Office of the Chief Economist

January 2014 U.S. Economic & Housing Market Outlook

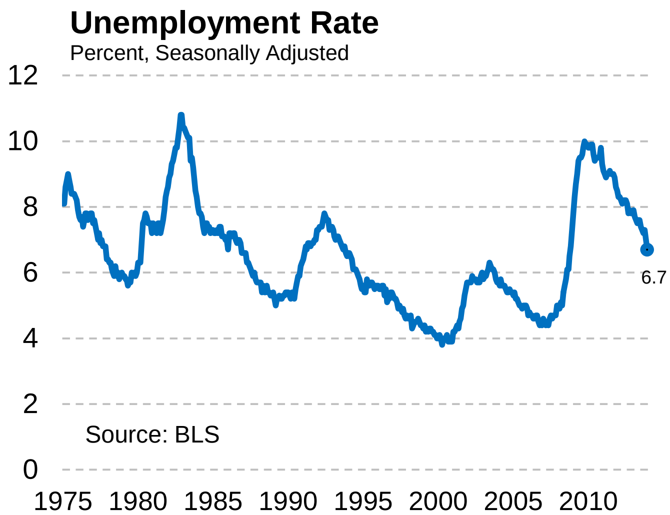
Taking the Temperature of the Market

After turning the corner in 2012, the housing recovery was fully underway in 2013. Based on our January 2014 outlook from Q4 2012 to Q4 2013 national house price indexes rose by about 10%, home sales increased 10%, and housing starts were up 17%. While the trends are decidedly positive, when will we be able to say that housing has fully recovered? In this outlook we examine this question in some detail.

There are a lot of ways to measure the overall health of the economy, but let's focus on four specific areas. For the economy and housing market to be functioning normally, we need to see four things: 1) a healthy jobs market with a low and stable unemployment rate, 2) mortgage delinquencies back down near historical averages, 3) house prices that are consistent with an affordable mortgage payment-to-income ratio, and 4) home sales consistent with historical norms.

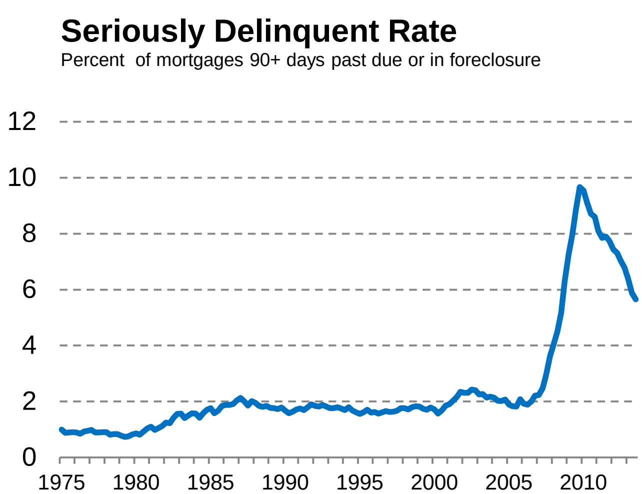
Healthy Jobs Market

A healthy jobs market requires a lower unemployment rate, robust job growth, and more income growth. In the aftermath of the Great Recession, the labor market recovery has been modest. The unemployment rate in December 2013 stood at 6.7%, high by historical standards, but moving in the right direction. Economists debate about exactly what the unemployment rate should be for an economy at its long-run potential, but most agree it is between 5 and 6 percent. Despite recent improvements in the labor market, we believe it may be another two years before we are back to full employment.



Low Mortgage Delinquencies

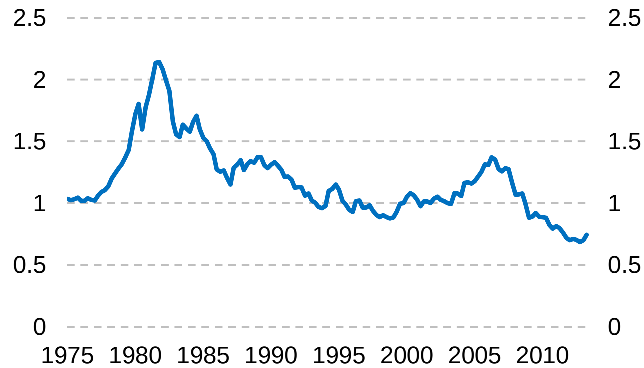
In the Great Recession mortgage delinquency rates spiked. Delinquency rates have been falling rapidly recently, but are still well above historical norms. From 1975 to 2005 serious delinquency rates on mortgages remained below two percent, but as of the third quarter 2013, they stood at 5.88 percent, more than double the historical average. With continued improvement in the labor market, and increasing house prices, the delinquency rate should continue to fall, but will not be back to normal levels for some time.



