U.S. Economic, Housing and Mortgage Market Outlook

MAY 2024 IN THIS ISSUE:

U.S. ECONOMY

Economic growth moderated in the first quarter and the labor market showed some signs of cooling. The effects of high inflation are weighing on growth

HOUSING & MORTGAGE MARKET

Mortgage rates rose above 7% in April and these higher rates slowed the housing market with declines in home sales and new construction.

SPOTLIGHT: RATES BY GENERATION

An analysis of mortgage rates by generation suggests that while Millennials and Gen Xers on average have secured low rates, refinance potential still exists among these generations. MORE →

Recent developments

U.S. economy: U.S. economic growth moderated to start the year. According to the U.S. Bureau of Economic Analysis (BEA) "advance" estimate of Real Gross Domestic Product (GDP), the seasonally adjusted annual rate (SAAR) of growth in GDP in Q1 2024 was 1.6%, slowing from a 3.4% rate in Q4 2023. The deceleration in GDP growth was led by slower growth in consumption expenditures, net exports, and government consumption expenditures.

Consumer spending was weaker due to a decline in spending on durable goods, primarily autos, and flatlining nondurable goods, primarily due to less spending on gasoline. Spending on services accelerated in the first quarter, led by higher spending on health care, financial services and insurance.

Trade weighed on GDP growth with more modest exports and an increase in imports. Compared to most advanced economies, the U.S. economy continues to perform relatively well.

The positive tailwinds to overall growth from government spending are waning. The contribution to GDP growth from government consumption expenditures and gross investment remains positive but was less than a third of what it was in Q4 2023. The latest report paints a picture of an economy that continues to perform well, but that is moderating as it settles into a growth pattern more consistent with long-run trends.

Consistent with economic growth trends, the labor market moderated in April 2024 with nonfarm payroll employment increasing by 175,000, down from an increase of 315,000 in March, according to the Bureau of Labor Statistics (BLS). The unemployment rate inched up from 3.8% in March to 3.9% in April. However, the unemployment rate has remained below 4% for the twenty-seventh consecutive month. Average hourly earnings for all employees on private nonfarm payrolls rose 0.2% month-over-month, and compared to a year ago, average hourly earnings increased 3.9%. Overall, the jobs report indicates a resilient but cooling labor market.

The core Personal Consumption Expenditures (PCE) price index, the Federal Reserve's preferred inflation gauge that strips out volatile food and energy prices, rose 0.3% month-over-month in March.[1] While this increase in the core PCE was in line with expectations, the progress on inflation has slowed and has implications for future Federal Reserve monetary policy. The index increased 2.8% from a year ago and remains above the Federal Reserve target of 2.0%.

The Consumer Price Index (CPI) increased by 0.4% in April, exceeding consensus expectations and triggering a negative market reaction. In another sign of persistent inflationary pressures, the employment cost index came in above expectations with a 1.2% quarter-over-quarter increase in Q1 2024 and a 4.2% increase in compensation costs over the year. The persistence of inflation has led market participants to conclude that the likelihood of multiple Federal Reserve rate cuts in 2024 is diminished and the next rate cut is also likely further away.

In summary, U.S. economic growth moderated at the beginning of 2024, reflecting the impact of higher interest rates and declining consumer savings. The labor market also showed signs of cooling with softer-than-expected job growth in April.

U.S. housing and mortgage market: After benefitting from stable mortgage rates in the first couple of months of the year, the housing market witnessed a slowdown in March due to the rebound in rates. Total (existing + new) home sales for March fell by 2.7% from February and were down 2.1% from a year ago. This decline was led by existing home sales, which continued to reel under the impact of rising rates. Existing home sales were at an annual rate of 4.19 million in March, 4.3% below February sales and 3.7% lower than March 2023.[2] However, new home sales for March grew 8.8% from February to an annualized rate of 693,000, accounting for about 14% of total home sales.[3] As the supply of existing homes for sale remains low and home prices continue to rise, more buyers are choosing to purchase new homes than in previous years.

According to the National Association of Homebuilders' Housing Market Index, homebuilder confidence remained steady in March with the index coming in at 51. This is above the threshold of 50, indicating positive building conditions.[4] However, the housing construction sector experienced some moderation. According to the U.S. Census Bureau, new residential construction fell in March with total starts decreasing 14.7%, the largest monthly decline since May 2022. The decline was led by multifamily starts which fell around 21% month-over-month and single-family housing starts fell 12% month-over-month in March.

