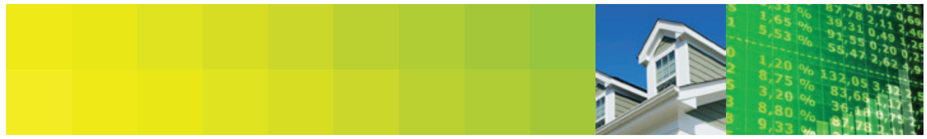


APRIL 2016

Economic outlook darkens, but housing remains bright spot

Recent data darkened the growth outlook for the first quarter of 2016. However, despite the disappointing economic reports, we still forecast housing to maintain its momentum in 2016.

We've revised down our forecast for economic growth to reflect the recent data for the first quarter, but our outlook for the balance of the year remains modestly optimistic for the economy.

We maintain our positive view on housing. In fact, the declines in long-term interest rates that accompanied much of the recent news should increase mortgage market activity, particularly refinance.

Growth outlook darkens

Data on the U.S. economy have painted a bleak picture of first quarter economic growth over the past few weeks. Consumer spending, manufacturing, auto sales, trade, and retail sales have led to successive downward revisions in the first quarter 2016 real GDP growth estimates. For example, the Federal Reserve Bank of Atlanta's GDPNow estimate of first quarter 2016 real GDP growth stood at 1.4 percent on March 24. By April 13, incoming data led to a revised estimate of 0.3 percent, a 1.1 percentage point reduction.

Alternative forecasts, such as the newly released Nowcast from the Federal Reserve Bank of New York are more upbeat. The Nowcast for first quarter 2016 Real GDP growth was 1.1 percent as of April 8, 2016. The Wall Street Journal Economic Forecasting Survey, a survey of more than 60 economists, reported[1] projected first quarter 2016 growth of 1.3 percent.

Forecast Snapshot (April 2016)

Summary (annualized)	2015	2016	2017
30-year PMMS (%)	3.9	4.0	4.7
Total home sales (M)	5.75	5.92	6.16
House price growth (%)	6.2	4.8	3.5
Total originations ($B)	1,750	1,700	1,460

1 As of April 1, 2016

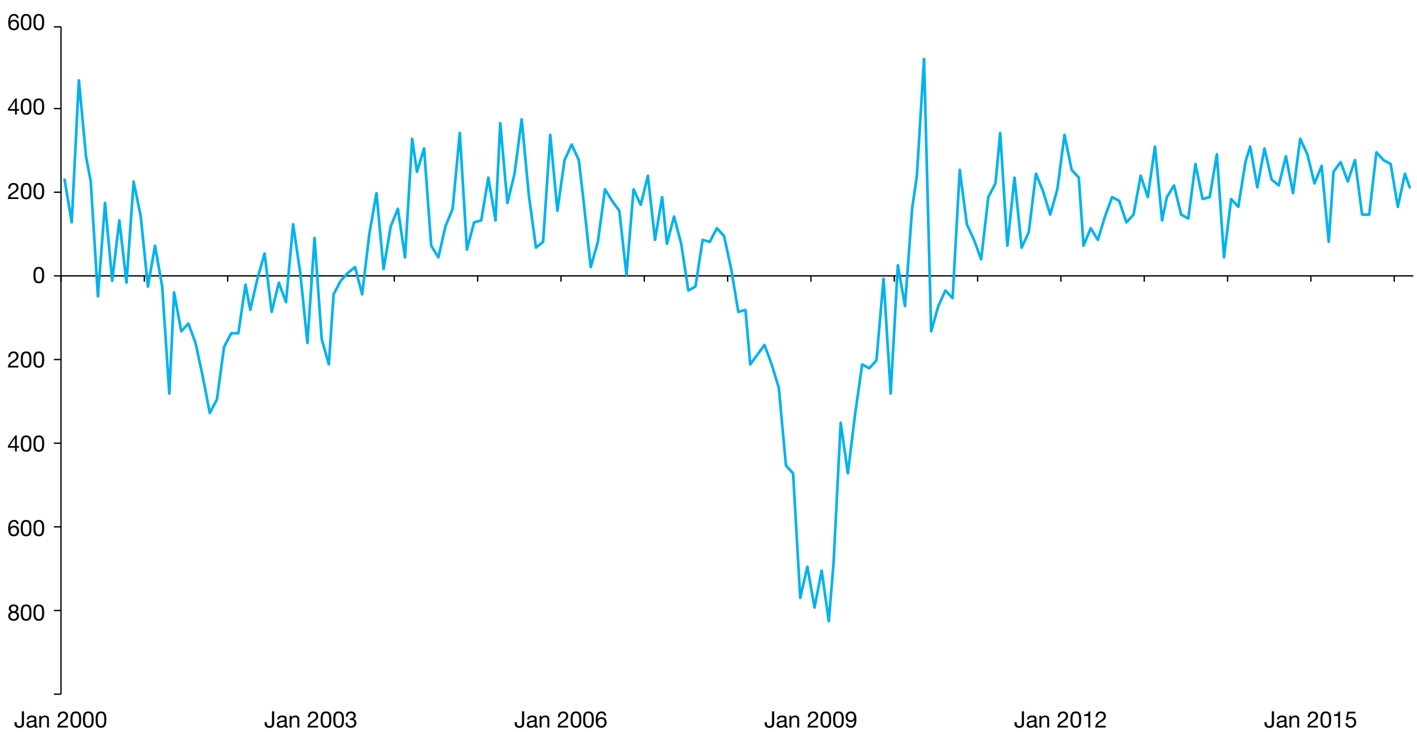
Based on new data, we have revised down our forecast from 1.8 to 1.1 percent for first quarter 2016 real GDP growth. Despite the slow start to the year, we expect consumer spending, wage growth, and residential and business investment to pick up in subsequent quarters and make up for weak first quarter growth. Our projections show GDP growth to be 2 percent for 2016 and 2.3 percent for 2017.

