Freddie Mac

AUGUST 2023

U.S. Economic, Housing and Mortgage Market Outlook

Key observations

- U.S. economic growth remains on firm ground, with strong consumption spending and a tight labor market. MORE ON THE U.S. ECONOMY →
- Although housing market activity has slowed, a demand-supply imbalance in the U.S. is causing a rebound in home prices. MORE ON THE HOUSING MARKET →
- Refinance origination activity in the first half of 2023 is the lowest in almost 30 years, mainly limited to those cashing out home equity. MORE ON REFINANCE TRENDS →

Recent developments in the U.S. economy

The economy remains on firm ground, with second quarter Real Gross Domestic Product (GDP) growing at an annualized rate of 2.4%, stronger than in the first quarter (annualized growth of 2.0%), according to the U.S. Bureau of Economic Analysis. That is modestly above-trend based on long-run demographics and productivity growth. Consumer spending grew at a 1.6% annualized rate in the second quarter. While consumers remained resilient in the face of rising interest rates and high inflation, the consumer "firewall" is getting weaker compared to the first quarter when consumer spending grew at an annualized growth rate of 4.2%. Consumers remain generally upbeat (consumer confidence rose to the highest level since July 2021),[1] likely reflecting the deceleration in inflation, tight labor market and the cushion they have from the excess savings accumulated during the pandemic. The pandemic recession and recovery was the first recession where consumers accumulated trillions of dollars in excess (above-trend) savings. While there are various estimates of the excess savings accumulated by consumers, most estimates suggest that total savings accumulated to be greater than $2 trillion.[2]

1 According to the US Conference Board Consumer Confidence Index.
2 Some estimates of excess savings: Federal Reserve Bank of San Francisco ($2.1 trillion), Federal Reserve Board ($2.3 trillion).

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The pace of job growth is moderating with the economy adding 187,000 jobs (less than the expected increase of 200,000) in July 2023 according to the Bureau of Labor Statistics (BLS) Employment Situation. These job gains were led by health care, social assistance, financial activities, and wholesale trade. Employment in construction and financial services also increased even as rising interest rates have adversely impacted these sectors because employers are holding on to workers. The unemployment rate ticked down to 3.5% to remain close to 50-year lows. Wage growth remained solid with average hourly earnings increasing 4.4% over the past year. The slight easing in the labor market conditions is also evident in the employment cost index, a measure of the change in the cost of labor, free from the influence of employment shifts among occupations and industries. According to the BLS, compensation costs increased 1.1% over the quarter and 4.5% over the year in Q2 2023. This is a decline from the 4.9% yearly growth in the Q1 2023 and 5.1% a year ago.

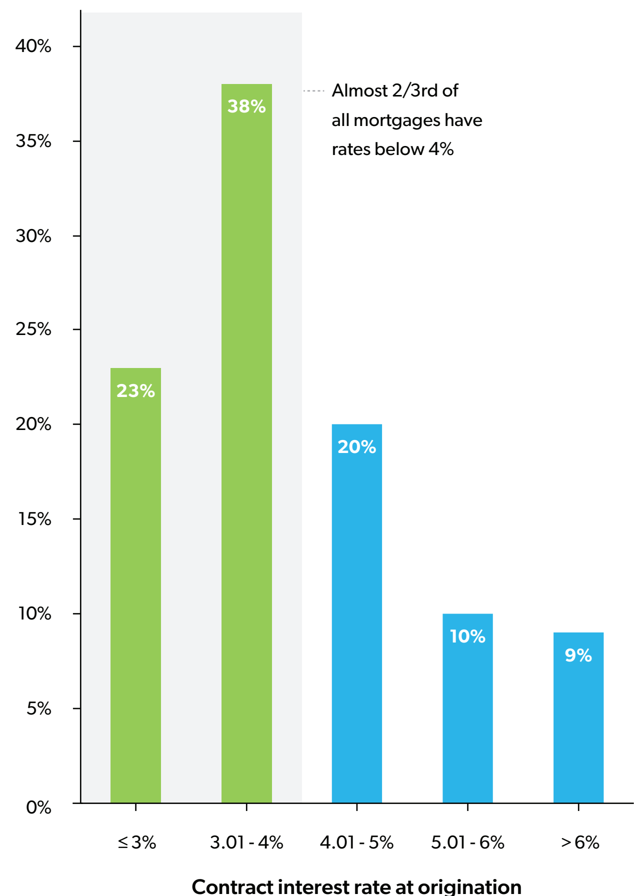
Inflationary pressures have been easing; data for June suggested a further cooling to 4.1% year-over-year in the Federal Reserve's preferred inflation measure (Core PCE, which is the U.S. Bureau of Economic Analysis' price index for personal consumption expenditures, excluding food and energy). The overall prices on goods continued to decelerate (at 0.1% month-over-month) while prices for services increased (0.3% month-over-month). From the beginning of the pandemic, prices for goods soared with everyone working from home and shifting their spending towards home improvement, new computers and durable goods like furniture, etc. As the economy reopened, the spending increasingly shifted back towards services, including housing services which are driven by rents.

