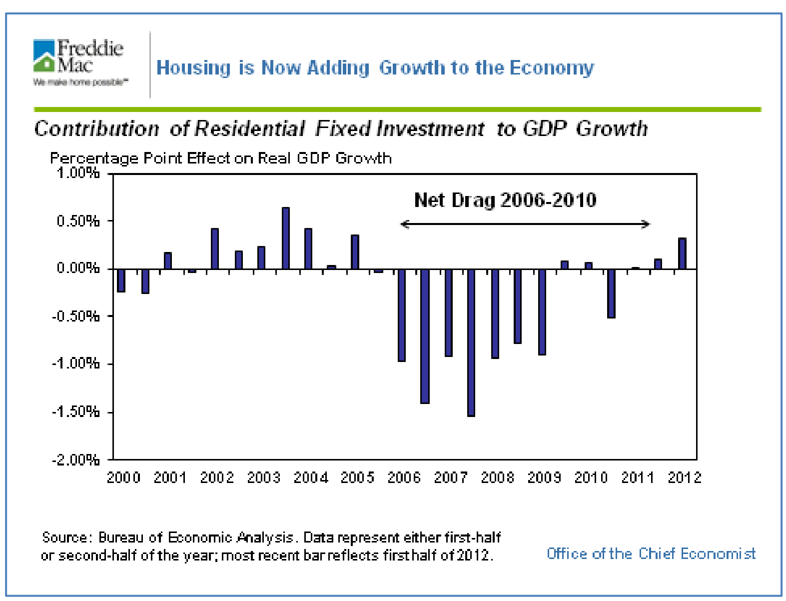
Office of the Chief Economist

October 2012 U.S. Economic & Housing Market Outlook

QE3 in Motion

The Federal Reserve took an important step when it announced an expansion of its Maturity Extension Program on September 13. Referred to in the media as "QE3" -- the third round of Quantitative Easing – the Federal Reserve stated that it would increase its purchases of agency mortgage-backed securities (MBS) by $40 billion per month and continue the 'term extension' of its portfolio; taken together, its holdings of longer-term securities will increase by about $85 billion per month through year-end. Its stated goal is to encourage lower long-term interest rates, especially on fixed-rate mortgages, and spark a further pick-up in housing activity. With QE3 in motion we have revisited our economic and housing market projections for the remainder of this year and for 2013. Moreover, the increased housing demand stimulated by QE3 may partly offset (albeit by a small amount) the substantial reduction in 2013 aggregate demand that would be expected if the so-called "fiscal cliff" occurs.

The housing sector's performance since the Great Recession of 2008-09 has been unlike any other economic recovery over the last 65 years. Typically, the housing industry leads the recovery charge helping to strengthen the early stages of the macroeconomic expansion. Yet housing has been the laggard during the current recovery. In fact, residential fixed investment (RFI) (the component of gross domestic product (GDP) that includes expenditures on new housing construction, additions and alterations to the existing housing stock, and broker commissions on property sales) was a net drag on GDP growth during 2006-2010 and added less than one-tenth of a percentage point to GDP growth in 2011. This year has been different; RFI added 0.3 percentage points to the first-half 2012 real GDP growth of 1.7 percent (annualized) and will likely add a similar boost during the second half of the year.



The gradual turnaround in housing activity reflects, in part, the Federal Reserve's accommodative monetary policy. With mortgage rates at their lowest levels since at least the 1940s, housing demand has begun to improve. New housing starts were up 25 percent and existing home sales gained 8 percent over the first eight months of 2012 compared with the same period last year. Property value indexes for the U.S. have also turned up, with the FHFA purchase-only house price index up 3.8

percent over the 12 months through July and the National Council of Real Estate Investment Fiduciaries' value index for apartment buildings up 7.6 percent over the four quarters through mid-2012.

Low mortgage rates have also spiked a refinance boom, with roughly three-fourths of all loan applications this year for refinance. For loans funded by Freddie Mac during the second quarter, the average borrower that refinanced lowered their mortgage rate by about 1.5 percentage points. For an average $200,000 loan, that translates into a savings in monthly payments of about $2,100 over the next year. Our new projection for the market as a whole for 2012 has about 7 million borrowers refinancing; if each experiences this average payment reduction then that will result in an aggregate of $15 billion in mortgage payment savings over the first 12 months after the refinance, a substantial infusion of funds to help strengthen savings and consumption spending by owners.

