Freddie Mac

U.S. Economic, Housing and Mortgage Market Outlook

NOVEMBER 2024 IN THIS ISSUE:

U.S. ECONOMY

The U.S. economy remains resilient with strong Q3 growth even as the labor market moderates.

HOUSING & MORTGAGE MARKET

Recent volatility in mortgage rates has weighed on housing and mortgage activity.

SPOTLIGHT: HOUSING SUPPLY

The housing market continues to be plagued by a shortage of housing units for rent and for sale. We estimate the national housing shortage is 3.7 million units as of Q3 2024. MORE →

Recent developments

U.S. economy: The U.S. economy continues to grow at a robust pace, as evidenced by the advance estimate of Q3 2024 seasonally adjusted annual rate of growth of Real Gross Domestic Product (GDP).[1] Growth for Q3 was 2.8%, a slight decrease from the rate of 3.0% in the second quarter, but well above the long-run potential growth of 1.8% estimated by the Congressional Budget Office (CBO). As with the previous quarters, in Q3 2024, consumption spending led the growth and at 3.7%, grew at the fastest pace since Q1 2023. Consumption spending has remained resilient even in the face of high inflation and a still-high interest rate environment. The contribution of this component to overall growth was around 2.5 percentage points. Compared to Q2 2024, the decrease in Q3 GDP growth was primarily due to a downturn in private inventory investment and a significant deceleration in residential fixed investment. This was partially offset by increases in exports, consumer spending, and federal government spending.

The labor market continued to moderate. Per the latest employment report from the Bureau of Labor Statistics (BLS), payroll growth for October witnessed a sharp decline, with the economy adding only 12,000 jobs. However, this slowdown was mainly attributed to Hurricanes Helene and Milton, which hit the Southeastern part of the country, and a strike at Boeing that subtracted around 44,000 jobs from the manufacturing sector. Despite facing temporary disruptions in job growth, the unemployment rate stayed consistent at 4.1% for the second month. Average hourly wage growth also remained at 4% on a year-over-year basis. While the payroll gains for October came in at the lowest level since December 2020, these declines led by temporary events are not a major cause for concern.

As measured by the Employment Cost Index, compensation costs for civilian workers, increased 3.9% in Q3 2024. This is a decrease from the second quarters' increase of 4.1% and is the lowest since late 2021. This decrease further shows wage growth moderating amid a softening labor market.

1 Bureau of Economic Analysis (BEA)

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Inflationary pressures have been receding over the past few months, but remain above the Federal Reserve's target of 2%. Core Personal Consumption Expenditure (PCE) Price Index, the Federal Reserve's preferred inflation gauge, rose 0.2% 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 0.1% monthly decline and a 1.2% yearly decline in September. Conversely, prices for services continue to rise and were up 0.3% month-over-month and rose 3.7% from a year ago.

Economic growth for Q3 2024 remained strong and above the long run trend growth estimate. With the labor market continuing to moderate and inflation cooling towards the Fed target of 2%, and the Federal Reserve might continue on its implied rate cut path.

U.S. housing and mortgage market: Home sales remained subdued despite mortgage rates declining and hitting 2-year lows in September. Total (new + existing) home sales fell 0.2% in September as homebuyers wait for rates to decrease. Existing home sales continued their downward trend with sales in September at the lowest level since October 2010 at 3.84 million. Existing sales continue to reel under the pressure of high mortgage rates and the rate lock-in effect. New home sales rose slightly to 738,000 in September, with the pace of new home sales continuing to run above the pre-pandemic average. In the face of increasing mortgage rates, more builders are using sales incentives and therefore making new homes more attractive for potential buyers. Slower sales have led to a slight pick-up in inventory, with the supply of existing homes at 4.3 months in September, the highest since October 2020. However, despite the recent increase, months' supply remains low by historical standards and is below the 5 to 6 months' supply that is typically considered consistent with a balanced housing market.

Housing construction also decelerated in September. Total housing starts declined 0.5% from August and 0.7% from last September. This decrease was primarily due to a slowdown in multifamily construction, which decreased over 15% from last September. Homebuilder confidence inched up for the second consecutive month to 43, according to the National Association of Home Builders' Housing Market Index. Though increasing for the second time in six months, the index has remained below 50 since August 2023, indicating that building conditions are expected to remain poor 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 August 2024 rose 0.3% month over month and 4.2% from last year. All nine census divisions showed annual increases, ranging from 2.4% in the West South Central division to 6.3% in the East North Central division.

