November 2014 U.S. Economic & Housing Market Outlook

2015: The Purchase Market Strengthens

A pickup in household formations and overall housing activity depends greatly on the pace of economic growth. The good news for 2015 is that the U.S. economy appears well poised to sustain about a 3.0 percent growth rate in 2015—only the second year in the past decade with growth at that pace or better. There are several reasons for the expected better macroeconomic performance. Governmental fiscal drag has turned into fiscal stimulus, lower energy costs support consumer spending and business investment, further easing of credit conditions for business and real estate lending support commerce and development, and more upbeat consumer and business confidence, all of which portend faster economic growth in 2015. And with that, the economy will produce more and better paying jobs, providing the financial wherewithal to support household formations and housing activity.

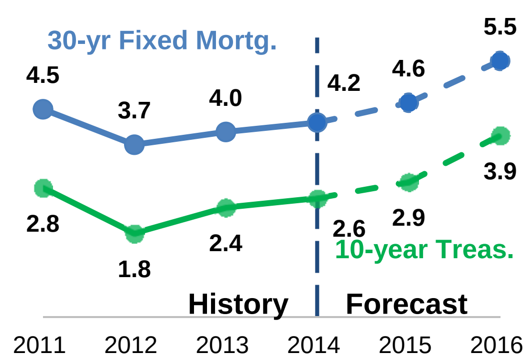
Of course, there are downside risks to the macro outlook. The dollar will likely strengthen in 2015, and while that's good for Americans touring abroad, it also may dampen U.S. exports. And the Federal Reserve is likely to start boosting the Federal funds target rate in 2015. The September poll of the Federal Open Market Committee members' views showed a clear consensus that the target would be raised by the end of 2015, although there was a wide range of opinions on when it should start to rise and by how much. While higher interest rates generally detract from housing activity, when they occur with strong job and income growth the net result can be increases in household formations, construction, and home sales. Our view for 2015 is exactly that, namely, income and job growth offset the negative effect of higher interest rates and translate into gains for the nation's housing market.

So, what will be some of the market features for 2015?

Interest rates

Interest rates entered 2014 at about 3 percent for the 10-year treasury and 4.5 percent for the 30-year fixed-rate mortgage. For most of 2014 interest rates were flat or declining. The 10-year treasury entered November at about 2.3 percent and the 30-year mortgage at 4.0 percent, but rates are likely at their bottom. We expect to see interest rates climb throughout 2015, averaging about 2.9 percent for 10-year Treasuries and 4.6 percent for 30-year mortgages.

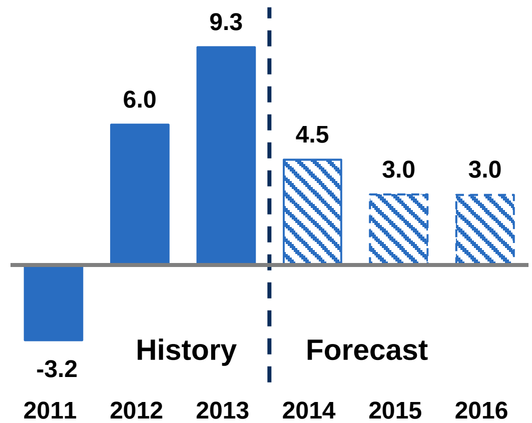
Interest Rates
Percentage Points
Source: Freddie Mac, Federal Reserve



Prices & Affordability

In addition to rising interest rates, we also expect house price gains to continue, albeit at a more moderate pace. Our current projection is for annual house price gains to slow from 9.3 percent in 2013, to 4.5 percent in 2014 and 3.0 percent in 2015. Continued house price appreciation and rising mortgage rates will dampen homebuyer affordability. Rising incomes could help to somewhat offset the effects of rising rates and increased house prices, but we expect income gains to be modest for most families in 2015. The result is declining affordability, but from very high levels to high levels in most local markets. However, rising interest rates and home prices will undoubtedly create an affordability pinch in much of the country. See our updated dynamic affordability map for more detail.

