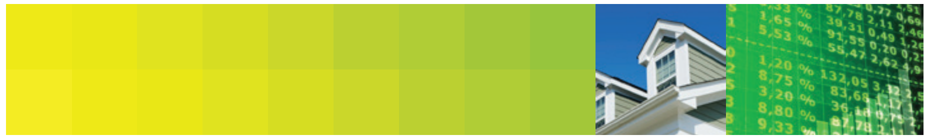


Economic & Housing Research **Outlook**

NOVEMBER 2017

Recap of 2017: The Best Year in a Decade

Macroeconomic conditions remained favorable for housing and mortgage markets in 2017. Despite challenges, the housing markets remain on track for their best year in a decade by a variety of measures. The mortgage market is transitioning from a refinance-dominated market to a purchase-dominated one, but low rates have bolstered refinance volumes this year. Let's recap the major trends in the U.S. economy, housing and mortgage markets in 2017.

WHAT'S INSIDE

Forecast Snapshot (November 2017)

Summary (annualized)	2017	2018	2019
30-year PMMS (%)	4.0	4.4	4.7
Total home sales (M)	6.13	6.30	6.41
House price growth (%)	6.7	5.7	4.6
Total originations ($B)	1,800	1,720	1,770

Real economy favorable for housing

Economic growth is modest, but solid job gains and low interest rates provide favorable economic conditions for housing and mortgage markets.

Economic growth picks up

Real Gross Domestic Product (GDP) grew at a three percent annual rate in the third quarter of 2017, following a 3.1 percent growth rate in the second quarter. Economic growth in this expansion remains relatively modest, averaging about two percent a quarter (Exhibit 1). Relative to prior economic expansions, the current expansion is rather weak (Exhibit 2). Nevertheless, growth has been consistently positive.

Exhibit 1

Real GDP growth (%)

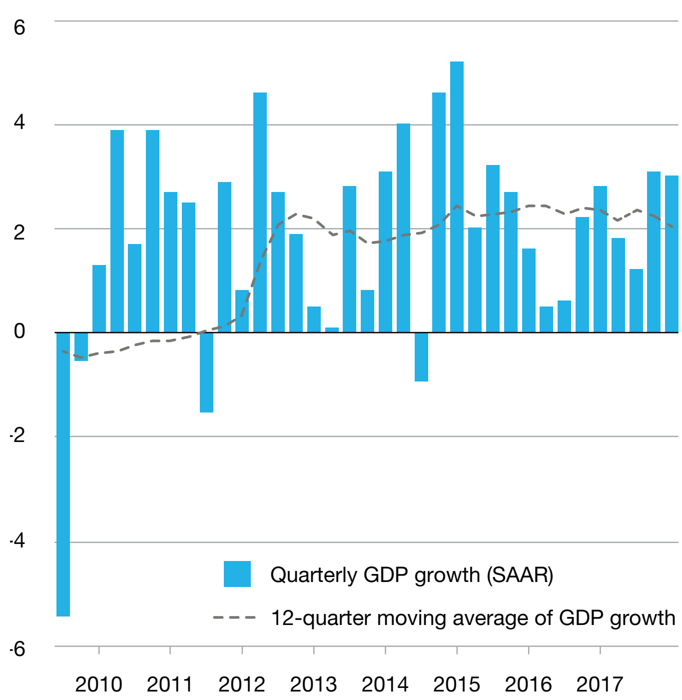
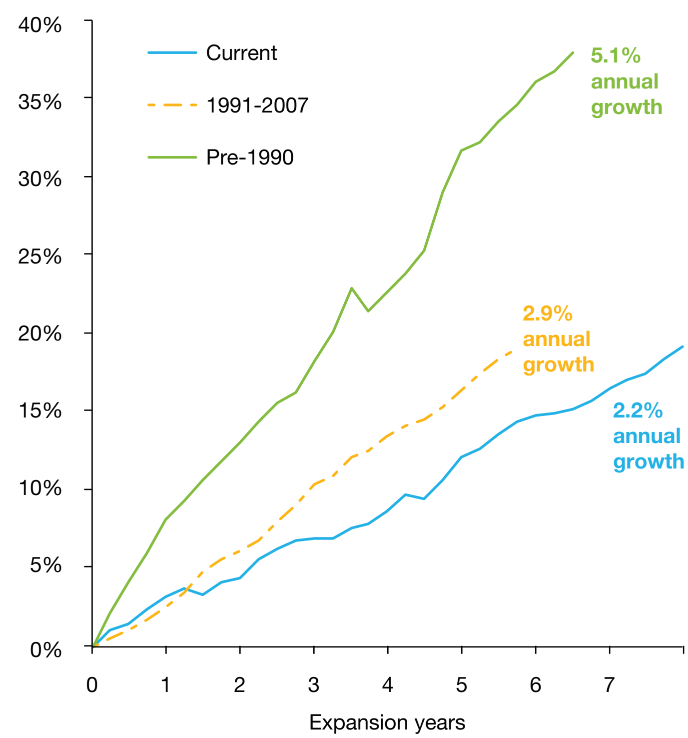


Exhibit 2

Cumulative GDP growth: postwar expansions



Source: Bureau of Economic Analysis

Low inflation

Inflation remains quite low, with headline consumer price inflation averaging about two percent for the first three quarters of 2017 (Exhibit 3), but averaging about one percent over the past three years. Declining energy prices starting in late 2014 helped contain inflation rates. Core inflation, which strips away volatile food and energy prices, has been increasing a bit faster, just under two percent per year over the past three years (Exhibit 4). Low inflation has helped to keep long-term interest rates low, as we highlight below.

