

# **Burnham-Moores Center for Real Estate Outlook Conference**

## **Economic Update**

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## Speaker Biography

Douglas G. Duncan is Fannie Mae's Vice President and Chief Economist. He is responsible for managing Fannie Mae's Economics & Strategic Research and Economics & Mortgage Market Analysis Groups. In this leadership role, Duncan provides all economic, housing, and mortgage market forecasts and analyses, and serves as the company's thought leader and spokesperson on economic and mortgage market issues.

Prior to joining Fannie Mae, Doug was Senior Vice President and Chief Economist at the Mortgage Bankers Association. His experience also includes service as a LEGIS Fellow and staff member with the Committee on Banking, Finance, and Urban Affairs for Congressman Bill McCollum in the U.S. House of Representatives, and work on the Financial Institutions Project at the U.S. Department of Agriculture. He has been elected to the Board of Directors for the National Association of Business Economists, is a member of the American Economics Association and the American Real Estate and Urban Economics Association, and is past president of the Housing Statistics Users Group.

Named one of the country's top four most accurate economists in 2010 by the *Wall Street Journal* and named one of Bloomberg / BusinessWeek's 50 Most Powerful People in Real Estate, Doug is a frequent speaker on national and state economic, housing, and mortgage market conditions. Duncan received his Ph. D. in Agricultural Economics from Texas A&M University and his B.S. and M.S. in Agricultural Economics from North Dakota State University.

