U.S. Economic, Housing and Mortgage Market Outlook

OCTOBER 2024 IN THIS ISSUE:

U.S. ECONOMY

The U.S. economy remains strong with upward revisions to GDP growth as well as job growth.

HOUSING & MORTGAGE MARKET

The housing market is showing some signs of thawing with the decline in mortgage rates and a slowdown in house price appreciation.

SPOTLIGHT: FIRST-TIME HOMEBUYERS

First-time homebuyers are increasingly driving demand in the housing market. However, they face headwinds in terms of affordability, supply and overall economic conditions. MORE →

Recent developments

U.S. economy: The third estimate of Q2 seasonally adjusted annual rate of growth of Real Gross Domestic Product (GDP) released by the Bureau of Economic Analysis (BEA) was 3%, unchanged from the second estimate. Real GDP growth in the first quarter was revised up 0.2 percentage points to 1.6%. Compared to Q1 2024, the increase in Q2 GDP was driven by consumer spending and private inventory investment while residential fixed investment turned negative. Consumer spending rose 2.8 percentage points in Q2 up from the 1.9% contribution in Q1 2024.

Along with the third estimate, BEA also released an annual update to the National Accounts, covering the period from Q1 2019 to Q1 2024. The revisions underscore the robustness of the U.S. economy, with the real GDP average annual growth rate revised up from 2.1% to 2.3%. Most of these revisions were driven by consumer spending. Real Gross Domestic Income (GDI), which measures the income side of economic output, had been previously estimated to be below GDP, was revised up from 1.8% to 2.2% average annual growth for the period 2018-2023. The post-pandemic GDI recovery (2021-2023) was also stronger than GDP growth in the same period. The upward revisions to GDI were mainly led by increases in employee compensation. Real personal disposable income for the years from 2021 was also revised higher as compared to the previously published estimates. The personal savings rate saw an upward revision from 3.3% to 5.2% for Q2 2024, and the revised savings rate for 2023 surpassed previous estimates.

EXHIBIT 1A

Previously estimated vs revised Real GDP

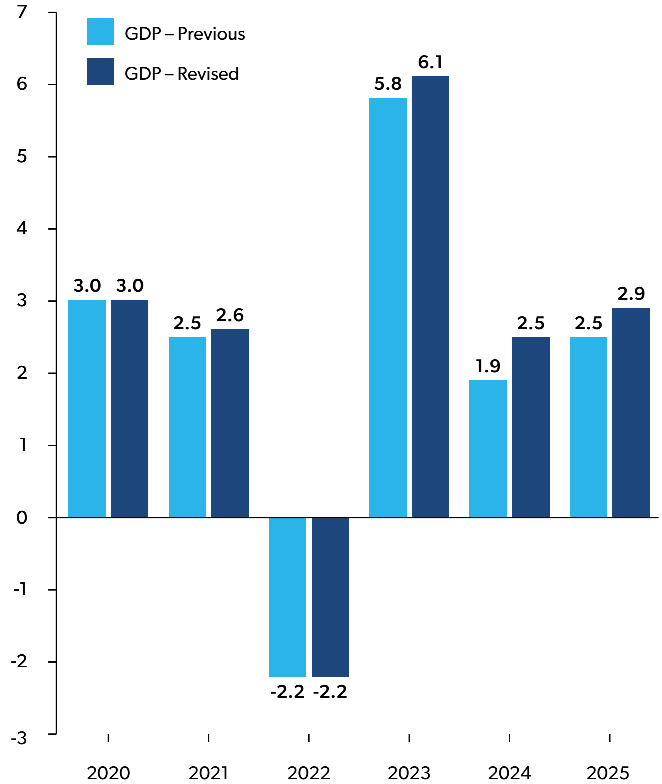
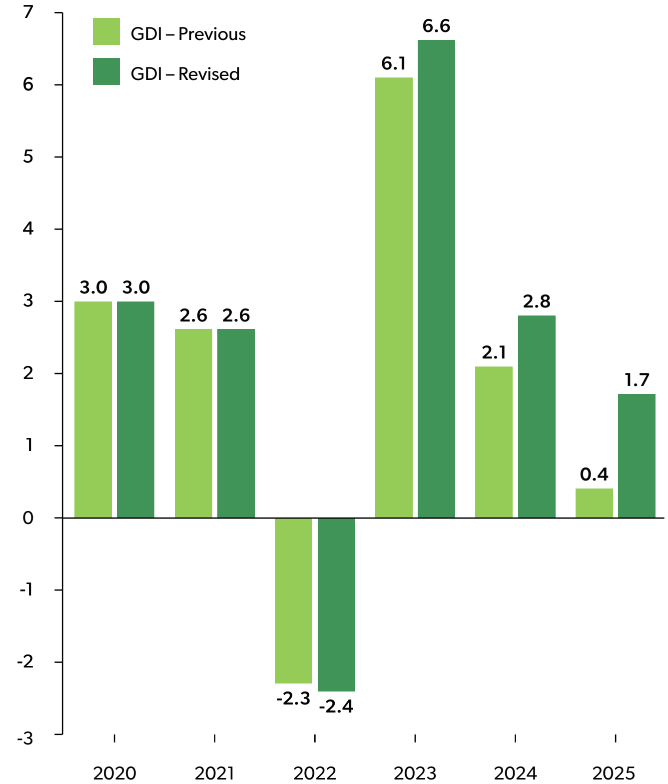