Solid job gains, but where's the wage growth?

Job growth has been solid (Exhibit 1), with an average of over 200,000 net job gains per month since 2011. The employment report from the Bureau of Labor Statistics reported net nonfarm payroll growth of 215,000 in March 2016, following a revised 245,000 added jobs in February. But despite declines in unemployment and solid job gains, wage growth has yet to materialize.

EXHIBIT 1

On average in the last year the US economy added over 200,000 jobs monthly



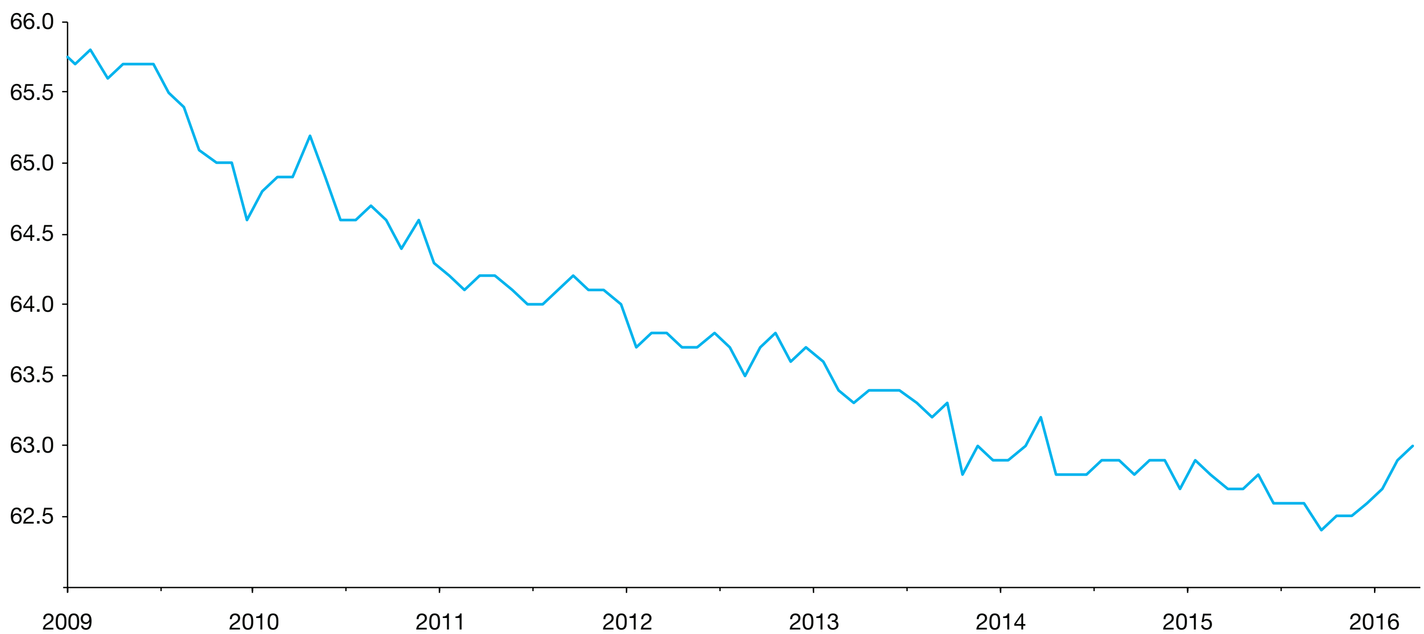
Source: Bureau of Labor Statistics, Change in Nonfarm Payrolls (Thousands).