The FHFA Purchase-Only Home Price Index for February increased by 1.2% month-over-month compared to a decrease of 0.1% in January. Year-over-year house price growth remained strong at 7.0% for February. The depleted inventory of homes available for sale, along with still high demand, continued to put upward pressure on house prices.

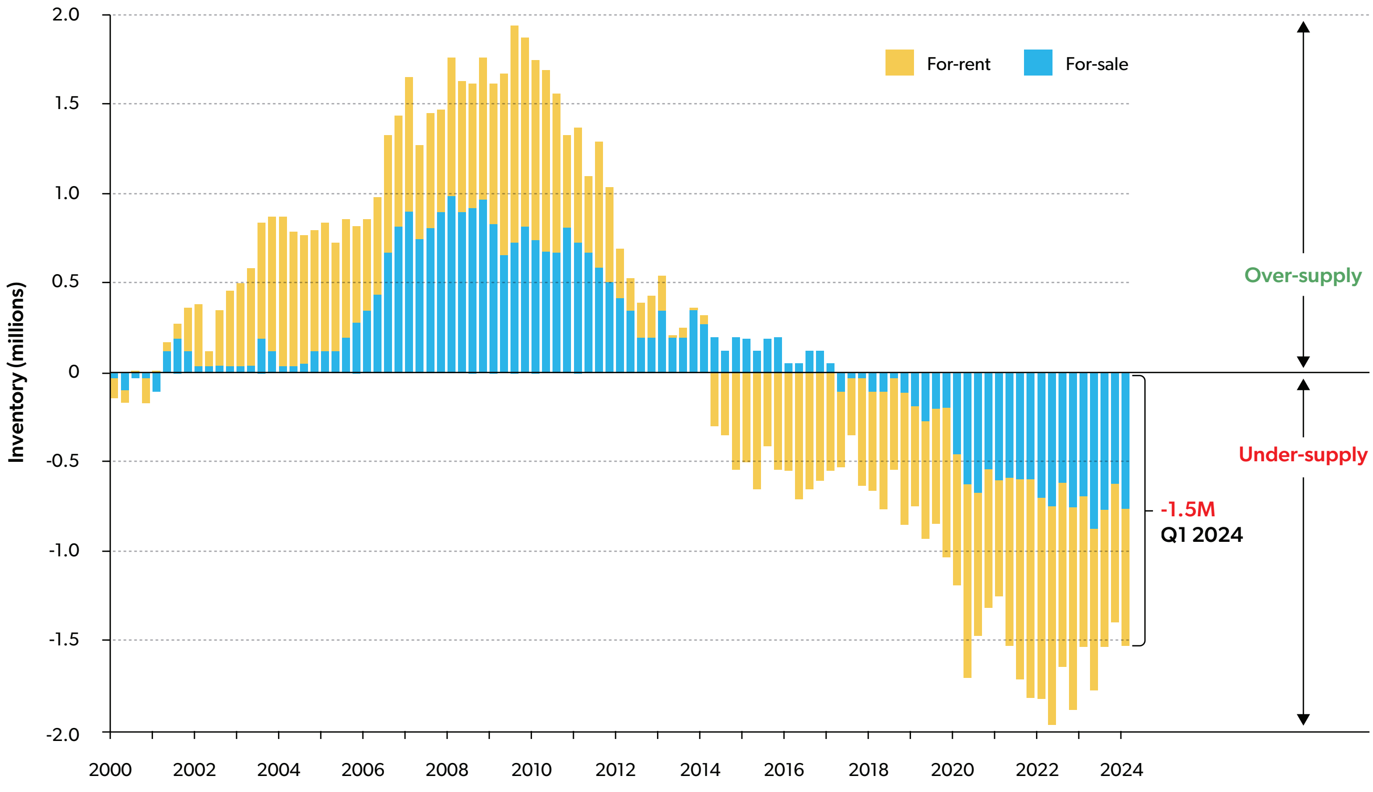
Mortgage rates ticked up in April averaging 6.99% for the month, as measured by Freddie Mac's Primary Mortgage Market Survey®, and ended the month at 7.17%. According to the Mortgage Bankers Association (MBA) Weekly Application Survey, mortgage activity declined over the month as rates exceeded 7% for the first time this year. Overall mortgage activity was down 1.8% month-over-month and 10.4% year-over-year at the end of April. Refinance activity for April was down 3.3% compared to March, and purchase applications were down 2.7% month-over-month.