Higher mortgage rates and low affordability impacted the homeownership rate in Q3 2024. The homeownership rate was slightly lower at 65.6% in Q3 2024 compared to 66% in Q3 2023, per the Residential Vacancies and Homeownership Report by the U.S. Census Bureau. Between Q3 2023 and Q3 2024, the total number of housing units rose from 145.4 million to 147.0 million, an increase of around 1.5 million units. Occupied units increased by 1.7 million, while vacant units fell by 0.2 million. Most notably, the increase in occupied housing units was primarily driven by renter-occupied units which increased by 1.1 million units from 44.3 million in Q3 2023 to 45.5 million in Q3 2024. However, owner-occupied units increased only 0.6 million units from 86.0 million to 86.6 million. The homeowner vacancy rate ticked slightly up from 0.9% in Q2 2024 to 1.0% in Q3 2024 and was up from 0.8% in Q3 2023. The renter vacancy rate at 6.9% in Q3 2024 increased from 6.6% in Q2 2024 and from the 6.6% a year ago. The increase in rental vacancy reflects a large backlog of recently completed multifamily construction projects, boosting the number of units available.

2 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).

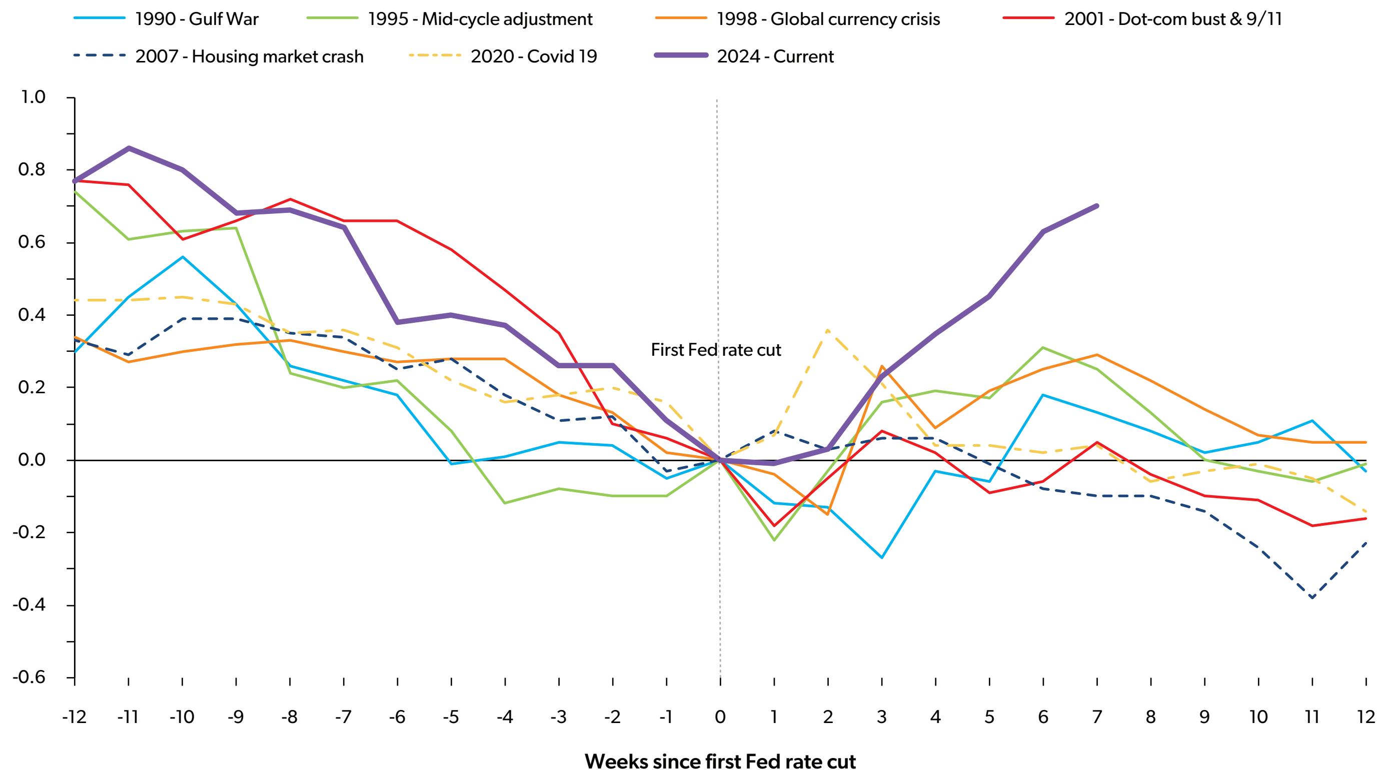
Mortgage rates rose from their two-year low, seen in September at 6.08% and reached 6.72% as of the last week of October. The 30-year fixed-rate mortgage as measured by Freddie Mac's Primary Mortgage Market Survey® averaged 6.43% in October. While homebuyers are waiting on the sidelines for mortgage rates to go down, especially after the 50-basis point rate cut by the Federal Reserve, most of the declines in rates were already baked in by the first Fed rate cut.