Wage growth has been slow to materialize at least partially due to remaining slack in the labor market. In March 2016 the labor force participation rate rose to 63 percent, up 0.6 percentage points since September 2015. The rebound in labor force participation (Exhibit 2) reflects discouraged workers returning to the labor market.

Discouraged workers are not in the labor force and therefore are not reflected in the national unemployment statistics. As the labor market expands and job opportunities increase, more discouraged workers return to the labor force. The 0.6 percentage point increase in labor force participation since September 2015 means the labor force has 1.5 million more individuals than if the rate had held steady at the September 2015 level. The expansion of the labor force more than offset the job gains over that time period, so the unemployment rate ticked up 0.1 percentage points to 5 percent in March 2016.

EXHIBIT 2

The decline in labor force participation has accelerated



Source: Bureau of Labor Statistics, Labor Force Participation (%).

How much additional slack is left in the labor force? Last month we pointed to analysis from Goldman Sachs that claimed the participation rate had nearly recovered the entire cyclical decline in the participation rate—the portion of the decline due to the recession and its aftermath—and the rest of the decline was due to demographics and other structural factors. The recent rally in the labor force participation rate suggests there is remaining slack in the labor market, but probably not too much more. Both the median weeks unemployed of unemployed workers, and the share of all unemployed workers who have been unemployed 27 weeks or more, have been declining (Exhibit 3). During the Great Recession these measures reached historical highs, but have been receding rapidly in recent months.

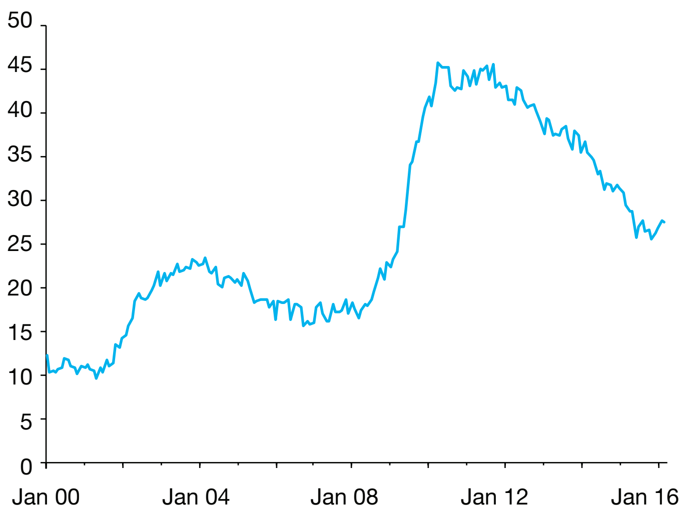
We expect the labor market to sustain its momentum and the unemployment rate to drop back below 5 percent for 2016 and 2017. Stronger economic growth for the remainder of 2016 and reduced slack in the labor market will drive wage gains above inflation, though the gains are likely to be modest.

