



December 2014 U.S. Economic & Housing Market Outlook

A Look Back at Five Predictions for 2014

Tis' the season to look back at the year, reflect, and, of course, make a list (sometimes checking it twice). In keeping with the spirit of the season, we decided to take the lead from the late Ed Koch, former mayor of New York City, who was known for asking his constituents, "How'm I doin'?" This month, we look back at consensus projections for five key housing and mortgage indicators in 2014 and ask "How'd we do?"

There were several key elements of the consensus projections for 2014 that were spot on: the shift to a purchase-money dominated primary market, a more modest pace of house-price gains in national indexes, and the continuing renaissance in the apartment rental market. But other consensus projections were off, such as expectations for a pickup in home sales (and, hence, single-family starts) and a rise in mortgage rates.

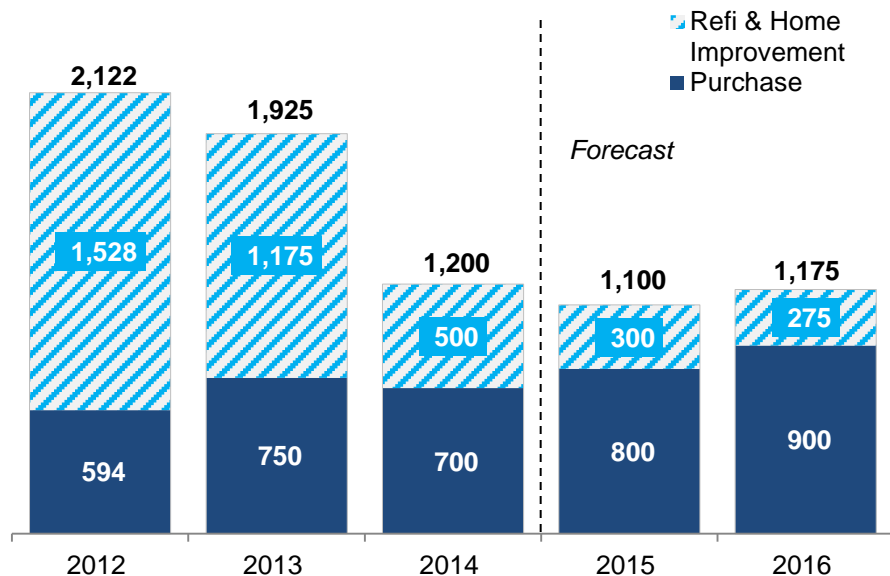
Let's look at each in turn.

Mortgage Originations. One key trend expected for 2014 was a huge drop in refinance activity and the emergence of the first majority purchase-money origination market in 14 years. It was also expected that the gains in purchase lending would be insufficient to offset the quickly shrinking refinance market, resulting in a large fall off in single-family originations.

What happened? The shift in origination activity did materialize in 2014 and we expect it to continue in 2015, with purchase-volume gains unlikely to make up for further declines in refinance activity. We project an 8 percent further decay in single-family originations in 2015, even though purchase-money volume will rise.

Home values. In 2013, many national house-price indexes recorded double-digit annual percentage gains through the third quarter of the year. For example, the Freddie Mac House Price Index (FMHPI) was up 10 percent from September 2012 through September 2013. A

Single-Family Mortgage Originations
Source: Freddie Mac



number of hard-hit, depressed housing markets reported annual appreciation in excess of 20 percent, reflecting strong investor demand for undervalued homes. Such torrid gains in excess of household-income growth were unlikely to continue. While low mortgage rates and limited home sale inventories were expected to support further appreciation, most expected a significant slowdown in value gains for 2014.

