U.S. Economic, Housing and Mortgage Market Outlook

JANUARY 2025 IN THIS ISSUE:

U.S. ECONOMY

The U.S. economy grew at a stronger pace than initially estimated in the third quarter of 2024 while the labor market remains resilient.

HOUSING & MORTGAGE MARKET

Despite the rebound in mortgage rates, housing activity picked up slightly indicating that homebuyers are ready to come off the sidelines.

OUTLOOK

We expect the U.S. economy to grow at a positive, but moderate pace in 2025.

Recent developments

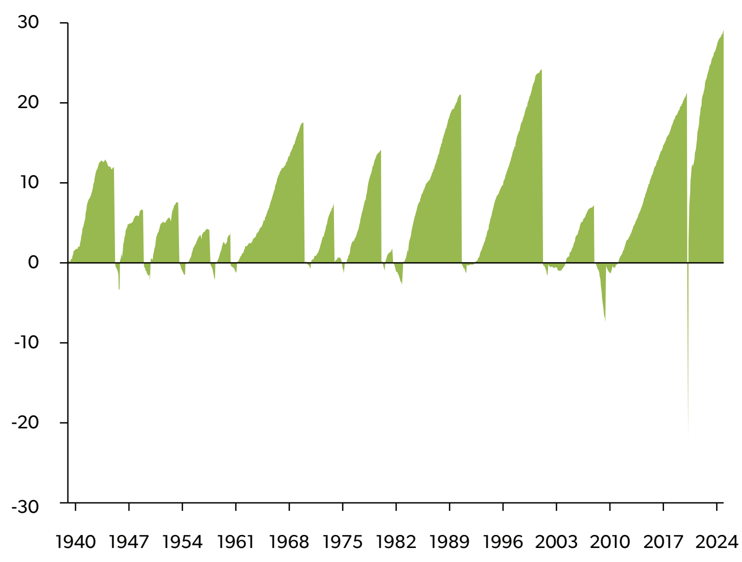
U.S. economy: In Q3 2024, Real Gross Domestic Product (GDP) grew at 3.1%, stronger than the initial estimate of 2.8% and up from 3.0% in Q2 2024.[1] Q3 growth reflected increases in consumer spending and exports while residential fixed investment and private inventory investment had a dampening effect on growth. Residential fixed investment fell 4.3% at a seasonally adjusted annual rate marking the second consecutive decline since the very strong 13.7% growth in Q1. However, consumers, the backbone of U.S. economic growth, remained strong with personal consumption expenditures increasing 3.7% in Q3 2024. This is the fastest pace of consumer spending growth since Q1 2023. Consumer spending contributed 2.5% to the 3.1% growth in total Real GDP growth for the third quarter.

The labor market ended the year on a good note, as December saw payroll gains of 256,000 compared to 212,000 in November, per the latest employment report of Bureau of Labor Statistics (BLS). Strong job growth gains in December were mostly due to gains in healthcare and leisure/hospitality, as well as a rebound in retail. Overall job growth for 2024 was 2.2 million with an average gain of 186,000 per month. Job gains in the pandemic recovery, at 29 million have been the largest in history after any recession, with the second largest gains of 24 million in the 2001 recovery (**Exhibit 1**). The unemployment rate remains low at 4.1% in December, ticking down from 4.2% in November.

EXHIBIT 1

Cumulative change in nonfarm payrolls (Millions)

Since start of a recession/expansion



Source: BLS

1 Bureau of Economic Analysis (BEA)

U.S. inflation, after a slight uptick in October, held steady in November. Core inflation as measured by the Price Index for Personal Consumption Expenditures (PCE), less food and energy, rose 0.1% over the month in November and 2.8% from a year ago. Prices for goods were unchanged over the month. Inflation for services slowed to 0.2% month-over-month as compared to 0.4% last month and was at its slowest pace since May. While inflation has cooled from the highs seen in 2022, it remains above the Federal Reserve target of 2%.

Economic growth for 2024 was stronger than expected at the beginning of the year even in the face of high interest rates and high inflation. The labor market eased with demand and supply more balanced now than at the beginning of 2024. Inflation might take longer than initially expected to move towards the Fed's target of 2%.