Housing will be an engine of growth

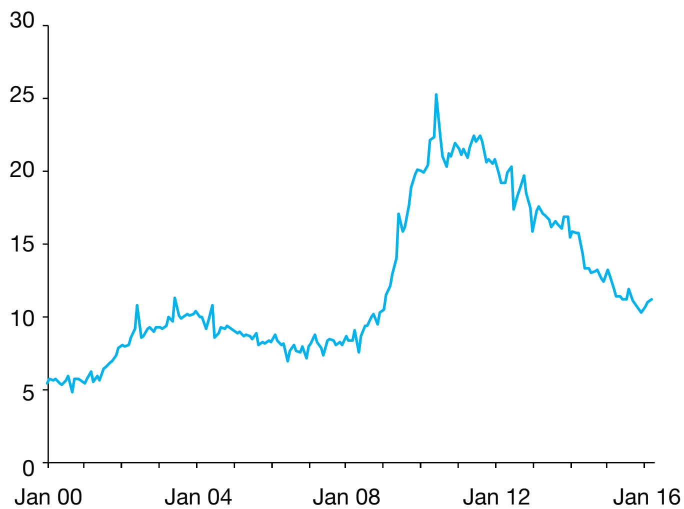
With overall economic growth slowing in the first quarter, how do we remain sanguine about economic and job growth for the balance of this year? We expect housing to be an engine of growth. Construction activity will pick up as we enter the spring and summer months, and rising home values will bolster consumers and help support renewed confidence in the remaining months of this year.

EXHIBIT 3

Long-term unemployment declining, but still high relative to history



Source: U.S. Bureau of Labor Statistics, Unemployed: Of total unemployed - % unemployed 27 Weeks & over, (%, SA).



Source: U.S. Bureau of Labor Statistics, Median Weeks unemployed: Total, (Weeks, SA).

Low mortgage rates support housing and mortgage markets

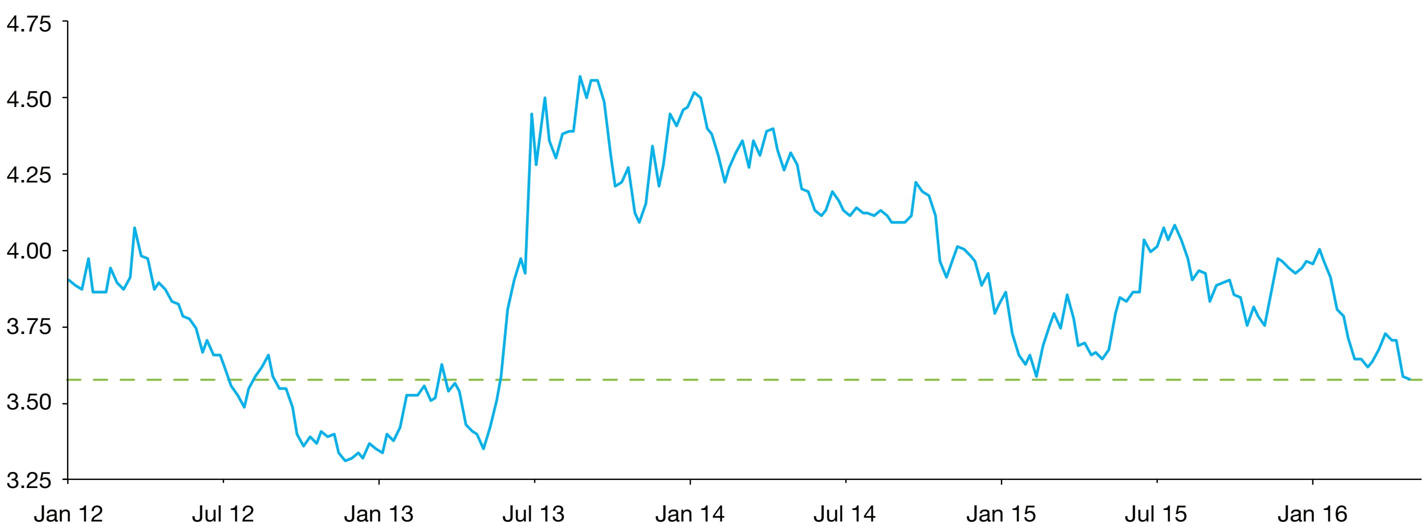
As of April 14, 2016, the national average for the 30-year fixed mortgage rate in the weekly Primary Mortgage Market Survey was 3.58 percent, the lowest since May of 2013. Mortgage rates have followed U.S. Treasuries closely, with the mortgage rate decline almost entirely a function of declining Treasury yields. As goes the 10-year Treasury, so too shall go the 30-year fixed mortgage rate.

