Economic & Housing Research **Outlook**

JULY 2016

Despite global risks, U.S. housing markets remains stalwart

With the U.K.'s decision to exit from the European Union, global risks increased substantially leading us to revise our views for the remainder of 2016 and all of 2017. Nonetheless, the turbulence abroad should continue to create demand for U.S. Treasuries and keep mortgage rates near historic lows; thereby, allowing mortgage originations to surpass 2015's level.

Economy poised for second quarter turnaround.

For the second time, Gross Domestic Product (GDP) for the first quarter of 2016 was revised upward from a seasonally adjusted annual rate of 0.8 percent to 1.1 percent. Upward revisions to growth in exports and nonresidential fixed investment were primary drivers in the adjustment to GDP growth. After the initial estimate of 0.5 percent growth, this newest figure suggests the start of 2016 was not as bad as originally thought.

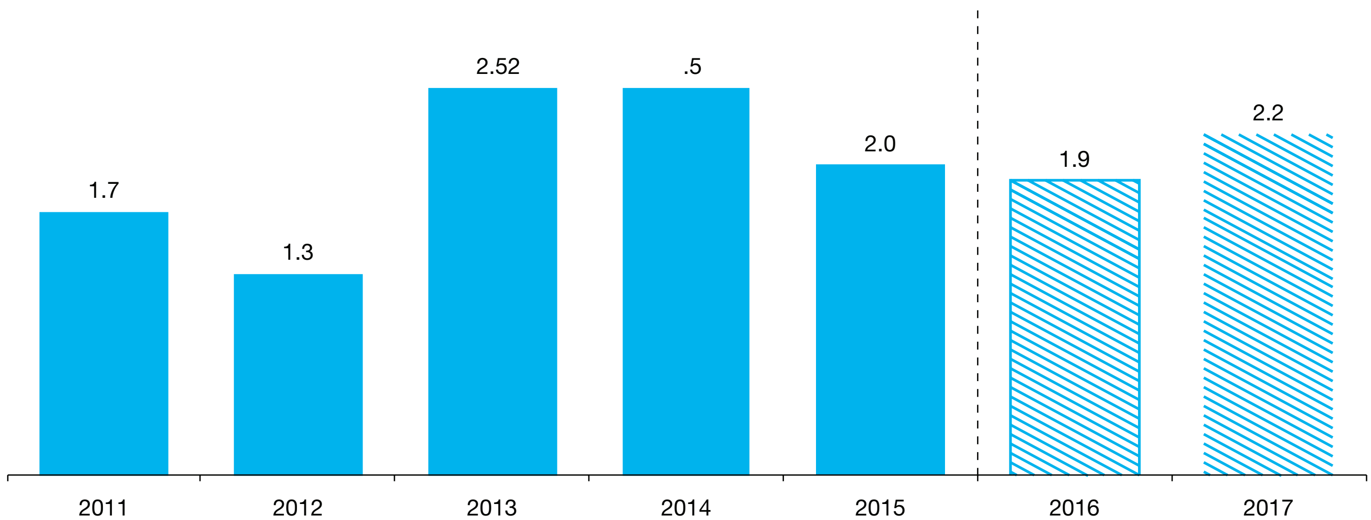
Additionally, we expect second quarter growth to reach 2 percent as consumers continue to push the economy forward. Consumer spending normalized in May after April's solid growth rate of 1.1 percent. May came in at a more moderate pace of 0.4 percent, but will still help overall growth bounce back this quarter. Furthermore, retail sales continue to show strength, growing at a 0.5 percent pace in May. This month's growth could be attributed to the continuing recovery of gasoline prices, which helped gasoline sales increase by 2.1 percent. Moreover, nonstore retail sales (ecommerce) were up 1.3 percent in May, following April's 2.5 percent rate. May's sales were slowed

Forecast Snapshot (July 2016)

Summary (annualized)	2015	2016	2017
30-year PMMS (%)	3.9	3.6	4.0
Total home sales (M)	5.75	5.96	6.16
House price growth (%)	6.0	5.0	4.0
Total originations ($B)	1,750	1,825	1,550

down by building materials, which fell 1.8 percent for the month. With that, building material sales have contracted three straight months, signaling a slowdown in residential investment. This, along with Industrial Production (down 0.4 percent in May) and Durable Goods Orders (down 2.2 percent in May) will create headwinds to second quarter GDP growth. However, strong personal consumption expenditures and residential investment should boost overall GDP back to near 2 percent growth.