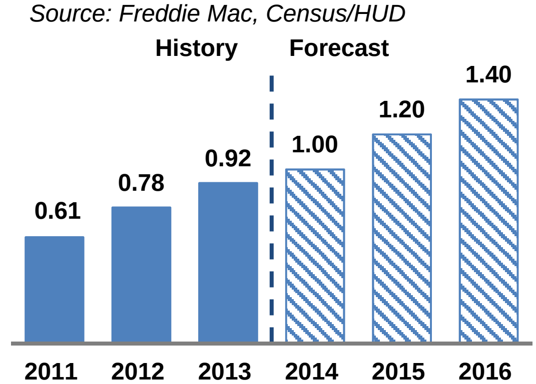
House Price Appreciation
Annual Percent Change
Source: Freddie Mac House Price Index



Home Sales/Starts

Look for housing activity to accelerate in 2015. We're forecasting total housing starts to increase by 20 percent from 2014 to 2015. We're also expecting to see total home sales increase by about 5 percent over that time period. While one-family homes will account for most of the construction pickup, rental apartment construction will also be up. Strengthening residential construction and improved home sales will help to bolster mortgage markets.

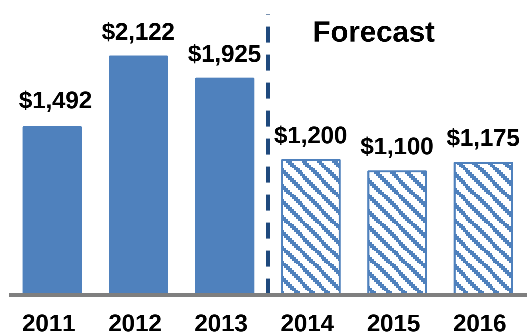
Total Housing Starts
Millions of Units
Source: Freddie Mac, Census/HUD



Single-family Originations

Increasing home sales are good news for mortgage markets. However, even with expected increases in purchase money volume, overall originations will fall due to sharply declining refinance activity. We saw refinance activity surge in 2012, with over $2.1 trillion in total single-family mortgage originations. But from 2012 to 2013 and from 2012 to 2014, total origination volume fell 9 percent and 38 percent, respectively. We expect originations will fall an

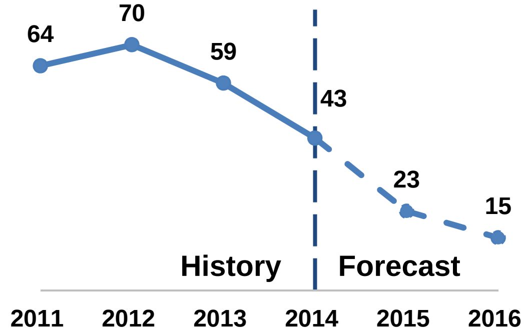
1-4 Family Mortgage Originations
Billions of Dollars
Source: Freddie Mac, FFIEC



additional 8 percent from 2014 to 2015, before rising home values and increasing purchase originations finally offset the decline in refinance volume and drive originations higher.

As we've indicated in our recent quarterly refinance [reports](), the refinance boom of the past few years is now over, and we expect the majority of new originations to be purchase-money originations for the next few years. In fact, with 30-year mortgage rates rising in 2015 and the average interest rate on debt outstanding currently about 3.9 percent (according to the Bureau of Economic Analysis), refinance activity will only comprise 20 to 25 percent of all mortgage activity in 2015.

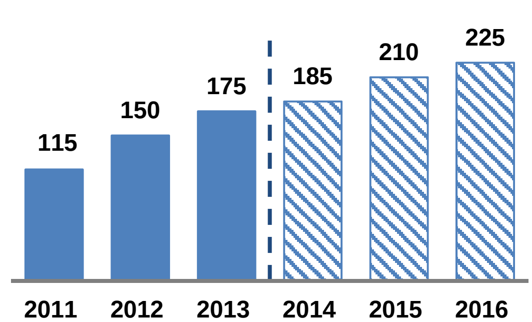
Refinance Share of Originations
Percentage Points
Source: Freddie Mac, FFIEC



Rentals in Demand

Rental markets are expected to remain tight in most urban markets across the U.S. in 2015 (for a recent update, see *Multifamily on the Move*, September 2014). As household formations pickup in 2015, rental apartments will generally be their first home. Rental vacancy rates remain at or near their lowest level since 2000, and rent growth exceeds inflation in most markets. That has prompted new development and property value gains, which has led to property sales and new mezzanine debt. Multifamily mortgage originations have risen about 60 percent between 2011 and 2014, and further increases in volume are anticipated in 2015.

Multifamily Mortgage Originations
Billions of Dollars
Source: Freddie Mac



Best wishes for a healthy and productive 2015.

