Freddie Mac

U.S. Economic, Housing and Mortgage Market Outlook

DECEMBER 2024 IN THIS ISSUE:

Recent developments

U.S. economy: The U.S. economy continues to grow at a strong pace, as evidenced by the second estimate of Q3 2024 Real Gross Domestic Product (GDP).[1] Growth for Q3 was 2.8% at a seasonally adjusted annual rate, a slight decrease from the rate of 3.0% in the second quarter, but consistent with the advance estimate. The second estimate reflected increases in consumer spending, exports, federal government spending, and nonresidential fixed investment. As with the previous quarters, in Q3 2024, consumption spending led growth by contributing 2.4 percentage points to real GDP growth, compared to a contribution of 1.9 percentage points in Q2 2024.

The labor market rebounded from the lows of October as the impact of the hurricanes receded and the Boeing strike resolved. November saw payroll gains of 227,000 with October gains revised up from 12,000 to 36,000. Combined, September and October were revised up by 56,000. Employment growth is still consistent with a job market that is cooling from the highs seen over the last couple of years. The unemployment rate remains low at 4.2% in November 2024.

U.S. inflation, which had been receding over the past few months, ticked up slightly in October. Core inflation as measured by the Price Index for Personal Consumption Expenditures (PCE) less food and energy rose 0.3% over the month in October and 2.8% from a year ago. Prices for goods decreased 0.1% over the month but were offset by a 0.4% increase in prices for services. Although showing a modest increase in the year over year rate, core PCE price inflation is still consistent with expectations of a gradual cooling of inflation as the long and variable lags of monetary policy work their way through the economy.

Economic growth for 2024 has remained strong and is on track to be above the long run trend growth estimate. The labor market, while cooling, continues to remain strong and inflation continues to slowly move towards the Fed target of 2% indicating that we remain on a path towards a soft landing.

1 Bureau of Economic Analysis (BEA)

U.S. housing and mortgage market: Home sales remained subdued amid rising interest rates throughout October. Total (new + existing) home sales remained virtually unchanged in October. After reaching their lowest level since 2010 in September, existing home sales increased 3.4% over the month in October to 3.96 million. This increase in existing home sales was offset by new home sales, which fell sharply in October to an annual rate of 610,000, the lowest level since November 2022. Both hurricanes Helene and Milton had negative effects on home sales, with much of the decline occurring in the south. After ticking up slightly last month, the supply of existing homes decreased to 4.2 months in October. Homeowners are still not incentivized to sell, keeping supply below the 5 to 6 months' supply indicative of a balanced housing market.

Housing construction slowed in October. Total housing starts declined 3.1% from September and 4.0% from last October. This decrease was primarily due to a slowdown in multifamily construction, which decreased 12.6% from last October. Homebuilder confidence rose for the third consecutive month to an index of 46 in November, according to the National Association of Home Builders' (NAHB) Housing Market Index. The increased confidence is mostly due to the Federal Reserve loosening monetary policy as builders benefit from interest rate cuts which help lower construction financing costs. Despite this increase, the index has remained below 50 since August 2023, indicating that building conditions are expected to remain weak in the near term. 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 indicate that sentiment is on balance positive (negative).

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 September 2024 rose 0.7% month-over-month and 4.4% from last year. All nine census divisions showed annual increases.

Mortgage rates remained elevated throughout November, ending the month at 6.81%. The 30-year fixed-rate mortgage as measured by Freddie Mac's Primary Mortgage Market Survey® averaged 6.81% in November. Mortgage rates have remained essentially flat throughout the last few weeks, keeping potential homeowners waiting for affordability to improve. Refinance activity accounted for about 38% of total application activity at the end of November, decreasing since September as mortgage rates continued to rise. While refinance activity decreased, there was a slight uptick in purchase activity as potential homebuyers reacted to the modest decrease in rates. Purchase applications were up 23.5% in the last week of November as compared to the last week in October.

Outlook

Before we delve into the outlook for 2025, let's look back at 2024 to see how the economy and housing markets evolved. Below are our top three trends of 2024.