Real GDP Growth (Percentage Points)



Source: Freddie Mac, Bureau of Economic Analysis

How will Brexit impact subsequent quarters?

In addition to all the latest economic data, Brexit will also have a major impact on domestic growth, and our forecast. A slowdown in global growth—especially in Europe—due to Brexit, will hurt demand for U.S. exports. Furthermore, global investors seeking a safe haven from the volatility of global markets will drive the value of the U.S. dollar up, and consequently, drag down net exports. Finally, the price of riskier assets will also fall somewhat, which in turn will raise capital costs and delay investment. As a result, we expect the economic implications of Brexit to shave off 10 basis points from GDP starting from the second quarter in 2016 to the end of 2017. This leaves the 2016 annual GDP growth outlook unchanged at 1.9 percent (due to the Q1 upward revision of GDP) and drops 2017 growth 10 basis points to 2.2 percent.

Prices remained flat in May, with the Consumer Price Index (CPI) registering only a 0.2 percent seasonally-adjusted annual growth rate. However, energy prices continue to rise, which should help price growth going forward. The energy index, led by gasoline and fuel oil, rose 1.2 percent, making it three straight months of increasing prices. Although the upward trend is encouraging, year over year energy prices are still down 10.1 percent; a major reason why yearly overall price growth has remained near 1 percent since the beginning of the year and below the Fed's inflation target of 2 percent. While we expect the risks of slower price growth to increase due to slower growth in international prices, our projections for inflation are relatively low, allowing us to maintain our current view of inflation unchanged from last month at 1.4 percent for 2016 and 1.9 percent for 2017.

Turning to employment, June's employment situation surpassed expectations following a dismal release last month. Change in nonfarm payroll employment came in at 287,000 in June, significantly higher than the disappointing 11,000 jobs created in May. Jobs in leisure and hospitality, healthcare, and financial activities were the main source of growth this month. Overall, the second quarter change in employment averaged just over 147,000 per month. Moreover, the unemployment rate rose back up to 4.9 percent as more people reentered the workforce. With that, the unemployment rate averaged 4.9 percent in the second quarter of 2016, unchanged from the previous quarter. Overall, we expect the unemployment rate to average 4.9 percent in 2016 and 4.8 percent in 2017.

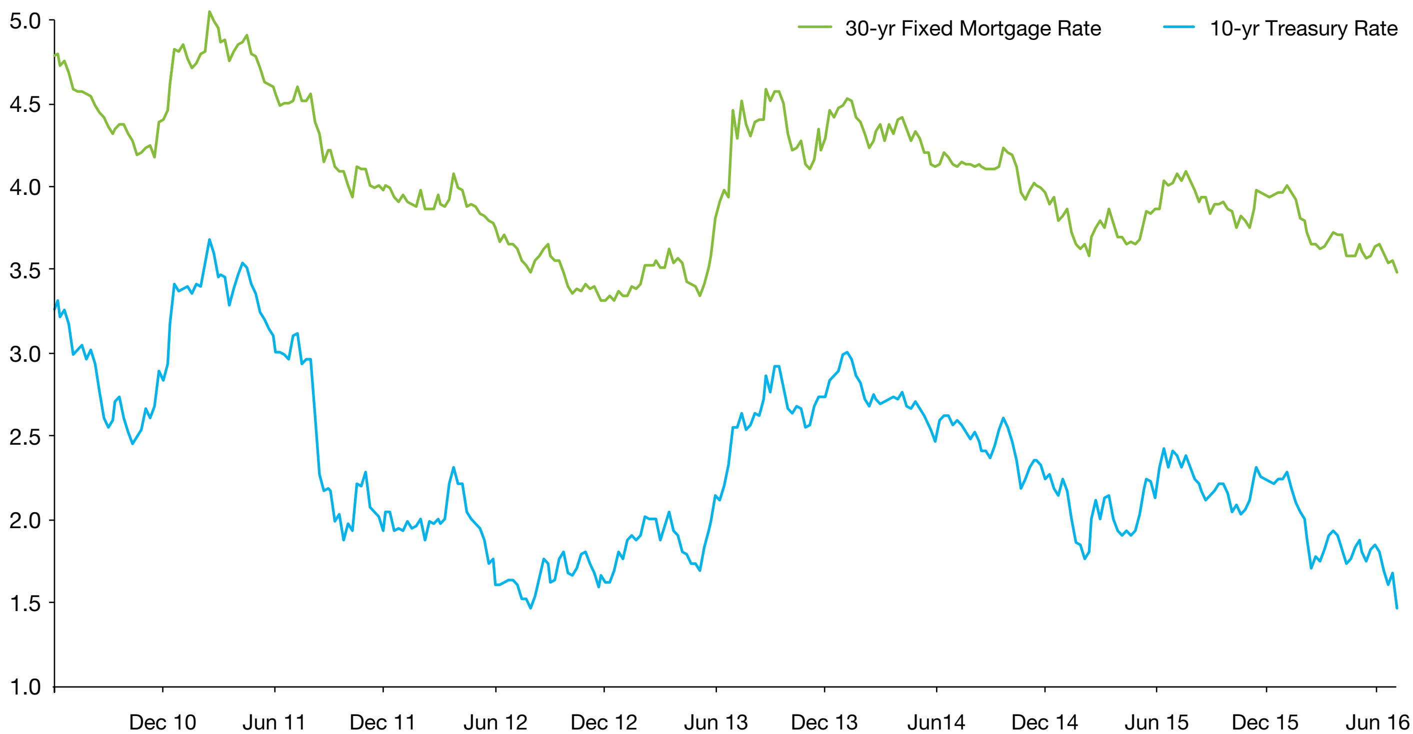
Fed still on hold. Mortgage rates staying cheap.