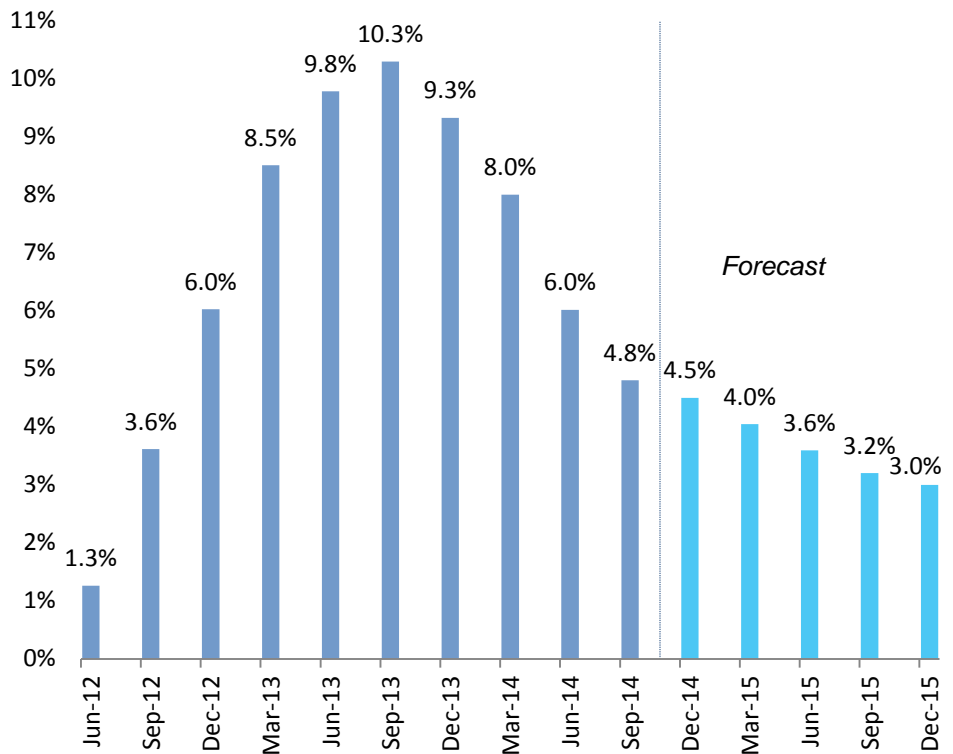
What happened? As expected, home value increases did continue but at a more moderate clip in national metrics for 2014. Between September 2013 and September 2014, the FMHPI continued to rise, but at a more modest 5 percent. For 2015, we expect further moderation in the national FMHPI growth, to about 3 percent.

Rental Market. Last year the consensus expected the apartment rental market would continue to gain steam in 2014 and further lead the recovery in the housing market with an increase in apartment completions and starts.

What happened? The rental market had a very good year. Rental vacancy rates fell to the lowest level since 2000, absorption rates on newly

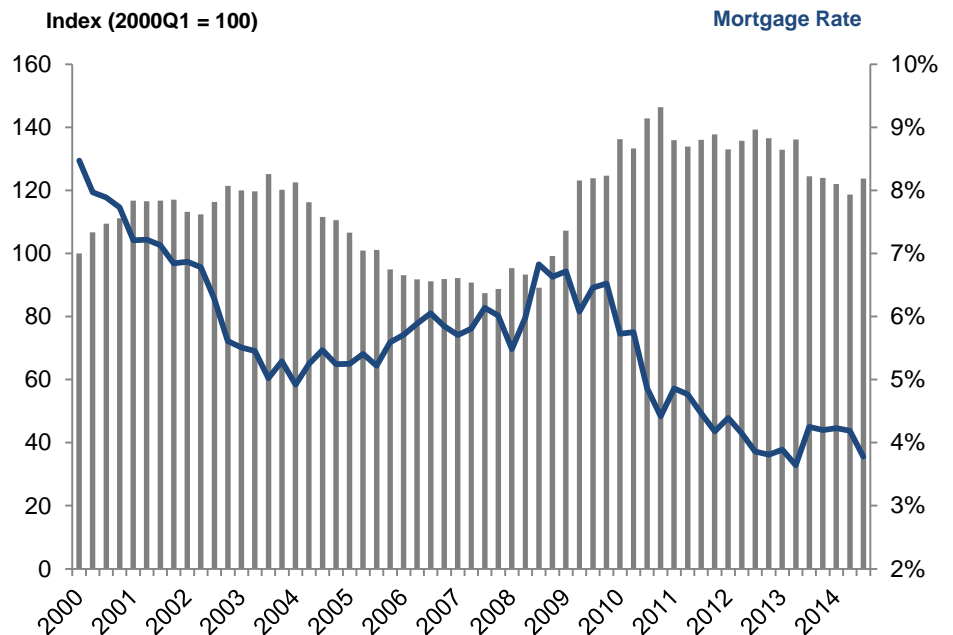
Annual House Price Growth

Source: Freddie Mac House Price Index; SA, Quarter End 12-month % Change



Multifamily Properties and Financing Currently Attractive

Source: Freddie Mac Multifamily Investment Index, American Council of Life Insurers



built apartment rentals rose, and developers started the largest number of rental apartments in 25 years. Rent growth exceeded inflation in most markets, and property values moved higher. In contrast to the single-family market, we estimate that mortgage originations on apartment buildings rose to \$185 billion during 2014, a record volume in nominal dollars spurred by strong fundamentals and low mortgage rates. These same conditions point to further origination gains in the multifamily market over the next two years. Freddie Mac's Multifamily Investment Index for the third quarter of 2014 remains above its long-term average, consistent with the positive signs we see throughout the apartment rental market.¹

Home sales. The consensus view was a gain in home sales, with some expecting sales to rise from 5.5 million in 2013 to over 6 million in 2014. (We forecasted an increase to 5.9 million in 2014). The consistent theme was faster economic growth in 2014 – with most forecast professionals generally predicting from 0.5 to 1.0 percent faster growth than during 2013. This pace of growth would support increased household income, push consumer and business confidence up, and translate into more home sales.

