



Show Me the Money

Sales of new and existing homes soared in March, and a rise in pending home sales contracts suggests the strength will carry over through the spring. Just as occurred last fall, the impending expiration of the homebuyers' tax credit has prompted a flurry of last-minute transactions. The key question is, how much will sales drop off in its aftermath?

We can get some clues from recent trends in mortgage activity. The MBA's index of mortgage applications for home purchase is generally a noisy confirmation of trends that are already observable in home sales, but lately it has been providing important insights into the outlook for home sales. Purchase applications rose relative to sales trends around mid-2007 for a number of reasons. Most importantly, tighter standards led buyers to submit multiple applications while lenders rejected a higher share of applications.

The relationship between purchase applications and sales changed again in 2009 as sales rose while applications continued falling. Cash purchases, especially investors in distressed sales, accounted for much of the widening differential. According to the National Association of Realtors, all-cash sales have ranged between 20 percent and 30 percent of all transactions over the past year, considerably above the cash share in earlier periods.

The homebuyers' tax credit has induced considerable short-term shifts in both home purchases and mortgage applications. Last fall, purchase applications rose 15 percent or more ahead of the tax credit's original expiration date, then fell back in subsequent months. Sales followed a similar pattern, with an important difference: They remained well above the levels exhibited in early 2009, boosted by an improving job market, rising confidence and continued low interest rates.

Purchase applications recently rose again, ahead of the April deadline for signing a contract to qualify for the extended tax credit. The rise has been more subdued than the jump last summer, though. In part this could reflect a smaller pool of buyers who meet the criteria for the tax credit, are interested in buying, have money for a down payment and qualify for financing. That is, many of the potential buyers whose purchases could be pulled forward already took advantage of the tax credit before the original expiration date last fall. To the extent that the recent deadline affected the timing of fewer home purchase, the slowdown of home sales in its aftermath may be more modest.

On the other hand, cash investors have played an important role in the recent surge in transactions. Cash buyers help provide a floor price for distressed sales, but are also more sensitive to price and tax incentives. This suggests that sales may drop sharply once the effect of the tax credit is gone. On balance, we expect sales in the months ahead to follow the pattern set last fall, where they slow from the peaks caused by the tax-credit deadline, but settling at a rising trend from last year.



The reason to expect this relatively benign outcome is that, despite short-term swings in sales activity, the underlying fundamentals for housing markets are steadily improving. The job market report for April showed a rise in nonfarm payrolls of 290,000, the largest new hiring in four years. While temporary Census workers accounted for 66,000 jobs, private payrolls posted a respectable gain of 231,000. The other “headline” figure in the report—the unemployment rate—gave a head fake by rising two tenths, to 9.9 percent. Somewhat paradoxically, this was due to improved labor market conditions, which attracted over 800,000 job seekers back into the labor force. A broader measure of employment that is not affected by changes in labor force participation, the employment-to-population ratio, rose two tenths of a percent. Overall, labor market trends are looking much better than a few months ago. More robust job growth and the incomes this will bring should directly contribute to the housing market recovery, and will likely also have further indirect effects by boosting household confidence.

No discussion of the economic outlook would be complete without some mention of the Greek fiscal crisis and the recent turmoil it caused in global financial markets. The situation remains in flux and could change considerably in the months ahead, but as this article goes to press, markets across the globe were rallying after measures to stem the spread of the crisis were announced by European finance ministers, the European Central Bank and the International Monetary Fund.

With this recent turmoil still fresh in mind, it is important to note two lessons from history. First, the crisis of 2008 showed that a sudden plunge in investor confidence can spread far faster, wider and more severely than ever anticipated. The second lesson goes back three-quarters of a century. U.S. authorities, in an effort to remove stimulative policies before the recovery was well established, raised taxes and interest rates in 1936. The moves were premature, however, and the economy began contracting again, with a sustainable recovery delayed for several more years. Today’s policymakers appear well aware of both of these lessons, suggesting that low interest rates will continue to bolster the housing market as well as the economy overall for an “extended” period.

