Office of the Chief Economist

June 2014 U.S. Economic & Housing Market Outlook

2014: A Mid-Year Assessment

This year started out far more sluggishly for the single-family sector than we had anticipated six months ago. Comparing the first four months of 2014 with the same period in 2013, existing home sales were down 7 percent and new home sales were off 3 percent. Single-family housing construction was lackluster too, with building permits slipping 2 percent and housing starts lower over this same four-month window. One of the few bright spots in housing activity occurred for multifamily rentals: starts of buildings with five-or-more apartments jumped 15 percent during January-through-April compared with a year ago, and vacancy rates on rental apartments tracked by Reis dipped to 4.0 percent in the first quarter, down from 4.4 percent a year earlier, and the lowest recorded by the firm since 2000.

Now that we're nearly half way through 2014, let's see where the overall economy and housing market stands, and also explore what we expect to see over the next year with the for-sale inventory and vacancy rates.

The Economy: We expect GDP to grow at a 3 percent rate over the next couple quarters. However, because of the dismal first quarter reading, the economy is likely to show another 2.0 to 2.5 percent real-growth rate for the year as a whole, similar to the last few years. Part of this slowdown in the first quarter came from lackluster housing activity. Residential fixed investment declined by an annualized 5.0 percent in the first quarter, whereas in 2013 it contributed 0.33 percent to overall GDP growth.

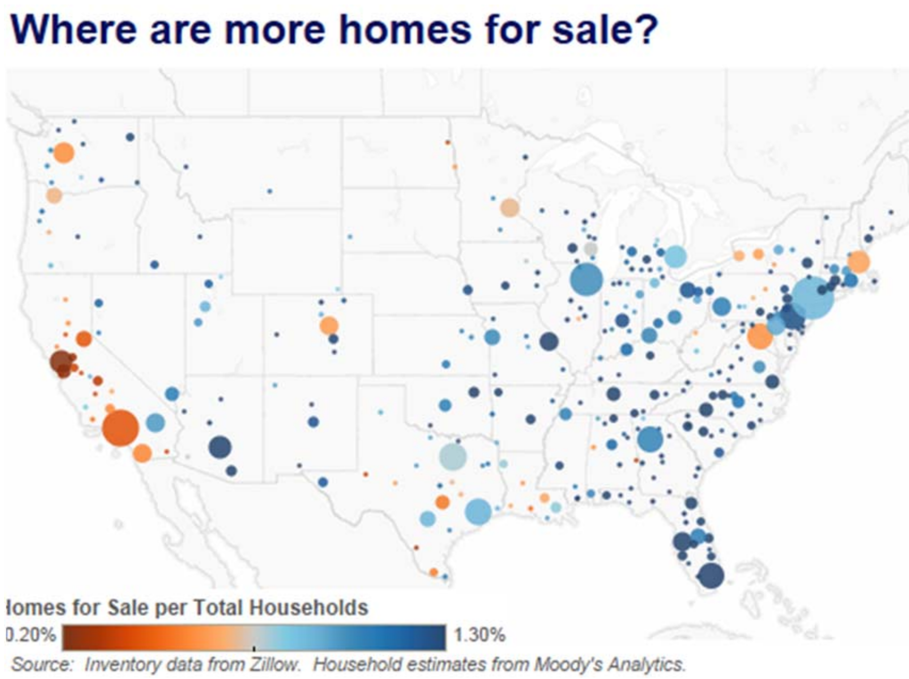
Employment: On the jobs front, the news is a bit better. The unemployment rate now stands at 6.3 percent versus 6.7 percent when we started the year and we've had four consecutive months of over 200,000 job gains. In May 2014, total nonfarm payrolls surpassed the pre-recession peak for the first time. Construction jobs are picking up, especially in the residential building and specialty trade sector, averaging about 9,500 jobs per month since the beginning of the year. While the trends are encouraging, the labor market is not yet fully recovered.