The global economic slowdown along with falling oil prices spurred a flight-to-quality to U.S. Treasuries. Furthermore, the Federal Open Market Committee's apprehensive tone about future rate hikes has further sunk Treasury yields. Over the 15 weeks from January 4, 2016, to April 14, 2016, the yield on the 10-year Treasury has declined 44 basis points.

As a result, the 30-year fixed mortgage rate has fallen more than 40 basis points since the beginning of 2016 (Exhibit 4). For the first quarter, the 30-year rate averaged 3.7 percent, and we've lowered our forecasts for subsequent quarters by a tenth of a percent. We now expect rates to average 4 percent in 2016. However, we still expect the FOMC to raise short-term rates twice in 2016. Our forecast reflects this and recent movements in the 1-year Treasury as we increased our 1-year constant maturity rate forecast by a tenth of a percent for 2016 and 2017.

EXHIBIT 4

Mortgage rates lowest in almost 3 years



Source: Freddie Mac, Primary Mortgage Market Survey® (PMMS®) (U.S. Weekly Averages).

Home sales expected to be best since 2006

Low mortgage rates and job growth will support the most home sales since 2006. Sales were slow in the first quarter, but trends in mortgage purchase applications remain robust and we expect home sales to accelerate throughout the second quarter of 2016 as we approach peak homebuying season.

Chronically low levels of for-sale inventory remain a challenge for home sales. Reports from across the country[2] indicate that many markets have low levels of available homes for-sale. National data from the National Association of Realtors® shows that the number of existing homes for sale has remained flat over the past three years even as the number of home sales has accelerated (Exhibit 5 left). For new homes the joint release by Census and the Department of Housing and Urban Development shows (Exhibit 5 right) only 236,000 new homes available for sale in February 2016 (not seasonally adjusted).

2 See e.g. Current Economic Conditions by Federal Reserve District. Federal Reserve, Apr. 2016.

Martin, Troy. "February New Listings Surged 12 Percent, But Overall Inventory Still Falling" Redfin.com. 17 Mar. 2016.

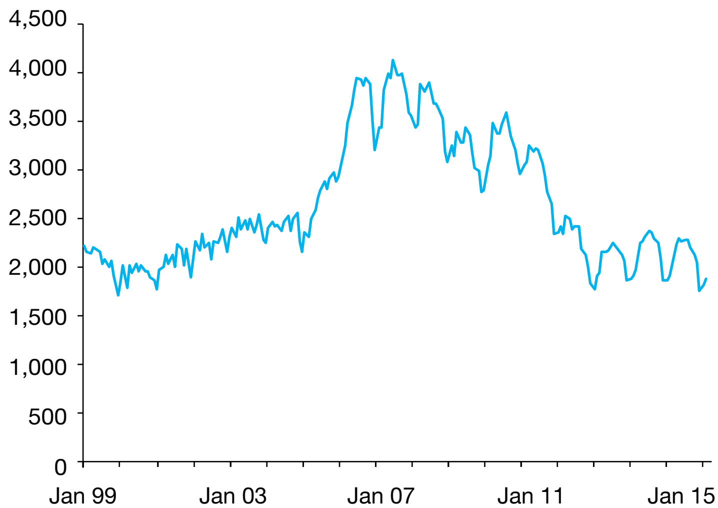
Gudell, Svenja. "January Market Report: Low Inventory Limiting Options For Buyers Nationwide" Zillow Research. 23 Feb. 2016.

