	81	77	82	**70**	**70**	**65**	**60**	**50**	48	70	76	75	**78**	**61**	**40**
Refinancing Share - Originations (%) j.	69	51	61	73	**75**	**71**	**76**	**66**	**67**	**64**	**60**	**50**	50	68	67	64	**70**	**60**	**40**
Residential Mortgage Debt (%) k.	-2.6	-2.3	-2.0	-1.9	-3.1	-1.8	**-1.0**	**-0.5**	**1.0**	**2.0**	**2.0**	**3.0**	-0.4	-1.6	-4.1	-2.2	**-1.6**	**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 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 11/13/2012 (MAS); Send comments and questions to chief_economist@freddiemac.com.