Mortgage Rates: A main reason for the year-over-year decline in mortgage applications was the spike in mortgage rates last June: rates for the 30-year fixed-rate mortgage jumped by more than a percentage point to a high of 4.58 percent in our weekly mortgage survey for the week ending on August 22, 2013. This spike triggered the rapid decline in refinance originations and also stunted the purchase market. Since then, rates have come down and will likely remain where they currently stand (near 4.25 percent) before gradually moving higher as the economy picks up steam over the next six months.

House prices and rents: A moderation in house price growth is welcome news as we move toward more stable and sustainable gains. The Freddie Mac House Price Index for the U.S. was up 9.3 percent in 2013, but gains are expected to slow to 5.0 percent for 2014. Average apartment rents in the U.S. will likely continue to rise, about 3.0 to 3.5 percent in the coming year.

Home Sales: Home sales are likely to be a bit below the 5.5 million pace from last year. Inventory of for-sale homes remains limited in some markets as many sellers remain underwater or prefer to keep the very low-rate mortgage they refinanced into, holding back a full recovery in the overall sales market. Home purchase applications have picked-up a bit recently with the traditional homebuying season underway, yet they're still currently 13 percent below last year. For this reason, we're lowering our overall homes sales forecast from 5.5 million to 5.4 million.

For-Sale Inventory

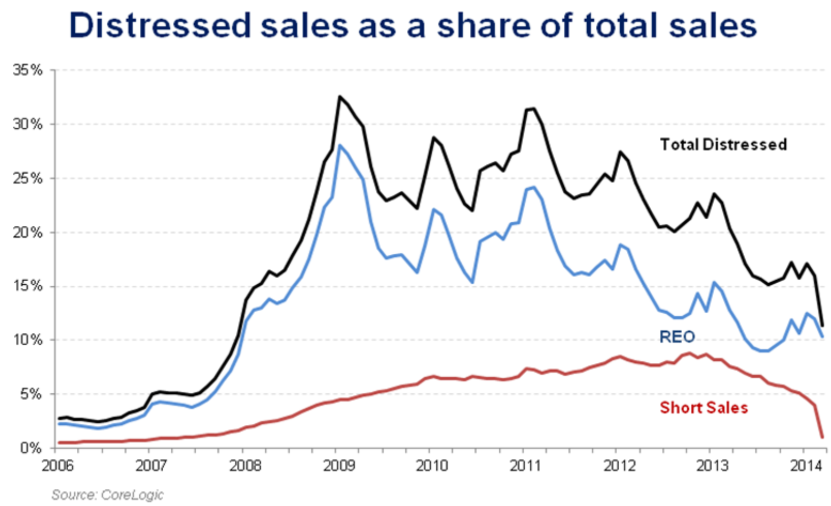


Real estate professionals in many markets have reported tighter markets, which will help to sustain house price and rent gains, but at the expense of affordability. The for-sale supply has almost entirely reversed from just a couple of years ago. As reported in last month's Outlook, the for-sale inventory of homes is historically low relative to the number of households. The for-sale inventory is extremely tight on the west coast and in Texas and Louisiana, but shows relatively more availability in the southeast.

The trend in inventory has been down across the country since 2010. For example, in metro areas like Houston and Dallas, where there have been strong job gains, inventories are low and building has picked up. Conversely, in the Miami and Atlanta metro areas, for-sale inventories have been nearly cut in half.

Vacancy Rates

In the first quarter of 2010 the homeowner vacancy rate (the percent of owner-occupied homes that are vacant and for sale) was 2.6 percent nationally. In the latest data for the first quarter of 2014, the homeowner vacancy rate was down to 2.0 percent, still high by historical standards, but much improved. While the total number of vacant units has decreased by 4.2 percent from the first quarter of 2010 to the first quarter of 2014, the number of vacant units for sale has declined by 24.2 percent (485,000 units). Vacancy rates also vary considerably by geographic area, with low rates in most of the coastal markets and higher rates in the Midwest. (To explore homeowner and rental vacancy rates across the country in more detail, visit the interactive chart book online.)