Recent developments in the U.S. housing market

Home sales have slowed due to the 30-year fixed-rate mortgage rate staying above 6.5% since May 2023. Existing home sales declined 19% from a year ago, while new home sales were up 23.8% over the year. Monthly new home sales numbers are volatile and fell for the first time since February, down 2.5% over the month.[3] And yet the market remains undersupplied given the current demand, partially due to the mortgage rate lock-in effect.[4] This lock-in effect continues to dampen the number of listings of homes for sale, as almost two-thirds of all mortgages have rates below 4% (**Exhibit 1**). The inventory of existing homes for sale remained unchanged in June at 1.08 million units, down 13.6% from a year ago. The months' supply of existing homes for sale inched up

EXHIBIT 1

Share of outstanding mortgages by interest rate at origination (Q1 2023, %)



Source: National Mortgage Database

3 Existing home sales data come from the National Association of Realtors®, while new home sales data comes from the U.S. Census Bureau and U.S. Department of Housing and Urban Development.

4 See the Spotlight in our July Outlook on how the average borrower would be giving up $55,000 in lifetime savings if they were to replace their current mortgage at today's rates.

slightly to 3.1 months—still near historic lows. The inventory of new homes for sale increased from last month to 432,000, representing a supply of 7.4 months at the current rate. Pending home sales, a forward-looking indicator for existing home sales, increased 0.3% in June indicating that existing home sales in coming months might increase a little. However, contracts were still down 15.6% year over year.[5]

The NAHB/Wells Fargo Housing Market Index for builder confidence continued to improve, with the index nudging up 1 point to 56 during July. However, according to the U.S. Census Bureau, housing starts fell 8% over the month and were down 8.1% year-over-year to register the biggest drop in a year. Permits also declined over the month of June and were down 3.7% on a month-over-month basis and fell 15.3% year-over-year.

Although housing market activity has slowed, a demand-supply imbalance in the U.S. housing market has led to a rebound in home prices. Since the beginning of the year, the Freddie Mac House Price Index (FMHPI) has shown a positive house price growth after falling for seven consecutive months (on a month-over-month basis) starting in June of 2022. FMHPI increased 0.7% month-over-month in June and 1.7% year-over-year on a seasonally adjusted basis.

Recent developments in the U.S. mortgage market

Despite some moderation in inflation, the Fed raised rates at their July meeting to bring the Fed funds rate up to the 5.25-5.5% range, the highest level in 22 years. The rate hike was well anticipated and led the 30-year fixed rate mortgage, as measured by our Primary Mortgage Market Survey®, to reach a high of 6.96% during the second week of July before settling in at around 6.8%. Purchase applications declined in response to these higher rates, with total applications down 25% over the year, purchase applications down 23% and refinance applications declining almost 30% during the third week of July, according to the Mortgage Bankers Association Weekly Applications Survey.

> Purchase applications declined in response to the rate hike, with total applications down 25% over the year.