"Existing-Home Sales Fizzle in February." Realtor.org. 21 Mar. 2016.

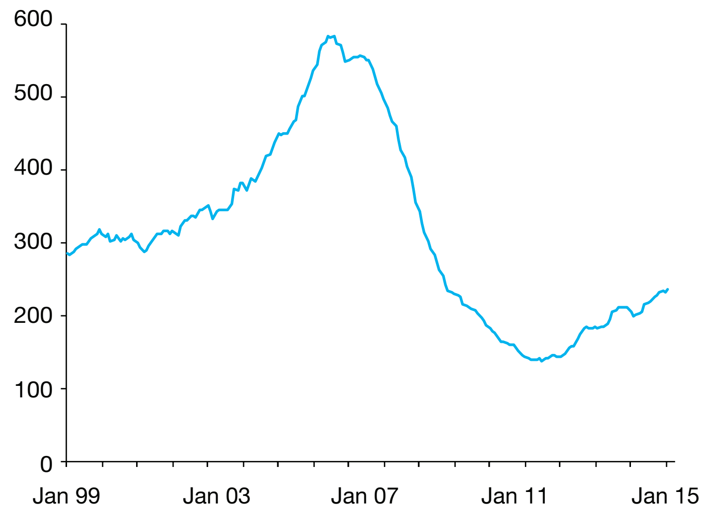
McLaughlin, Ralph. "House Arrest: How Low Inventory Is Slowing Home Buying" Trulia's Blog. 21 Mar. 2016.

EXHIBIT 5

Inventory of for-sale homes tight, both for new and existing homes



Source: National Association of Realtors, Number of homes available for sale: Single-Family & Condo & Co-op, (Ths., NSA)



Source: U.S. Census Bureau/HUD, New Home Sales: Single-Family Houses for Sale, (Ths., NSA)

Estimates from HUD's Components of Inventory Change (CINCH) indicate that over a two-year period from 2009-2011[3] approximately 808,000 1-unit housing units were lost due to conversion, demolition/disaster, condemnation, or other reasons. With approximately 90 million 1-unit housing units in the United States, about 414,000 per year must be replaced just to keep the stock constant. Single-family (1-unit) housing starts have been accelerating recently, reaching a level of 822,000 in March of 2016. While housing construction for 1-unit properties is running above replacement rates, the difference is only about 400,000 per year, which is constraining growth in the single-family market.

We expect total housing starts to increase by about 200,000 per year over the next two years. This increase will help to alleviate the tight supply of for-sale homes, but only gradually.

> At the current rate of construction, people should get used to seeing headlines about low inventory of for-sale homes in many markets for years to come. Demographics and demand are only going to increase the pressure on the housing stock.

