



A Brighter Outlook for the Year Ahead

The economic outlook anticipates real GDP growth of 3-to-3.5 percent as the still-fragile recovery gradually gains more solid footing by year-end. The jobs picture will improve with some delay, though, as many employers postpone hiring until their business picks up further. The housing market showed broad signs of stabilizing in the second half of last year, although risks of retrenchment remain high in the face of the heavy flow of foreclosures and REO, potentially depressing prices further in the hardest-hit areas. At the national level, we expect the housing market to weather the growth in distressed sales without further significant setbacks, though risks remain.

Is such a view of recovery justified? Yes, considering current conditions and economic policies as well as the lessons from past business cycles. This scenario does assume that there is no further flare-up of financial crisis. This appears a reasonable expectation, as conditions in most parts of the market are on the mend. Many risk spreads are returning to pre-crisis normal and corporate bond markets have largely recovered. In December the first commercial mortgage-backed security (CMBS) was issued without TALF backing since mid-2008; however, the private-label single-family MBS market is still largely frozen.

The pace of recovery in this forecast is well below the growth following most recessions over the past half-century. For example, following the 1974-75 recession and the double-dip recessions in the early 1980s, economic growth surged 7 percent or more for sustained periods, more than twice the pace we expect over the coming year. Seen in this light, the question is not whether the outlook is optimistic, but rather why do we expect such a subdued performance? The answer is that the aftereffects of the financial crisis—the high rate of mortgage defaults and the growing inventory of loans in foreclosure, weakened bank balance sheets and corresponding reluctance to lend, and depressed household net worth—remain a drag.

Macroeconomic policies aimed at offsetting these drags are providing support for the recovery. About one-third of the \$787 billion of fiscal stimulus money was spent or went to Americans in the form of tax deductions during 2009; including funds obligated for projects and activities brought the total funds committed to about one-half of the total. Thus, most of the rest will flow into the economy this year, bolstering private spending. Monetary policy is extremely accommodative, and FOMC statements have signaled that target interest rates are likely to remain “extraordinarily low” until the economy (and labor markets) improve. The Fed has also stated that most of the liquidity facilities put into place during the crisis will continue to wind down. Private markets, however, appear ready to reassume their role, eliminating the need for these facilities going forward.

The passing of the original deadline for the first-time homebuyers' tax credit last November clouds the near-term picture of housing market trends. Home sales surged late last year in advance of the planned end of the credit and may experience a temporary slowdown as many potential buyers who would normally have bought a home in early 2010 rushed to close before



the end of November. Initial reports of housing activity are consistent with such a decline. The Mortgage Bankers Association reports that mortgage applications for home purchase declined 20 percent in December, relative to its third quarter average, while the National Association of Realtors reported a 16 percent decline in pending home sales in November (the weakness in pending home sales even prior to the original expiration of the tax credit could be due to the length of time from when a contract is signed until closing; a lower level of closings in December would imply fewer pending contracts in November). Because the tax credit has been extended through the spring (and broadened to include existing home buyers), it is likely that additional buyers will accelerate their purchase decisions into the first half of 2010, leading to a rebound in sales.

Even with the pickup in sales, single-family mortgage originations are projected to be about 10 percent lower in 2010 compared with last year. The decline in originations are driven by lessened refinance activity as the refinance share is projected to slip from approximately two-thirds of lending last year to just over one-half of 2010's volume. ARM volume is anticipated to continue to be muted as borrowers prefer the steady principal-and-interest payments of a fixed-rate loan in a market where the interest-rate differential relative to ARMs is small. Interest rates for 30-year fixed-rate loans are projected to largely remain in the 5-to-6 percent range through this year, marking a continuation of a relatively low-rate environment that will support the housing market recovery.

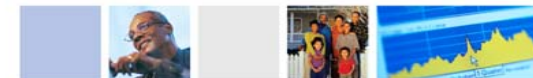
Frank E. Nothaft
Chief Economist

Amy Crews Cutts
Deputy Chief Economist

Calvin Schnure
Economic Analysis Director

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January 2010 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	2.2	4.0	3.5	3.5	3.3	3.3	2.4	2.5	-1.9	-0.2	3.4	3.5
Consumer Prices (%) a.	4.5	4.5	6.2	-8.3	-2.4	1.3	3.6	3.8	1.5	1.5	1.5	1.5	1.9	4.0	1.7	1.6	1.5	2.0
Unemployment Rate (%) b.	4.9	5.3	6.0	6.9	8.1	9.3	9.6	10.0	10.3	10.1	9.8	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	5.1	5.5	5.8	6.0	6.4	6.3	6.0	5.0	5.6	6.2
1-Year Treas. Indexed ARM Rate (%) b.	5.1	5.2	5.2	5.1	4.9	4.8	4.7	4.4	4.5	4.9	5.2	5.5	5.5	5.6	5.2	4.7	5.0	5.3
10-Year Const. Mat. Treas. Rate (%) b.	3.7	3.9	3.9	3.7	2.7	3.7	3.5	3.5	3.7	3.9	4.2	4.4	4.9	4.6	3.8	3.4	4.1	4.8
1-Year Const. Mat. Treas. Rate (%) b.	2.1	2.1	2.1	1.0	0.6	0.5	0.5	0.4	0.7	0.8	1.0	1.1	4.9	4.5	1.8	0.5	0.9	1.3

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	5.05	5.80	5.50	5.50	5.50	5.50	6.73	5.72	4.84	4.98	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	\$285	\$328	\$392	\$308	\$2,858	\$2,312	\$1,310	\$1,503	\$1,313	\$1,440
FHA & VA	\$46	\$70	\$90	\$84	\$96	\$125	\$119	\$107	\$96	\$108	\$128	\$105	\$80	\$120	\$290	\$447	\$437	\$360
Total	\$486	\$475	\$345	\$294	\$450	\$585	\$515	\$400	\$381	\$436	\$520	\$413	\$2,938	\$2,432	\$1,600	\$1,950	\$1,750	\$1,800
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	66	65	55	45	35	43	42	48	68	50	39
Refinancing Share - Originations (%) j.	64	53	39	51	78	70	59	66	70	60	50	40	47	49	54	68	55	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	-1.5	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 1/10/2010 (MAS); Send comments and questions to chief_economist@freddiemac.com.

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