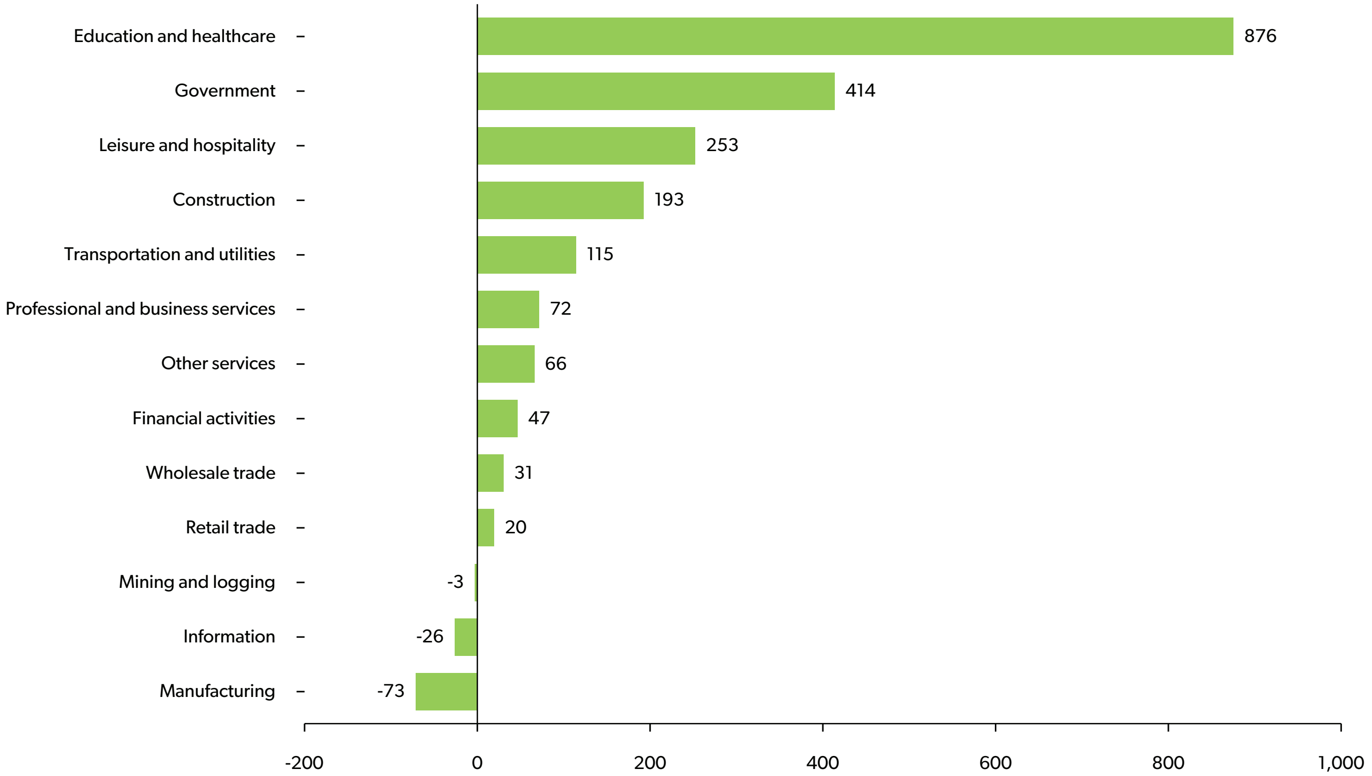
1. Resilient U.S. labor market:

The 2024 U.S. labor market, despite the uncertainty, demonstrated remarkable resilience. Job openings and hiring rates stabilized compared to the post-pandemic recovery. As of November 2024, 1.98 million jobs were added to the economy, equating to 165,000 jobs per month. Education and healthcare sectors added the most jobs followed by government, professional and business services and leisure and hospitality (**Exhibit 1**).

The unemployment rate hovered near the pre-pandemic level and currently sits at 4.2% averaging around 4% for the eleven months of the year so far. Despite economic challenges, there was a gain in average hourly earnings of around 3.9% to 4.3% in 2024. Overall, the labor market exhibited resilience, even in the face of economic shifts and inflationary pressures.

EXHIBIT 1

Jobs added by sector in 2024, (thousands, SA)



Source: BLS

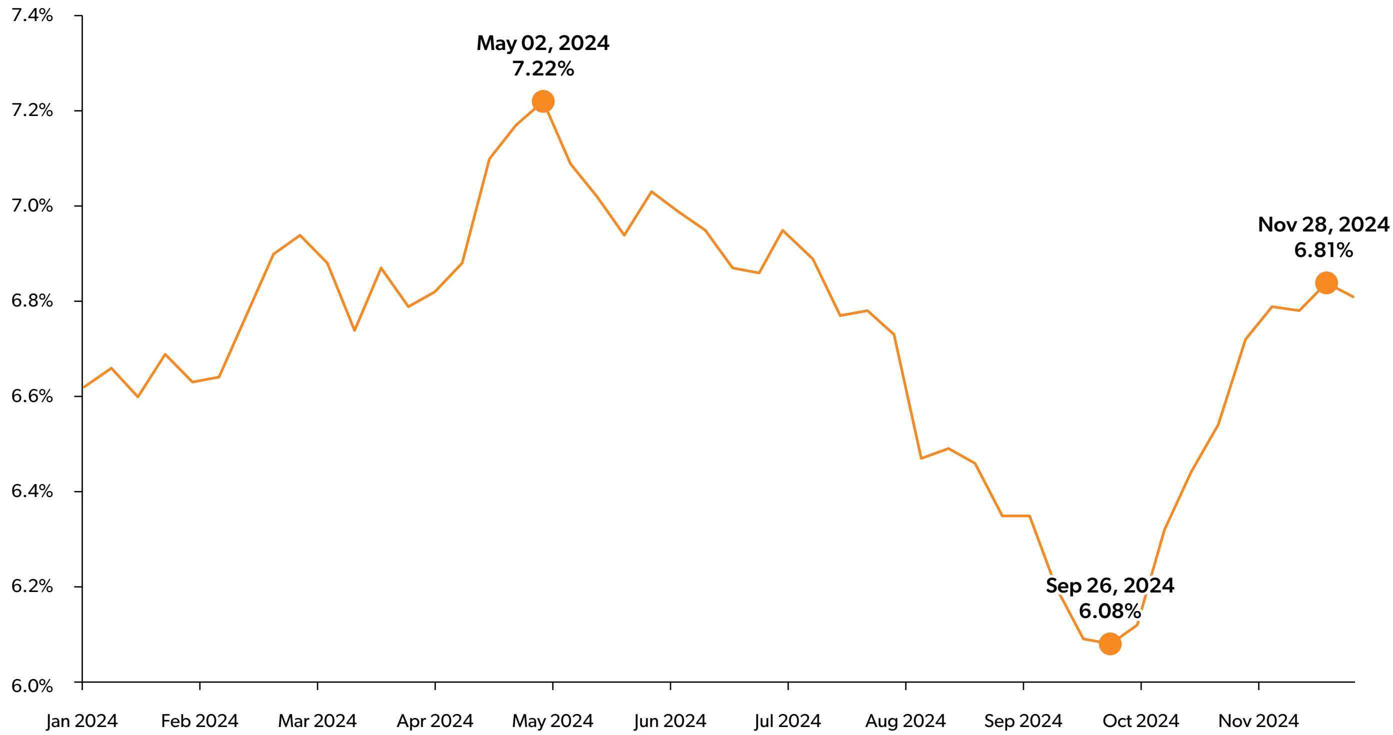
2. Interest rate volatility:

Interest rates have been very volatile over the year mainly due to the uncertainty around the Federal Reserve rate path and the elections (**Exhibit 2**). At the beginning of the year, higher-than-expected inflation and stronger economic growth led to a reevaluation of the Fed's rate path and the Federal Reserve decided to hold the fed fund rates at the 5.25-5.5% range. But since May, with some cooling in the inflationary pressures, the Federal Reserve signaled upcoming rate cuts, which materialized starting in September. Most of the declines in mortgage rates were already baked in by the first Fed rate cut in September. Since September, rates have been on the rise again, as we explained in our November Outlook, and ended the month of November at 6.81% after hitting 2-year lows of 6.08% in late September.

EXHIBIT 2

Mortgage rates have been on a roller coaster ride this year

30 year fixed rate mortgage rate (U.S. weekly average)



Source: Freddie Mac Primary Mortgage Market Survey

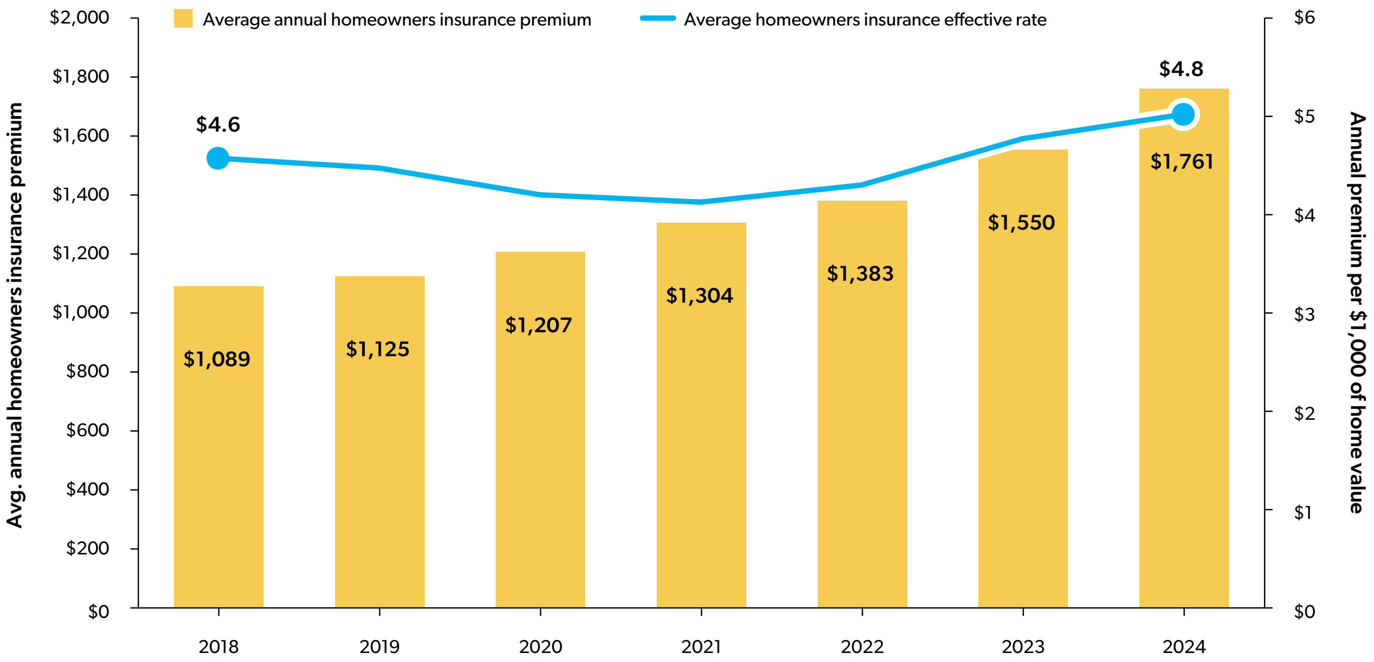
3. Rising homeowners' insurance costs:

In 2024, housing affordability remained one of the most significant issues facing American households. High mortgage rates and home prices significantly contributed to declining affordability. Growing homeowners' insurance costs further challenged housing affordability. According to our latest calculations, as of August 2024, an average borrower paid an annual homeowners' insurance premium of $1,761, 13.6% higher than in 2023 and 61.8% higher than in 2018, with substantial variation across different states. As homeowners' insurance costs continue to rise, borrowers face an increased financial burden. From 2018 to 2024 (as of August), the average borrower's share of income spent on homeowners' insurance premiums has increased from 1.5% to 1.7%. The burden of these costs is not evenly distributed. Some homeowners, especially those with lower incomes, are affected more by the increased cost of homeowners' insurance than moderate- and high-income borrowers. Between 2018 and 2024, very low-income borrowers (those with an income no greater than 50% of the area median income) were consistently most burdened by such costs. As of August 2024, low-income borrowers spent 3.4% of their monthly income on homeowners' insurance premiums. The impact of high interest rates and home prices affecting the principal and interest payments is much larger than the net impact of insurance cost, but it is still a significant burden on marginal borrowers trying to get into the housing market as well as homeowners with fixed incomes.