The Federal Open Market Committee (FOMC) will likely keep the fed funds target rate increase on hold until at least the end of the year or even early next year. In its June meeting, the FOMC decided to keep the fed funds rate unchanged following a weaker than expected employment report for May as well as continued uncertainty in the global financial markets. Furthermore, following the results of the Brexit vote in late June, the Fed will likely continue to express caution before easing monetary accommodations.

On June 27 (the Monday after the Brexit vote) 10-year Treasury rates fell below 1.5 percent for the first time since July 26, 2012. According to Freddie Mac's Primary Mortgage Markets Survey, the 30-year fixed-rate mortgage rate also fell to 3.41 percent for the week ended on July 7, 2016, the lowest since May 2, 2013 when it was 3.35 percent.

In light of this recent activity, we have lowered our 10-year Treasury rate forecast by 40 basis points to 1.8 percent and 2.3 percent in 2016 and 2017 respectively. Accordingly, we have also lowered our 30-year fixed-rate mortgage forecast for both 2016 (by 30 basis points) and 2017 (by 50 basis points) to 3.6 percent and 4.0 percent, respectively.

10-yr Treasury Rate & 30-yr Fixed Rate Mortgage



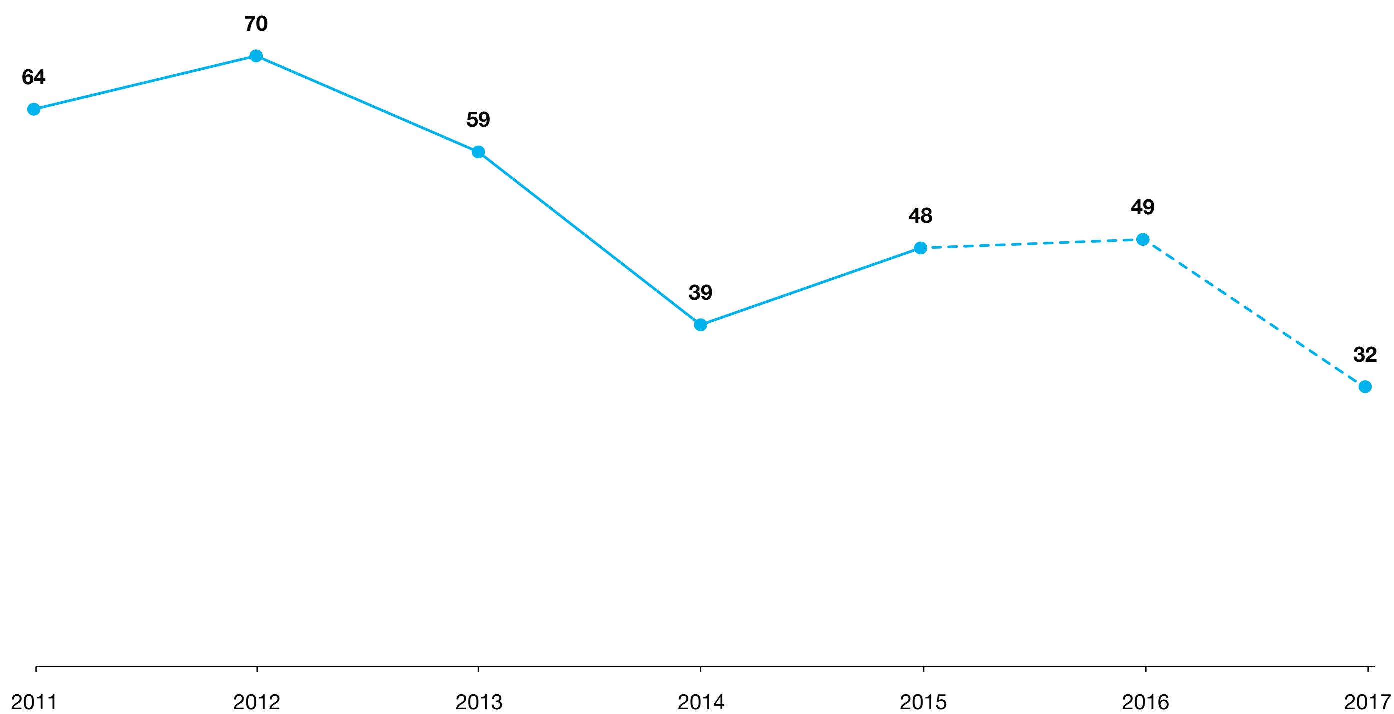
Source: Freddie Mac, Federal Reserve

Low mortgage rates will boost refinance activity.

International concerns, particularly slowing growth in China and the Brexit vote in the U.K., have played a major role in driving down mortgage rates. In our most recent survey, mortgage rates fell below 3.5 percent nearing historic lows. Since we have tempered our expectations on mortgage rates for the rest of 2016, we believe there will be a boost in housing activity, particularly refinance, as homeowners take advantage of the current low rates.

