



Timing Is Everything

Recent economic reports have had a far more positive tone than they did earlier in the year. Real GDP growth swung sharply less negative in the second quarter, to a 1.0 percent annualized decline versus the 6.4 percent plunge posted in the first quarter. Consensus forecasts call for real GDP growth to turn positive this quarter – forecasts generally range from plus 0.5 percent to over 3.0 percent. There is a dark cloud over this outlook, however, as labor market weakness remains a threat to the tentative signs of recovery. Indeed, most forecasters expect the unemployment rate to reverse July's slight decline and continue rising through the end of the year. How does the more optimistic overall economic outlook square with the job market picture?

First, let's consider some positives outside of improving real GDP figures. The ISM manufacturing activity index rose to 48.9 in July, the highest level since last August and close to the 50 mark that separates increasing versus decreasing activity. More importantly, the new orders and production components moved up to 55.3 and 57.9, respectively, signaling that factory output has turned the corner. As production increases, firms will need more workers.

In addition, productivity growth has been resilient over the past year, in contrast to most previous recessions. In the second quarter, non-farm productivity rose at a 6.4 percent annual rate, the highest rate since the third quarter of 2003, bringing it 1.8 percent above a year ago. Unit labor costs fell six-tenths of a percent versus a year ago, the first decline in production costs in half a decade. These developments reflect the fact that firms responded to the steep drop in demand by slashing excess labor. While this has been painful for workers, it suggests that further (large) cuts will be unnecessary, and leaves businesses in a stronger financial position to expand output and hiring as the economy turns.

Further, housing market trends have followed suit. Sales of both new and existing homes have flattened and have even been up in recent months. Housing starts have surprised on the upside. And, while the evidence here may be more preliminary, house prices have stopped falling in many markets during the second quarter.

Given these signs of improvement, why is the unemployment rate expected to go higher from its already elevated levels? Paradoxically, rising unemployment rates can at times reflect an actual improvement in labor market conditions. To see why, note that the U.S. Department of Labor publishes various measures of labor utilization. The well-known official statistic is the overall unemployment rate, which covers the entire civilian labor force, defined as any person actively seeking a job. Another is the insured unemployment rate, which reflects joblessness among workers who qualify for unemployment insurance after having been laid off.

As a recession deepens, people may become discouraged by the lack of available jobs, and drop out of the labor force. These people are no longer counted as unemployed, and the reported overall unemployment rate is artificially low. There is usually little impact on the



insured unemployment rate, though – the worker only receives an unemployment check if they are still looking for a job, which provides a powerful incentive to remain in the labor force. As job prospects improve, the process works in reverse as previously discouraged workers may re-enter the labor force, pushing the overall unemployment rate higher.

This phenomenon affects the timing of the peak in the unemployment rate. For example, in the recession in the early 1990s, the insured unemployment rate peaked in June 1991, while the overall unemployment rate did not top out until more than a year later, in July 1992. Earlier this decade, the overall unemployment rate kept rising for a full year after the insured rate leveled off in July 2002.

A similar trend may be underway today. The insured unemployment rate averaged 5.1 percent in June, but has since fallen to a 4.7 percent average for July. Indeed, the total number of people on unemployment insurance rolls has fallen to the lowest level since April. The overall unemployment rate slipped one-tenth in July, but only because 422,000 discouraged workers dropped out of the labor force. As hiring prospects begin to improve in the coming months, many of these workers are likely to renew their job search, pushing the overall unemployment rate back up.

With many major indicators turning less negative/more positive over the past few months, the question has changed from “when will the recovery begin?” to “now that it’s apparently starting, how vigorous will it be?” Only time will tell, but our current forecast is that the early stages will be tentative, until firms begin hiring again, household incomes start to rise, and confidence in business and job prospects solidifies.