Exhibit 3

Headline inflation (%)

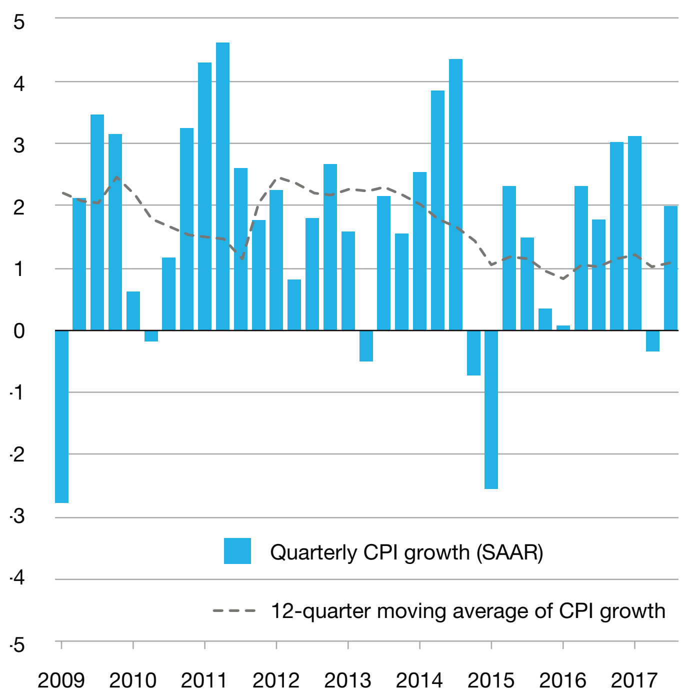
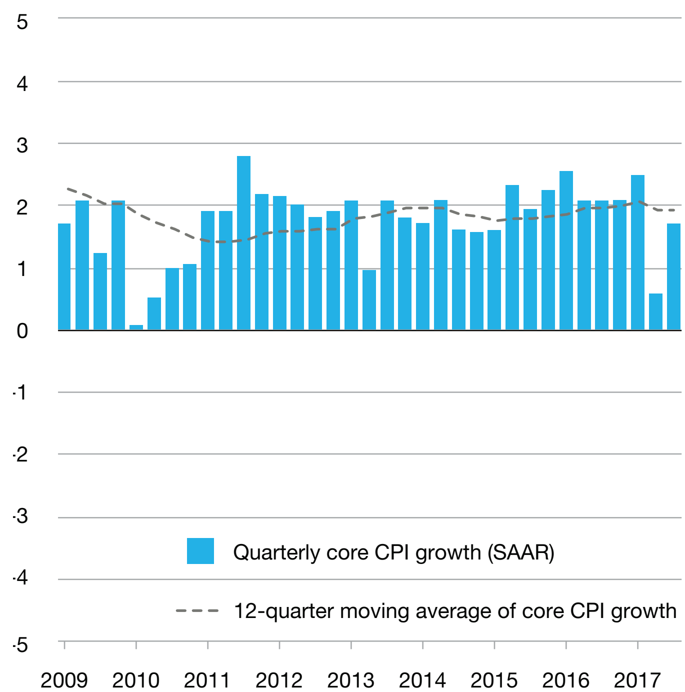


Exhibit 4

Core inflation (%)



Source: U.S. Bureau of Labor Statistics

Robust job growth

The U.S. labor market keeps chugging along. Following revisions to the estimate for September's nonfarm payrolls, the U.S. labor market has had positive month-over-month job growth for 85 consecutive months, averaging about 200,000 net job gains since 2014 (Exhibit 5). Job growth has helped push the unemployment rate down to 4.1 percent in October, the lowest level since December 2000 (Exhibit 6). Robust job gains have helped to support homebuyer demand, though the lack of an acceleration in wages remains disappointing.

Exhibit 5

Monthly nonfarm payroll growth (in thousands)