1 BEA
2 National Association of Realtors
3 U.S. Census Bureau
4 National Association of Home Builders (https://www.nahb.org)

Tight inventory coupled with higher rates resulted in a stagnant start to the year in terms of homeownership. The homeownership rate in Q1 2024 ticked down to 65.6% from 65.7% in Q4 2023 and 66% in Q1 2023.[5] The historical average homeownership rate over the period from Q1 1964 to Q1 2024 is 65.2%. Total housing stock was at 146.4 million units as of Q1 2024, an increase of around 1.6 million units compared to the same time last year. This reflected an increase of approximately 1.4 million in total occupied housing units and 0.2 million vacant units. A large share of the increase in occupied units came from renters compared to homeowners. Renter-occupied units increased approximately 1 million over the last year while owner-occupied units were up around 0.6 million. The homeowner vacancy rate in Q1 2024 was down to 0.8% from 0.9% in Q4 2023. The rental vacancy rate was unchanged over the quarter at 6.6%. Vacancy rates remain on balance very low. To bring the vacancy rate, both rental and homeowner, back in line with historical averages, the U.S. would need to add an additional 1.5 million vacant for-sale and for-rent homes (**Exhibit 1**).[6] Without such units, the pressure on housing markets will persist. Additionally, the vacant housing undersupply metric is almost certainly a dramatic underestimate of the total housing shortage for the U.S. This is because this metric does not account for latent housing demand and vacant housing that is not for sale or for rent.[7]

EXHIBIT 1

Total for-sale and for-rent vacant housing is 1.5 million units below a balanced market



Source: Freddie Mac calculations using U.S. Census Bureau data

Overall, tight inventory and "higher for longer" rates are still key barriers to home sale volumes. Mortgage rates above 7% continue to price out many prospective homebuyers and sellers have less incentive to sell.

5 U.S. Census Bureau - Housing Vacancy Survey Q1 2024
6 Historical vacancy rate estimates based on the average vacancy rate from Q1 1994 to Q4 2003.
7 See our earlier insight https://www.freddiemac.com/research/insight/20210507-housing-supply for a more complete metric.

Outlook

While the U.S. economy has shown resilience so far, we expect higher interest rates to weigh on future growth, with the economy settling into a lower rate of growth in 2024 and 2025. However, we do not expect a recession in our baseline scenario. In our baseline, slower growth and a weaker labor market help to rein in inflation while the economy throttles back but avoids stalling.

Our baseline scenario has one Federal Reserve rate cut towards the end of the year. As a result, we expect mortgage rates to remain elevated through most of 2024. These high interest rates will prompt prospective buyers to readjust their housing expectations, but we anticipate housing demand to remain high due to favorable demographics, particularly in the starter home segment.

Despite the strong housing demand, our housing market outlook is tempered by lack of inventory for sale. Under our baseline scenario, we anticipate improvement in home sales compared to 2023, albeit by a slim margin, as the rate lock-in effect will delay existing homes from entering the market. Our outlook on the mortgage origination market is also clouded by the expectation of low sale volumes. With our projection of mortgage interest rates remaining higher for longer, we anticipate modest growth in mortgage origination volumes, supported by high home prices. However, the combination of higher interest rates and limited inventory could limit purchase originations. Additionally, we expect refinance origination volumes to decline as homeowners have already secured low rates, posing potential challenge in the refinance market.

While our outlook is positive, there are emerging risks, particularly from inflation. Over the last year, almost half of the overall gains in inflation came from housing inflation, and in an environment where home prices are growing, inflationary pressures might persist for longer. Under a high inflation scenario, interest rates will remain high, negatively impacting consumer spending behavior and credit performance, which can further slowdown economic growth.