Source: MBA National Delinqeuncy Survey. Seriously Delinquent is the sum of % of loans 90 Days or more past due and the % in the foreclosure inventory at the end of the quarter.

Payment-to-Income Ratios

December 1999=1

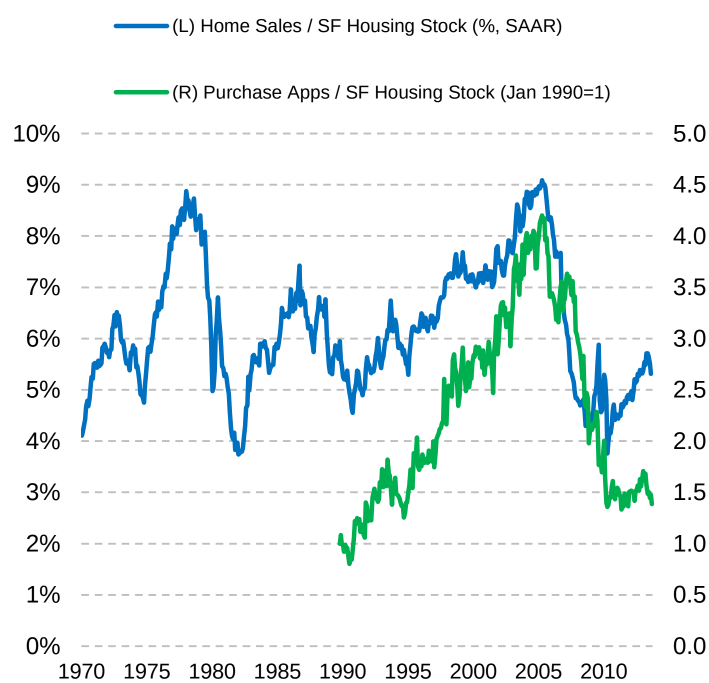


Payment-to-Income calculated as the ratio of mortgage payments on a 30 year fully amortizing fixed rate mortgage for a loan amount set to $200,000 in December 1999 and inflated using the FMHPI divided by median household income. The ratio is set to 1 in December 1999. **Source:** House Prices (Freddie Mac), Interest Rates (Freddie Mac PMMS), Income (Moody's Analytics).

House prices consistent with Income

As we saw in the previous decade, house prices rising too rapidly relative to income is not sustainable. In order to have a stable housing market, house prices should rise more or less in line with incomes. When looking at housing affordability, mortgage rates also have a big effect on the monthly payment. With rising interest rates, the house price that a typical family can afford using traditional fixed-rate financing will fall. The chart to the right plots the historical variation in the payment-to-income ratio on a hypothetical 30-year fixed-rate mortgage taken out at different dates. From 1999-2006, mortgage payments on this hypothetical 30-year fixed mortgage increased by 50 percent more than income growth in large part because of rapid house-price appreciation. Currently, payment-to-income ratios are only 60 percent of the level we had in 1999 suggesting fixed-rate loans will generally remain manageable for a typical family's budget even with some additional increases in mortgage rates and house prices in 2014.

Home Sales and Purchase Applications Relative to Single Family Housing Stock



Source: Home Sales is the sum of new home sales (Census) and Existing SF home sales (NAR). Purchase apps are total purchase applications in the MBA weekly application survey. Housing stock estimates are from Moody's Analytics. All data extrapolated/interpolated to monthly frequency.

Solid Home Sales

Home sales have increased over the past two years but remain well below the sales pace of a decade ago. When measured against the single-family housing stock, we see that historically home sales have averaged about 6 percent of the stock at an annual rate. During the housing boom, home sales increased to about 9 percent of the single-family housing stock, and then plummeted to below 4 percent. With home sales at a 5.8 million pace in 2014 this rate should rise up to 5.7% for 2014. Homes offered for sale currently remains limited in some markets as many sellers remain financially underwater, holding back a full recovery in the overall sales market. Over the past couple of years, home sales have rebounded with a relatively large share of all-cash sales. When we look at mortgage originations, or applications for home purchase loans, we see that the lending recovery is more muted.

So are we there yet? No. The housing market hasn't fully recovered and has a good ways to go, but it is moving in the right direction. Moreover, some markets are recovering faster than others and the home sales recovery is likely to slow with mortgage rates moving higher. We'll continue to follow these four key indicators in 2014 to see how the housing recovery is shaping up.