EXHIBIT 3

Homeowners' insurance premiums and effective rate

30 year fixed rate mortgage rate (U.S. weekly average)



Source: Authors' calculation using Uniform Closing Database (UCD).

Note: Single-family owner-occupied property with a fully amortizing 30-year fixed-rate mortgage funded by Freddie Mac.

*2024 YTD as of August 2024.

With this background, for 2025, we expect the economy to continue its growth, although at a slightly slower pace than in 2024. While there is still a considerable amount of policy uncertainty, under our baseline scenario, we expect inflation to continue to move towards the Federal Reserve's target rate of 2% and a gradual cooling of the labor market from its recent levels. We also expect the Federal Reserve to continue on its implied rate cut path over the course of the next year.

We expect mortgage rates to decline over 2025, but very gradually. Declining rates will boost home sales to a slightly higher level than what we saw in 2024. Interest rate lock-in remains a major challenge for the housing market. Our estimate of the average interest rate lock-in effect for conventional mortgage borrowers was up from $42,000 in October to $47,800 in November 2024. House price growth may continue to moderate given increased supply and declining but still high mortgage rates. This modest growth in house prices, and the increase in home sales should support the purchase market in 2025. We also expect refinance volumes to increase mainly based on declining mortgage rates. We forecast total origination volumes to increase in 2025.

DECEMBER 2024 SPOTLIGHT:

Homeowner vs. renter spending in an era of rising housing costs

Housing expenses are the largest component of a household's budget and account for around a third of total monthly expenses for the average American household. The rising demand for housing along with the shortage of homes available have pushed up both house prices and rents. We explored buying vs. renting in a recently published research note where we found that poor affordability has widened the gap between the typical payments and rents on the same house. While affordability of owning relative to renting is very poor compared to pre-pandemic levels, it is similar to the early 2000s and within the upper range of historical norms. In this spotlight, we focus on how housing expenditures have shifted in recent years in an era of rising housing costs.

How much does a typical American consumer spend on average in a year and on what?

According to the Consumer Expenditure Survey (CEX) by Bureau of Labor Statistics (BLS), as of 2023 a typical consumer spent around $77,000 per annum with the largest share of expenditure going towards housing followed by transportation and food.[2] Renters allocate a larger share of their expenses towards rent at 39% compared to homeowners who spend 31% on their total housing expenses. Housing expenses include shelter expenses (mortgage payments, taxes and insurance), utilities, fuel and services, household operations, housekeeping supplies and household furnishings, and equipment. While in nominal terms the total expenses increased by 252% over the period between 1984 and 2023, after accounting for inflation, expenses in real terms increased by 20%. In this spotlight, we study the share of expenses homeowners and renters spend on various expenditure categories to account for increases in both incomes and price levels over the period from 1984 to 2023.

2 The BLS also produces the Current Employment Statistics which is often abbreviated CES, so we use CEX as the abbreviation for the Consumer Expenditure Survey to avoid confusion.

EXHIBIT 4

Total expenditure by a typical American consumer

	Total (USD)	Share of expenses	Homeowners (USD)	Share of expenses	Renters (USD)	Share of expenses
Housing	25,436	33%	27,205	31%	22,137	39%
Shelter	15,499	20%	15,302	17%	15,866	28%
Utilities	4,625	6%	5,465	6%	3,060	5%
Household operations	1,985	3%	2,420	3%	1,173	2%
Household furnishings and equipment	2,508	3%	3,055	3%	1,488	3%
Foods	9,985	13%	11,154	13%	7,804	14%
Apparel and services	2,041	3%	2,198	2%	1,746	3%
Transportation	13,174	17%	15,330	17%	9,156	16%
Healthcare	6,159	8%	7,633	9%	3,411	6%
Entertainment	3,635	5%	4,406	5%	2,198	4%
Education	1,656	2%	1,931	2%	1,145	2%
Miscellaneous	1,184	2%	1,383	2%	814	1%
Personal insurance and pensions	9,556	12%	11,479	13%	5,973	10%
Other	4,452	6%	5,337	6%	2,804	5%
Total expenses	**77,280**	**100%**	**88,055**	**100%**	**57,186**	**100%**

Source: BLS CEX, 2023

Note: Housing also includes expenses on housekeeping supplies which is in the total but not shown as a line item but is included in the "Other" category. "Other" category includes alcoholic beverages, personal care products and services, reading, tobacco and smoking supplies, and cash contributions.