Regarding mortgage performance, overall delinquency rates as well as foreclosure starts continue to remain low according to the Q2 2023 Mortgage Bankers Association's (MBA's) Delinquency Survey. The delinquency rate of all loans past due declined from 3.56% in Q1 2023 to 3.37% in Q2 2023. The current delinquency rate is well below the historical average of 5.16% and the pre-pandemic (2016-19) average of 4.5%. Foreclosure starts rose to 0.13% in Q2, up from 0.12% in Q1 2023. Delinquency rates for conventional loans declined from 2.44% in Q1 2023 to 2.29% in Q2 2023, while FHA loans went down from 9.27% to 8.95% over the same period. While foreclosure starts during Q2 2023 declined for conventional and FHA loans, they increased for VA loans from 0.15% to 0.27%, still below the historical average of 0.36%.

5 According to the National Association of Realtors®.

The outlook

The better-than-expected economic growth in the first half of the year signals that the U.S. economy continues to grow above-trend. However, the macroeconomic outlook is still uncertain as the Federal Reserve may continue with rate hikes through the rest of this year. Currently, there is a 60% probability that there will be no more rate hikes according to the futures markets, with a quarter of the analysts expecting the Fed to raise rates by another quarter point in the September meeting, and only 2% expecting the year to end in the 5.75-6% target range for the Fed funds rate. The economic risks are weighted to the downside until the Fed completes its tightening cycle.

General economy, rates, inflation

Consumers are the backbone of the U.S. economy and have been on a spending spree, but that is likely to moderate as consumer balance sheets shrink, partly due to moderating yet still persistent inflationary pressure and high interest rates. The economy will continue to grow if consumer spending remains undeterred. But there is a risk that if inflation remains sticky and interest rates keep rising, the labor market could weaken, and the economy will start shrinking. That said, we expect inflation to cool, although at a slower pace, and remain above the Fed's target of 2% through next year. Putting all this together, our baseline forecast remains the same; we expect the labor market to gradually soften without a major adverse effect on the economy.

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Home sales

The combination of high interest rates and tight inventory due to the rate lock-in effect will keep home sales low through 2023. Our forecast is for mortgage interest rates to remain above 6% for the rest of the year, and we do not expect a lot more existing homes to come on to the market. Therefore, we expect home sales to remain muted for the rest of the year.

Home prices

Our corporate forecast for the next twelve months has house prices rising by 0.8% and an additional 0.9% over the following twelve months, consistent with our projection of a gradually softening labor market. This is more optimistic than earlier in the year mainly due to the rebound in prices after the house price declines in the second half of 2022. We believe the rebound in prices is driven by a combination of very tight supply and the large cohort of Millennial first-time homebuyers reaching prime homebuying age. It is evident that despite affordability issues, there is tremendous demographic-driven demand for houses relative to supply, which will continue to keep upward pressure on prices.

Mortgage originations

Mortgage origination volume depends on home sales, prices, and refinance activity. While we expect prices to remain high, we forecast sales to remain low and refinance activity to stay muted this year. Therefore, for the rest of the year we expect total mortgage originations to remain flat. We expect purchase originations to resume modest growth in 2024 as rates moderate and more existing homes hit the market to facilitate sales activity.

AUGUST 2023 SPOTLIGHT:

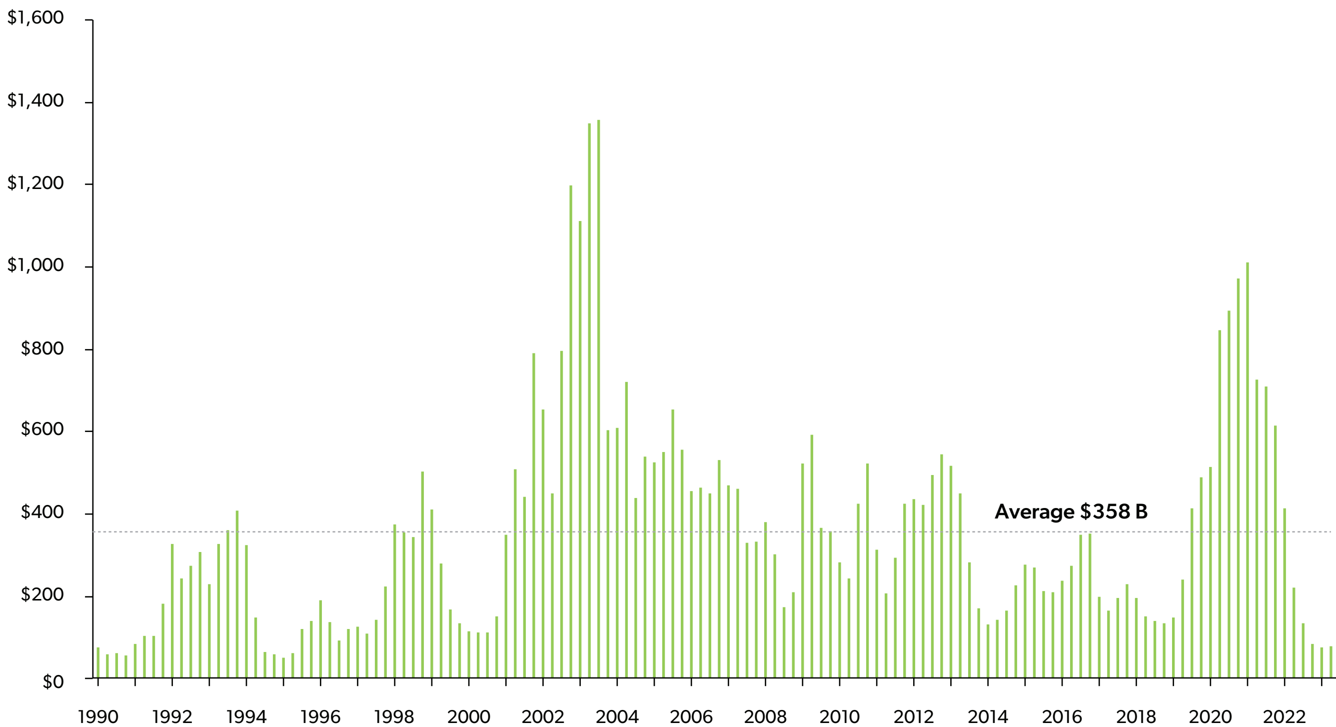
Refinance trends

Refinance origination activity in 2023 has been at the lowest level in almost 30 years. In the first and second quarters of 2023 there were only $75 and $80 billion, respectively, in mortgage refinance originations nationally, the lowest quarterly volumes since 1995 (see **Exhibit 2**, which is adjusted for inflation). The decline in refinance activity is a direct result of higher mortgage interest rates. Since most homeowners locked-in low rates relative to current market rates, relatively few people can lower their rate now by refinancing. However, some borrowers are still opting to refinance to cash out home equity or to lengthen their loan term, as we will discuss next.

EXHIBIT 2

U.S. single-family refinance originations (2022 U.S. dollars, billions)

Refinance volume is the lowest it's been since Q2 1995



Source: National Mortgage Database

EXHIBIT 3

Trends for conventional prime refinances

Year of refinance	(1) Cash-out share of refinances** based on loan count)	(2) Average dollars of equity cashed out of cash-out refinances (in 2022 dollars)	(3) Average equity cashed out as a percent of property value for cash-out refinances	(4) Total home equity cashed out (in 2022 dollars, billions)
1998	48.6%	$52,000	17.4%	$72
1999	56.8%	$57,000	19.2%	$65
2000	79.4%	$75,000	25.4%	$44
2001	56.2%	$60,000	17.9%	$137
2002	50.1%	$57,000	15.9%	$181
2003	36.6%	$51,000	14.2%	$235
2004	45.9%	$63,000	16.9%	$221
2005	72.4%	$79,000	19.1%	$393
2006	86.7%	$95,000	22.4%	$465
2007	83.0%	$92,000	22.2%	$339
2008	62.4%	$81,000	19.8%	$130
2009	35.6%	$66,000	16.3%	$100
2010	19.3%	$66,000	17.3%	$45
2011	16.8%	$65,000	17.2%	$35
2012	14.3%	$54,000	15.0%	$38
2013	15.2%	$58,000	16.1%	$37
2014	24.1%	$66,000	18.2%	$31
2015	34.5%	$64,000	16.5%	$53
2016	41.6%	$66,000	16.2%	$74
2017	57.6%	$68,000	17.8%	$85
2018	76.5%	$73,000	19.5%	$101
2019	52.3%	$71,000	17.7%	$123
2020	35.7%	$63,000	14.0%	$162
2021	50.5%	$66,000	14.4%	$289
2022	83.1%	$77,000	18.6%	$183
2022H1*	80.9%	$76,000	17.7%	**$141**
2022H2*	95.7%	$84,000	22.7%	**$42**
2023H1*	88.8%	$89,000	24.0%	**$24**