There are a number of forces that have contributed to the low for-sale inventory. For one, REO sales have been trending lower as servicers have made more use of loan modifications and other foreclosure alternatives. Importantly, one of those alternatives, short sales, has dropped substantially as a result of the expiration of the Mortgage Debt Forgiveness Act at the end of December. Higher mortgage rates and house prices also helped to stunt short sales activity. According to CoreLogic, short sales accounted for 9 percent of nationwide sales in December 2012, but only 1 percent in March 2014.

Another reason for the low for-sale inventory is that millions of owners have either refinanced or modified their home loan at historically low rates, as low as 2 percent for some recipients of a Home Affordable Modification Program (HAMP) modification. Most of these owners today enjoy relatively low monthly mortgage payments and are less likely to put their home up for sale.

Rental market conditions have continued to tighten as well. A broad measure of rental vacancy rates compiled by the Census Bureau—which includes single-family houses, public housing projects, small “mom and pop” buildings, and large professionally managed complexes—shows vacancies averaging 8.3 percent nationwide over the last four quarters, the lowest four-quarter average in 14 years. The National Multifamily Housing Council also reported that its Market Tightness Index was up considerably in April compared with three months earlier, a sign that property managers in most metro areas across the U.S. have experienced lower vacancy rates and/or higher rent increases. Reis reported that effective rents were up 3.2 percent during the first quarter compared with a year earlier, and the Bureau of Labor Statistics’ residential rent index was up 2.9 percent over the first four months of 2014 compared with a year ago, both increases faster than overall consumer price inflation.

Near-term Outlook

With vacancy rates moving back in line with historical averages - even falling below historical averages in some markets - and for-sale inventories remaining tight, U.S. home price indexes are likely to continue their above-inflation growth for the remainder of the year, albeit much slower than in 2013. U.S. rent metrics will likely show gains that are better than general inflation, with new rental construction slowing rent gains in coming months. The important question is how much further will prices and rents have to rise to give incentives for more existing owners to list their property for sale and developers to bring more supply to the market. Construction has rebounded over the past two years but is still significantly below the levels one would expect to see given projections of household formations.

Tight inventories will be further exacerbated by acceleration in job growth and household formations. The May jobs report was solid, with nonfarm payrolls increasing by 217,000. Increased job growth will help to boost household formation, which has been lagging throughout the recovery. In the long run, household formations are almost entirely driven by demographics, but in the short run job and income growth are critical.

In the next few months, mortgage rates are likely to remain at their current, low level, but will not remain there for long. As the Federal Reserve is expected to ‘taper’ its purchases of long-term Treasuries and mortgage-backed securities, and as economic growth picks up, long-term yields will gradually rise. Fixed-rate mortgages are expected to be higher in six months, and may even approach 5 percent a year from now. Ten-year Treasury yields will be up as well, and may average above 3 percent by the first quarter of 2015.

Frank E. Nothaft
Chief Economist
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Leonard Kiefer
Deputy Chief Economist