Frank E. Nothaft
Chief Economist

Amy Crews Cutts
Deputy Chief Economist

Calvin Schnure
Economic Analysis Director

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August 2009 Economic and Housing Market Outlook



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Major Economic Indicators

Indicator	2008				2009				2010				Annual Totals					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2005	2006	2007	2008	2009	2010
Real GDP (%)	-0.7	1.5	-2.7	-5.4	-6.4	-1.0	2.0	3.0	3.0	3.0	3.5	3.5	2.7	2.4	2.5	-1.9	-0.6	3.3
Consumer Prices (%) a.	4.5	4.5	6.2	-8.3	-2.4	1.4	2.0	1.5	1.8	2.0	2.0	2.2	3.8	1.9	4.0	1.7	0.6	2.0
Unemployment Rate (%) b.	4.9	5.3	6.0	6.9	8.1	9.3	9.6	9.8	9.8	9.7	9.7	9.6	5.1	4.6	4.6	5.8	9.2	9.7
30-Year Fixed Mtg. Rate (%) b.	5.9	6.1	6.3	5.9	5.1	5.0	5.3	5.4	5.6	5.8	5.9	6.1	5.9	6.4	6.3	6.0	5.2	5.9
1-Year Treas. Indexed ARM Rate (%) b.	5.1	5.2	5.2	5.1	4.9	4.8	4.8	4.9	5.0	5.2	5.3	5.5	4.5	5.5	5.6	5.2	4.9	5.3
10-Year Const. Mat. Treas. Rate (%) b.	3.7	3.9	3.9	3.7	2.7	3.7	3.6	3.8	4.0	4.2	4.3	4.5	4.3	4.9	4.6	3.8	3.5	4.2
1-Year Const. Mat. Treas. Rate (%) b.	2.1	2.1	2.1	1.0	0.6	0.5	0.5	0.6	0.7	0.8	0.9	1.1	3.6	4.9	4.5	1.8	0.5	0.9

Housing and Mortgage Markets

Indicator	2008				2009				2010				Annual Totals					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2005	2006	2007	2008	2009	2010
Housing Starts c.	1.06	1.02	0.87	0.66	0.53	0.54	0.58	0.60	0.65	0.75	0.85	0.95	2.07	1.80	1.36	0.91	0.56	0.80
Total Home Sales d.	4.93	4.84	4.89	4.62	4.46	4.59	4.95	5.10	5.25	5.50	5.70	5.95	7.46	6.73	5.72	4.84	4.78	5.60
Conventional Mtg. Home Price Index (%) e.	-2.1	-7.5	-10.4	-1.0	3.6	-4.2	-5.0	-2.0	-2.5	-1.5	-1.5	-0.5	12.4	5.5	0.0	-5.3	-1.9	-1.5
S&P/Case-Shiller® Home Price Index (%) f.	-23.9	-8.5	-13.1	-26.4	-26.6	-10.0	-8.0	-7.0	-5.0	-3.0	-3.0	-1.0	14.7	-0.3	-8.6	-18.3	-12.9	-3.0
1-4 Family Mortgage Originations g.																		
Conventional	\$440	\$480	\$280	\$210	\$369	\$555	\$500	\$440	\$405	\$455	\$540	\$430	\$3,167	\$2,858	\$2,312	\$1,410	\$1,864	\$1,830
FHA & VA	\$46	\$70	\$90	\$84	\$96	\$120	\$125	\$95	\$100	\$110	\$125	\$105	\$90	\$80	\$120	\$290	\$436	\$440
Total	\$486	\$550	\$370	\$294	\$465	\$675	\$625	\$535	\$505	\$565	\$665	\$535	\$3,257	\$2,938	\$2,432	\$1,700	\$2,300	\$2,270
ARM Share (%) h.	8	8	8	3	1	3	2	2	3	4	5	6	31	21	10	7	2	5
Refinancing Share - Applications (%) i.	49	47	39	56	78	70	55	55	52	51	47	46	44	43	42	48	64	49
Refinancing Share - Originations (%) j.	54	52	43	58	80	74	59	59	58	57	53	54	48	47	49	52	68	56
Residential Mortgage Debt (%) k.	2.7	0.1	-1.1	-2.9	-0.2	0.0	1.0	1.0	2.0	4.0	6.0	5.0	13.3	11.1	7.1	-0.3	0.5	4.3

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 detached single-family homes; quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).

e. Annualized growth rate of Freddie Mac's Conventional Mortgage Home Price Index (CMHPI); not seasonally-adjusted

f. National composite index (annualized growth rate), not seasonally-adjusted

g. Billions of dollars (not seasonally-adjusted).

h. Federal Housing Finance Board (FHFB); quarterly averages of monthly shares 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 8/10/2009 (MAS); Send comments and questions to chief_economist@freddiemac.com.

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