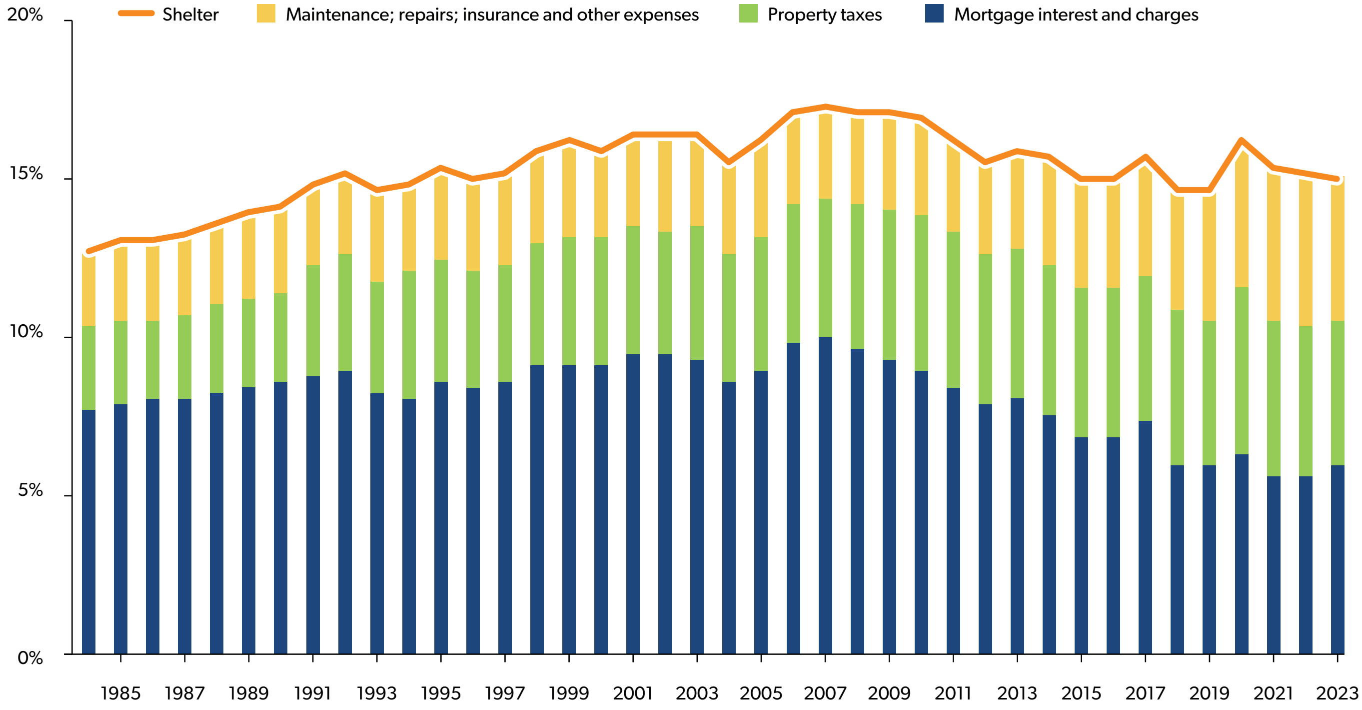
Homeowners' expenditures

Per the 2023 CEX, on average a homeowner's expense on shelter as a share of total expenditures has been around 15% since 1984. The shelter portion of housing expenses includes maintenance, property taxes, and mortgage and interest charges. **Exhibit 5** (on the following page) plots the shelter expense for homeowners. As can be seen from the exhibit, the share of homeowner expenses on shelter rose and eventually peaked at 17% right before the financial crisis and has come down since then. There was another uptick during the pandemic, but since then it has stabilized back to its previous levels. Within shelter, mortgage and interest charges account for around 8% of total homeowner expenditures on average since 1984, peaking in 2006. As of 2023, mortgage interest and charges contributed to 6% of the total housing expense. While mortgages rates and house prices have increased now, a vast majority of the homeowners are locked into very low rates, helping homeowners keep their monthly payments lower as compared to the other expenses. Additionally, about two out of five homeowner households own their home free and clear without a mortgage, so their expenses on shelter are limited to insurance, taxes and maintenance.

Property taxes as well as maintenance and repairs have steadily increased over the years. Property taxes contributed to 3% of the total housing expense in 1984 and increased to 5% by 2009, remaining at that level since. Maintenance, repairs and other expenses also steadily rose over the years and doubled by 2023. In terms of the other broad categories BLS collects data for, we find that expenses on utilities and fuel declined between 1984 and 2023, along with household furnishings. On the other hand, expenses on household operations increased slightly while expenses on housekeeping supplies have remained constant.