EXHIBIT 1B

Previously estimated vs revised Real GDI



Source: BEA

The latest employment report from the Bureau of Labor Statistics (BLS) showed a very strong rebound in job growth, with the economy adding 254,000 payroll jobs in September and job growth for July and August revised up by a combined 72,000. With the September payroll data, the economy added a total of 1.8 million jobs in the first nine months of 2024, in line with the pre-pandemic (2016-2019) average job growth for the first nine months of the year. The unemployment rate ticked down to 4.1% with layoffs remaining low. Average hourly wage growth rose 4% on a year-over-year basis. Job growth, unemployment and wage growth all beat consensus forecasts and indicate that the U.S. labor market remains resilient.

Job openings increased from 7.7 million in July to 8 million in August, as per the Job Openings and Labor Turnover Survey of BLS. Despite a slight downward trend in job openings in recent months, the job openings to unemployed ratio was unchanged at 1.1 over the month in August. Total separations edged slightly lower to 5 million, and the separations rate decreased to 3.1%. Within this, the number of quits decreased to 3.1 million, and the quits rate decreased slightly by 0.1 percentage point to 1.9%. Layoffs were also little changed at 1.6 million and a rate of 1.0%.

Inflationary pressures have been receding over the past few months with the Federal Reserve's preferred inflation gauge, the core Personal Consumption Expenditure (PCE) Price Index, which strips out volatile food and energy prices, rising 0.1% over the month in August and 2.7% from a year ago. Prices for goods have been leading the slowdown in overall inflation with a 0.2% monthly decline and a 0.9% yearly decline in August. On the other hand, prices for services continue to rise and were up 0.2% month-over-month and rose 3.7%

from a year ago. While the Consumer Price Index (CPI) also continued to trend lower on a year-over-year basis, the shelter index increased 5.2% year-over-year and accounted for over 70% of the yearly increase in CPI.

The upward revisions to economic growth along with the revisions to job growth, reiterate the strength of the U.S. economy. With inflation on its path towards the Fed target, and the Federal Reserve's shift in focus to the objective of maximum employment with the 0.5 percentage point rate cut in September, we reaffirm our optimism for a soft landing in our baseline scenario.

U.S. housing and mortgage market: Even with declines in mortgage rates to 2-year lows, total (new + existing) home sales declined 2.9% in August, with both existing and new home sales declining over the month. Existing home sales for August fell to the lowest level since October 2010, and new home sales fell to 716,000. Slower sales have coincided with inventory picking up. Months' supply of existing homes was 4.2 months in August, the highest level since July 2019.

Lower mortgage rates in September helped breathe some life back into the housing market, as evidenced by the slight uptick in the pending home sales index to 70.6 from last month's historic low of 70.2. However, in early October, the strong jobs report has pushed long-term rates, including mortgage rates, higher which will add to affordability challenges. Despite affordability challenges, the demand for housing has been bolstered by the demographic tailwind from Millennials and Gen Z, who are at prime home-buying age. We take a deeper dive on first-time homebuyers in our spotlight section this month.

Given declining mortgage rates, housing construction picked up in August. Single-family housing starts increased 15.8% from July, reversing the losses seen in July. While single-family completions fell 5.6%, multifamily completions increased 36.5% from July and almost 80% from last August. Homebuilder confidence inched up to 41, according to the National Association of Home Builders' Housing Market Index. Though increasing for the first time in five months, the index remains below 50[1] indicating that building conditions are expected to remain poor in the near term.

House price appreciation continues to slow from the highs we saw in 2022. As measured by the FHFA House Price Index, U.S. house prices rose 0.1% in July 2024 and 4.5% from last year. All nine census divisions showed annual increases, ranging from 7.5% in the East North Central division to 1.6% in the West South-Central division.

While overall mortgage delinquency rates remain low as we highlighted in the September Outlook, it's important to understand the reasons for the delinquencies. Research has found that it is usually life events which account for a larger share of defaults.[2] As per the FHFA Foreclosure Prevention and Refinance Report, the top reason for delinquency as of Q2 2024 was curtailment of income at 27%.[3] This was followed by excessive obligations (17%) and unemployment (15%) as of Q2 2024. Illness of the primary mortgagor or family member was also cited as a reason for delinquency at 11%. National emergency declaration, which was what had happened during COVID and was the main reason for delinquency from Q2 2020 through Q3 2023, was the least common reason in the last couple of quarters at 4%.