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November 17, 2014

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November 2014 Economic and Housing Market Outlook

Revised 11/13/2014

	2013		2014				2015				Annual Totals						
Indicator	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Real GDP (%)	4.5	3.5	-2.1	4.6	3.5	**3.0**	**3.0**	**3.0**	**3.0**	**3.0**	2.7	1.7	1.6	3.1	**2.3**	**3.0**	**3.0**
Consumer Prices (%) a.	2.2	1.1	1.9	3.0	1.1	**1.0**	**1.5**	**2.0**	**2.0**	**2.0**	1.2	3.3	1.9	1.2	**1.8**	**1.9**	**2.0**
Unemployment Rate (%) b.	7.2	7.0	6.7	6.2	6.1	**5.8**	**5.7**	**5.6**	**5.5**	**5.4**	9.6	8.9	8.1	7.4	**6.2**	**5.6**	**5.3**
30-Year Fixed Mtg. Rate (%) b.	4.4	4.3	4.4	4.2	4.1	**4.0**	**4.2**	**4.5**	**4.7**	**5.0**	4.7	4.5	3.7	4.0	**4.2**	**4.6**	**5.5**
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	3.2	3.0	3.1	3.0	3.0	**3.0**	**3.2**	**3.4**	**3.7**	**3.9**	3.8	3.3	2.8	2.9	**3.0**	**3.6**	**4.6**
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	2.5	2.4	2.4	**2.5**	**2.5**	**2.6**	**2.7**	**2.8**	3.8	3.0	2.7	2.6	**2.5**	**2.7**	**3.1**
10-Year Const. Mat. Treas. Rate (%) b.	2.7	2.7	2.8	2.6	2.5	**2.3**	**2.5**	**2.8**	**3.0**	**3.3**	3.2	2.8	1.8	2.4	**2.6**	**2.9**	**3.9**
1-Year Const. Mat. Treas. Rate (%) b.	0.1	0.1	0.1	0.1	0.1	**0.1**	**0.2**	**0.3**	**0.6**	**1.0**	0.3	0.2	0.2	0.1	**0.1**	**0.5**	**2.5**

	2013		2014				2015				Annual Totals						
Indicator	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Housing Starts c.	0.88	1.03	0.93	0.99	1.02	**1.06**	**1.15**	**1.15**	**1.25**	**1.25**	0.59	0.61	0.78	0.92	**1.00**	**1.20**	**1.40**
Total Home Sales d.	5.71	5.39	5.03	5.29	5.57	**5.50**	**5.55**	**5.55**	**5.60**	**5.70**	4.51	4.57	5.03	5.50	**5.35**	**5.60**	**5.80**
FMHPI House Price Appreciation (%) e.	2.1	1.4	1.5	0.9	1.2	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**	-4.9	-3.2	6.1	9.3	**4.5**	**3.0**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	2.6	2.3	1.5	-0.3	**1.2**	**1.0**	**0.8**	**0.8**	**0.8**	**0.8**	-4.1	-3.7	6.6	10.8	**3.5**	**3.0**	**3.0**
1-4 Family Mortgage Originations g.																	
Conventional	$380	$260	**$198**	**$257**	**$282**	**$224**	**$224**	**$280**	**$216**	**$160**	$1,300	$1,206	$1,750	$1,570	**$961**	**$880**	**$928**
FHA & VA	$87	$59	$52	$63	$68	**$56**	**$56**	**$70**	**$54**	**$40**	$367	$286	$372	$355	**$239**	**$220**	**$247**
Total	$450	$350	**$250**	**$320**	**$350**	**$280**	**$280**	**$350**	**$270**	**$200**	$1,667	$1,492	$2,122	$1,925	**$1,200**	**$1,100**	**$1,175**
ARM Share (%) h.	9	10	11	11	10	**11**	**12**	**13**	**15**	**17**	5	11	10	9	**11**	**14**	**20**
Refinancing Share - Applications (%) i.	54	59	52	45	50	**45**	**40**	**25**	**18**	**15**	73	71	77	63	**48**	**25**	**15**
Refinancing Share - Originations (%) j.	49	43	**48**	**41**	**45**	**40**	**35**	**22**	**16**	**15**	67	64	70	59	**43**	**23**	**15**
Residential Mortgage Debt (%) k.	0.9	-0.5	-0.8	0.3	**1.0**	**2.0**	**2.5**	**3.0**	**3.0**	**3.5**	-4.2	-2.1	-1.7	-0.5	**0.6**	**3.0**	**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.
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; seasonally-adjusted; annual rates for yearly data.
f. National composite index (quarterly growth rate), seasonally-adjusted; annual rates 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. MBA Applications Survey: activity by dollars, total market refi share percent for United States (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 11/13/2014 (GTW); Send comments and questions to chief_economist@freddiemac.com.