EXHIBIT 5

Shelter expenses as a share of total expenses - homeowners



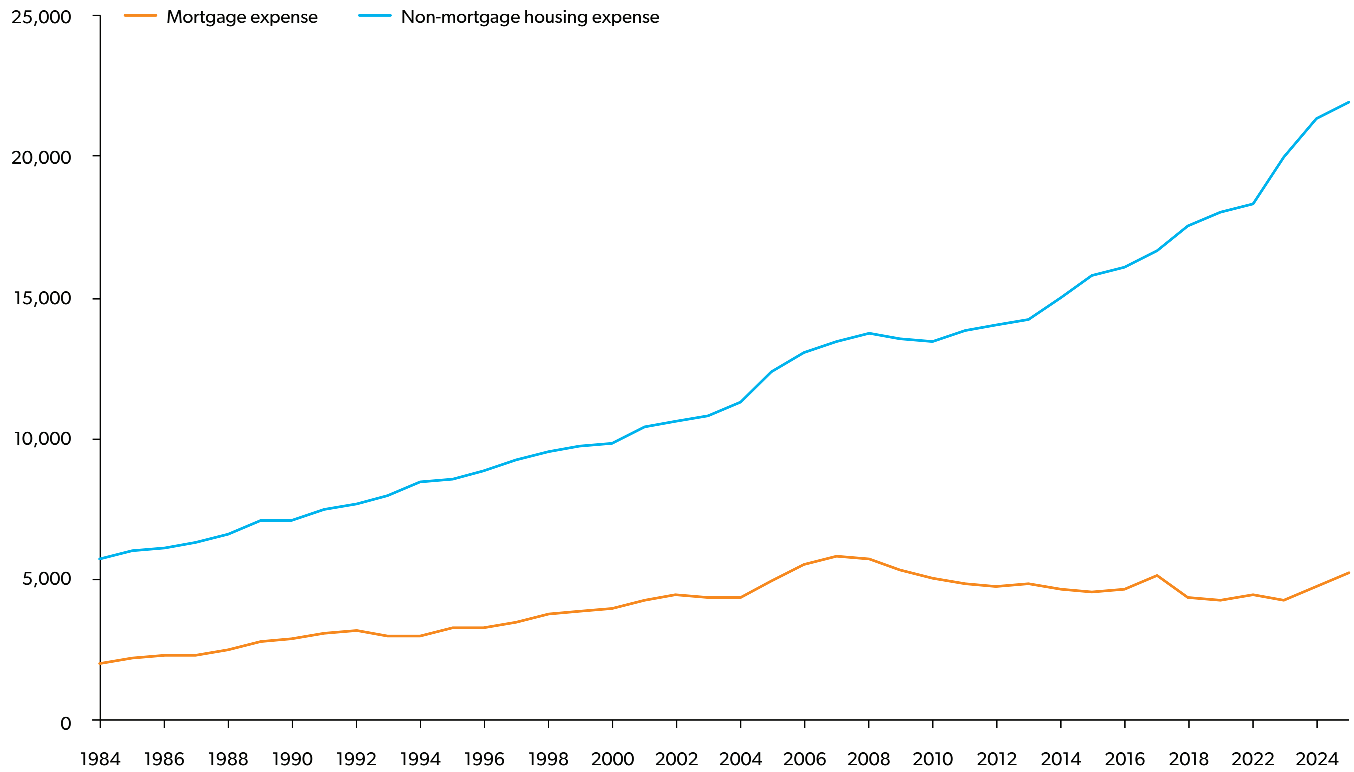
Source: BLS CEX, 2023

Note: Shelter includes mortgage interest and charges, property taxes and maintenance, repairs, insurance and other expenses but excludes other lodging (for example, hotel and motel accommodations).

If we look at mortgage versus the non-mortgage expenses, we find that non-mortgage expenses have gone up more than the mortgage expenses. Non-mortgage expense is the total housing expense (which includes expenses on shelter, utilities, household supplies, household operations, etc.) less the expenses on mortgage interest and charges (**Exhibit 6**). Even though mortgage expenses increased from $1,982 in 1984 to $5,263 in 2023, the share of mortgage expense to total housing expenditures declined from 26% to 19% over the same period, mainly due to the fixed rate mortgages. On the other hand, non-mortgage expenses increased from $5,751 to $21,942 but their share also increased from 74% to 81% of total house expenditure share over the same period. So, while overall expenses on housing have increased over the period, how have homeowners adjusted and how have their expenses shifted over the years?