Mortgage rates continued to decline and reached a two-year low during the last week of September at 6.08%. The 30-year fixed-rate mortgage as measured by Freddie Mac's Primary Mortgage Market Survey® averaged 6.18% in September. The Mortgage Bankers Association (MBA) Weekly Application Survey has shown refinance activity steadily increasing as rates continued to drop in September. Refinance activity accounted for about 55% of total application activity as of the month, a significant increase from August.

1 The NAHB Housing Market Index is a diffusion indexed constructed so that a value of 50 indicates sentiment is on balance neutral, while values above (below) 50 indicates that sentiment is on balance positive (negative).
2 Ganong, P and Pascal J. Noel. 2020. "Why Do Borrowers Default on Mortgages?" NBER Working Paper 27585 http://www.nber.org/papers/w27585
3 The reasons for delinquency pertain to the loans with Freddie Mac, Fannie Mae, FHA and VA.

Outlook

The U.S. economy grew at a stronger pace than initially reported per the revisions of the BEA national accounts, mainly on strong consumer spending, and we expect it to continue to grow, though at a slower pace. Under our baseline scenario, we expect inflation to continue to trend lower. The Federal Reserve cut the federal funds rate by 0.5 percentage points in September and indicated further cuts of almost one percentage point in 2024 and another percentage point in 2025. Even though mortgage rates moved lower in anticipation of the rate cut, the most recent employment report has pushed rates higher in early October. Our baseline view has rates easing very gradually over time, with potential volatility as economic news may surprise the market.

Lower mortgage rates are expected to boost the housing market, but the lift will be modest given continued tightness in the existing inventory and homebuyers staying on the sidelines expecting further rate declines. We have seen some loosening in the average mortgage rate lock-in effect. The average rate lock-in effect for Freddie Mac borrowers as of September 2024 is down to $38,000 per borrower compared to the peak of $66,000 per borrower as of October 2023 when rates were at 23-year highs.[4] This loosening will likely bring more existing inventory into the housing market, but not enough to accommodate growing demand. Therefore, we expect home sales to remain flat in the remainder of 2024 but pick up slightly in 2025 as rates decline further and more housing inventory comes on the market. However, we expect home prices to grow as the supply-demand imbalance remains a core issue in the housing market.

In the mortgage market, we anticipate a slight growth in origination volumes in 2024 and 2025 compared to the low volumes in 2023—which were at the lowest since 2014. We forecast purchase origination volumes to continue to increase at a modest pace consistent with modest increases in home sales and house prices. Lower rates are already stimulating refinance volumes, and we expect this trend to continue, thereby pushing up total origination volumes in 2024 and 2025.

Overall, our outlook for the economy remains optimistic. The Federal Reserve's 0.5 percentage point cut is expected to have a positive impact on consumer spending and credit performance. However, while inflationary pressures have been declining, there are potential upside risks to inflation. One area where inflation could resurge is housing inflation in an environment where the fundamental mismatch of supply and demand remains a major challenge for the housing market.

4 Rate lock-in effect is calculated by taking the difference between the outstanding balance of the mortgage and the present value of the mortgage at prevailing market interest rates. For more on rate lock-in effect please see our July 2023 Outlook.

OCTOBER 2024 SPOTLIGHT:

First-time homebuyer activity

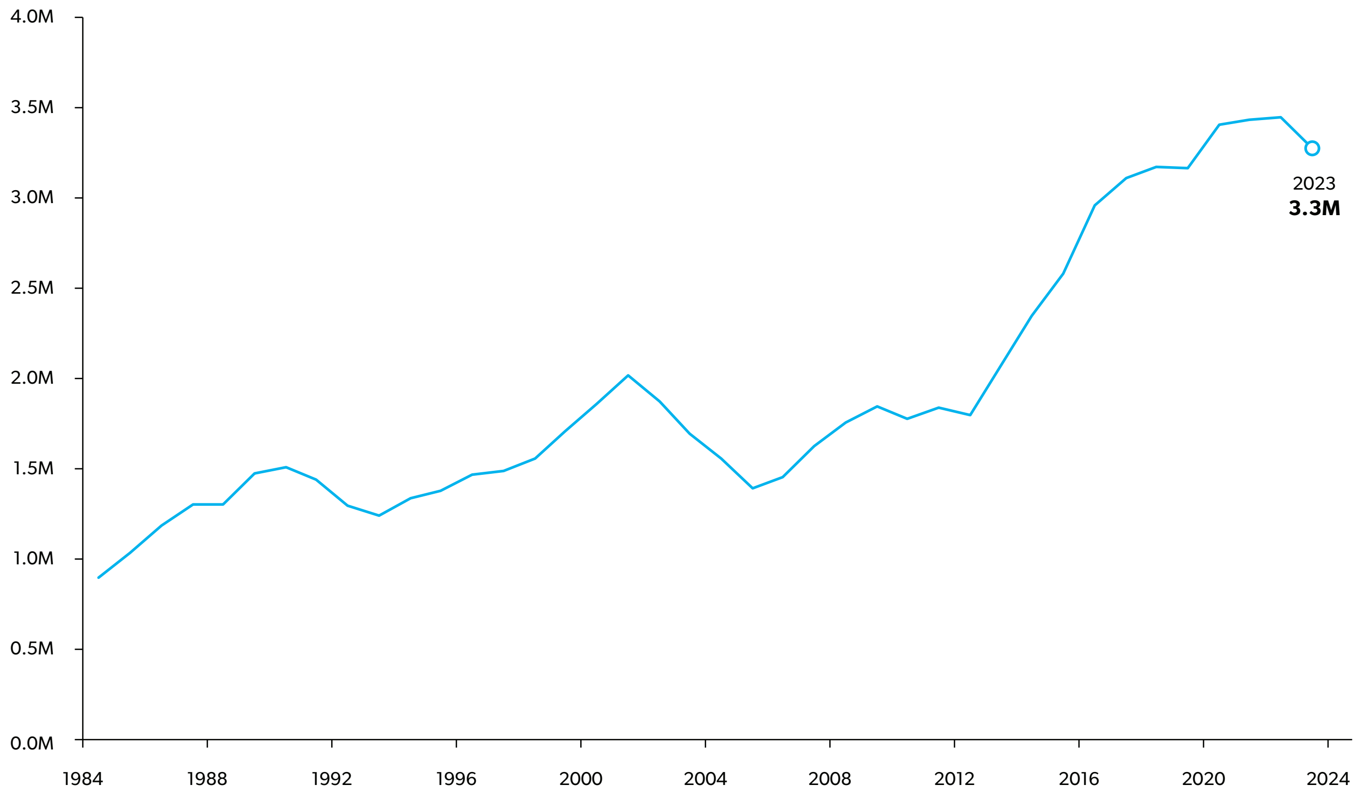
First-time homebuyers are an essential and growing segment of the housing market. In this month's spotlight, we delve into current first-time homebuyer trends. Using Freddie Mac data, we show their increasing role in housing demand, a trend that should continue thanks to favorable demographics. We also explore the geographic preferences of first-time buyers, identifying the regions where their share has grown the fastest over the last five years. Finally, we consider headwinds that might hinder first-time homebuyer activity in the near future.

Recent first-time homebuyer trends

Millennials are now of prime homebuying age, and Gen Z's oldest members are entering the workforce. These two cohorts will become the driving force in the housing market in the coming years and add to the pool of first-time buyers. Additionally, young adults who are renting are making more money now than in prior years, even after adjusting for inflation. **Exhibit 2** shows renter households between 25 and 44 years of age with real (inflation-adjusted) earnings of at least $75,000. Since 2012, the number of potential first-time homebuyers has been rising substantially, and as of 2023, there were three million of these households.

EXHIBIT 2

Renter households between 25 and 44 years of age earning at least $75,000 (Inflation-adjusted)



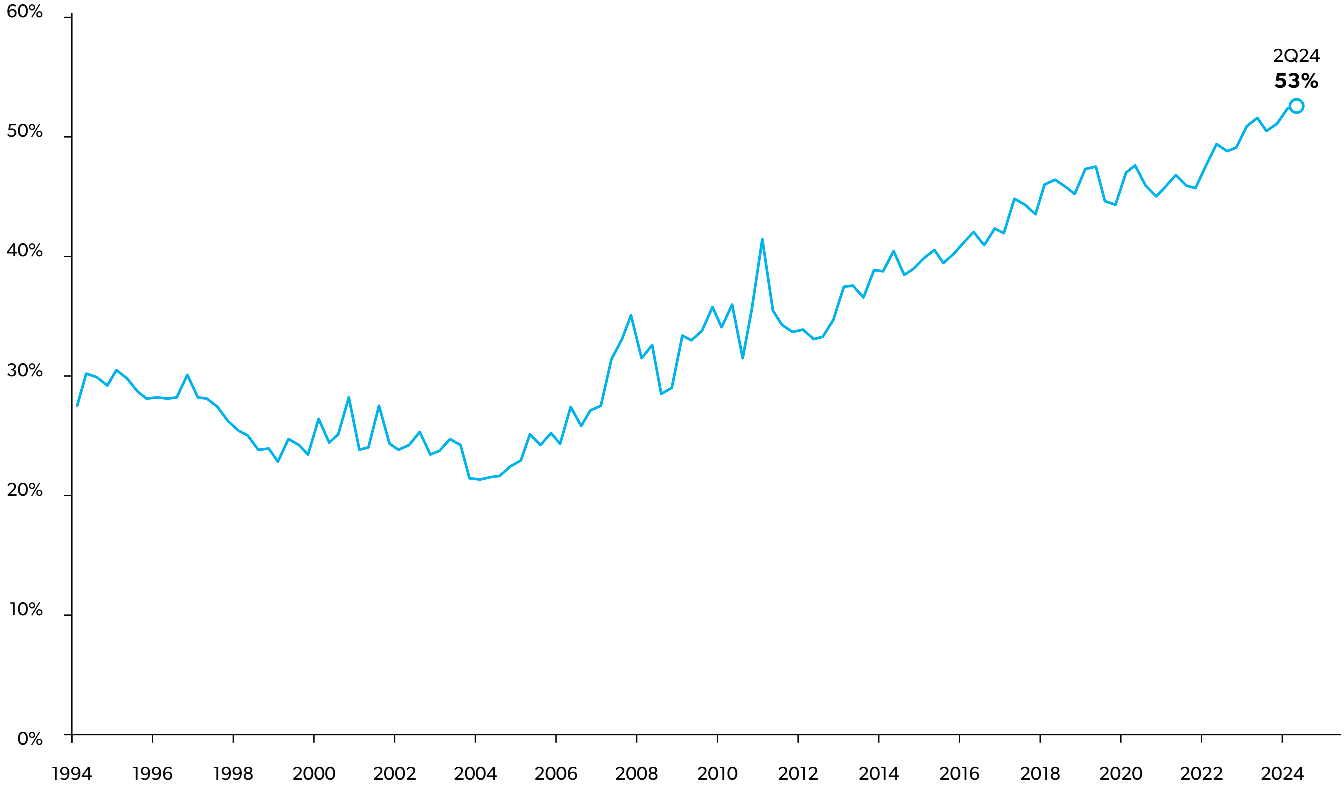
Source: U.S. Census Bureau Current Population Survey