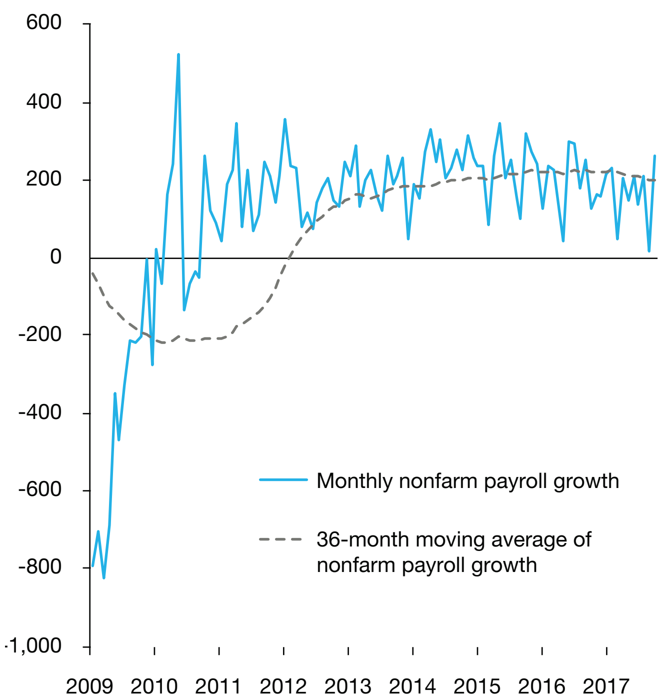
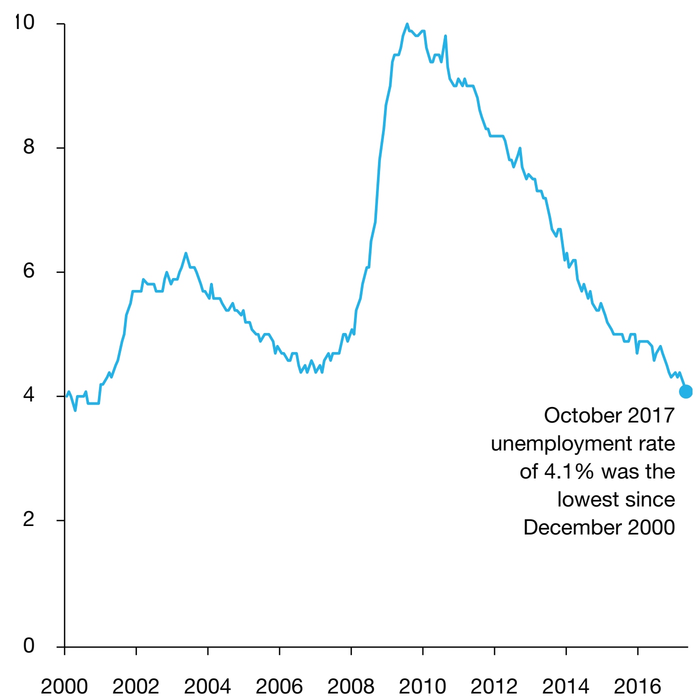


Exhibit 6

Unemployment rate (%)



Source: U.S. Bureau of Labor Statistics

Mortgage rates are low

Through the first 10 months of 2017, mortgage rates remained low by historical standards (Exhibit 7). Following the U.S. general election in November of 2016, mortgage rates increased over 0.5 percentage points for the 30-year fixed mortgage and remained above four percent through the first quarter of 2017. After March rates drifted down, the 30-year fixed mortgage has remained under four percent since July (Exhibit 8). With house prices outpacing income, low mortgage rates are the one factor helping to support homebuyer affordability.

Exhibit 7

Freddie Mac Primary Mortgage Market Survey®, 30-year FRM

(%, U.S. weekly average through 11/9/2017)

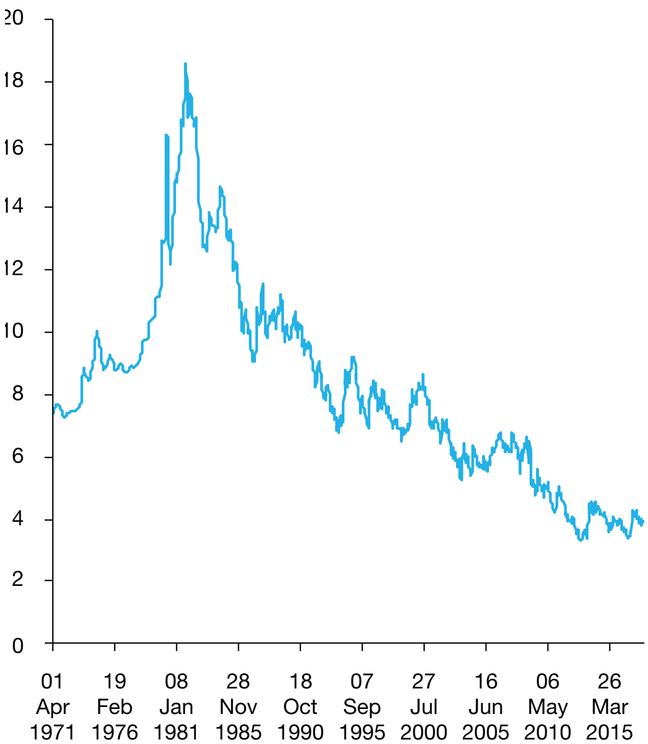
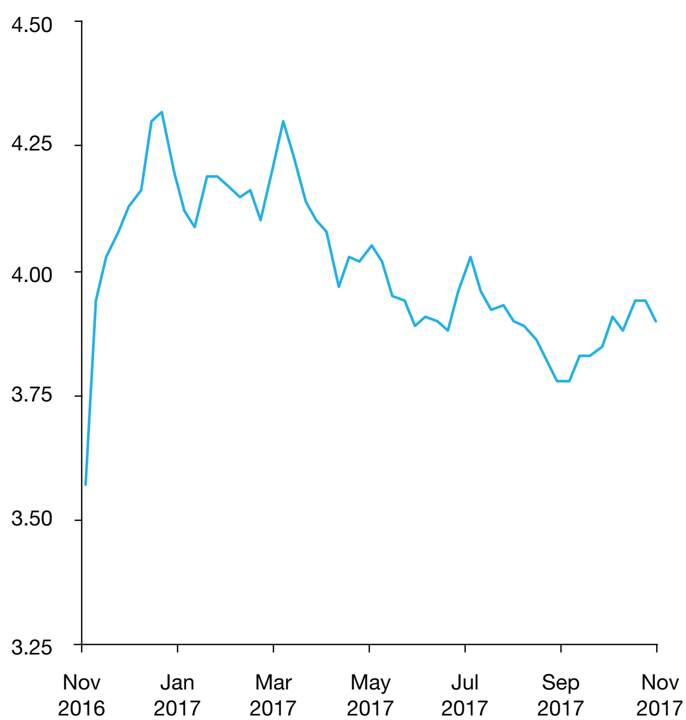


