



## What makes "green shoots" grow?

The economy remains in recession. GDP fell at a 5.7 percent annualized rate during the first quarter, not a meaningful improvement from the 6.3 percent decline in the fourth quarter. Jobs are still disappearing at a rapid pace, and unemployment is high and still rising. What makes us expect a turnaround later this year?

Trends in consumer spending and business inventories hold the key. In the fourth quarter, falling consumer spending subtracted 3 percentage points from GDP growth, while inventory investment had little impact. Last quarter, in contrast, consumer spending stabilized and managed a slight rebound, making a positive 1.1 percentage point contribution to GDP growth. Inventory liquidation, meanwhile, shaved 2.3 percentage points from GDP growth and is currently the greatest single negative factor in the economy.

A turn in the inventory cycle will be the most important economic event in coming months. As the economy stalled last year, manufacturers' inventory-to-sales ratio jumped from 1.2 months to 1.45 months. In response, firms slashed production to clear excess inventories, leading directly to extensive job losses. Because of the production cuts, though, manufacturers' inventories have fallen 7 percent from their summer 2008 peak. At this rate, inventories will have fallen to 2005 levels by the end of this year, even without further decreases in production.

As inventories get leaner and leaner, firms will need to step up production just to meet sales. This will stem the job losses, giving consumers more spending power and prompting businesses to renew investment in plant and equipment. Macroeconomic policies are also supporting the turnaround, as the Fed's monetary stance is highly accommodative, and the fiscal stimulus has begun to kick in. Barring another financial catastrophe, it is more and more likely that the macroeconomic outlook will be appreciably better by year-end.

There is a similar dynamic at work with our housing market forecast. While residential fixed investment subtracted more than a percentage point from GDP growth, on average, in 2008:Q4 and 2009:Q1, this drag on the macro economy will diminish and then be reversed as construction picks up. Indeed, we expect housing starts to rise 60 percent next year. Far from being a wide-eyed optimistic forecast, though, such an increase would still leave starts some 20 percent below the worst annual total (prior to 2009!) since the Census Bureau began keeping records in 1959. Despite the high growth rate we expect, starts are at such a low base that they do not come close to matching the rate of household formation. The number of households in the United



States has been increasing an average of one million or more per year. Our projection of starts totaling 500,000 this year and 800,000 next year implies that U.S. households would fairly quickly “grow into” the excess housing that was built during the boom years. As excess inventory disappears from the market over this year and next, home prices and housing starts will gradually firm. But keep your fingers crossed.

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# June 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	2005	2006	2007	2008	2009	2010
Real GDP (%)	0.9	2.8	-0.5	-6.3	-5.7	-1.5	1.0	2.0	2.5	3.0	3.0	3.5	2.7	2.4	2.3	-0.8	-1.1	3.0
Consumer Prices (%) a.	4.5	4.5	6.2	-8.3	-2.4	0.8	1.5	1.5	1.8	2.0	2.0	2.2	3.8	1.9	4.0	1.7	0.4	2.0
Unemployment Rate (%) b.	4.9	5.3	6.0	6.9	8.1	9.5	9.7	9.7	9.8	9.8	9.7	9.6	5.1	4.6	4.6	5.8	9.3	9.7
30-Year Fixed Mtg. Rate (%) b.	5.9	6.1	6.3	5.9	5.1	4.9	5.3	5.3	5.4	5.5	5.7	5.9	5.9	6.4	6.3	6.0	5.1	5.6
1-Year Treas. Indexed ARM Rate (%) b.	5.1	5.2	5.2	5.1	4.9	4.8	4.8	4.9	4.9	5.1	5.3	5.5	4.5	5.5	5.6	5.2	4.8	5.2
10-Year Const. Mat. Treas. Rate (%) b.	3.7	3.9	3.9	3.7	2.7	3.4	3.8	3.8	4.0	4.1	4.3	4.5	4.3	4.9	4.6	3.8	3.4	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	0.9	1.0	1.2	3.6	4.9	4.5	1.8	0.6	1.0

## 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	0.46	0.47	0.55	0.65	0.75	0.85	0.95	2.07	1.80	1.36	0.91	0.50	0.80
Total Home Sales d.	4.93	4.84	4.89	4.62	4.46	4.70	4.85	5.00	5.15	5.40	5.60	5.85	7.46	6.73	5.72	4.84	4.75	5.50
Conventional Mtg. Home Price Index (%) e.	-2.1	-7.5	-10.4	-1.0	3.6	-5.0	-5.0	-2.0	-2.5	-1.5	-1.5	-0.5	12.4	5.5	0.0	-5.3	-2.1	-1.5
S&P/Case-Shiller® Home Price Index (%) f.	-23.9	-8.5	-13.1	-26.4	-26.6	-14.0	-10.0	-7.0	-5.0	-3.0	-3.0	-1.0	14.7	-0.3	-8.6	-18.3	-14.4	-3.0
1-4 Family Mortgage Originations g.																		
Conventional	\$440	\$480	\$280	\$210	\$370	\$603	\$753	\$512	\$385	\$435	\$520	\$410	\$3,167	\$2,858	\$2,312	\$1,410	\$2,238	\$1,750
FHA & VA	\$46	\$70	\$90	\$84	\$96	\$128	\$137	\$102	\$95	\$105	\$120	\$105	\$90	\$80	\$120	\$290	\$463	\$425
Total	\$486	\$550	\$370	\$294	\$466	\$730	\$890	\$614	\$480	\$540	\$640	\$515	\$3,257	\$2,938	\$2,432	\$1,700	\$2,700	\$2,175
ARM Share (%) h.	8	8	8	3	1	2	2	2	3	4	5	6	31	21	10	7	2	5
Refinancing Share - Applications (%) i.	49	47	39	56	78	71	70	60	52	51	47	46	44	43	42	48	70	49
Refinancing Share - Originations (%) j.	54	52	43	58	80	75	74	64	58	57	53	54	48	47	49	52	73	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 6/8/2009 (MAS); Send comments and questions to chief\_economist@freddiemac.com.

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