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

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Indicator	2013		2014				2015				Annual Totals						
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012	2013	2014	2015
Real GDP (%)	4.1	2.6	-1.0	**3.2**	**3.0**	**3.2**	**3.3**	**3.3**	**3.3**	**3.3**	-0.2	2.8	2.0	2.0	2.6	**2.1**	**3.3**
Consumer Prices (%) a.	2.2	1.1	1.9	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	**2.0**	1.5	1.2	3.3	1.9	1.2	**2.0**	**2.0**
Unemployment Rate (%) b.	7.2	7.0	6.7	**6.3**	**6.3**	**6.2**	**6.1**	**6.0**	**5.9**	**5.8**	9.3	9.6	8.9	8.1	7.4	**6.4**	**6.0**
30-Year Fixed Mtg. Rate (%) b.	4.4	4.3	4.4	**4.2**	**4.2**	**4.4**	**4.6**	**4.8**	**5.0**	**5.2**	5.0	4.7	4.5	3.7	4.0	**4.3**	**4.9**
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	3.2	3.0	3.1	**3.1**	**3.1**	**3.3**	**3.5**	**3.7**	**3.9**	**4.1**	4.8	3.8	3.3	2.8	2.9	**3.2**	**3.8**
1-Year Treas. Indexed ARM Rate (%) b.	2.7	2.6	2.5	**2.4**	**2.4**	**2.5**	**2.5**	**2.6**	**2.6**	**2.7**	4.7	3.8	3.0	2.7	2.6	**2.5**	**2.6**
10-Year Const. Mat. Treas. Rate (%) b.	2.7	2.7	2.8	**2.6**	**2.6**	**2.8**	**3.0**	**3.2**	**3.4**	**3.6**	3.3	3.2	2.8	1.8	2.4	**2.7**	**3.3**
1-Year Const. Mat. Treas. Rate (%) b.	0.1	0.1	0.1	**0.1**	**0.1**	**0.1**	**0.2**	**0.2**	**0.3**	**0.3**	0.5	0.3	0.2	0.2	0.1	**0.1**	**0.3**

Indicator	2013		2014				2015				Annual Totals						
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011	2012	2013	2014	2015
Housing Starts c.	0.88	1.03	0.92	**1.05**	**1.15**	**1.25**	**1.30**	**1.40**	**1.40**	**1.50**	0.55	0.59	0.61	0.78	0.92	**1.09**	**1.40**
Total Home Sales d.	5.71	5.39	5.04	**5.27**	**5.60**	**5.70**	**5.75**	**5.75**	**5.80**	**5.90**	4.72	4.51	4.57	5.03	5.50	**5.40**	**5.80**
FMHPI House Price Appreciation (%) e.	1.6	-0.7	1.2	**2.5**	**1.5**	**-0.3**	**0.0**	**2.0**	**1.0**	**0.0**	-3.1	-4.9	-3.3	6.1	9.3	**5.0**	**3.0**
S&P/Case-Shiller® Home Price Index (%) f.	3.1	-0.3	0.2	**4.4**	**1.0**	**-0.6**	**0.0**	**2.0**	**1.0**	**0.0**	-2.5	-3.8	-3.7	7.2	11.4	**5.0**	**3.0**
1-4 Family Mortgage Originations g.																	
Conventional	**$363**	**$291**	**$248**	**$312**	**$256**	**$192**	**$228**	**$288**	**$224**	**$160**	$1,549	$1,300	$1,206	$1,750	**$1,570**	**$1,008**	**$900**
FHA & VA	$87	$59	$52	**$78**	**$64**	**$48**	**$57**	**$72**	**$56**	**$40**	$451	$367	$286	$372	$355	**$242**	**$225**
Total	**$450**	**$350**	**$300**	**$390**	**$320**	**$240**	**$285**	**$360**	**$280**	**$200**	$2,000	$1,667	$1,492	$2,122	**$1,925**	**$1,250**	**$1,125**
ARM Share (%) h.	9	10	11	**11**	**12**	**13**	**14**	**15**	**15**	**15**	3	5	11	10	9	**12**	**15**
Refinancing Share - Applications (%) i.	54	59	52	**45**	**35**	**34**	**32**	**22**	**18**	**17**	68	73	71	77	63	**42**	**23**
Refinancing Share - Originations (%) j.	**52**	**51**	**48**	**42**	**34**	**34**	**32**	**22**	**18**	**17**	68	67	64	70	**61**	**40**	**23**
Residential Mortgage Debt (%) k.	0.8	-0.7	-1.0	**1.0**	**2.0**	**3.0**	**3.0**	**4.0**	**4.0**	**5.0**	-1.7	-4.2	-2.1	-1.7	-0.5	**1.3**	**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. MBA Applications Survey: activity by dollars, total market refi share percent for United States (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 6/18/2014 (PTT); Send comments and questions to chief_economist@freddiemac.com.