EXHIBIT 6

Mortgage vs non-mortgage housing expenses for homeowners

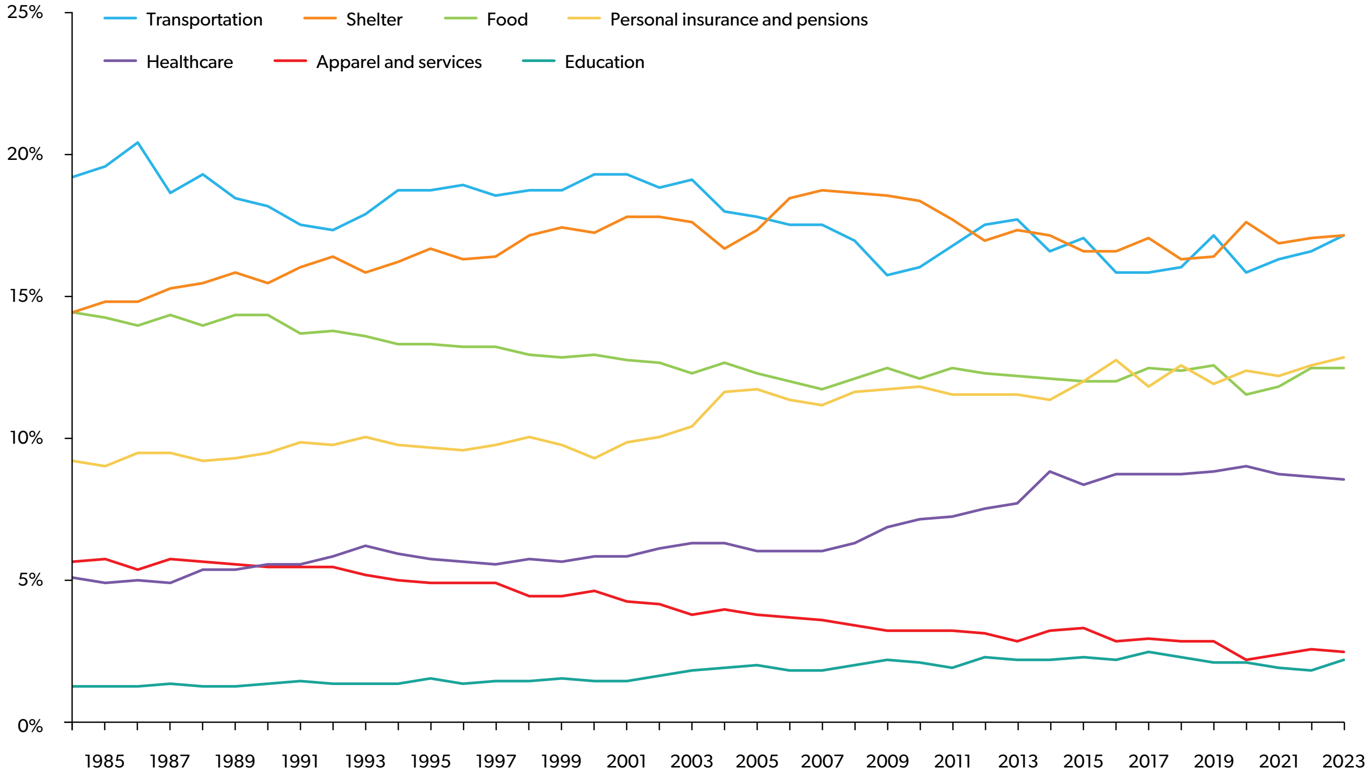


Source: BLS CEX, 2023

The components of homeowner expenditures that saw declining expenditure shares are food, apparel and transportation. **Exhibit 7** plots the homeowner expenses excluding housing. Apparel saw the largest decline as a share of total expenditures, from 6% in 1984 to just 2% in 2023.

EXHIBIT 7

Homeowner expenses excluding housing



Source: BLS CEX, 2023

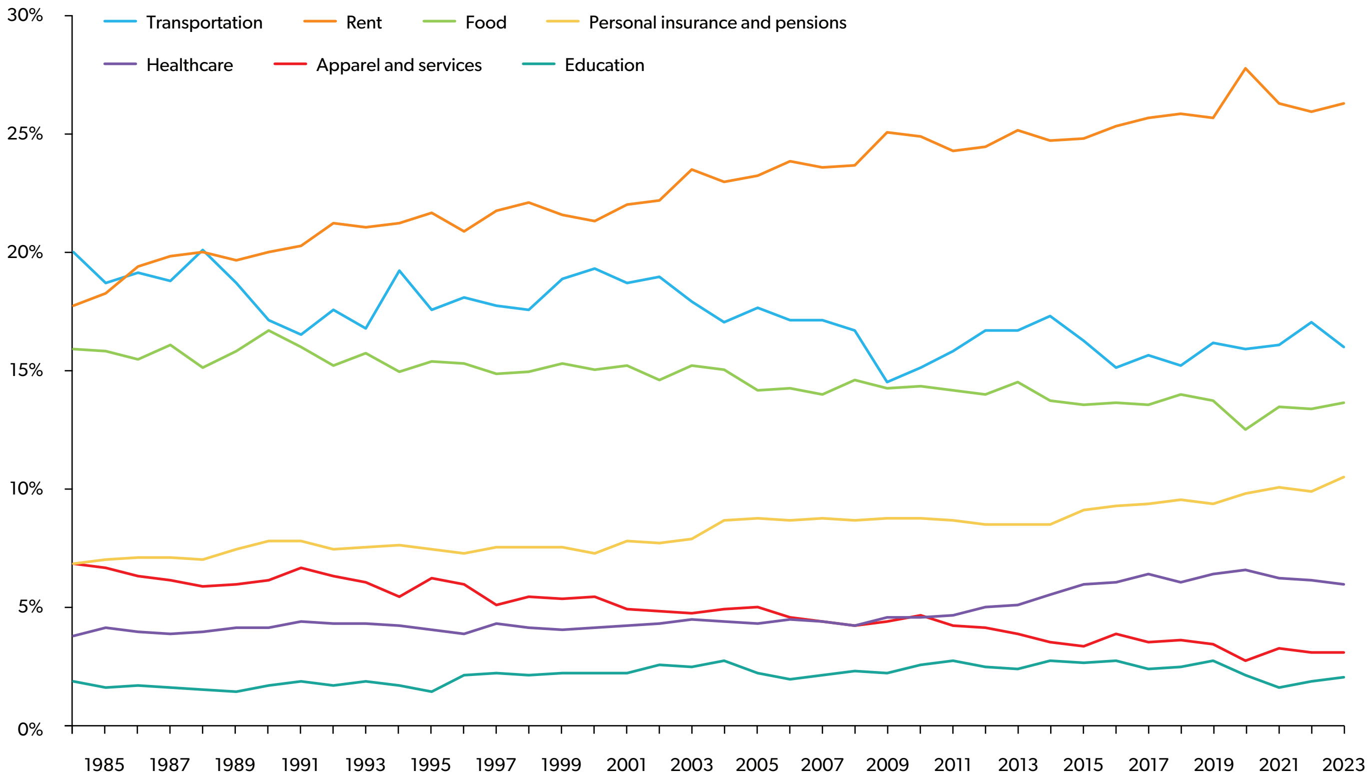
Renters' expenditures

Unlike homeowners, who mostly have a fixed-rate mortgage and are shielded from rising interest rates and house prices, renters do not have the same advantage and must deal with rising rent costs. For renters, the share of average annual expenditures spent on rent rose from 18% to 26% between 1984 to 2023 (**Exhibit 8**). As opposed to homeowners, this steady increase in rent expenditure means that renters are having to cut back on their spending elsewhere.