MAY 2024 SPOTLIGHT:

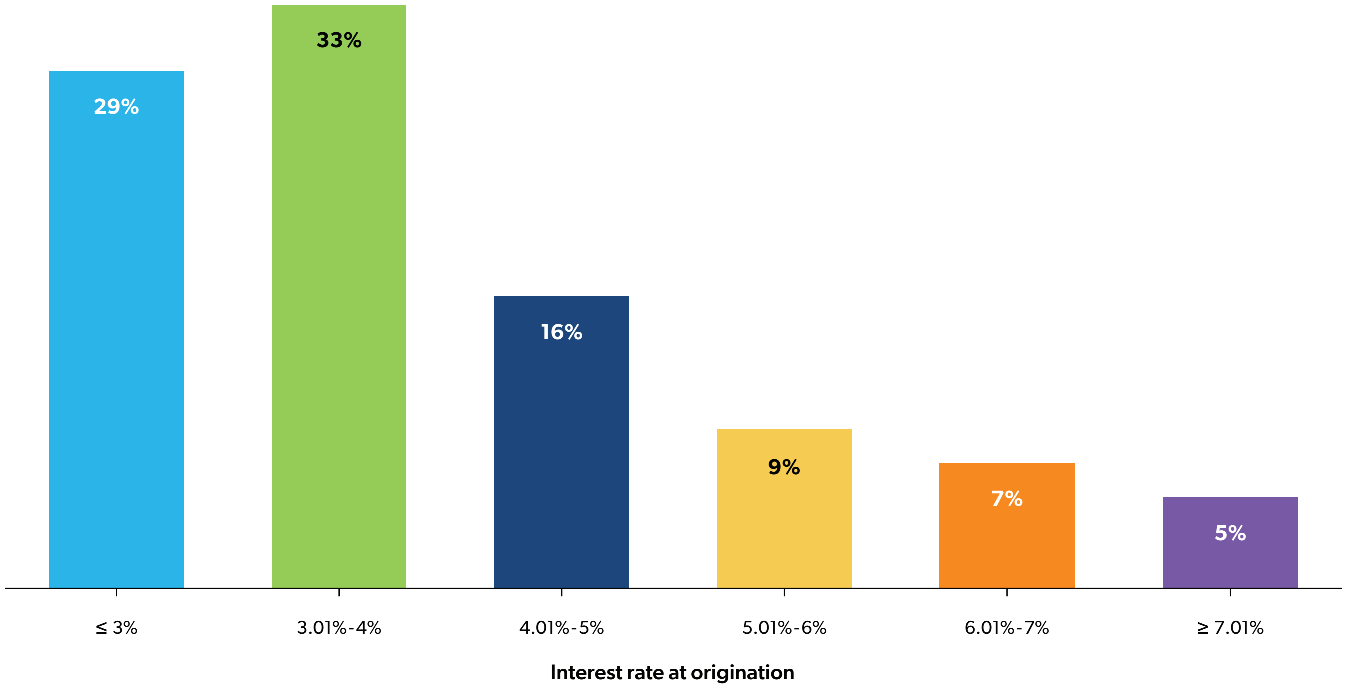
Mortgage interest rate dispersion by generation—implications for the housing market

Mortgage interest rates are on the rise again, with the 30-year fixed-rate mortgage recently crossing the 7% mark, according to the Freddie Mac Primary Mortgage Market Survey®. While elevated interest rates have put homes out of reach for many prospective homebuyers, current homeowners are refraining from listing their homes for sale, keeping the existing home inventory low. Many homeowners are hesitant to sell their current home to move to a new one because they secured historically low mortgage rates when rates on average were 3.20% in 2020 and 3.06% in 2021.[8] **Exhibit 2** shows that more than six out of ten mortgages have rates below 4% through purchase or refinancing. In previous analysis, we found that homeowners with a fixed mortgage rate have locked-in $66,000 in savings on average per household, and selling means giving up those savings.

EXHIBIT 2

More than six out of ten mortgages have rates below 4%

Mortgage interest rate at origination: Active single-family owner-occupied purchase + refi loans conforming + jumbo



Note: Includes single-family owner occupied, mortgage originated since 1990 and active as of January 2024, both purchase and refinance. "At Origination" refers to when purchased or refinanced.

Source: Freddie Mac calculations using the National Mortgage Database (NMDB).

8 These rates are average rates on all loans originated since 1990. Rates on average for conventional loans were 3.11% in 2020 and 2.96% in 2021, according to Freddie Mac Primary Mortgage Market Survey®.

While a financial disincentive exists for selling and moving to a new home in the current rate environment, life events will ultimately push people to move. More importantly, the interest rate that different generations have locked in will be a key determinant of whether there will be a healthy housing market churn to keep people moving along through their life stages. So, what does a typical mortgage look like for different generations, and what rates have they locked?