Frank E. Nothaft
Chief Economist

Leonard Kiefer
Deputy Chief Economist

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www.freddiemac.com/news/finance **chief_economist@freddiemac.com**

Freddie Mac — Office of the Chief Economist

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Revised 1/15/2014

	2013				2014				2015		Annual Totals						
Indicator	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Real GDP (%)	1.1	2.5	4.1	**3.0**	**2.1**	**2.8**	**3.0**	**3.2**	**3.3**	**3.3**	-0.2	2.8	2.0	2.0	**2.7**	**2.8**	**3.3**
Consumer Prices (%) a.	1.4	0.0	2.6	**0.7**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	1.5	1.4	3.0	1.8	**1.2**	**2.0**	**2.0**
Unemployment Rate (%) b.	7.7	7.5	7.2	7.0	**7.0**	**6.9**	**6.8**	**6.7**	**6.6**	**6.5**	9.3	9.6	8.9	8.1	7.4	**6.9**	**6.5**
30-Year Fixed Mtg. Rate (%) b.	3.5	3.7	4.4	4.3	**4.6**	**4.8**	**5.0**	**5.1**	**5.3**	**5.5**	5.0	4.7	4.5	3.7	4.0	**4.9**	**5.6**
1-Year Treas. Indexed ARM Rate (%) b.	2.6	2.6	2.7	2.6	**2.6**	**2.6**	**2.7**	**2.7**	**2.8**	**2.9**	4.7	3.8	3.0	2.7	2.6	**2.7**	**2.9**
10-Year Const. Mat. Treas. Rate (%) b.	2.0	2.0	2.7	2.7	**3.1**	**3.3**	**3.4**	**3.6**	**3.8**	**4.0**	3.3	3.2	2.8	1.8	2.4	**3.4**	**4.0**
1-Year Const. Mat. Treas. Rate (%) b.	0.2	0.1	0.1	0.1	**0.1**	**0.2**	**0.2**	**0.3**	**0.3**	**0.4**	0.5	0.3	0.2	0.2	0.1	**0.2**	**0.4**

	2013				2014				2015		Annual Totals						
Indicator	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Housing Starts c.	0.96	0.87	0.88	**0.95**	**1.00**	**1.05**	**1.15**	**1.20**	**1.25**	**1.30**	0.55	0.59	0.61	0.78	**0.92**	**1.10**	**1.35**
Total Home Sales d.	5.39	5.50	5.74	**5.50**	**5.65**	**5.75**	**5.85**	**5.95**	**6.05**	**6.10**	4.72	4.51	4.57	5.03	**5.53**	**5.80**	**6.10**
FMHPI House Price Appreciation (%) e.	2.7	5.4	2.2	**-1.0**	**1.0**	**2.5**	**1.5**	**-0.1**	**0.5**	**1.5**	-2.3	-4.9	-3.2	5.8	**9.5**	**5.0**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	1.1	7.1	3.2	**-1.0**	**1.1**	**3.5**	**1.0**	**-0.6**	**0.5**	**1.5**	-2.5	-3.8	-3.7	7.2	**10.6**	**5.0**	**3.0**
1-4 Family Mortgage Originations g.																	
Conventional	**$435**	**$456**	**$359**	**$280**	**$280**	**$340**	**$266**	**$194**	**$248**	**$308**	$1,549	$1,300	$1,206	$1,750	**$1,530**	**$1,080**	**$952**
FHA & VA	$105	$104	$91	**$70**	**$70**	**$85**	**$67**	**$48**	**$62**	**$77**	$451	$377	$294	$380	**$370**	**$270**	**$238**
Total	**$540**	**$560**	**$450**	**$350**	**$350**	**$425**	**$333**	**$242**	**$310**	**$385**	$2,000	$1,677	$1,500	$2,130	**$1,900**	**$1,350**	**$1,190**
ARM Share (%) h.	8	9	9	**9**	**10**	**11**	**12**	**13**	**14**	**15**	3	5	11	10	**9**	**12**	**15**
Refinancing Share - Applications (%) i.	79	73	64	**57**	**50**	**45**	**40**	**40**	**30**	**20**	70	76	75	81	**70**	**44**	**20**
Refinancing Share - Originations (%) j.	**71**	**65**	**56**	**49**	**44**	**40**	**35**	**35**	**30**	**20**	68	67	64	70	**60**	**38**	**20**
Residential Mortgage Debt (%) k.	-1.7	-0.5	0.9	**0.0**	**0.0**	**1.0**	**2.0**	**3.0**	**3.0**	**4.0**	-1.6	-4.3	-2.2	-2.1	**-0.3**	**1.5**	**4.0**

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.

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 (FMHPI); not seasonally-adjusted; Dec.to-Dec. for yearly data.

f. National composite index (quarterly growth rate); not seasonally-adjusted; Q4-to-Q4 for yearly data.

g. Billions of dollars (not seasonally-adjusted).

h. Federal Housing Finance Agency (FHFA); quarterly averages of monthly shares of number of loans 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).

Prepared by Office of the Chief Economist and reflects views as of 1/15/2014 (PTT); Send comments and questions to chief_economist@freddiemac.com.