These cuts are likely to be seen in more discretionary categories rather than necessities. As outlined in Engels Law, it is likely that the percentage of average annual expenditure for food at home will stay relatively constant regardless of how much the share of shelter expenditures increase.[3] As can be seen in Exhibit 8, expenditures on food declined only slightly during the period from 1984-2023.

EXHIBIT 8

Average expenses (%) - renters



Source: BLS CEX, 2023

If we break down food into food away from home and food at home, we find that food away from home has increased slightly from its low in 2020 but has not made the recovery back to its pre-pandemic levels. Aside from food, a downward trend is also observed with renters' expenditures on apparel and services.

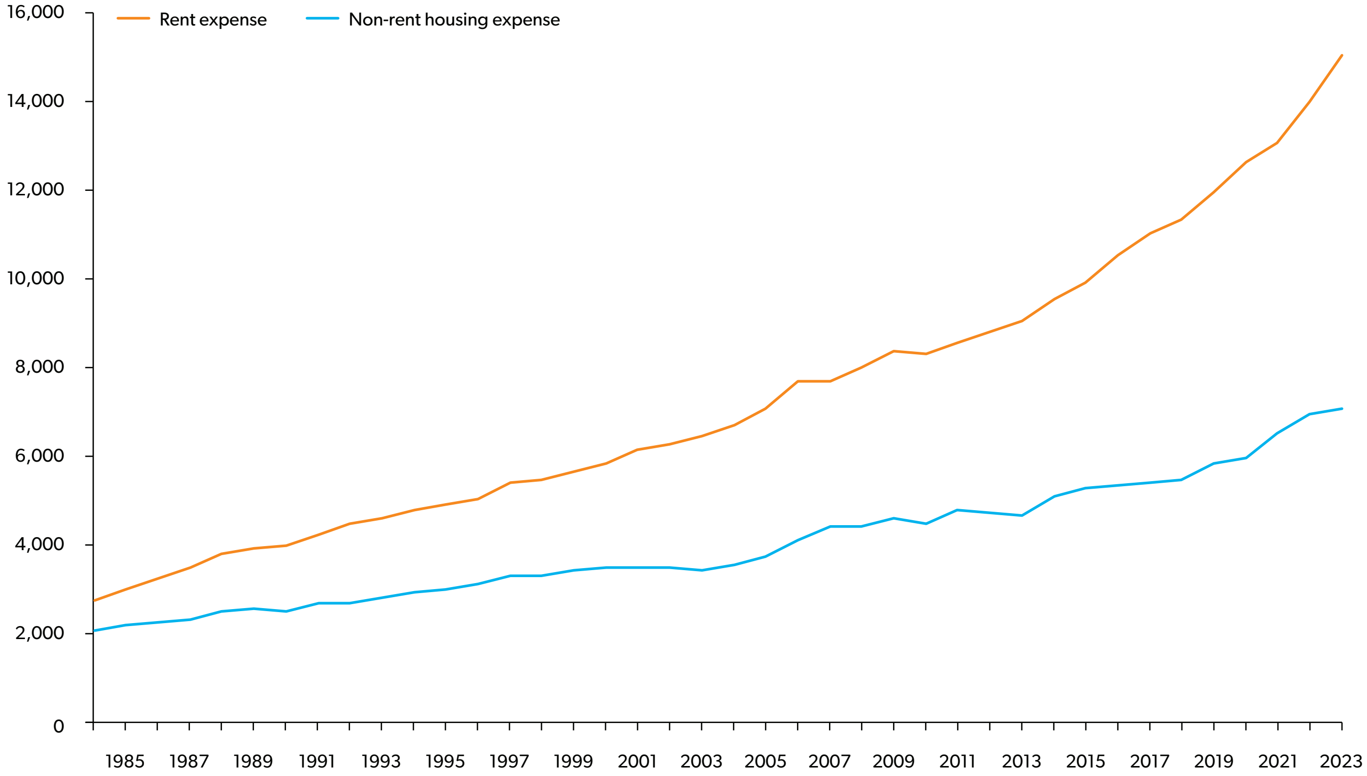
3 Chai, A., & Moneta, A. (2010). Retrospectives Engel Curves. Journal of Economic Perspectives, 24, 225–240. https://doi.org/10.1257

Another area where renters have cut back expenses is transportation. Expenditure shares for transportation have declined more for renters than homeowners. One possible explanation for this could be homeowners moving away from city centers to suburbs to buy a home, therefore spending more on transportation in order to commute to work. Renters, however, are more likely to live closer to work and can spend less on transportation as a percentage of their total expenses.

Unlike homeowners, for renters, the share of rent in total housing expenses has been rising as compared to the non-rent expense (**Exhibit 9**). Non-rental housing expenses like the non-mortgage expense includes utilities, household operations, furnishings, housekeeping supplies etc.

EXHIBIT 9

Average annual rent vs non-rent housing expense



Source: BLS CEX, 2023

To conclude, homeowners were able to lock themselves into lower mortgage rates and shield themselves from the rising interest rates and house prices. However, renters do not have the same advantage and must deal with rising rent costs. These rising costs meant reducing spending on other categories of expenses such as apparel and food away from home. While overall transportation expenses declined, they declined more for renters who typically try to rent closer to work, while homeowners have seen a movement away from city centers to the suburbs indicating a large share of transportation expenses as compared to renters.

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