* This denotes the operative half of the year. H1 means the first half, and H2 means the second.

** We define cash-out refinance as a refinance loan that involves a 5% or more increase in the UPB of the new loan relative to the outstanding UPB of the refinanced loan. In other contexts, Freddie Mac uses an alternative definition of cash-out. For (1), (2), and (3) data is based on Freddie Mac matched refinance transactions and for (4) Freddie Mac estimate in 2022 dollars of equity cashed-out through the refinancing of prime, first-lien conventional mortgages. We do not estimate how much equity is taken out through the refinance of FHA or VA loans or through refinance loans originated in the subprime market. In column (2) the numbers were rounded to the nearest $1,000.

In the first half of 2023, nearly nine out of ten conventional refinance originations were cash-out refinances demonstrating just how few rate-and-term refinance borrowers exist in the current market. The faster pace of decline in the rate-and-term refinance originations is pushing up the cash out refinance share even as the overall refinance volumes decline. **Exhibit 3** shows trends in conventional cash-out

refinance activity over time. During this period, the average cash-out refinance borrower extracted $89,000 in equity in 2022 dollars, representing 24% of the property value. However, since refinance activity is down, the total is only $24 billion in aggregate dollars in the first half of 2023, down from $141 billion in the first half of 2022. As a share of total home equity, aggregate equity cashed out represented only 0.04% in the first and second quarters of 2023, down from 0.28% and 0.17% in the first and second quarters of 2021 respectively (see **Exhibit 4**). Historically the highest equity extraction share was 0.59% in the second quarter of 2006, more than ten times as much equity extraction as in 2023.

EXHIBIT 4

Home equity cashed-out as a share of total home equity

Sources: Freddie Mac 2023Q2 Refinance Statistics; Federal Reserve Board's Financial Accounts of the United States