Our analysis of the borrower-level National Mortgage Database (includes all single-family owner-occupied purchase and refinance loans originated since 1990 and active as of January 2024) reveals that Millennials have the highest average loan amount and remaining balance, with a remaining term of 25 years on average (**Exhibit 3**). Interestingly, the Silent and Baby Boomer generations still have more than 18 years in remaining term, a result of refinancing at low rates in recent years. It's worth noting that over 90% of Gen Z are first-time homebuyers and there are very few ARM rates, primarily concentrated among the Silent and Baby Boomer generations, with the majority of all generations opting for conventional loans.

EXHIBIT 3

Millennials and Gen Xers have locked the lowest rates

An average mortgage profile by generation

	Silent (1928-1945)	Boomers (1946-1964)	Gen X (1965-1980)	Millennials (1981-1996)	Gen Z (1997-2012)
Loan amount at origination ($ in thousands)	195	229	283	290	224
Remaining balance ($ in thousands)	162	193	250	273	218
Term at origination (Years)	26.9	25.9	26.5	28.4	29
Remaining term (Years)	18.3	18.6	20.5	24.7	27.2
Monthly payment ($ in thousands)	1.2	1.5	1.8	1.9	1.6
Percent of FTHB (%)	6.9	8.7	20.6	52.1	91.2
Percent of refinances (%)	70.7	65.2	52.7	27.5	3.2
Percent of ARM (%)	5.1	4.4	3.6	2.0	1.3
Percent of conventional loans (%)	83.4	81.9	76.0	69.6	60.5
Interest rate at origination (%)	**4.3**	**4.1**	**4.0**	**4.0**	**4.9**

Notes: Includes single-family owner-occupied, mortgage originated since 1990 and active as of Jan 2024, both purchase and refinance. "At Origination" refers to when purchased or refinanced. Birth year of different generations in brackets

Source: Freddie Mac calculations using NMDB

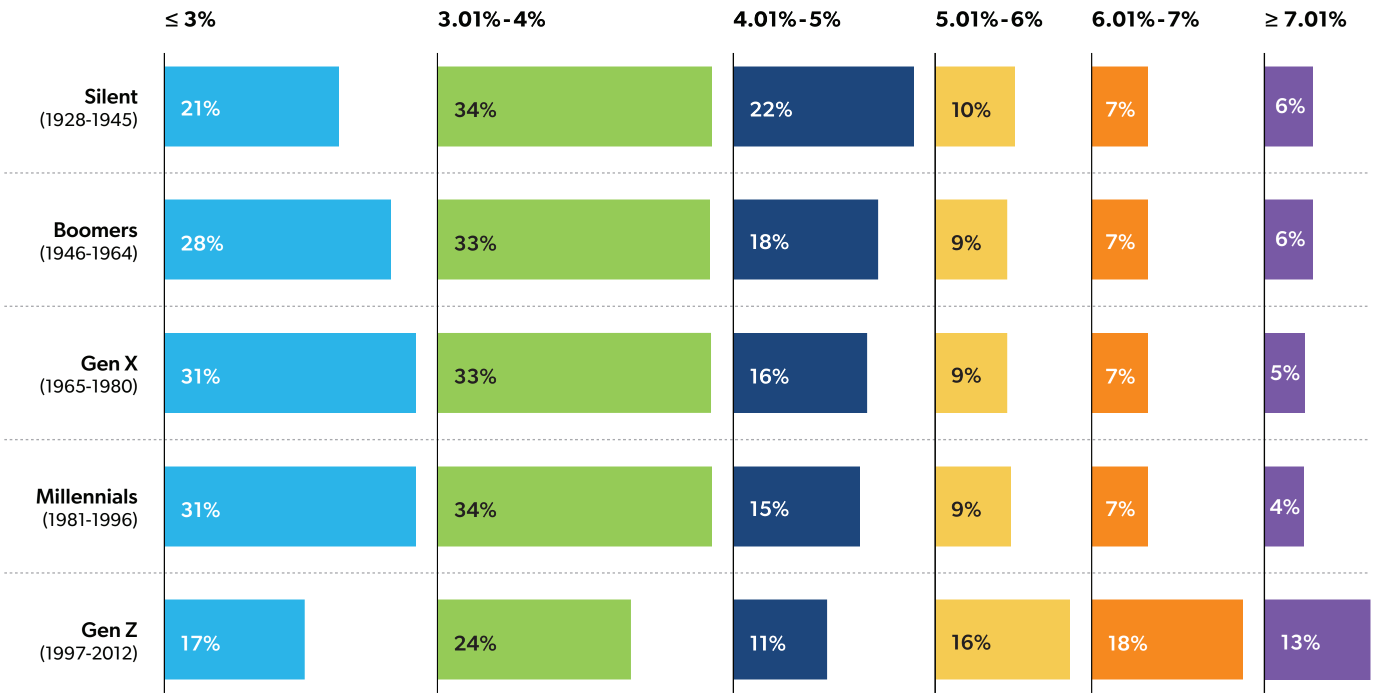
Regarding average interest rates, Exhibit 3 shows that Gen Z has the highest rate at 4.9%, and Millennials and Gen Xers have the lowest rates at 4.0%. We find that purchase rates primarily drive the low rates Millennials obtained and the low rates of the Gen Xers are driven mainly by refinance rates. Millennials entered the market when the rates were low, with 37% of all Millennial borrowers' purchases occurring in 2020 and 2021, according to our NMDB data analysis. While 25% of all Gen Xers' purchases were in 2020 and 2021, Gen Xers who already were homeowners took advantage of low rates and refinanced during the low-rate period. Gen Z started stepping into the housing market when rates were high: 62% of Gen Z borrowers purchased a home in 2022 and 2023 when the rates on average were 4.9% and 6.7%, respectively, placing them at the higher end of the mortgage rate spectrum.