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Major Economic Indicators

Indicator	2008		2009				2010				2011		Annual Totals					
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	2006	2007	2008	2009	2010	2011
Real GDP (%)	-2.7	-5.4	-6.4	-0.7	2.2	5.6	3.2	4.0	3.3	3.3	3.5	3.5	2.4	2.5	-1.9	0.1	3.5	3.5
Consumer Prices (%) a.	6.4	-9.2	-2.2	1.9	3.7	2.6	1.5	1.5	1.5	1.5	1.7	2.0	1.9	4.0	1.6	1.5	1.5	2.0
Unemployment Rate (%) b.	6.0	6.9	8.1	9.3	9.6	10.0	9.7	9.9	9.6	9.3	9.1	8.9	4.6	4.6	5.8	9.3	9.6	8.8
30-Year Fixed Mtg. Rate (%) b.	6.3	5.9	5.1	5.0	5.2	4.9	5.0	5.1	5.4	5.5	5.7	5.9	6.4	6.3	6.0	5.0	5.3	6.0
1-Year Treas. Indexed ARM Rate (%) b.	5.2	5.1	4.9	4.8	4.7	4.4	4.3	4.2	4.3	4.4	4.5	4.6	5.5	5.6	5.2	4.7	4.3	4.6
10-Year Const. Mat. Treas. Rate (%) b.	3.9	3.7	2.7	3.7	3.5	3.5	3.7	3.9	4.0	4.1	4.2	4.4	4.8	4.6	3.7	3.3	3.9	4.5
1-Year Const. Mat. Treas. Rate (%) b.	2.1	1.0	0.6	0.5	0.5	0.4	0.4	0.5	0.6	0.8	0.9	1.0	4.9	4.5	1.8	0.5	0.6	1.3

Housing and Mortgage Markets

Indicator	2008		2009				2010				2011		Annual Totals					
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	2006	2007	2008	2009	2010	2011
Housing Starts c.	0.87	0.66	0.53	0.54	0.59	0.56	0.62	0.65	0.70	0.75	0.90	1.00	1.80	1.36	0.91	0.55	0.68	1.10
Total Home Sales d.	4.89	4.59	4.47	4.63	5.05	5.61	4.85	5.60	5.50	5.50	5.70	6.00	6.73	5.72	4.84	4.94	5.36	6.10
Conventional Mtg. Home Price Index (%) e.	-10.4	-0.9	4.2	-10.0	-8.1	-2.8	-4.9	-1.5	-1.5	-0.5	-0.5	-0.4	5.3	-0.2	-5.4	-4.3	-2.1	1.0
S&P/Case-Shiller® Home Price Index (%) f.	-13.4	-26.3	-26.4	12.7	13.9	-4.4	-5.0	-3.0	-2.0	-1.0	-0.5	-0.2	-0.3	-8.4	-18.2	-2.5	-2.8	0.0
1-4 Family Mortgage Originations g.																		
Conventional	\$255	\$210	\$354	\$460	\$396	\$339	\$255	\$295	\$310	\$240	\$240	\$275	\$2,858	\$2,312	\$1,310	\$1,549	\$1,100	\$1,150
FHA & VA	\$90	\$84	\$96	\$125	\$119	\$111	\$92	\$106	\$116	\$86	\$90	\$100	\$80	\$120	\$290	\$451	\$400	\$350
Total	\$345	\$294	\$450	\$585	\$515	\$450	\$347	\$401	\$426	\$326	\$330	\$375	\$2,938	\$2,432	\$1,600	\$2,000	\$1,500	\$1,500
ARM Share (%) h.	8	3	1	3	4	5	4	4	5	6	7	9	21	10	7	3	5	10
Refinancing Share - Applications (%) i.	39	56	78	70	59	74	72	55	35	25	25	25	43	42	48	70	47	25
Refinancing Share - Originations (%) j.	36	47	75	69	61	77	77	60	40	30	30	30	47	49	50	70	52	30
Residential Mortgage Debt (%) k.	-1.3	-3.1	-0.3	-1.6	-3.1	-2.3	0.0	1.0	2.0	3.0	3.0	4.0	11.1	7.1	-0.4	-1.9	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)

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