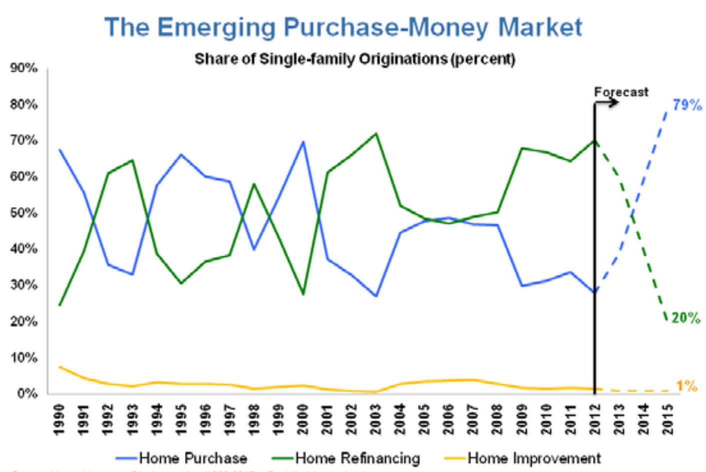
November 2013 U.S. Economic & Housing Market Outlook

2014: The Emerging Purchase Market

As we look forward to 2014, we see reasons to be optimistic about the economy. Led by a resurgent housing sector, 2014 should shape up to be better than 2013, with consensus forecasts placing economic growth in the 2.5 to 3.0 percent range, more than a 0.5 percentage point better than is expected for 2013. A quickening in the recovery pace will also lead to more job creation and should push the unemployment rate below 7 percent, perhaps by mid-2014. We expect single-family home sales and housing starts to be at the highest level since 2007, and expect multifamily transactions and construction to post gains as well. Despite rising mortgage rates and continued property-value appreciation, housing will remain generally affordable in most parts of the country. With household formations expected to pick up and new home completions gaining more slowly, for-sale inventories may remain tight and vacancies low next year.

The big shift ahead will occur as the single-family mortgage market begins transitioning from a rate-and-term refinance dominated market, to the first purchase-dominated market we've seen since 2000. The emerging purchase market should gather momentum in the coming year.



So, what will be some of the market features for 2014?

Interest rates rise. After hitting near record lows in early May, mortgage rates have increased about a full percentage point – to about 4.5 percent in September for 30-year fixed-rate single-family mortgages and 10-year fixed-rate multifamily mortgages. While rates have backed down from that level, we look for fixed-rate mortgage rates to creep higher in 2014, gradually moving up throughout the year and ending at close to 5 percent. However, expect some volatility in the short-term from renewed concerns about the debt ceiling or other fiscal policy. And when the Fed does announce a "Taper," markets will probably jump around too.

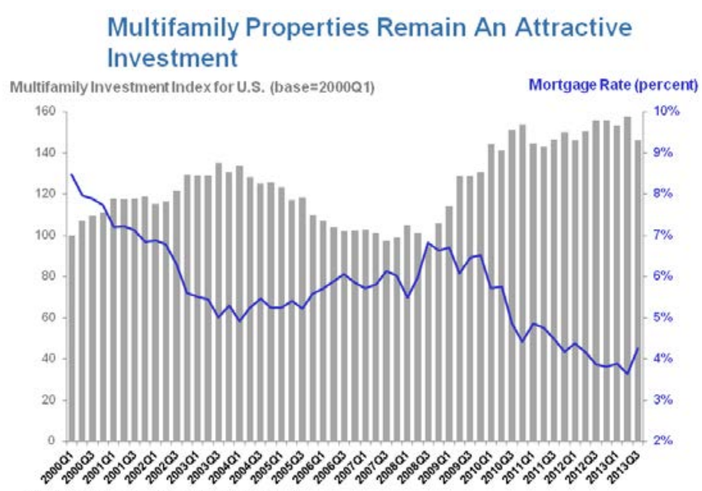
Affordability remains high. How much of an impact will rising mortgage rates have on housing and affordability? Even if rates were to go to 5.0 percent next year, housing in most of the country would remain affordable. To be sure, large metro areas along the Atlantic and Pacific coasts are already expensive for the typical family, so rising rates will have a bigger effect there. But in most of the country, incomes and home prices are such that rising rates by themselves will not be enough to end the recovery. What we need is some better income growth.

Housing starts hover. While housing construction has picked up, it is still operating at a low level. For example, new construction should be sufficient to keep up with household formations, teardowns of existing housing, and second-home demand. But from July 2012 through June 2013, 710,000 new homes were completed, less than the 750,000 net household formations and far less than what would occur in a healthy market. The National Association of Home Builders (NAHB) has estimated that each single-family home that is built creates three jobs in the local economy. Starts have ratcheted up to about a 900,000-unit annualized pace, and we expect new building to rise to about 1.15 million homes in 2014; using the NAHB estimates, this pick up alone should ultimately add close to 700,000 jobs and support a quicker pace of economic growth. That positive momentum in housing construction should help to bring the unemployment rate down and put many back to work.

Inventories remain tight. We expect an increasing number of home buyers to match or exceed increases in the supply of homes on the market, keeping the inventory-to-sale pace relatively low in the face of increased sales. Many potential home sellers are constrained by negative equity; house price growth will lift many families "above water," but only slowly, and not all of them will sell. New construction should continue to rebound, but not fast enough to keep pace with rising demand. Thus, gains in home sales will be limited in many markets, but we anticipate U.S. home sales will be able to rise about 5 percent in 2014 from 2013's level. Continued tight inventory and very high affordability (albeit less than in 2013) will help to support continued price increases into next year.