Exhibit 1 outlines the change in mortgage rates in the 12 weeks prior and the 12 weeks after the first Fed rate cut in seven episodes since the 1990s. As can be seen from the chart, rates begin declining in anticipation of the Fed rate cut but after the cut, rates remain stable and decline only very gradually. While the Fed usually cuts rates during times of economic distress, this time is different. The U.S. economy remains in a position of strength. Since the first Fed rate cut in September, mortgage interest rates are up nearly ¾ of a percentage point, which is more than average and speaks to the unique circumstances in the economy today.

Rising rates are unwelcome news to potential homebuyers who might have been hoping that Fed rate cuts would result in lower mortgage rates. However, if we look back historically at past rate cutting cycles, we see that interest rates typically do not fall much following a rate cut. If we look at the previous 6 rate cutting cycles, 6 weeks after the initial Fed rate cut mortgage rates *increased* on average 0.1 percentage points. This is because mortgage rates are influenced by the long-term rates, which already priced in the Fed rate cut. With economic growth surprising on the upside, bond market participants are starting to consider a slower pace of future rate cuts and factor in the potential for higher-than-expected inflation in the near-term. This has resulted in upward pressure on long-term rates, including mortgage rates.

EXHIBIT 1:

Change in mortgage rates since first fed rate cut



Source: Freddie Mac, Federal Reserve

Recent volatility in rates has weighed on housing and mortgage activity. Existing home sales have fallen to 14-year lows. Refinance activity, which witnessed a boomlet in September, is also receding as rates are on the rise again.

Outlook

Our outlook has not been adjusted to reflect any impact of the U.S. election. As such, we have not factored in any potential changes to the U.S. fiscal outlook or other policy.

While the U.S. economy continues to surprise on the upside, we expect a moderation in economic growth in 2025. This is due to a further cooling of the labor market and a potential decrease in consumer spending. Under our baseline scenario, we expect inflation to continue to move towards the Federal Reserve's target rate of 2%. As a result, we expect the Federal Reserve to implement further rate cuts in the upcoming meetings.

Mortgage rates rebounded rapidly from the 2-year lows in October and are back up above 6.7%. In the near-term, rates may continue to be volatile and higher rates will keep home sales muted for the remainder of this year. But as we get into 2025, we anticipate that rates will gradually decline throughout the year. The expected decline in mortgage rates in 2025 should loosen some of the rate lock-in effect for existing homeowners, offering more inventory in the market. The rate lock-in effect for October increased again as mortgage rates increased—up from $38,000 in September to $42,000 as of October 2024. Lower rates and the boost to inventory should lead to slightly higher home sales in 2025. We expect house prices to continue to grow, although at a slower pace.

In the mortgage market, as of Q2 2024, total purchase volumes were $336 billion while refinance volumes were $93 billion for a total volume of $429 billion. For 2025, we expect the decline in rates to boost refinance origination volumes. This, coupled with expected increase in purchase originations due to a modest growth in home sales and home prices, should improve the mortgage market in 2025. We forecast total origination volumes to increase modetly in 2025.