What happened? Contrary to expectations, the economy contracted at a 2.1 percent annualized rate during the first quarter of 2014, raised fears of another lackluster macroeconomic environment, and calendar-year growth will likely end up 0.5 to 1.0 percent slower than in 2013. Adding to the shivering housing demand was the depth of the 'polar vortex' that gripped the nation during the first quarter, an "external shock" that is always hard to predict. And while macroeconomic data are seasonally adjusted, the adjustment accounts for 'typical' seasonal patterns, not for severe disturbances.

The combined effect of an unexpected economic contraction, unseasonably lousy weather, and expiration of the Mortgage Debt Forgiveness Act at the end of 2013 conspired to deflate home sales. Home buying recovered by the second half of 2014 and sales over the past few months have been running on par with a year ago, but the shortfall during the first half of 2014 translated into a decline in sales relative to 2013. While full-year data are not yet available, it appears that home sales will come in between 5.35 and 5.40 million for 2014, more than 500,000 less than the consensus view of a year ago. Further, assuming that three-fourths of these purchases would be financed with a mortgage, the lower-than-expected home sales reduced purchase-money originations by almost \$100 billion during 2014 relative to consensus projections. And weaker-than-anticipated new home sales led to the flat year-over-year progress in one-dwelling starts.

Over the second and third quarter of 2014 the economy grew at better than a 4 percent annualized pace, and we believe it is well poised to expand close to a 3 percent pace in 2015. Growth at this level will raise household income and support more home sales. We are projecting a 4 percent rise in sales to 5.6 million, which would mark the highest level of annual sales since 2007.

Mortgage Rates. As we entered 2014, mortgage rates had been inching higher and were expected to continue gradually rising throughout 2014. This expectation was based on a more robust macroeconomy and improved housing demand, perhaps motivating the Federal Reserve to back off its accommodative monetary policy before year-end 2014.

¹ The Multifamily Investment Index is produced by Freddie Mac's Multifamily Division. A description of the Investment Index is located at <http://freddiemac.mwnewsroom.com/press-releases/freddie-mac-releases-mid-year-multifamily-outlook--otcqb-fmcc-1041278>. The original Investment Index used property values from the NCREIF NPI; the current Investment Index series has been enhanced to include an average of the NPI and the Moody's/RCA CPPI.

What happened? Quite the opposite happened. Mortgage rates generally moved lower during the course of 2014, with our Primary Mortgage Market Survey® reaching a calendar-year low for fixed-rate loans in early December. The first-quarter economic contraction and adverse external shocks led capital market participants to expect that the Federal Reserve would delay monetary policy tightening to a later date. This helped calm market jitters that ‘tapering’ would accelerate a rise in long-term rates. Consequently, long-term rates, such as 30-year fixed-rate mortgages and 10-year Treasury yields, gradually moved lower over the course of 2014, and fixed-rates are lower than they were a year ago. These low rates have been a needed spark to spur refinance and a home sales activity during the latter months of the year. Nonetheless, an extended period of extraordinarily low mortgage rates remains a temporary gift from the Federal Reserve, and we expect rates to increase gradually in the coming year.

So, what do we expect for the year ahead? As outlined in last month’s [Economic and Housing Market Outlook](#), we anticipate that economic growth in 2015 will be about 3 percent – slightly less than what we believe the final three quarters of 2014 will be (annualized), but only the second year in the 2006-2015 decade with annual growth of 3 percent or better. This pace should generate more jobs than over the past year, and we project that household incomes will rise as will housing starts and home sales; in fact, we project home sales up about 4 percent in the coming year, placing sales volume at the highest level in eight years. With the quicker pace of economic activity, the Federal Reserve will likely allow long-term rates to drift higher, especially in the second half of the year, but with fixed-rate mortgages remaining below 5 percent.

Have a great winter holiday, and best wishes for a successful 2015!

