



## Are We There Yet?

Children on long trips often cry out, “Are we there yet?” Economists and the public at large have been asking the same question about when the recession will end. With positive economic growth in the third quarter, a sharp decrease in monthly job losses, low interest rates and a stabilization of financial markets, the outlook has been improving steadily since early summer. Even in the housing sector, which was ground zero for many of the economic troubles during the crisis, signs are looking up. Total new and existing home sales have risen 36 percent through October from their January low, home prices have leveled off in many indexes and one-family construction has begun to ascend in some markets. We should be “there” soon if we aren’t already.

But many risks remain, and the uncertain effect of three forthcoming events could have a material impact on the housing recovery: the Fed’s eventual tightening of monetary policy, the end of the government’s MBS and GSE debt purchase programs, and the expiration of the home-buyer tax credits. Based on the Federal Open Market Committee’s statements, a market consensus has emerged that monetary tightening is not imminent; pricing of fed funds futures contracts indicate that markets expect the funds target to be unchanged over the next six months.

The other events are more immediate – Treasury MBS purchases will be completed by year-end and Fed purchases of MBS and Freddie Mac and Fannie Mae debt are scheduled to terminate by the end of the first quarter 2010, while home-purchase contracts need to be signed by next April 30 to qualify for the tax credits. The stabilization of the housing markets that has occurred to date has been sufficient to turn homebuyer sentiment from fear to guarded optimism, and to cause inventories to shrink, especially for moderately priced homes. The tax credits have likely caused some families to purchase a home earlier than they might have otherwise, thus moving sales forward in time and helping support the housing market. Offsetting this timing issue, though, high affordability and improved buyer sentiment are bolstering sales. Indeed, the 6.2 percent rise in new home sales in October mostly reflects contracts that will close after the original expiration date of the tax credit, indicating that underlying demand continues to firm and should be strong enough to weather the end of the credit next spring without a significant disruption. Additionally, many sales are to investors that do not qualify for the credits and many more are to buyers paying cash. For instance, a survey by Campbell Communications and *Inside Mortgage Finance* indicates that 23 percent of homes purchased in October were for cash and 15 percent went to investor buyers.

The end of the government’s MBS and GSE debt purchase program potentially poses the risk of a rise in mortgage rates relative to benchmark yields. Brian Sack, executive vice president at the Federal Reserve Bank of New York and manager of the Fed’s Open Market Account, addressed such concerns in a recent speech (“The Fed’s Expanded Balance Sheet,” December 2, 2009). A critical issue to the market response is whether the *flow* of Fed purchases has been



responsible for the decline in mortgage interest rates, or if it is the *stock* of MBS that the Fed holds in its portfolio that matters. To mitigate risks to the extent that the flow has had a significant impact, the Fed plans a gradual tapering of its MBS and debt purchases to allow “time for new investors (or perhaps previously displaced investors) to enter the MBS market in the place of Fed purchases.” Sack also notes that the Fed followed a similar tapering strategy to their purchases of Treasury securities, which ended with no adverse market response.

Sack noted that it is more likely that the stock of MBS in the Fed’s portfolio has had the greatest effect, because the Fed has removed a significant amount of duration and convexity from the private market. The Fed will continue holding these positions well beyond the date it stops purchasing more securities, leading Sack to conclude that the impact on financial markets – and on mortgage rates – will be manageable.

The Fed is planning quite carefully its exit strategy from the extraordinary programs it put in place to support the economy during the financial crisis. While there may well be some bumps along the way, the transition will likely be orderly. As a result, the economy will likely continue to gradually improve with steady real GDP growth in the 3 to 3.5 percent range next year, a cessation of job losses in the first quarter, a higher level of home sales next year, and a strengthening of housing starts in some markets. The effect of rising mortgage delinquencies remain another uncertainty, but the Making Home Affordable modification program has begun to gain traction in recent months and should help slow the foreclosure tide. If we’re lucky, we’ll soon be “there.”