NOVEMBER 2024 SPOTLIGHT:

Housing supply: still undersupplied by millions of units

Housing affordability remains one of the top economic issues facing American households. Both homeowners and renters have seen the cost of housing increase faster than other consumer prices, putting a significant strain on household budgets. As we have documented in several previous research notes,[3] the root cause of decreased housing affordability is the fact that housing supply has not increased enough to match demand. Inadequate housing supply leads homeowners and renters to bid up the sale price and rent of available housing, which puts a squeeze on affordability.

In this spotlight we provide an updated estimate of the housing supply shortage relative to long-run housing demand. In our last published estimate from May of 2021, we estimated that the U.S. housing shortage was 3.8 million units as of Q4 2020. Our updated estimate based on data through Q3 2024 is that the U.S. housing shortage has declined slightly to 3.7 million units.

3 https://www.freddiemac.com/research/insight/20210507-housing-supply, https://www.freddiemac.com/research/insight/20200227-the-housing-supply-shortage, https://www.freddiemac.com/research/insight/20181205-major-challenge-to-u.s.-housing-supply

Exhibit 2 below breaks down how we arrived at the new estimate and compares it to prior estimates. Since our previous estimate for Q4 2020, the U.S. housing stock has increased by 5.8 million units, or an average annual rate of 2.1 million units per year. However, over that same time the number of households increased by 6.3 million (2.3 million annual rate), while target or latent households increased by 6.9 million (2.5 million annual rate). But despite the increases in housing stock and the much larger increase in household formation, our estimate of housing shortage is slightly lower than our previous estimate.

That's due to our lower target vacancy rate assumption. Our previous analysis assumed a target vacancy rate of 13% which was the average vacancy rate during the period between Q1 1990 and Q2 2018. The target vacancy rate assumed units held off market would continue to remain high as was the trend at that time. However, since our last estimate, housing market conditions have changed, and the units held off market have been declining, especially since 2022. Therefore, we revised our target vacancy rate assumption to correspond to the stable period in the housing market which we consider was from Q1 1994 - Q4 2003. Thus, our target vacancy rate declined from 13% to 11.7%, reducing the number of vacant housing units needed by 1.3 million.

EXHIBIT 2

Estimates of the housing shortage over time

	Q2 2018			Q4 2020			Q3 2024		
HVS, millions	Actual	Target	**Gap**	Actual	Target	**Gap**	Actual	Target	**Gap**
1 Households	121.2	122.5	**1.3**	125.8	126.2	**0.4**	132.1	133.1	**1.0**
2 Vacant units	17.0	18.3	**1.3**	15.4	18.9	**3.5**	14.9	17.6	**2.7**
3 Housing stock	138.3	140.8	**2.5**	141.2	145.0	**3.8**	147.0	150.8	**3.7**

Source: Freddie Mac Economic and Housing Research calculations based on the U.S. Census Bureau, Current Population Survey / Housing Vacancy Survey

Housing demand

The first component in estimating the housing shortage is housing demand. While we can directly observe the actual number of households in any given period, we cannot see households that have not formed due to high housing costs. To estimate the target number of households, we employ a counterfactual analysis. This method allows us to project the number of households that would have formed if housing cost had remained at the level in our benchmark period, which is the year 2000.

While household formation increased during the pandemic, limited supply has meant that many potential homebuyers have been priced out due to affordability concerns. To estimate the latent demand, we consider the households that could have been formed were the housing costs more favorable. For our estimate of housing costs, we utilize rent data.[4] From 2000 to 2024 inflation-adjusted rents increased by 11%, from $1,396 per month to $1,556 per month. In our counterfactual, we set real rents back at 2000 levels and estimate the number of additional households that would create.

4 We obtain the data on rents by Metropolitan Statistical Area (MSA) from RealPage.

We obtain the current headship rates by 5-year population groups starting from 15-19, 20-24, 25-29, etc., from the Current Population Survey–Annual Social and Economic Supplement (CPS-ASEC) using the Integrated Public Use Microdata Series (IPUMS) (Flood et al. 2017).[5] We then adjust the current headship rate by the housing cost factor to obtain the target headship rate. To obtain the housing cost factor, we run an Oaxaca-Blinder decomposition on the factors affecting household formation (including income and education, housing costs, race and age, marriage and children, etc.). We use rents as a proxy for housing costs as rents directly impact household formation. Based on the contribution of these factors, we add back the factors related to housing costs to the current headship rate to get the target headship rate which can be written as:

$$hr_i^* = hr_{i,2024} + \alpha_{housing\ cost,i}$$

Where hr_i is the headship rate by 5-year age groups and $\alpha_{housing\ cost,i}$ is the contribution of housing costs to the total headship rate.