Frank E. Nothaft
Chief Economist
December 16, 2014

Leonard Kiefer
Deputy Chief Economist

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

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Indicator	2014				2015				2016				Annual Totals					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2011	2012	2013	2014	2015	2016
Real GDP (%)	-2.1	4.6	3.9	2.5	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	1.7	1.6	3.1	2.2	3.0	3.0
Consumer Prices (%) a.	1.9	3.0	1.1	0.5	1.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	3.3	1.9	1.2	1.6	1.9	2.0
Unemployment Rate (%) b.	6.7	6.2	6.1	5.8	5.7	5.6	5.5	5.4	5.4	5.3	5.3	5.2	8.9	8.1	7.4	6.2	5.6	5.3
30-Year Fixed Mtg. Rate (%) b.	4.4	4.2	4.1	4.0	4.1	4.3	4.5	4.7	4.9	5.1	5.3	5.5	4.5	3.7	4.0	4.2	4.4	5.2
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	3.1	3.0	3.0	3.0	3.2	3.4	3.7	3.9	4.2	4.5	4.7	5.0	3.3	2.8	2.9	3.0	3.6	4.6
1-Year Treas. Indexed ARM Rate (%) b.	2.5	2.4	2.4	2.5	2.5	2.6	2.7	2.8	2.9	3.0	3.2	3.4	3.0	2.7	2.6	2.5	2.7	3.1
10-Year Const. Mat. Treas. Rate (%) b.	2.8	2.6	2.5	2.3	2.5	2.7	2.9	3.1	3.3	3.5	3.7	3.9	2.8	1.8	2.4	2.6	2.8	3.6
1-Year Const. Mat. Treas. Rate (%) b.	0.1	0.1	0.1	0.1	0.1	0.3	0.5	0.8	1.0	1.5	2.0	2.5	0.2	0.2	0.1	0.1	0.4	1.8

Indicator	2014				2015				2016				Annual Totals					
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2011	2012	2013	2014	2015	2016
Housing Starts c.	0.93	0.99	1.03	1.06	1.15	1.15	1.25	1.25	1.30	1.35	1.45	1.50	0.61	0.78	0.92	1.00	1.20	1.40
Total Home Sales d.	5.03	5.29	5.56	5.60	5.55	5.60	5.60	5.65	5.70	5.80	5.80	5.90	4.57	5.03	5.52	5.37	5.60	5.80
FMHPI House Price Appreciation (%) e.	1.5	0.9	1.2	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	-3.2	6.1	9.3	4.5	3.0	3.0
S&P/Case-Shiller® Home Price Index (%) f.	1.4	-0.2	1.2	1.0	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	-3.7	6.6	10.8	3.4	3.0	3.0
1-4 Family Mortgage Originations g.																		
Conventional	\$198	\$257	\$282	\$224	\$224	\$264	\$232	\$160	\$200	\$280	\$280	\$180	\$1,206	\$1,750	\$1,570	\$961	\$880	\$940
FHA & VA	\$52	\$63	\$68	\$56	\$56	\$66	\$58	\$40	\$50	\$70	\$70	\$45	\$286	\$372	\$355	\$239	\$220	\$235
Total	\$250	\$320	\$350	\$280	\$280	\$330	\$290	\$200	\$250	\$350	\$350	\$225	\$1,492	\$2,122	\$1,925	\$1,200	\$1,100	\$1,175
ARM Share (%) h.	11	11	10	11	12	13	14	15	16	17	18	19	11	10	9	11	14	18
Refinancing Share - Applications (%) i.	52	45	50	45	40	30	25	25	24	23	22	21	71	77	63	48	30	23
Refinancing Share - Originations (%) j.	44	38	42	38	35	25	20	20	20	20	20	20	64	70	59	40	25	20
Residential Mortgage Debt (%) k.	-0.8	-0.1	1.2	1.5	2.5	3.0	3.0	3.5	3.5	4.0	4.0	4.5	-2.1	-1.7	-0.5	0.5	3.0	4.0

Note: Quarterly and annual forecasts 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; seasonally-adjusted; annual rates for yearly data.
- f. National composite index (quarterly growth rate), seasonally-adjusted; annual rates for yearly data.

- g. Billions of dollars (not seasonally-adjusted); conventional for 2014 are Freddie Mac estimates.
- 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 (2014 estimated).
- k. Federal Reserve Board; growth rate of residential mortgage debt, the sum of single-family and multifamily mortgages

Prepared by Office of the Chief Economist and reflects views as of 12/15/2014 (PTT); Send comments and questions to chief_economist@freddiemac.com.

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