U.S. housing and mortgage market: Despite rising interest rates, home sales increased in November 2024. Total (new + existing) home sales increased 4.9% from October. Existing home sales increased 6.1% from last year to 4.15 million, the fastest pace since June 2021. New home sales increased in November to 664,000, a seasonally adjusted annual rate, offsetting the declines in October due to hurricanes Helene and Milton. The month's supply of existing homes decreased further from 4.2 months in October to a 3.8-month supply at the current sales pace in November.

Housing construction slowed in November. Total housing starts declined 1.8% from October and 14.6% from last November. The slowdown was primarily due to a slowdown in multifamily construction, which decreased 28.8% from last November. Homebuilder confidence held steady at an index value of 46 in December, according to the National Association of Home Builders' Housing Market Index. Builders are hopeful for an improvement in the regulatory environment for building, but confidence remains weak due to the chance of higher financing costs in the future. The index remains below 50, indicating that building conditions are expected to remain weak in the near term.[2]

House price appreciation continued to slow from the highs witnessed in 2022. As measured by the FHFA House Price Index, U.S. house prices in October 2024 rose 0.4% month-over-month and 4.5% from last year. All nine census divisions showed annual increases; however, three divisions posted monthly price decreases. Limited housing inventory continues to drive house prices higher, as do elevated mortgage rates affecting affordability, which is weakening demand.

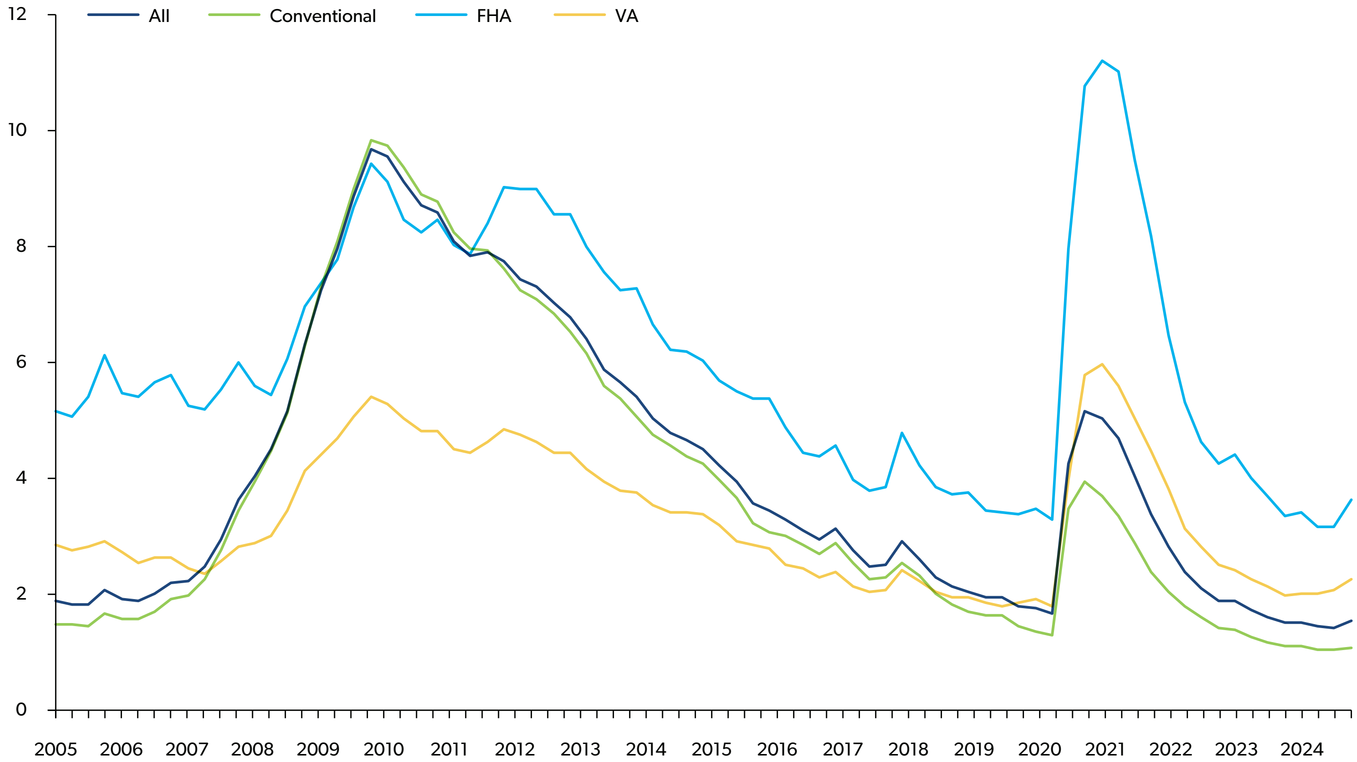
Mortgage rates remained elevated throughout December, ending the month at 6.85%. The 30-year fixed-rate mortgage measured by Freddie Mac's Primary Mortgage Market Survey® averaged 6.72% in December. With rates moving higher and reaching a time of the year when mortgage activity typically slows, there were declines for both refinance and purchase activity. Refinance activity decreased throughout December. Purchase activity decreased 15.4% in the last week of December compared to the last week of November.