While the current rates make it challenging to spur purchase or refinance activity, there is dispersion in mortgage rates across and within generations that may lead to some mortgage activity if rates fall below the current levels. **Exhibit 4** shows that although Millennials and Gen Xers have 4% rates on average, 4%-5% of the borrowers from those generations have rates above 7%.

EXHIBIT 4

While the average rate is the lowest for Millennials and Gen Xers, 4-5% have rates above 7%

Mortgage interest rate dispersion by generation: Active single-family owner-occupied purchase + refi loans conforming + jumbo



Note: Based on all active loans originated since 1990, active as of January 2024.
Source: Freddie Mac calculations using NMDB.

So, what does this varied interest rate by generation mean for a housing market where refinance activity has tapered off and the inventory of existing homes for sale is lean? Next, we discuss two key implications.

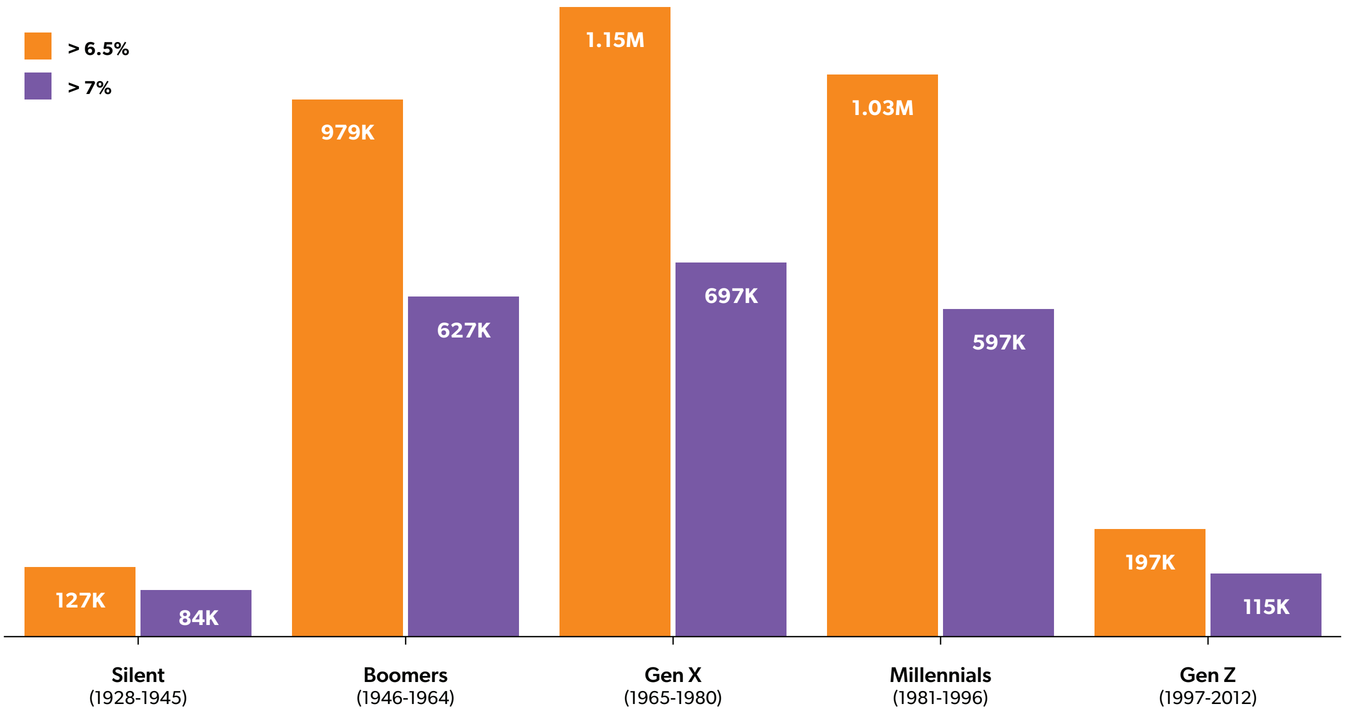
Millennials and Gen Xers on average have low rates, but refinance potential still exists among these generations.