Exhibit 8

Primary Mortgage Market Survey® (PMMS®)

(%, U.S. weekly averages)



Source: Freddie Mac Primary Mortgage Market Survey Survey® (PMMS®)

Housing markets on track for best year in a decade

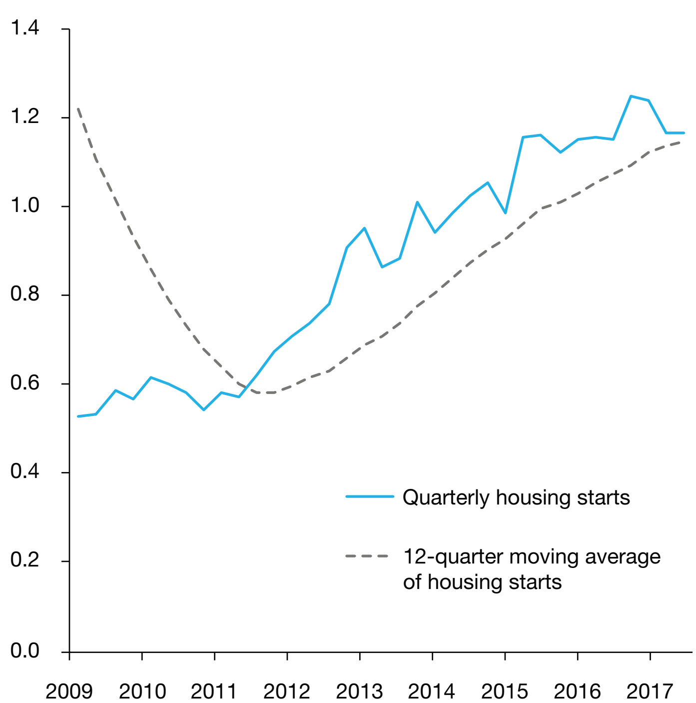
Modest economic growth, robust job gains, and low interest rates make for a favorable economic environment for housing and mortgage markets. But despite the favorable environment, housing markets have stalled a bit through summer and into fall. A lack of available for-sale inventory is helping to contribute to an acceleration in home prices.

Housing construction and sales stall

Home construction and home sales got off to a good start in 2017, but stalled later in the year. Single-family housing starts kept grinding higher, but not enough to offset the sharp decline in multifamily housing starts (Exhibit 9). Home sales have been unable to keep their momentum from earlier in the year (Exhibit 10). However, due to their strong start to the year, both total home sales and housing starts are on track for their best year in a decade.

Exhibit 9

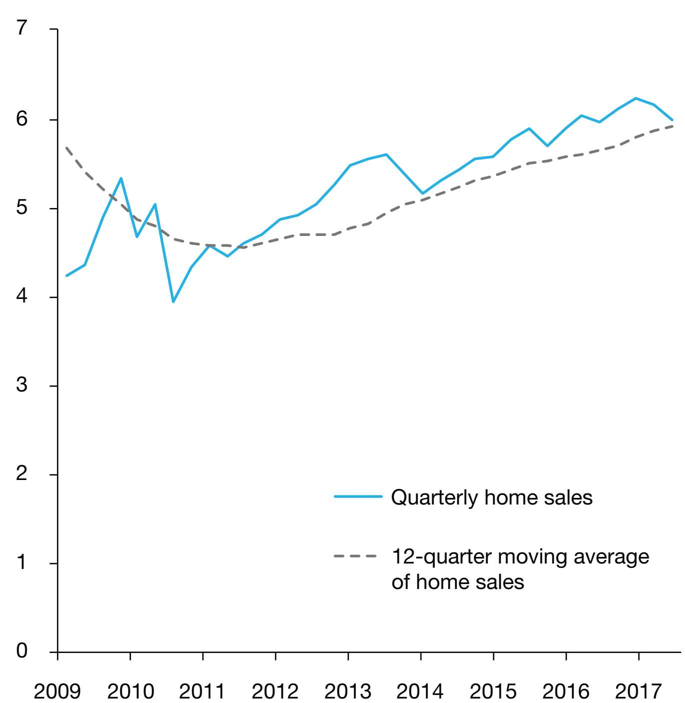
Housing starts (millions, SAAR)



Source: U.S. Census Bureau

Exhibit 10

Total home sales (new + existing in millions, SAAR)