We have boosted our projection of single-family mortgage originations for the remainder of this year and for 2013 for two main reasons. First, the September release of the 2011 Home Mortgage Disclosure Act (HMDA) data (which includes purchase-money, refinance, and home-improvement loans), has led to an upward revision in our estimate of 2011 origination volume. Lenders covered under HMDA reported $1.43 trillion in originations for 2011; assuming HMDA covered about 95 percent of all volume in 2011, this equates to about $1.50 trillion in originations. The larger volume for 2011 also increased our estimate for 2012 because the latter is based, in part, on our estimates of purchase-money and refinance growth between the two years.

Second, the expectation of an extended period of low mortgage rates ushered in by QE3 has resulted in our boost to the new purchase-money and refinance volume during the second half of 2012 and into 2013. We expect single-family origination volume to come in close to $2 trillion in 2012, about a 30-percent rise from 2011, and then drop by 15 to 20 percent in 2013 as refinance 'burnout' and somewhat higher mortgage rates during the latter half of next year lead to less refinance activity.

The Federal Reserve's QE3 initiative will take on even more importance if the assortment of temporary tax cuts are allowed to expire at year-end and government spending levels are reduced with the start of 2013. Popularly known as the "fiscal cliff," these items include (but are not limited to) the expiration of the 2 percentage-point payroll-tax cut and Bush-era tax-rate reductions, and the spending cuts related to long-term unemployment benefits and automatic reductions required under the Budget Control Act of 2011. The Congressional Budget Office has estimated that if all the temporary tax cuts expire and government spending levels are reduced, that 2013 GDP growth would be reduced by at least 2.2 percentage points from what it otherwise would have been, possible pushing the U.S into recession with unemployment rising to 9 percent. Moody's Analytics also concluded the economy would be much weaker in 2013 in such a scenario, with growth estimated to be 2.8 percentage points slower and unemployment rising to 9.2 percent.[1] With QE3 already in place and helping to bolster housing demand in the near term, the economic effects of experiencing the "fiscal cliff" will be somewhat less than they otherwise would be.

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[1] *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022*, Congressional Budget Office, August 2012; "Moody's Analytics Adds US Fiscal Cliff Scenarios to its Forecast Database," News Release, September 18, 2012.

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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	2008	2009	2010	2011	2012	2013	2014
													Annual Totals						
Real GDP (%)	0.1	2.5	1.3	4.1	2.0	1.3	2.0	1.7	2.5	2.8	3.2	3.5	-3.3	-0.1	2.4	2.0	1.8	3.0	4.0
Consumer Prices (%) a.	4.5	4.4	3.1	1.3	2.5	0.8	2.3	2.0	2.0	2.0	2.0	2.0	1.6	1.5	1.2	3.3	1.9	2.0	2.0
Unemployment Rate (%) b.	9.0	9.0	9.1	8.7	8.3	8.2	8.1	8.1	8.0	7.9	7.8	7.7	5.8	9.3	9.6	9.0	8.2	7.9	7.3
30-Year Fixed Mtg. Rate (%) b.	4.9	4.7	4.3	4.0	3.9	3.8	3.6	3.3	3.4	3.5	3.6	3.7	6.0	5.0	4.7	4.5	3.7	3.6	4.0
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	2.7	2.8	2.8	5.2	4.7	3.8	3.0	2.7	2.8	3.0
10-Year Const. Mat. Treas. Rate (%) b.	3.5	3.2	2.4	2.1	2.0	1.8	1.6	1.6	1.7	1.8	1.9	2.0	3.7	3.3	3.2	2.8	1.8	1.9	2.3
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	2008	2009	2010	2011	2012	2013	2014
													Annual Totals						
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	5.02	5.10	5.20	5.30	5.40	5.50	4.59	4.72	4.51	4.57	4.99	5.35	5.80
FMHPI House Price Appreciation (%) e.	-1.3	1.5	-1.9	-2.4	0.6	4.8	0.5	-3.7	0.0	2.5	0.5	-1.0	-11.7	-2.3	-5.6	-4.1	2.0	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	$434	$424	$357	$355	$328	$280	$1,310	$1,549	$1,300	$1,208	$1,570	$1,320	$960
FHA & VA	$77	$70	$73	$72	$83	$95	$116	$106	$83	$95	$82	$70	$290	$451	$377	$292	$400	$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 10/18/2012 (MAS); Send comments and questions to chief_economist@freddiemac.com.