Indeed, these favorable demographic and economic tailwinds are helping first-time homebuyers become a more significant presence in the housing market. Using Freddie Mac-funded loan data, we can examine the historical share of conventional conforming loans that went to first-time homebuyers. **Exhibit 3** shows that the share of first-time homebuyers has consistently been growing since 2004, from around 20% of funded loans to over 50% as of the second quarter of 2024.

One possible explanation for the recent increase in the share of first-time buyers is that repeat buyers are less active in the market due to the mortgage lock-in effect. From 2018 through 2022 the share of first-time homebuyers was steady at around 45% of funded loans. That share increased in 2023 and 2024 as the rate lock-in effect chilled the home resale market. However, even if the entirety of the increase from 2022 through 2024 was due to the rate lock effect, first-time homebuyers would still represent a significant share of all activity. And if the rate lock-in effect persists, then that underscores the importance of first-time homebuyers as one of the few sources of growing housing demand in the current environment.

EXHIBIT 3

Freddie Mac share of first-time homebuyers (Inflation-adjusted)



Source: Freddie Mac

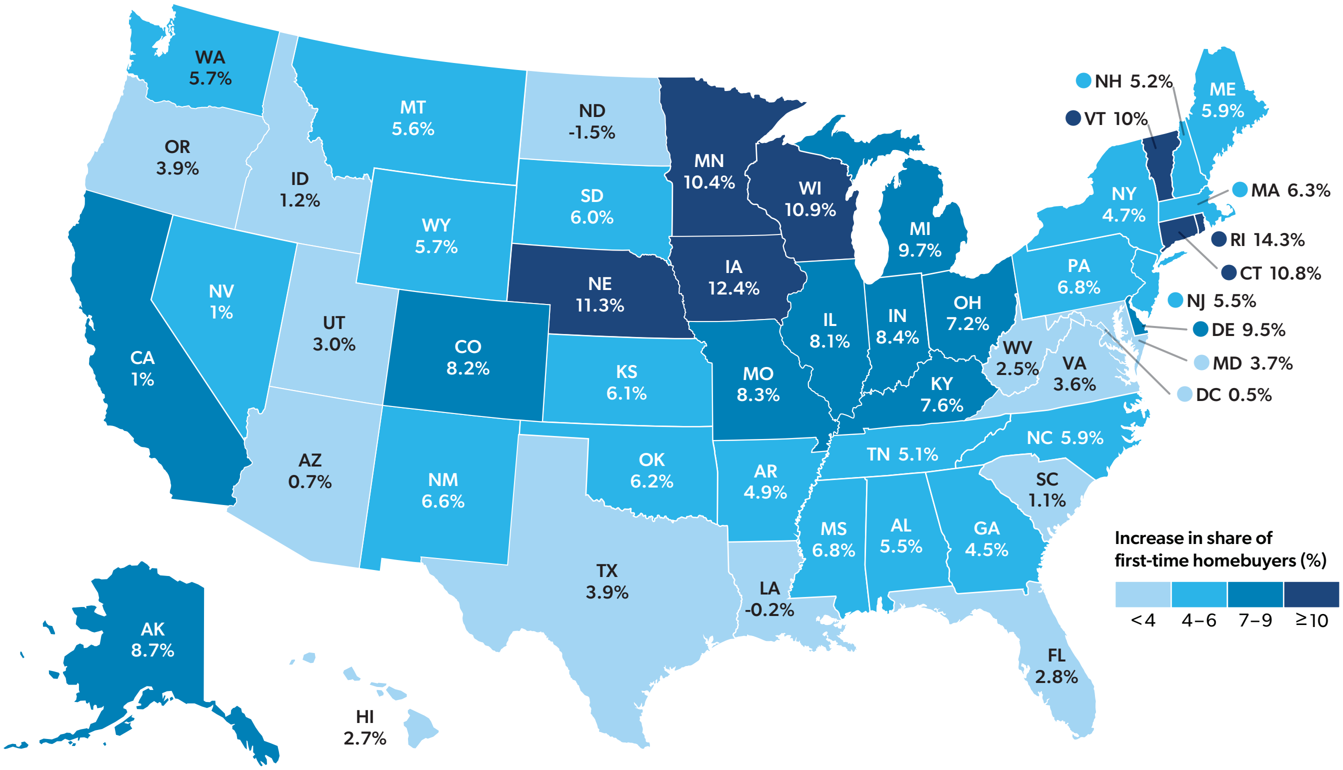
Where is the first-time homebuyer share increasing?