Source: U.S. Census Bureau, National Association of Realtors

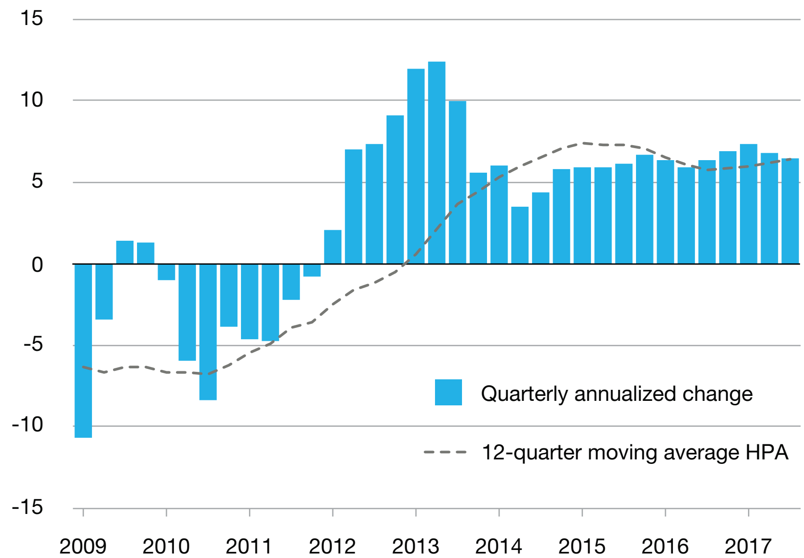
Home prices accelerate

Strong demand, low mortgage rates and a lack of for-sale inventory have contributed to accelerating house prices. Nationally, home prices increased at a 6.4 percent annualized rate over the quarter ending September 2017 (Exhibit 11). Home price growth in some markets exceeds 10 percent a year, with Washington (12.8%) and Nevada (11.3%) leading the way in 12-month percent growth in house prices (Exhibit 12). For an in-depth analysis of the factors driving house prices and whether recent rates of home price appreciation are sustainable, see our Insight "The 'B' Word: Can we spot the next house price bubble?"

Exhibit 11

Annualized percent change in house prices

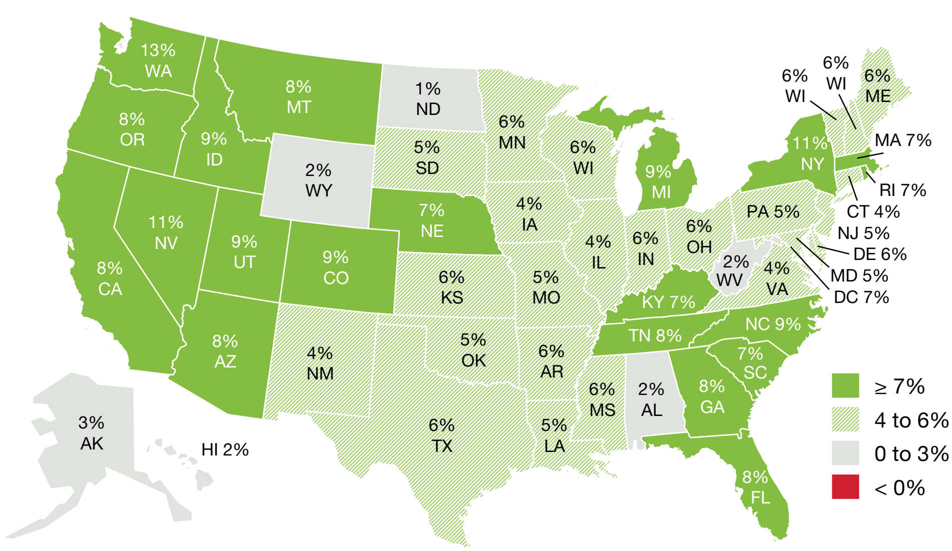
(% change, quarterly average of U.S. house price index, SA)



Source: Freddie Mac House Price Index

Exhibit 12

Home price performance by state (September 2016 to September 2017)*



United States: 6.8%

Significant variability by region and state since the peak

*The Freddie Mac House Price Index for the U.S. is a value-weighted average of the state indexes where the value weights are based on Freddie Mac's single-family credit guarantee portfolio. Other indices of home prices may have different results, as they are determined using different pools of mortgage loans and calculated under different conventions. The Freddie Mac House Price Index for the U.S. is a non-seasonally adjusted monthly series. Percent changes were rounded to nearest whole percentage point.