3 The latest CINCH report available uses the 2011 American Housing Survey

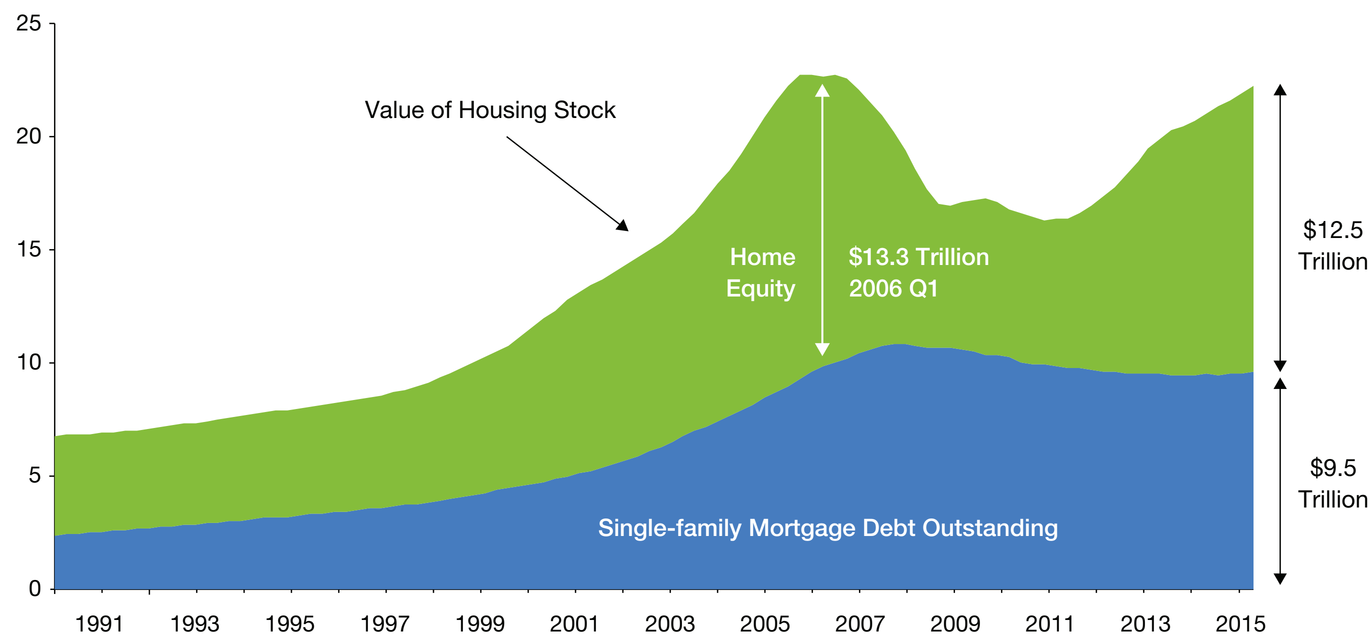
Home prices boost homeowner equity

With tight supply and demand supported by low mortgage rates and solid job gains, home prices will keep rising above their long-run historical average rate. We forecast that on average, house prices will rise by 4.8 and 3.5 percent in 2016 and 2017 respectively. Rising home prices will drive up homeowner equity.

Homeowner equity is the largest source of wealth for many Americans and rising homeowner equity will support consumer confidence and consumer spending. Based on the latest data from the Federal Reserve as of December 31, 2015, homeowner equity was at $12.4 trillion, just below the (not inflation-adjusted) peak of $13.3 trillion in 2006. Unlike the 2006 experience, the recent surge in homeowner equity has not been accompanied by a surge in mortgage debt (Exhibit 6). Rising home values have gone almost exclusively on net to bolstering the balance sheet of American households.

EXHIBIT 6

At the end of 2015 home equity increased 98% to $12.5 Trillion since its bottom in 2011



Note: Value of U.S. housing stock includes homes with and without underlying mortgages. U.S. home equity is the difference between the value of the U.S. housing stock and the amount of U.S. single-family mortgage debt outstanding.

Source: Federal Reserve Board's Flow of Funds Accounts, Table B. 101. Data as of December 31, 2015.

With home sales rising we expect to see mortgage debt outstanding to increase 3.5 percent in 2016 and 4.0 percent in 2017. While these forecasts are substantially above recent years—0.7 and 1.3 percent in 2013 and 2014 respectively—they still are well below the long-run historical average of about an annual 10 percentage point increase in mortgage debt outstanding.

Refinance originations get a lift from low mortgage rates

With mortgage rates at the lowest level in nearly three years, there's opportunity for increased refinance activity. In February we looked at refinance potential and concluded that rates dipping below 4 percent would increase refinance potential by about $122 billion. Now rates have declined even further and we examine how much incremental refinance potential we might expect given the decline in mortgage rates.

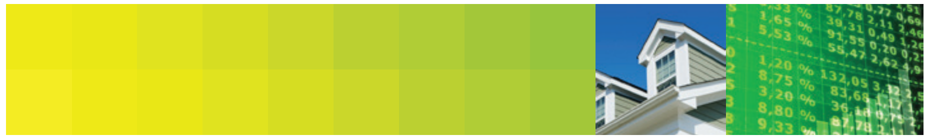
In this analysis we take two approaches to quantifying the impact of the lower interest rates on refinance originations. First, we extend our empirical analysis from February to account for lower rates. Secondly, we compare those estimates to the results from a statistical model of the U.S. economy, housing, and mortgage market.