Using our Freddie Mac data, we can also examine states which have seen the most activity with respect to first-time homebuyers. Overall, we see consistent growth in the share for most states; however, states in the Northeast and Midwest have relatively higher shares of first-time homebuyers, especially in recent years.

Exhibit 4 shows how much the first-time homebuyer share of Freddie Mac-funded loans has increased from 2019 to the most recent four quarters, ending with the second quarter of 2024. The map suggests that the first-time homebuyer share is growing faster in areas with moderate or slower home sale activity. Conversely, retiree destinations where repeat buyers are abundant, like Arizona and Florida, saw lower first-time homebuyer share increase over the last five years.

EXHIBIT 4

Change in the share of first-time homebuyers from 2019 to the four quarters ending in 2Q2024



Source: Freddie Mac

Potential headwinds for future first-time homebuyers

While there is tremendous demand potential from these cohorts, there are headwinds which might hinder first-time buyer activity in the near term. In this section we identify three of the most pressing issues affecting first-time buyers.

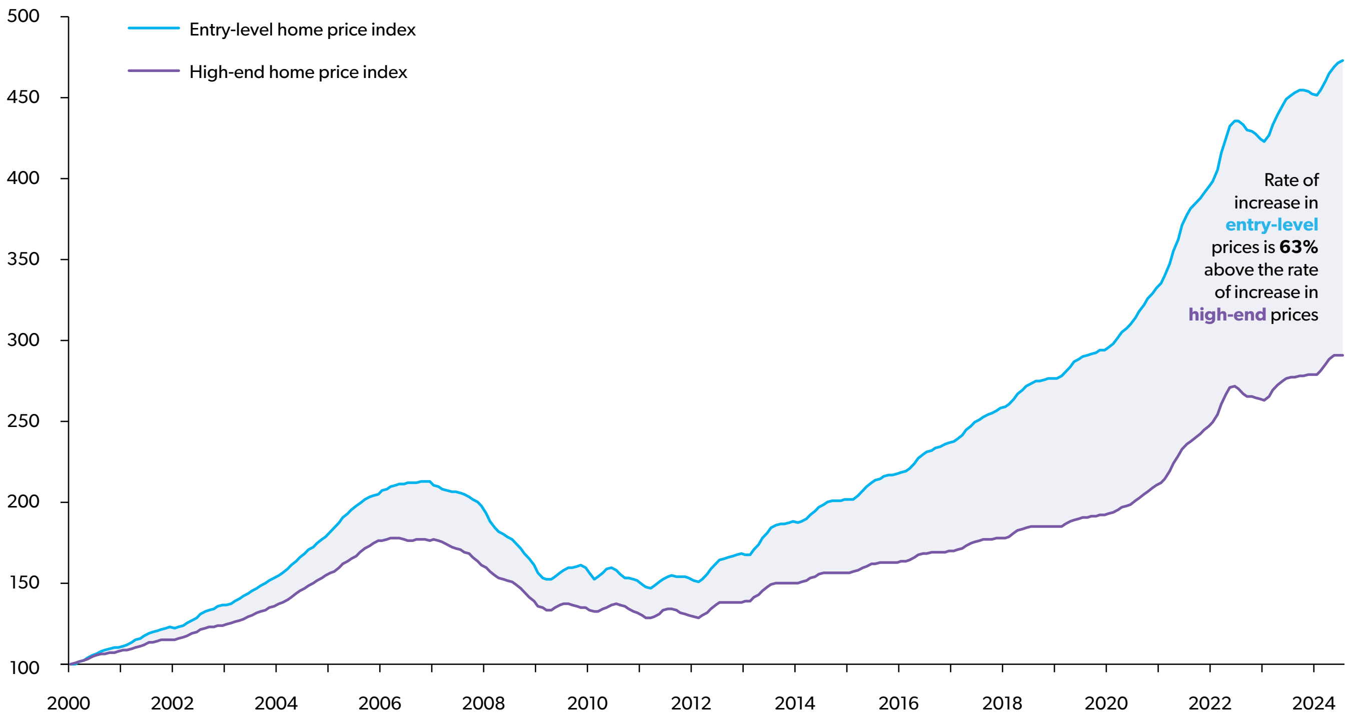
1. Affordability

People attempting to buy their first home today must navigate an environment of higher mortgage rates and house prices. Even though mortgage rates are back to averaging under 6.5% in recent weeks, many who bought their starter homes before the 2022 mortgage rate increases have little incentive to sell to the incoming cohorts of new buyers. More importantly, starter home price appreciation has exceeded other appreciation in the other segments of the housing market. **Exhibit 5** shows the cumulative gap in house price appreciation between entry-level homes (defined as homes that sell at 75% of the median or below) versus high-end homes (defined as homes that sell at 125% of the median or higher). Between January 2000 and July 2024, cumulative entry-level prices grew 63% more than high-end home prices. Less affordable housing is acutely felt by those seeking to buy their first homes, especially those without substantial wealth at their disposal.