Source: Freddie Mac

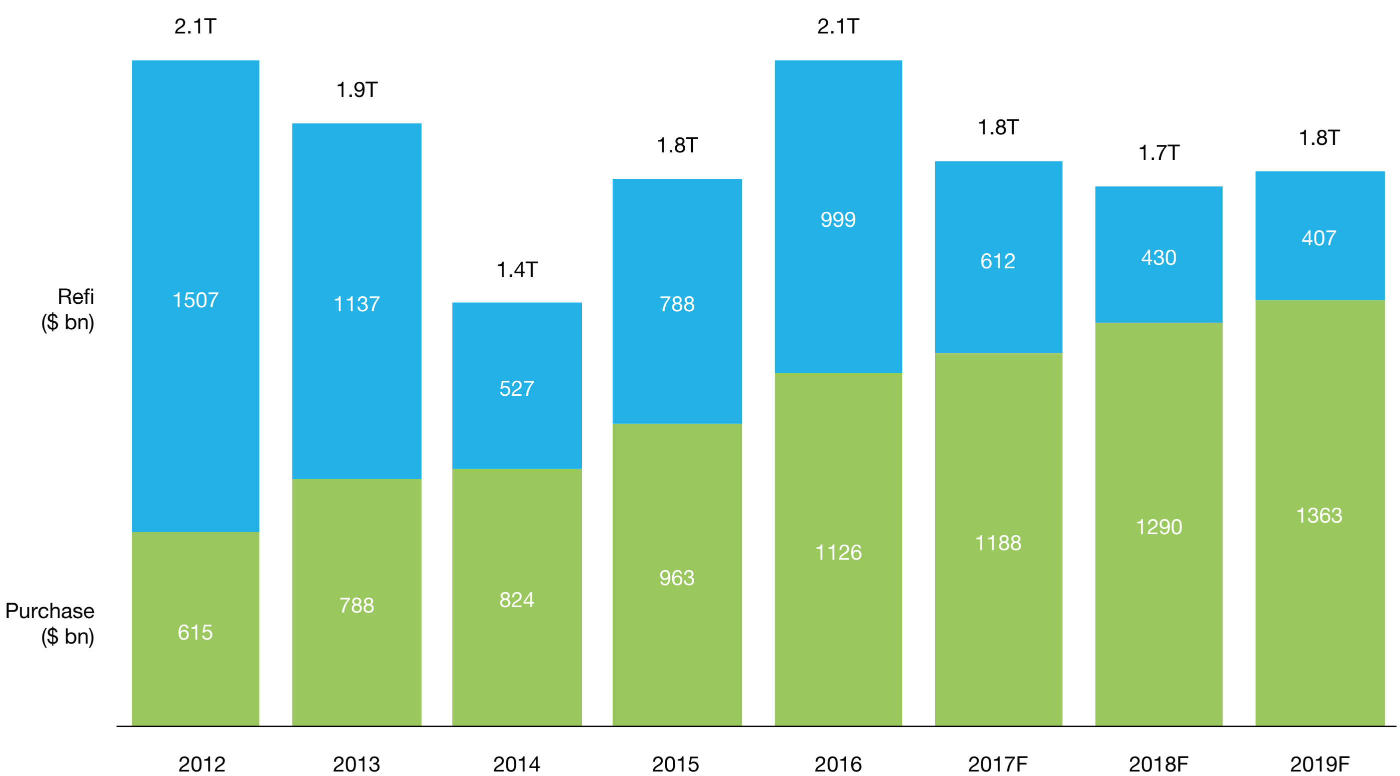
The mortgage market shifts

Mortgage originations

Bolstered by low interest rates, single-family mortgage origination volume has held up better than expected. Low mortgage rates helped refinance volumes exceed expectations. Nevertheless, as we documented in September of this year, mortgage rates don't have to increase much to dampen refinance activity. Through the first three quarters of 2017, refinance originations are down 35 percent from last year's pace. Purchase activity has partially offset the decline, but for the full year, we forecast volume to decline about 15 percent from 2016's level (Exhibit 11). For more on the mortgage market, see our September 2017 Outlook.

Exhibit 13

Annual single-family mortgage originations ($ trillions)



Source: Freddie Mac November 2017 Economic and Housing Research Outlook

What's ahead in 2018 and 2019?

It's unlikely the economic environment will be much more favorable for housing and mortgage markets in 2018 and 2019. We forecast that interest rates will remain low by historical standards, but gradually creep higher over the next two years. We also forecast that housing construction will gradually pick up, helping to supply more homes to inventory-starved markets. More housing supply and modestly higher rates will lead to a moderation in house price growth. Refinance activity will drop to very low levels and the mortgage market will be dominated by purchase activity. After dropping from 2017 to 2018, the mortgage market will return to positive growth in 2019 as refinances stabilize at a low level and home purchase activity drives an expansion in overall activity.

Changes to tax policy could have large effects on the economy. Considering the current level of uncertainty surrounding tax reform, we have not factored in the potential effects of recent tax plans unveiled by both the Senate and House of Representatives into our latest Outlook forecast. Estimates from different analysts show a large variation in estimated impact, based on assumptions about which provisions will be enacted and how the economy will respond. Given the uncertainty around the tax proposals and their impact on the economy, we present a baseline forecast assuming no tax changes.