Home values rise. Property values have increased substantially, with single-family home prices up about 10 percent in the first nine months of 2013. Rising mortgage rates suggest a slowdown in value growth. We expected house prices to increase, but at a less robust pace of around 5-6 percent annualized nationally with some of the strongest gains in those areas that were hit hardest during the housing market crash.

Rental renaissance continues. Rental property values have risen as well over the past year, but at a more modest 5.3 percent pace. Freddie Mac's Multifamily Investment Index, which summarizes the effect of three major components -- mortgage rates, property values, and effective gross income -- that influence the relative attractiveness of investments in apartment buildings, remains well above its 2000-2013 average during the third quarter, suggesting that multifamily currently remains a relatively attractive investment compared with the past decade. Even if mortgage rates move up to 5 percent, given today's property values and income flows, apartments remain a favorable investment compared to the first decade of the 2000s.



Purchase-money majority. We expect home sales to rise about 5 percent in 2014 from this year's level. Add in home value gains, and a decline in all-cash purchases, and purchase-money lending may be up about 15 percent in 2014 compared with 2013. At the same time, the upward creep in fixed-rate mortgage rates and a dwindling pool of “in-the-money” borrowers who could refinance will translate into a big drop in refinance originations in coming months. We expect the lending market to transition to one dominated by purchase-money in 2014, and even more so in 2015.

Frank E. Nothaft
Chief Economist

Leonard Kiefer
Deputy Chief Economist

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www.freddiemac.com/news/finance chief_economist@freddiemac.com

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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**	**2015**
Real GDP (%)	2.8	0.1	1.1	2.5	2.8	**2.0**	**2.6**	**2.8**	**3.0**	**3.2**	-0.2	2.8	2.0	2.0	**2.1**	**2.9**	**3.2**
Consumer Prices (%) a.	2.1	2.2	1.4	0.0	2.6	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	1.5	1.4	3.0	1.8	**1.5**	**2.0**	**2.0**
Unemployment Rate (%) b.	8.0	7.8	7.7	7.6	7.3	**7.3**	**7.2**	**7.1**	**6.9**	**6.8**	9.3	9.6	8.9	8.1	**7.5**	**7.0**	**6.5**
30-Year Fixed Mtg. Rate (%) b.	3.6	3.4	3.5	3.7	4.4	**4.2**	**4.4**	**4.6**	**4.8**	**5.0**	5.0	4.7	4.5	3.7	**4.0**	**4.7**	**5.5**
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	2.6	2.6	2.7	**2.7**	**2.7**	**2.8**	**2.8**	**2.9**	4.7	3.8	3.0	2.7	**2.7**	**2.8**	**3.1**
10-Year Const. Mat. Treas. Rate (%) b.	1.6	1.7	2.0	2.0	2.7	**2.6**	**2.8**	**3.0**	**3.2**	**3.4**	3.3	3.2	2.8	1.8	**2.3**	**3.1**	**3.9**
1-Year Const. Mat. Treas. Rate (%) b.	0.2	0.2	0.2	0.1	0.1	**0.1**	**0.1**	**0.2**	**0.2**	**0.3**	0.5	0.3	0.2	0.2	**0.1**	**0.2**	**0.5**

	2012		2013				2014				Annual Totals						
Indicator	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Housing Starts c.	0.78	0.90	0.96	0.87	**0.89**	**0.95**	**1.05**	**1.10**	**1.20**	**1.25**	0.55	0.59	0.61	0.78	**0.92**	**1.15**	**1.40**
Total Home Sales d.	5.12	5.28	5.39	5.50	**5.76**	**5.65**	**5.80**	**5.90**	**5.90**	**6.00**	4.72	4.51	4.57	5.03	**5.58**	**5.90**	**6.10**
FMHPI House Price Appreciation (%) e.	1.1	0.1	2.7	5.4	2.2	**0.0**	**1.0**	**2.5**	**2.0**	**0.4**	-2.3	-4.9	-3.2	5.8	**10.6**	**6.0**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	2.1	-0.4	1.1	7.1	**1.5**	**0.0**	**1.1**	**3.1**	**1.5**	**0.2**	-2.5	-3.8	-3.7	7.2	**9.9**	**6.0**	**3.0**
1-4 Family Mortgage Originations g.																	
Conventional	$471	$495	**$435**	**$456**	**$309**	**$280**	**$306**	**$362**	**$266**	**$194**	$1,549	$1,300	$1,206	$1,750	**$1,480**	**$1,128**	**$952**
FHA & VA	$97	$105	$105	$104	$91	**$70**	**$77**	**$91**	**$66**	**$48**	$451	$377	$294	$380	**$370**	**$282**	**$238**
Total	$568	$600	**$540**	**$560**	**$400**	**$350**	**$383**	**$453**	**$332**	**$242**	$2,000	$1,677	$1,500	$2,130	**$1,850**	**$1,410**	**$1,190**
ARM Share (%) h.	8	7	8	9	8	**9**	**10**	**11**	**12**	**13**	3	5	11	10	**9**	**12**	**15**
Refinancing Share - Applications (%) i.	82	83	79	73	64	**45**	**50**	**46**	**45**	**40**	70	76	75	81	**68**	**46**	**20**
Refinancing Share - Originations (%) j.	69	73	**72**	**65**	**57**	**38**	**44**	**40**	**39**	**35**	68	67	64	70	**60**	**40**	**20**
Residential Mortgage Debt (%) k.	-3.0	-0.1	-1.8	-1.2	**-0.6**	**0.0**	**0.0**	**1.0**	**2.0**	**3.0**	-1.6	-4.2	-2.2	-2.1	**-0.9**	**1.5**	**4.0**

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. 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 11/15/2013 (MAS); Send comments and questions to chief_economist@freddiemac.com.