EXHIBIT 5

Cumulative gap between entry-level and high-end home prices

Home price index level (2000=100)



Source: CoreLogic

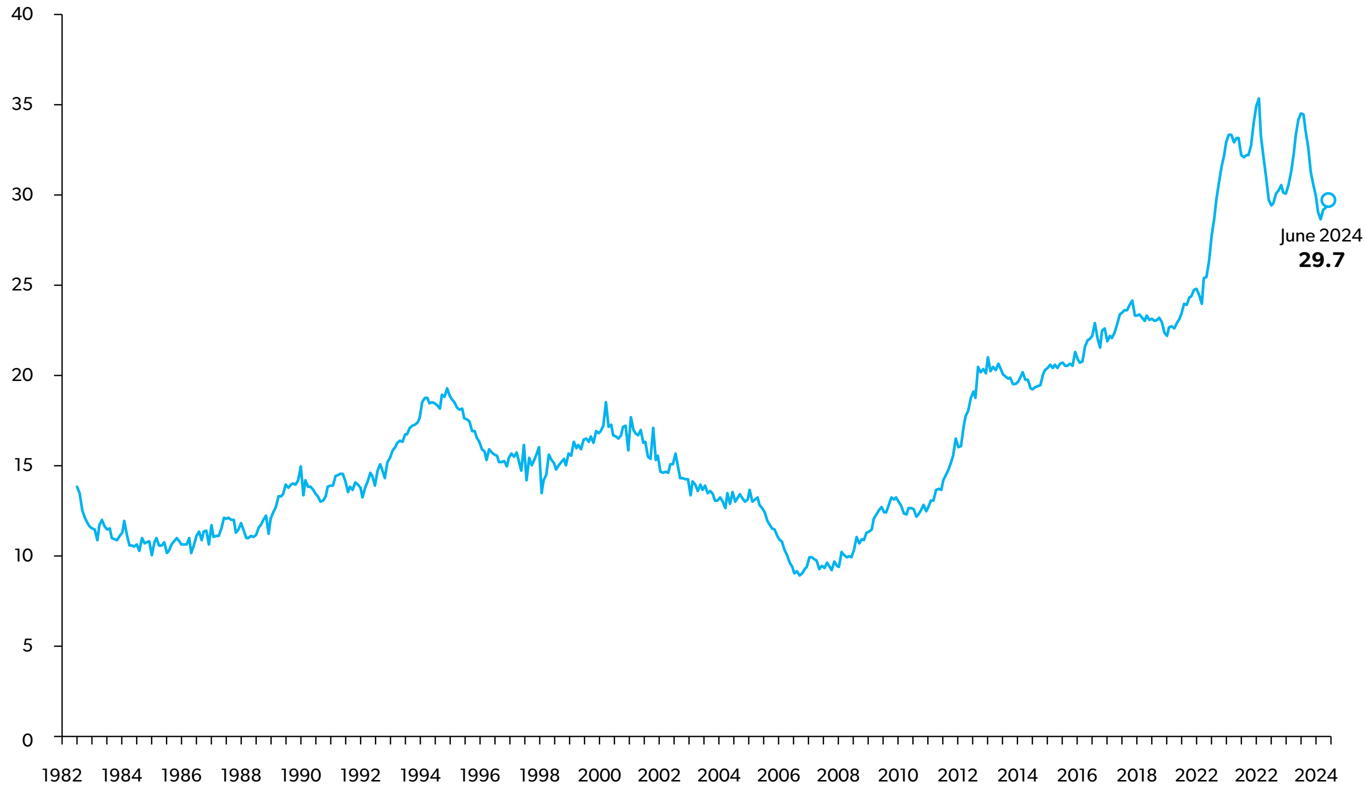
Note: Entry level home prices are homes that sell at 75% of the median or below. High end home prices sell at 125% of the median or higher. Data through July 2024.

2. Supply

We can't bring up affordability issues without discussing the lack of supply in the housing market. The supply deficit has its roots in the lack of residential construction post-Great Financial Crisis and was exacerbated due to a surge in demand during the pandemic. **Exhibit 6** shows the number of renter households per homes for sale. The number of renters per homes for sale has been trending up since 2006, rising from less than 10 to above 30 renter households per home available. Therefore, not only do people seeking to buy their first home have to navigate an expensive market, but they also have to compete with more first-time buyers as supply continues to trail demand.