ON REFINANCE STATISTICS

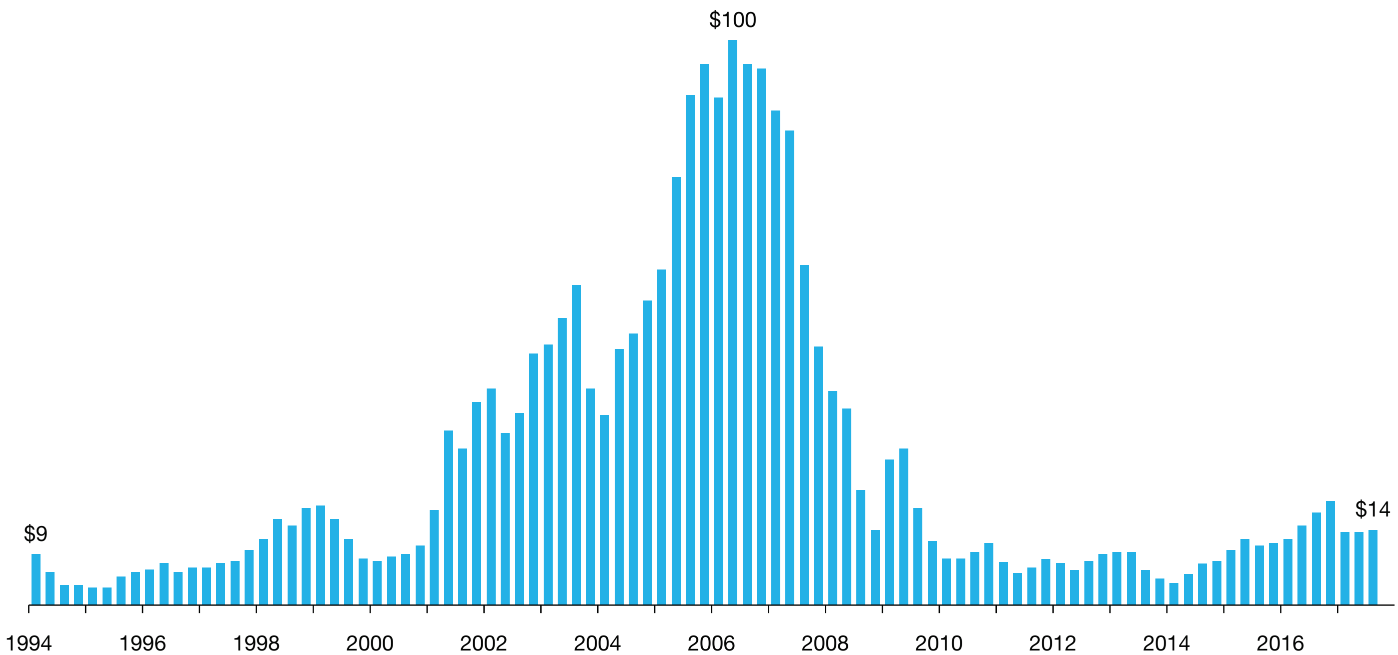
Equity extraction remains less than 25 percent of the equity extracted during the peak in 2006

Based on Freddie Mac's third quarter Quarterly Refinance Statistics, "cash-out" borrowers represented 62 percent of refinances. Though cash-out shares have been increasing in recent quarters, they are still below the peak of 89 percent in the third quarter of 2006. According to the flow-of-funds data of the Federal Reserve, home equity reached a new high of $13.9 trillion in the second quarter of 2017. That is a $1.3 trillion increase from the second quarter of 2016.

We estimate $13.5 billion (in 2016 dollars) in net home equity was cashed out in the third quarter of this year during the refinance of conventional, conforming home mortgages, up from an estimated $13.1 billion in the second quarter (Exhibit 5). This compares with a high of about $100.2 billion (in 2016 dollars) in cash-out refinance volume during the second quarter of 2006 when home equity reached $13.1 trillion. So, even if the equity extraction through cash-out refinances has been increasing, it's nowhere near the levels we saw last decade.

Exhibit 14

Net equity cashed-out in refinance of prime conventional loans (billions, in 2016 dollars)