The contract rate on most loans clusters around every eighth of a percentage point. For example, there are clusters of loans around 3 percent, 3.125 percent, 3.25 percent, and 3.5 percent, but not many loans with contract rates in between. If borrowers react to specific rate incentives, e.g., refinance if market rates drop 1 full percentage point below the borrower's contract rate, then refinance activity will tend to ratchet higher with each eighth point reduction in mortgage rates. In the week of April 7, 2016, mortgage rates had their biggest one-week decline in over a year of 0.12 percentage points (nearly one eighth). Based on our analysis[4]—replicating the February 2016 Outlook—that one-week decline increased in-the-money refinance potential by $66 billion.

We also ran a macro simulation of the U.S. economy, housing, and mortgage market. This simulation was based upon estimates of statistical relationships between refinance activity, mortgage interest rates and other macroeconomic variables. Our simulation results showed that a decline in mortgage rates corresponding to this month's Outlook relative to last month's increased refinance activity by about $50 billion.

Taking into account these independent analyses, we revised our 1-4 family mortgage originations estimate for 2016 up by $50 billion to $1.70 trillion.

4 This analysis removes loans that might not refinance due to currently high LTV, recent delinquencies, a previous HARP refinance, or burnout. In this analysis, we consider burnout to be captured by loans that have had a current LTV under 80 for more than a year and have not been recently delinquent and have had rate incentive to refinance for more than a year.



April 2016 Economic & Housing Market Forecast

Forecasted Figures

Historical Data

	2016				2017				Annual Totals		
INDICATOR	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2015**	**2016**	**2017**
Real GDP (%)	1.1	2.1	2.3	2.4	2.3	2.3	2.3	2.3	2.0	2.0	2.3
Consumer Prices (%) a.	-0.3	1.9	1.9	2.0	1.9	1.9	1.9	1.9	0.4	1.4	1.9
Unemployment Rate (%) b.	4.9	4.9	4.9	4.8	4.8	4.8	4.7	4.7	5.3	4.9	4.8
30-Year Fixed Mtg. Rate (%) b.	3.7	3.8	4.1	4.3	4.4	4.6	4.8	5.0	3.9	4.0	4.7
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	2.9	3.0	3.4	3.7	3.9	4.1	4.3	4.5	2.9	3.3	4.2
10-Year Const. Mat. Treas. Rate (%) b.	1.9	2.0	2.3	2.5	2.6	2.8	3.0	3.2	2.2	2.2	2.9
1-Year Const. Mat. Treas. Rate (%) b.	0.6	0.6	0.9	1.1	1.3	1.5	1.7	1.9	0.3	0.8	1.6
Housing Starts c.	1.17	1.25	1.33	1.38	1.43	1.48	1.53	1.58	1.11	1.28	1.51
Total Home Sales d.	5.81	5.91	5.91	6.06	6.11	6.16	6.16	6.21	5.73	5.92	6.16
FMHPI House Price Appreciation (%) e.	1.4	1.2	1.0	1.1	0.9	0.9	0.9	0.8	6.2	4.8	3.5
1-4 Family Mortgage Originations f.											
- Conventional	$265	$396	$347	$316	$285	$299	$261	$246	$1,340	$1,325	$1,091
- FHA & VA	$70	$109	$103	$94	$95	$101	$88	$84	$410	$375	$369
- Total	$335	$505	$450	$410	$380	$400	$350	$330	$1,750	$1,700	$1,460
Refinancing Share - Originations (%) g.	48	42	38	35	27	25	23	22	48	40	24
Residential Mortgage Debt (%) h.	2.7	3.5	3.7	4.0	4.0	4.0	4.0	4.0	1.3	3.5	4.0

Note: Quarterly and annual forecasts 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 single-family homes; quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).

e. Quarterly growth rate of Freddie Mac's House Price Index; seasonally-adjusted; annual rates for yearly data.

f. Billions of dollars (not seasonally-adjusted); conventional for 2014 are Freddie Mac estimates.

g. Home Mortgage Disclosure Act for all single-family mortgages (not seasonally-adjusted); annual share is dollar-weighted average of quarterly shares (2014 estimated).

h. 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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