We estimate the refinance share of originations to rise up to 49 percent for 2016, 8 percentage points above last month's forecast. This translates to about $100 billion more in originations, bringing the total for 2016 to $1,825 billion. Furthermore, our 2017 interest rate forecast reflects our belief that the impact of Brexit isn't strictly a short-term disruption, but rather it will have a lingering effect on the housing market. Thus, we have increased our forecast of 2017 originations to $1,550 billion.

Refinance Share of Originations (Percentage Points)



Source: Freddie Mac, FFIEC

Freddie Mac

July 2016 Economic & Housing Market Forecast

Forecasted Figures

Historical Data

As of 7/8/2016

	2016				2017				Annual Totals		
INDICATOR	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**2015**	**2016**	**2017**
Real GDP (%)	1.1	2.0	2.2	2.3	2.2	2.2	2.2	2.2	2.0	1.9	2.2
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	3.6	3.6	3.6	3.8	3.9	4.1	4.2	3.9	3.6	4.0
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	2.9	2.8	2.9	3.2	3.4	3.6	3.7	3.9	2.9	3.0	3.7
10-Year Const. Mat. Treas. Rate (%) b.	1.9	1.8	1.7	1.9	2.0	2.3	2.4	2.6	2.2	1.8	2.3
1-Year Const. Mat. Treas. Rate (%) b.	0.6	0.6	0.6	0.7	0.9	1.1	1.3	1.5	0.3	0.6	1.2
Housing Starts c.	1.15	1.19	1.33	1.38	1.43	1.48	1.53	1.58	1.11	1.26	1.51
Total Home Sales d.	5.83	6.05	5.91	6.06	6.11	6.16	6.16	6.21	5.75	5.96	6.16
FMHPI House Price Appreciation (%) e.	1.4	1.3	1.1	1.1	1.0	1.0	1.0	0.9	6.0	5.0	4.0
1-4 Family Mortgage Originations f.											
- Conventional	$298	$406	$387	$341	$295	$319	$291	$276	$1,344	$1,432	$1,181
- FHA & VA	$87	$109	$103	$94	$95	$101	$89	$84	$406	$393	$369
- Total	$385	$515	$490	$435	$390	$420	$380	$360	$1,750	$1,825	$1,550
Refinancing Share - Originations (%) g.	55	50	48	45	38	35	30	25	48	49	32
Residential Mortgage Debt (%) h.	0.0	3.5	3.7	4.0	4.0	4.0	4.0	4.0	1.6	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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