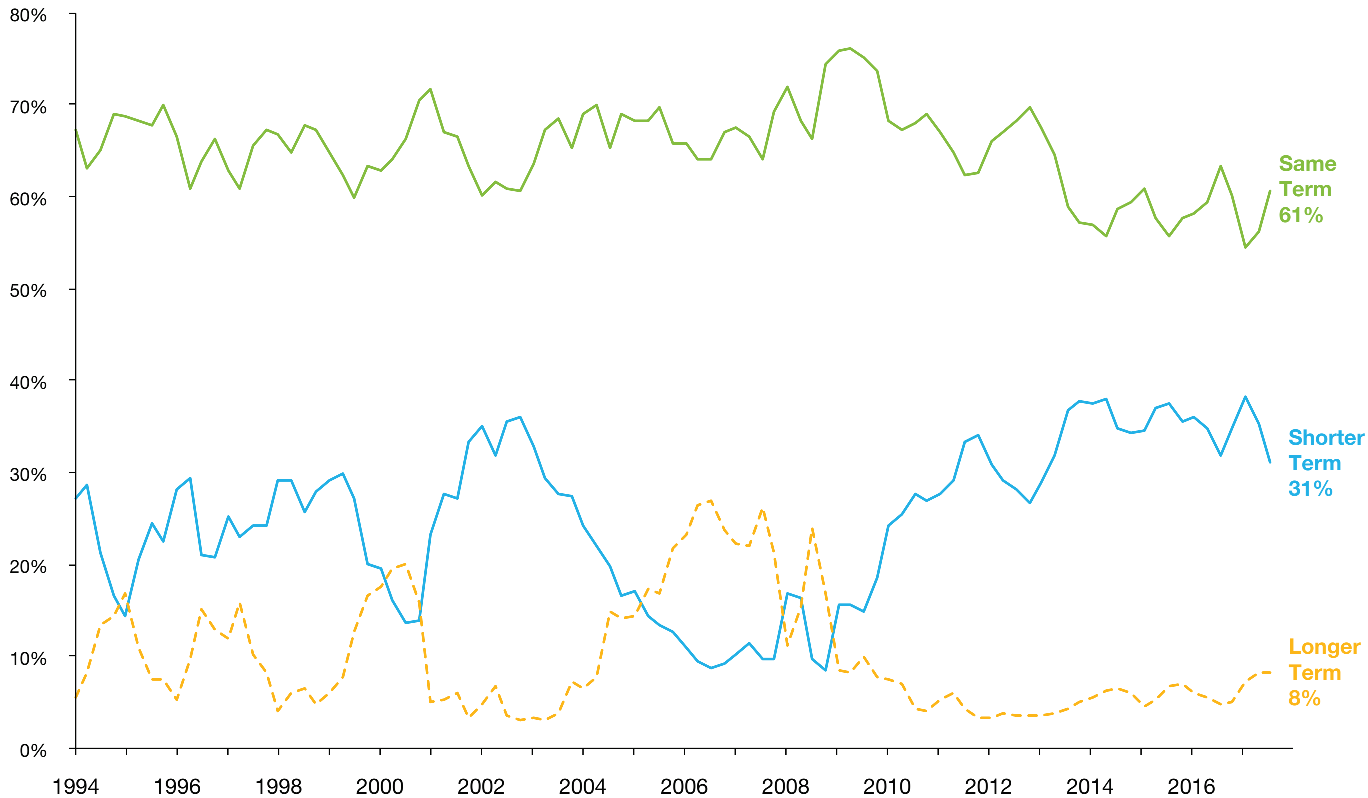


Sources: Mortgage Bankers Association Weekly Mortgage Application Survey: Activity by Dollars, Conventional Market Refi Share (NSA), Freddie Mac, Bureau of Labor Statistics (Consumer Price Index) Third Quarter 2017, Equity cashed-out adjusted for inflation (2016 CPI – All Urban Consumers SA).

Borrowers cut their mortgage rate by about 14 percent, or an average interest-rate reduction of 0.6 percentage points, through refinancing. Furthermore, 31 percent of homeowners refinanced into a shorter-term fully amortizing loan, to pay down principal and build home equity faster than on their previous loan; this is down from 35 percent in the previous quarter (Exhibit 15).

Exhibit 15

Total single-family refinance originations by quarter (Quarterly volume, billions 2016 dollars, inflation-adjusted)

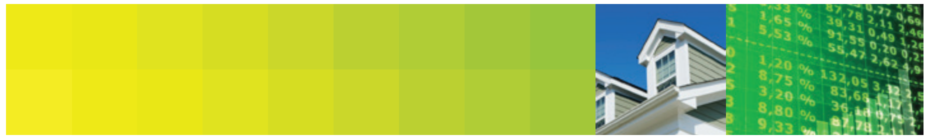


Source: Freddie Mac 2017Q3 Refinance Report. Balloons are excluded from the analysis. Percentages rounded to nearest whole number.

Among the refinanced loans in Freddie Mac's analysis, the median appreciation of the collateral property was 15 percent over the median prior-loan life of 6.1 years. This was the highest appreciation rate since the third quarter of 2008.

More than 95 percent of refinancing borrowers chose a fixed-rate loan. Fixed-rate loans were preferred regardless of what the original loan product had been. For example, 91 percent of borrowers who had a hybrid ARM chose a fixed-rate loan during the third quarter while the remaining 9 percent chose to refinance back into a hybrid ARM.

Freddie Mac



November 2017 Economic & Housing Market Forecast

Forecasted Figures
Historical Data

As of 11/10/2017

Indicator	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2	2018 Q3	2018 Q4	Annual Totals 2017	Annual Totals 2018	Annual Totals 2019
Major Economic Indicators											
Real GDP (%)	1.2	3.1	3.0	2.3	2.2	2.2	2.2	2.2	2.4	2.2	2.0
Consumer Prices (%) a.	3.1	-0.3	2.0	2.2	2.1	2.2	2.3	2.4	1.8	2.2	2.3
Unemployment Rate (%) b.	4.7	4.4	4.3	4.3	4.2	4.2	4.1	4.1	4.4	4.2	4.1
30-Year Fixed Mtg. Rate (%) b.	4.2	4.0	3.9	3.9	4.1	4.3	4.4	4.6	4.0	4.4	4.7
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	3.2	3.1	3.2	3.1	3.3	3.6	3.7	4.0	3.2	3.7	4.1
10-Year Const. Mat. Treas. Rate (%) b.	2.4	2.3	2.2	2.2	2.4	2.5	2.6	2.8	2.3	2.6	2.9
1-Year Const. Mat. Treas. Rate (%) b.	0.9	1.1	1.3	1.4	1.5	1.7	1.8	1.9	1.2	1.7	2.1
Housing & Mortgage Markets											
Housing Starts c.	1.24	1.17	1.17	1.22	1.26	1.28	1.31	1.33	1.20	1.30	1.40
Total Home Sales d.	6.24	6.17	6.00	6.10	6.15	6.30	6.35	6.40	6.13	6.30	6.41
FMHPI House Price Appreciation (%) e.	1.8	1.6	1.6	1.5	1.5	1.5	1.4	1.2	6.7	5.7	4.6
1-4 Family Mortgage Originations f.											
- Conventional	$290	$369	$387	$330	$254	$377	$381	$312	$1,376	$1,324	$1,364
- FHA & VA	$107	$106	$113	$98	$76	$113	$114	$93	$424	$396	$406
- Total	$397	$475	$500	$428	$330	$490	$495	$405	$1,800	$1,720	$1,770
Refinancing Share - Originations (%) g.	42	30	32	32	30	25	24	23	34	25	23
Residential Mortgage Debt (%) h.	2.5	3.5	4.2	4.3	4.4	4.6	4.8	4.9	3.6	4.7	5.2

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).

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).

Prepared by the Economic & Housing Research group; Send comments and questions to chief_economist@freddiemac.com.

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