

Peering Into 2012

With the New Year fast approaching, 'tis the season to assess the 2012 outlook for the macroeconomy and housing market. Here are five items from our crystal ball.

First, economic growth will likely strengthen to about 2.5 percent in 2012.

U.S. economic growth appears to have accelerated in the waning months of 2011, with fourth quarter growth expected to come in around 2.5 to 3.0 percent, annualized, by most forecasters. Evidence to support the pick-up were stronger retail sales, low inventory levels, and a 477,000 three-month gain in private non-farm payroll employment from August through November. Given the anemic 1.2 percent annualized growth over the first three quarters of the year, the final quarter could provide some needed momentum as we head into 2012.

Residential fixed investment, which has been lackluster over the past couple of years, will likely contribute modestly to 2012 growth. New construction, including additions and alterations to the existing housing stock, is the main component of residential investment, and there are signs it may (finally) be turning up, albeit gradually. Single-family housing starts will likely remain weak, but new multifamily starts have already gained and will help drive residential investment expenditures in the New Year.

Second, the U.S. unemployment rate will decline but likely remain above 8 percent.

The drop in the unemployment rate from 9.0 percent to 8.6 percent in November was welcome news, although roughly one-half of the decline appears to have been discouraged workers who quit the labor force. Broader measures of labor underutilization, which include discouraged workers and part-timers who want full-time work, also moved lower in November but remain very high, at 15.6 percent. Over the twelve months ending in November, the unemployment rate dropped 1.2 percentage points--more of a drop than would have been inferred from payroll job gains that averaged only 130,000 per month.

Part of the reason that relatively modest payroll job gains have, nonetheless, pushed the unemployment rate lower has to do with sluggish labor force growth. Discouraged workers are one part of this equation, and they will likely come back into the labor market if economic growth strengthens and firms hire at a more brisk pace. This scenario means stronger job growth in 2012, which appears likely, though it may not put much of a dent in the nation's unemployment rate. The path over the year may have a couple upticks in the reported unemployment rate before modest declines bring it lower in the latter half of next year, ending 2012 below November 2011's level but still uncomfortably above 8 percent.

Third, mortgage rates will likely remain very low, at least through mid-2012.

Thirty-year fixed-rate conforming mortgages have hovered around 4.0 percent (or lower) during the fourth quarter to-date thanks in large part to the Federal Reserve's Maturity Extension Program and its stated intent to push and keep long-term rates low. The Program (a.k.a. "Operation Twist" by the popular press) is expected to last until mid-2012. This should keep fixed-rates for 15- through 30-year product relatively low during the first half of the year, with rates edging up during the second half. Further, the Federal Reserve's August announcement



that it was likely to maintain its current federal funds target through mid-2013 assures that initial-period interest rates for one-year and various hybrid ARMs will remain extraordinarily low throughout 2012.

Fourth, housing activity will be better in 2012, but not robust.

A full-fledged recovery in the housing sector will likely elude the U.S. in 2012, but new construction and home sales are expected to be greater than in 2011. The rental market appears to be leading the housing recovery, as rents have risen in most markets, vacancies are down, and property values for professionally managed complexes are up in most neighborhoods. Good rental market fundamentals and a dearth of new apartment completions should translate into more starts of rental buildings with five or more units, pushing total housing starts up slightly more than 10 percent in 2012. Single-family starts may inch higher too, but no significant bounce back in single-family construction is likely in coming quarters.

A strong headwind holding back new home sales is the very affordable competition from existing homes. Low mortgage rates and existing house prices could lead to a bump-up in sales by three- to five-percent in 2012 over the past year's level. While encouraging, sales volume is still low given the affordability of housing. And ample distressed sales and sluggish home-buying demand will continue to keep prices soft in many markets: We expect U.S. house price indexes to move lower before bottoming out in 2012, with modest appreciation forestalled until 2013. Still, these national indexes mask the sizable variation in local house-price performance. Some markets have appreciated over the past year and are likely to gain further in 2012, while those markets with higher vacancy rates and relatively large distressed sales will continue to see downward price pressure over the next year.

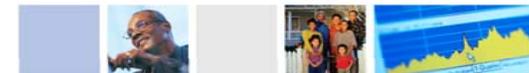
Fifth, expect less single-family originations but more multifamily lending in 2012.

While single-family refinance volume is currently strong, many borrowers have already locked in relatively low rates, or are constrained (because of being underwater or having late payments) thus reducing refinance activity over time. Further, somewhat higher mortgage rates in the second half of 2012 (after the expiration of 'Operation Twist') will reduce financial incentives to refinance. Enhancements to HARP are expected to add more than \$100 billion to 2012 refinance originations, but overall refinance volume will likely be less than in 2011, so much so that it will more than offset a small incremental amount of purchase-money lending, leaving overall single-family originations lower in 2012. The better fundamentals in the rental market and pent-up demand for refinance of multifamily loans should translate into higher lending volumes in that portion of the market, driven by both more refinance and more sales transactions.