EXHIBIT 6

Number of renter households per homes for sale



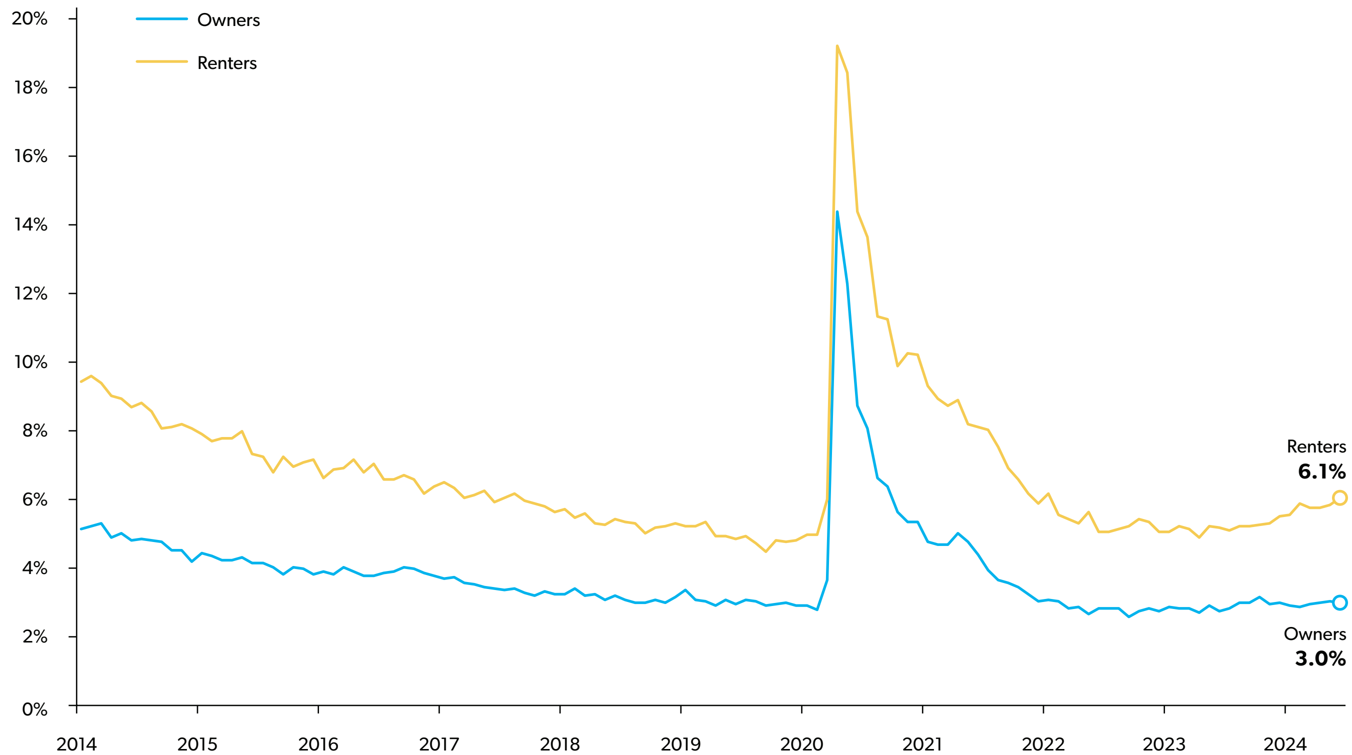
Source: U.S. Census Bureau, National Association of Realtors

3. Tougher economic conditions

The Federal Reserve's tight monetary policy has helped ease inflation over the last few years. However, higher interest rates (among other factors) have also contributed to higher unemployment. The U.S. unemployment rate increased half a percentage point from 3.7% in January 2024 to 4.2% in August. Renter households, especially, are seeing a faster acceleration in the unemployment rate than homeowner households. This trend is something to consider in the context of future first-time homebuyer activity, as many future buyers are currently renting. **Exhibit 7** shows that the renter unemployment rate has increased from about 5% to over 6% since 2023. On the other hand, the unemployment rate of owner-occupied households has remained relatively flat. There could be disproportionate impacts on first-time homebuyer activity if labor conditions were to tighten and renters are the first to feel the pinch.

EXHIBIT 7

Unemployment rate by tenure (Seasonally adjusted)



Source: U.S. Census Bureau Current Population Survey

Note: Data through June 2024

Throughout the country, we see the perseverance of first-time homebuyers as they navigate through stubbornly complex market dynamics. That's why Freddie Mac continues to work closely with lenders and community organizations to help people achieve their personal housing goals. For example, we offer a variety of customized loan products to help first-time buyers overcome housing challenges and become homeowners. In the second quarter of 2024 alone, we financed approximately 200,000 primary home purchases, 53% of which were for first-time homebuyers. We've also launched an innovative platform to help potential buyers work with their lender to find down payment assistance programs. These are just some of the ways we are working to Make Home Possible.

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