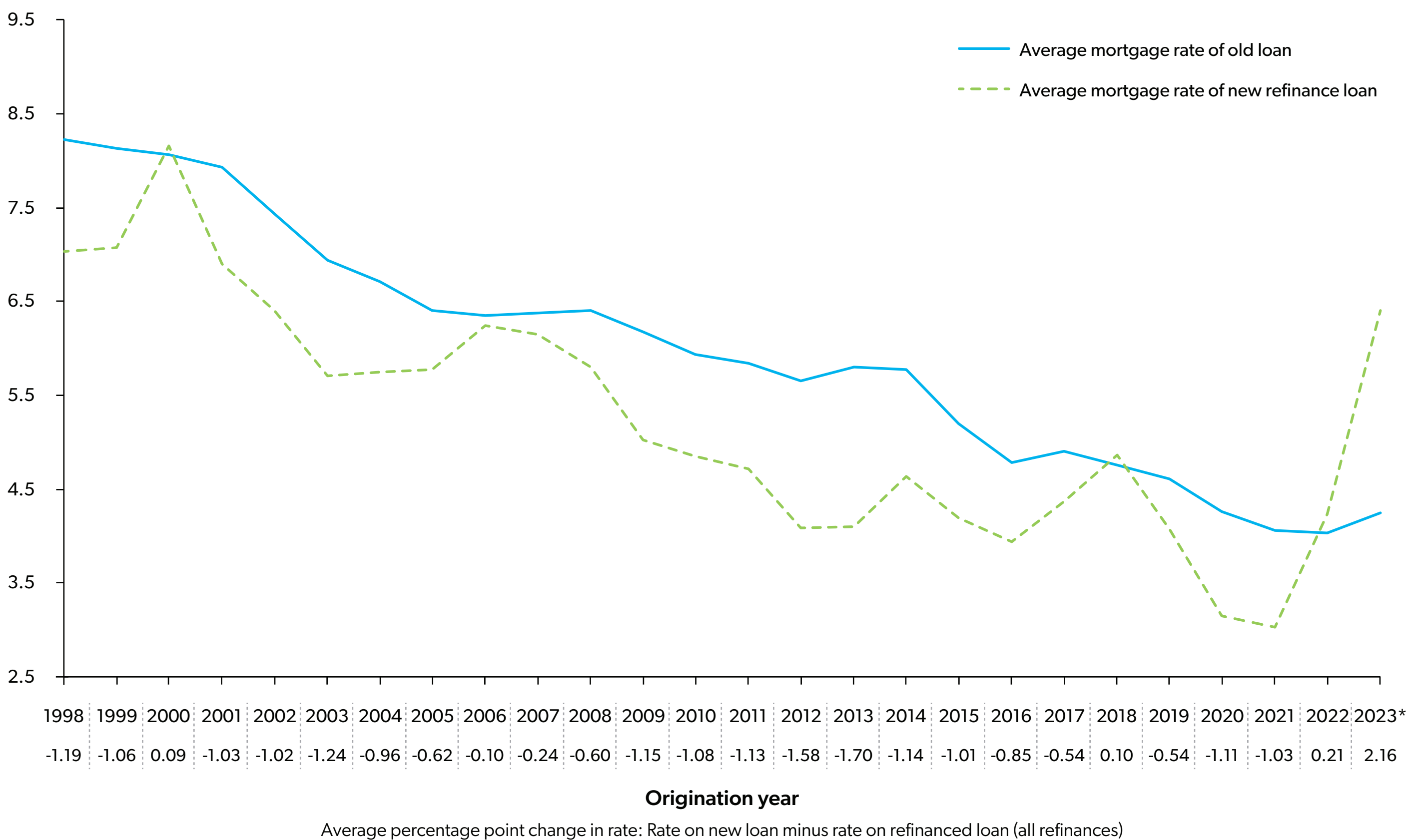
Borrowers who do opt to cash out or otherwise refinance their loan are paying a much higher interest rate on their new loan. **Exhibit 5** (following page) shows the average rate on the loans out of which borrowers refinanced and the rate on their new loan if both loans were 30-year fixed-rate mortgages. During the first half of 2023, the average rate on a new refinance loan was 6.4% vs 4.2% for the old loan—an increase of more than two percentage points. These higher rates resulted in an average increase of $591 in monthly principal and interest payments for borrowers who refinanced.

One way that borrowers can help mitigate the effects of higher interest rates is to extend the term on their loan, since that extends the payments over a longer period. Extending the term results in more interest payment over the life of the loan but has the benefit of reducing the required monthly payment. In the second quarter of 2023, 23% of refinance borrowers lengthened their term, up from 11% a year prior and the highest share since the third quarter of 2008.

As mentioned earlier, we expect the average 30-year fixed-rate mortgage to remain elevated in the 6-6.5% range at least through the first quarter of next year, leading to a further decline in the aggregate refinance volume. Offsetting mortgage rate headwinds somewhat is the record high aggregate homeowner equity, which was over $28 trillion as of the first quarter of 2023, with the aggregate ratio of home equity to the value of housing stock at 70%.[6] This large pool of untapped home equity could help some homeowners, for example to payoff higher-rate debt, finance a home renovation, purchase a new vehicle, update home appliances, or pay medical bills. Therefore, we expect most refinances for an extended period of time to be cash-out refinances.

EXHIBIT 5

Mortgage rates on new and old loans for conventional refinances of 30-year fixed-rate mortgages



Source: Freddie Mac refinance data

*2023 average percentage point change in rate is inclusive of first half of year only

6 According to the latest data from the Federal Reserve Board's Financial Accounts of the United States.

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