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# December 2009 Economic and Housing Market Outlook



Office of the Chief Economist

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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	2006	2007	2008	2009	2010	2011
Real GDP (%)	-0.7	1.5	-2.7	-5.4	-6.4	-0.7	2.8	3.0	3.0	3.0	3.5	3.5	2.4	2.5	-1.8	-0.3	3.3	3.5
Consumer Prices (%) a.	4.5	4.5	6.2	-8.3	-2.4	1.3	3.6	2.0	1.3	1.5	1.5	1.7	1.9	4.0	1.7	1.1	1.5	2.0
Unemployment Rate (%) b.	4.9	5.3	6.0	6.9	8.1	9.3	9.6	10.2	10.2	10.0	9.7	9.5	4.6	4.6	5.8	9.3	9.9	9.0
30-Year Fixed Mtg. Rate (%) b.	5.9	6.1	6.3	5.9	5.1	5.0	5.2	4.9	4.9	5.3	5.6	5.9	6.4	6.3	6.0	5.0	5.4	6.0
1-Year Treas. Indexed ARM Rate (%) b.	5.1	5.2	5.2	5.1	4.9	4.8	4.7	4.6	4.7	4.9	5.0	5.1	5.5	5.6	5.2	4.8	4.9	5.1
10-Year Const. Mat. Treas. Rate (%) b.	3.7	3.9	3.9	3.7	2.7	3.7	3.5	3.3	3.5	3.7	4.0	4.3	4.9	4.6	3.8	3.3	3.8	4.5
1-Year Const. Mat. Treas. Rate (%) b.	2.1	2.1	2.1	1.0	0.6	0.5	0.5	0.4	0.5	0.6	0.8	0.9	4.9	4.5	1.8	0.5	0.7	0.9

## Housing and Mortgage Markets

Indicator	2008				2009				2010				Annual Totals					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2006	2007	2008	2009	2010	2011
Housing Starts c.	1.06	1.02	0.87	0.66	0.53	0.54	0.59	0.55	0.60	0.72	0.85	0.95	1.80	1.36	0.91	0.55	0.78	1.20
Total Home Sales d.	4.93	4.84	4.89	4.62	4.46	4.61	5.06	5.30	5.50	5.50	5.50	5.50	6.73	5.72	4.84	4.86	5.50	6.10
Conventional Mtg. Home Price Index (%) e.	-1.8	-7.9	-10.3	-0.7	3.9	-10.1	-8.1	-2.0	-2.5	-1.5	-1.5	-0.5	5.4	-0.1	-5.3	-4.1	-1.5	1.0
S&P/Case-Shiller® Home Price Index (%) f.	-23.7	-8.3	-13.4	-26.5	-26.5	12.8	13.2	-7.0	-5.0	-3.0	-3.0	-1.0	-0.3	-8.5	-18.3	-1.9	-3.0	0.0
1-4 Family Mortgage Originations g.																		
Conventional	\$440	\$405	\$255	\$210	\$354	\$460	\$396	\$293	\$311	\$354	\$419	\$336	\$2,858	\$2,312	\$1,310	\$1,503	\$1,420	\$1,639
FHA & VA	\$46	\$70	\$90	\$84	\$96	\$125	\$119	\$107	\$94	\$106	\$126	\$104	\$80	\$120	\$290	\$447	\$430	\$361
Total	\$486	\$475	\$345	\$294	\$450	\$585	\$515	\$400	\$405	\$460	\$545	\$440	\$2,938	\$2,432	\$1,600	\$1,950	\$1,850	\$2,000
ARM Share (%) h.	8	8	8	3	1	3	4	4	4	4	5	6	21	10	7	3	5	10
Refinancing Share - Applications (%) i.	49	47	39	56	78	70	59	65	60	50	40	30	43	42	48	68	45	39
Refinancing Share - Originations (%) j.	64	53	39	51	82	75	65	70	65	55	45	35	47	49	54	73	50	44
Residential Mortgage Debt (%) k.	2.9	-0.1	-1.1	-3.1	-0.4	-1.6	-3.1	-1.0	0.0	1.0	2.0	3.0	11.1	7.1	-0.3	-2.3	1.5	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 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 12/10/2009 (MAS); Send comments and questions to chief\_economist@freddiemac.com.

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