Applying the new headship rates to the 2024 population by these 5-year age groups, we get the target households for each of the age group. If housing costs as measured by rents were more affordable, we estimate that the U.S. would have added 1 million more households with most of the growth coming from younger households.

Vacant units for a well-functioning market

The second component in the estimation of the housing shortage is vacant units. A well-functioning housing market requires some vacant properties. If there are too few vacant housing units, home sales and new rentals will be hard to fill as there will be limited options that are move-in ready. In addition, there are some homes that are either seasonally vacant or held off market. Overall vacancy rate was at 10.1% in Q3 2024, 1.6 percentage points below our target vacancy rate of 11.7%, which is derived as described below.

For the estimation of the housing supply shortage, we need a target vacancy rate. As explained above, we assume the vacancy rate during the “stable period” in the housing market (Q1 1994 – Q4 2003), 11.7%, to be the target vacancy rate.[6] Within this vacancy, we assume that the seasonally vacant units average 2.8% of the housing stock, 0.7% are assumed to be in the process of being rented or sold, 3.6% for rent or sale, and 4.5% held off market. **Exhibit 3**, on the following page, converts the target vacancy rate to the target number of vacant units needed by type of vacancy. The various components equal 2.7 million additional vacant housing units needed to balance the market given the demand estimates presented in the previous section.

5 Sarah Flood, Miriam King, Steven Ruggles, and J. Robert Warren. 2017. Integrated Public Use Microdata Series, Current Population Survey: Version 5.0. [dataset]. Minneapolis: University of Minnesota. https://doi.org/10.18128/D030.V5.0 (Opens a new window).

6 Our previous analysis assumed a target vacancy rate of 13% which was the average vacancy rate during the period between 1990Q1 and 2018Q2. The target vacancy rate assumed units held off market would continue to remain high as was the trend at that time. However, since our last estimate of the housing shortage in May 2021, housing market conditions have changed and the units off market have been declining especially since 2022. Therefore, we revised our target vacancy rate assumption to correspond to the stable period in the housing market.

EXHIBIT 3

Additional vacant units needed by type of vacancy

	Vacancy rates			
	Current Q32024 vacant units (millions)	Current Q32024 vacancy rate (%)	Benchmark 1994-2003 vacancy rate (%)	Additional vacant units needed (millions)
Vacant	14.9	10.1%	11.7%	2.7
Year-round vacant	11.5	7.8%	8.9%	1.9
For rent	3.4	2.3%	2.7%	0.7
For sale only	0.9	0.6%	1.0%	0.6
Rented or sold	1.0	0.7%	0.7%	0.1
Held off market	6.2	4.2%	4.5%	0.6
Seasonal	3.4	2.3%	2.8%	0.8
Memo: Housing Stock	147.0			

Source: Housing Vacancy Survey

Conclusion

Our updated estimates show that the housing market is still dramatically undersupplied relative to long-run housing demand. Despite adding 5.8 million housing units over approximately four years (since our previous estimate), housing demand has increased by almost the same amount, resulting in very little progress in reducing the housing shortage. In the aggregate, we estimate that U.S. housing stock is 3.7 million units below what is needed given our current population and assuming inflation-adjusted housing costs returned to historical levels. Even without the push from latent housing demand, the current housing stock remains below levels consistent with historical vacancy rates.

While there is reason to be optimistic about the housing market given the demographic tailwind and the cohort of Millennials and young adults entering the housing market, high mortgage rates have put a damper on affordability. Rising home prices have also had an effect and are directly related to the supply shortage. Building more houses is essential but builders are also contending with high interest rates.

There is no silver bullet to alleviating this ongoing shortage. That said, there are viable options being considered and acted, upon including accessory dwelling units (ADUs), Community Land Trusts, condominium conversions, manufactured homes, to name a few. We will continue to study this topic and work with the industry to uncover potential solutions.

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