2 The National Association of Home Builders' Housing Market Index is a diffusion index constructed so that a value of 50 indicates sentiment is on balance neutral, while values above (below) 50 indicate that sentiment is on balance positive (negative).

In terms of mortgage performance, according to the Mortgage Bankers Association's mortgage delinquency survey, a seasonally adjusted (SA) 3.92% of outstanding mortgage debt was in some stage of delinquency as of Q3 2024, down five basis points from Q2 2024 but up 30 basis points year-over-year. Loans 30+ days delinquent decreased 14 basis points from 2.26% in Q2 2024 to 2.12% in Q3 2024 and rose nine basis points from Q3 2023. Loans in foreclosure increased two basis points from last quarter to 0.45% in Q3 2024 and decreased four basis points year-over-year (SA). In terms of seriously delinquent loans (90 days or more past due or in foreclosure), the overall share increased from 1.43% in Q2 to 1.55% in Q3 2024 and were up three basis points from Q3 2023. Shown in **Exhibit 2**, VA loans saw an uptick from 2.07% in Q2 2024 to 2.26% in Q3 2024 and were up from 1.99% in Q2 2023, non-seasonally adjusted (NSA). The share of conventional loans was up from 1.04% in Q2 to 1.09% in Q3 2024, down from 1.12% in Q3 2023 and the share of FHA loans increased from 3.17% to 3.63% during the second and third quarter of the year and up from 3.34% in Q3 2023 (NSA).

EXHIBIT 2

Total seriously delinquent loans by loan type



Source: Mortgage Bankers Association's Delinquency Survey

Outlook

Our outlook for the U.S. economy in 2025 is positive, though we expect the pace of growth to moderate. In late 2024, the U.S. labor market started showing signs of cooling and we expect that to persist in 2025. Modestly higher unemployment and slower job gains will reduce some of the pressures on inflation.

Mortgage rates remained higher than expected in 2024. Unlike last year when many were anticipating that mortgage rates would decline, in early 2025 the prevailing sentiment is that rates will stay higher for longer. This may impact prospective buyers and sellers as we get into spring. While last year, prospective buyers and sellers anticipating rate declines may have stayed on the sidelines waiting for lower rates, this year, they may make a move earlier as they are not expecting rates to move lower. This should increase home sales relative to last year, though the absolute level of sales is still likely to remain well below historical averages.

The rate lock-in effect is also expected to cool off in the new year, adding more inventory to the market. Our estimate of the average interest rate lock-in effect for conventional mortgage borrowers was up to $47,800 in November 2024, which is up from an estimated $42,000 in October 2024, but significantly below its peak of over $65,000 in October 2023. Even if mortgage rates stay flat or decline modestly, amortization of mortgage balances will bring down the lock-in effect and make it more palatable for potential home sellers to list their property despite having a low mortgage rate.

In 2025, we expect the pace of house price appreciation to moderate from the levels seen in 2024, while still maintaining a positive trajectory. This positive house price growth, coupled with increased home sales, is expected to drive purchase volumes higher than in 2024. The slightly lower rates in 2025 as compared to last year should also lead to higher refinance volumes. This increase in both purchase and refinance volumes is likely to boost total origination volumes in 2025, offering a promising outlook for 2025.

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