As mortgage rates stay higher for longer, refinance activity continues to be challenging. Looking at the average interest rate by generation, Gen Z is at the forefront regarding refinance potential with 13% of Gen Z having rates above 7%. However, Gen Z is a fraction of total mortgage borrowers, and the number of borrowers with a rate over 7% is slim among Gen Zers. The rate dispersion suggests that there is refinance potential among other generations, notably Gen Xers and Millennials. Millennials are the largest population cohort, and therefore, despite the low homeownership rate compared to Baby Boomers and Gen Xers, the sheer number of Millennial borrowers with rates >7% is high (**Exhibit 5**). But the refinance potential is mainly concentrated among Gen Xers, with almost 700,000 Gen X borrowers holding mortgage rates >7%. All generations combined, over two million mortgage borrowers have rates above 7%, with over 1.2 million borrowers from the Millennial and Gen X cohorts. If rates fall below 6.5%, an additional 1.4 million borrowers, i.e., a total of over 3.4 million, will have rates above 6.5%, primarily concentrated within the Gen X generation. These borrowers are more likely to refinance their mortgage.

EXHIBIT 5

Over 2 million mortgages have rates above 7%; mostly concentrated among Gen Xers

Loan counts by mortgage interest rate and generation: Active single-family owner-occupied purchase + refi loans conforming + jumbo



Note: Based on all active loans originated since 1990, active as of January 2024
Source: Freddie Mac calculations using NMDB.

Low rates will lock Gen Xers for longer, but Millennials may make the move regardless.

Due to the ongoing rate lock effect, the housing market is currently plagued by a lean inventory of existing homes for sale. While homeowners moving to another home does not add to the net supply of homes for sale, churn is essential for keeping people moving along through their life stages. An individuals demand for housing keeps evolving as young families move into starter homes and then transition up into larger homes as their families grow. Gen Xers are generally several years away from retirement and have already transitioned from their starter homes to accommodate their growing family; therefore, they are less likely to move from their current homes. The added benefit of low rates may mean that they will remain rate-locked for longer. Millennials, on the other hand—particularly the younger Millennials—are more prone to changing jobs and transitioning into bigger homes as families grow, making them more likely to move regardless of their current low rates. According to the American Community Survey, in 2022, when the average mortgage rate was 5.3%, 12% of Millennial homeowners still moved to a new place, while only 3.8% of Baby Boomers and 5.5% of Gen Xers moved. This suggests that while Baby Boomers and Gen Xers will likely stay put and retain their low mortgage rates, Millennials will likely unlock their locked rate and transition up.

To conclude, demographics play a significant role in the housing market. Mortgage rates acquired by different generations and their behavior will determine the future churn in the housing market. Our analysis suggests that while Gen Xers will be a savior for the refinance market if and when rates decrease, Millennials will likely support the purchase market by upgrading from their starter homes. However, mortgage rates are not the only determinant of the moves. House prices also play a leading role, and risks are weighted to the upside with growing prices, which may keep the housing churn lower for longer.

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