Best wishes for a healthy and profitable 2012!

Frank E. Nothaft
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December 2011 Economic and Housing Market Outlook



Office of the Chief Economist

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Major Economic Indicators

Indicator	2011				2012				2013				Annual Totals						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008	2009	2010	2011	2012	2013
Real GDP (%)	0.4	1.3	2.0	2.8	2.3	2.3	2.7	2.7	3.0	3.3	3.6	4.0	2.2	-3.3	-0.5	3.1	1.6	2.5	3.5
Consumer Prices (%) a.	5.2	4.1	3.1	1.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	4.0	1.6	1.5	1.2	3.5	2.0	2.0
Unemployment Rate (%) b.	8.9	9.1	9.1	8.8	8.8	8.8	8.7	8.7	8.5	8.3	8.1	8.0	4.6	5.8	9.3	9.7	9.0	8.8	8.2
30-Year Fixed Mtg. Rate (%) b.	4.9	4.7	4.3	4.0	4.2	4.4	4.6	4.8	5.1	5.3	5.4	5.6	6.3	6.0	5.0	4.7	4.5	4.5	5.4
1-Year Treas. Indexed ARM Rate (%) b.	3.3	3.1	2.9	2.9	3.0	3.0	3.0	3.0	3.1	3.2	3.3	3.5	5.6	5.2	4.7	3.8	3.0	3.0	3.3
10-Year Const. Mat. Treas. Rate (%) b.	3.5	3.2	2.4	2.1	2.2	2.4	2.6	2.8	3.1	3.3	3.5	3.7	4.6	3.7	3.3	3.2	2.8	2.5	3.4
1-Year Const. Mat. Treas. Rate (%) b.	0.3	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.4	0.5	0.7	4.5	1.8	0.5	0.3	0.2	0.2	0.5

Housing and Mortgage Markets

Indicator	2011				2012				2013				Annual Totals						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008	2009	2010	2011	2012	2013
Housing Starts c.	0.58	0.57	0.61	0.62	0.62	0.66	0.70	0.74	0.85	0.90	0.95	1.00	1.36	0.91	0.55	0.59	0.60	0.68	0.93
Total Home Sales d.	4.77	4.61	4.60	4.63	4.65	4.70	4.80	5.05	5.30	5.40	5.45	5.45	5.72	4.84	4.94	4.63	4.65	4.80	5.40
FMHPI House Price Appreciation (%) e.	-2.1	1.9	-0.7	-1.8	-2.0	1.5	-0.5	0.0	0.4	0.9	0.5	0.2	-5.0	-11.7	-2.3	-6.1	-2.7	-1.0	2.0
S&P/Case-Shiller® Home Price Index (%) f.	-4.1	3.8	0.1	-2.5	-3.0	2.5	-0.5	0.0	0.5	1.0	0.4	0.1	-8.4	-18.4	-2.4	-3.7	-2.8	-1.1	2.0
1-4 Family Mortgage Originations g.																			
Conventional	\$264	\$218	\$235	\$283	\$205	\$234	\$228	\$188	\$200	\$250	\$200	\$155	\$2,312	\$1,310	\$1,549	\$1,300	\$1,000	\$855	\$805
FHA & VA	\$76	\$67	\$69	\$88	\$65	\$75	\$70	\$70	\$70	\$75	\$65	\$50	\$120	\$290	\$451	\$377	\$300	\$280	\$260
Total	\$340	\$285	\$304	\$371	\$270	\$309	\$298	\$258	\$270	\$325	\$265	\$205	\$2,432	\$1,600	\$2,000	\$1,677	\$1,300	\$1,135	\$1,065
ARM Share (%) h.	8	11	12	13	13	13	13	13	13	13	14	14	10	7	3	5	11	13	14
Refinancing Share - Applications (%) i.	69	70	78	77	77	75	70	60	60	65	67	66	42	48	70	76	74	71	65
Refinancing Share - Originations (%) j.	71	56	68	80	75	70	60	55	50	50	50	50	49	50	68	67	69	65	50
Residential Mortgage Debt (%) k.	-2.5	-1.9	-2.1	-2.0	-1.5	-1.0	-1.0	-0.5	1.0	2.0	2.0	3.0	7.1	-0.4	-1.6	-3.0	-2.1	-1.0	2.0

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 (not seasonally-adjusted).

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 detached 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; annual rates for yearly data.

f. National composite index (quarterly growth rate); not seasonally-adjusted; annual rates 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. Primary Mortgage Market Survey®; quarterly averages of monthly shares of all single-family mortgage applications (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 12/14/2011 (MAS); Send comments and questions to chief_economist@freddiemac.com.

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