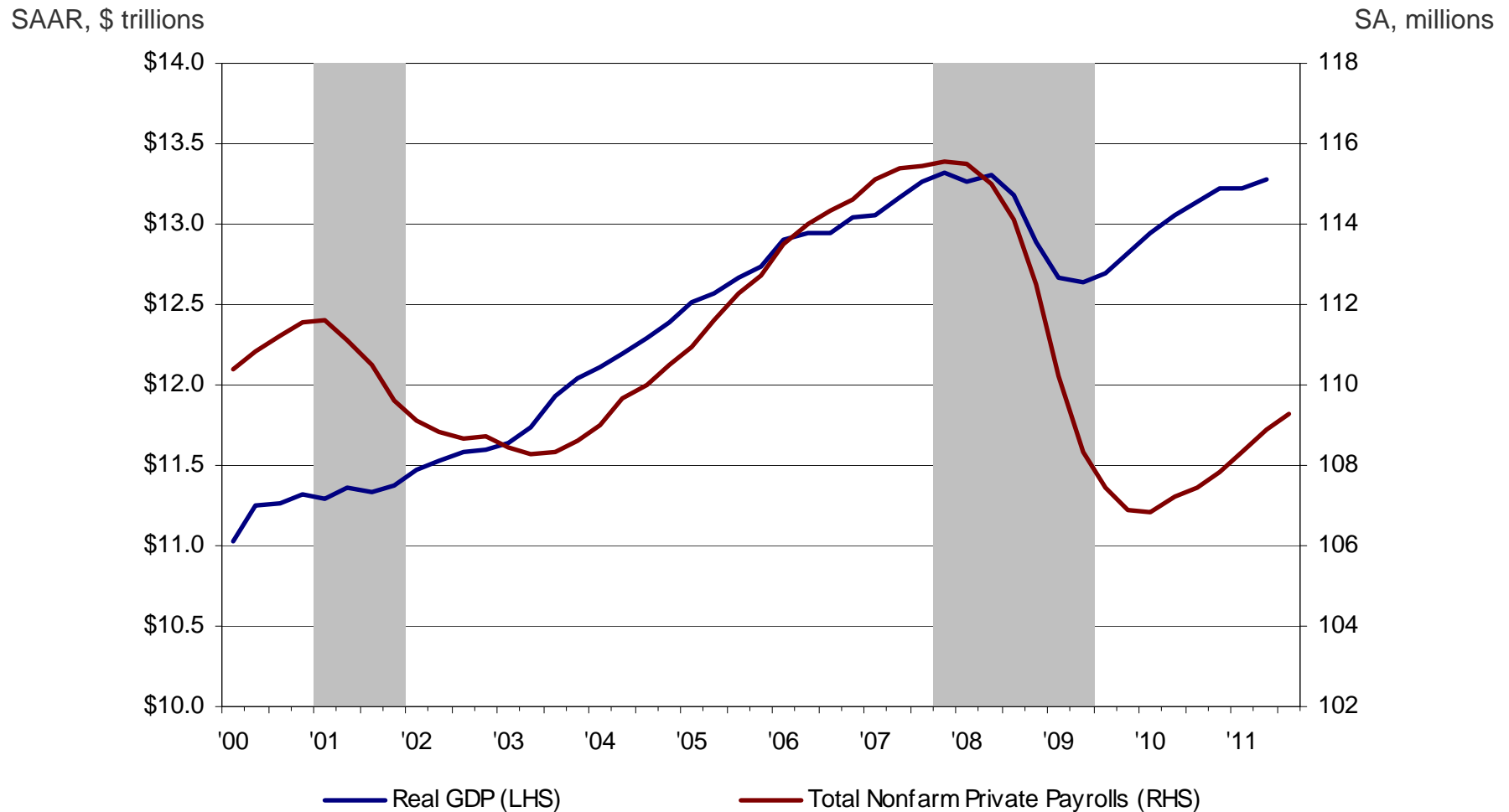


## Agenda

- The Macro Economy
- Household Financial Condition
- Consumer Attitudes
- The State of Housing
- Commercial Real Estate
- Policy

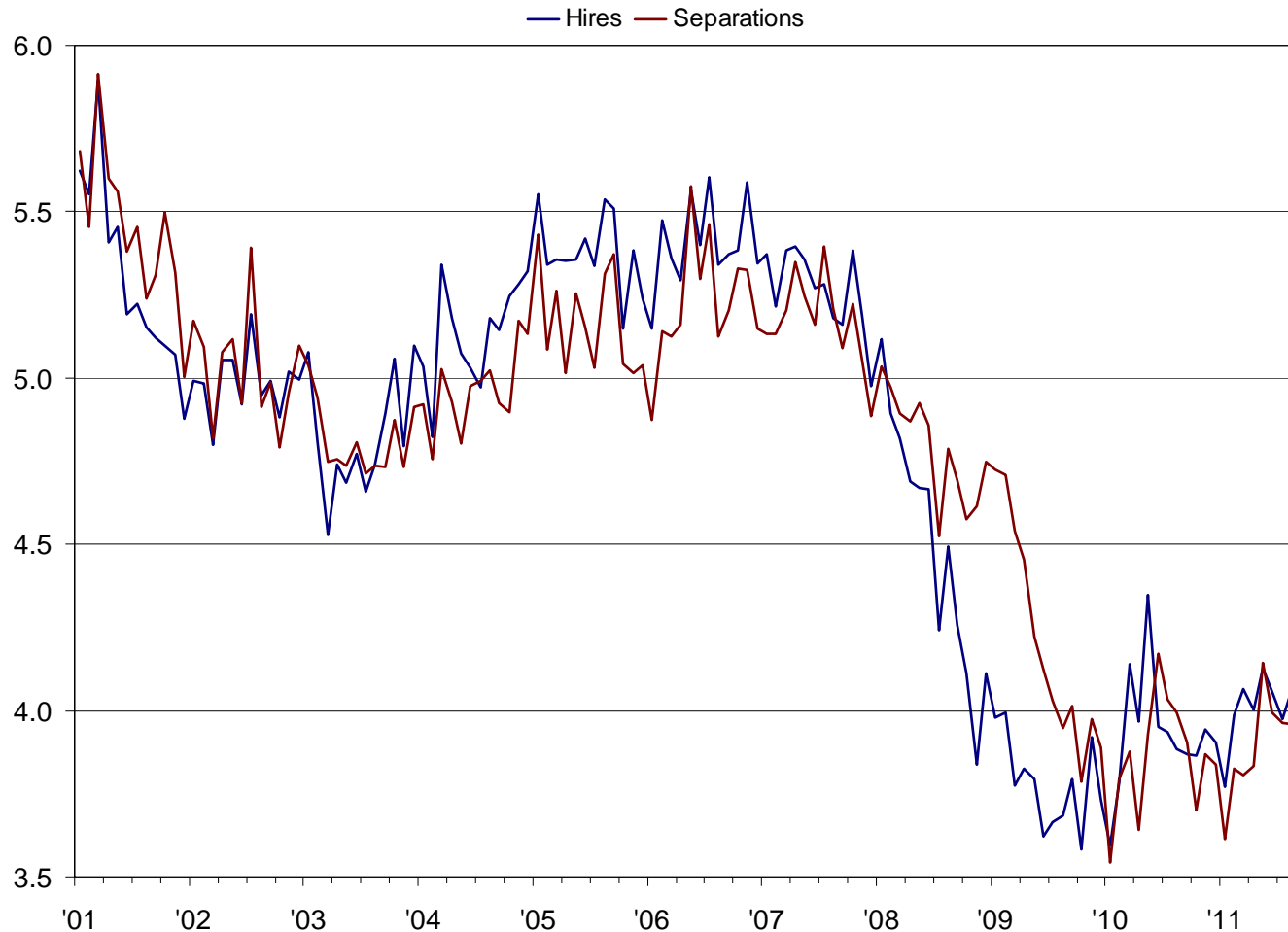
# **The Macro Economy: Slowing Growth and Employment Struggles**

## Employment activity is not matching economic activity.



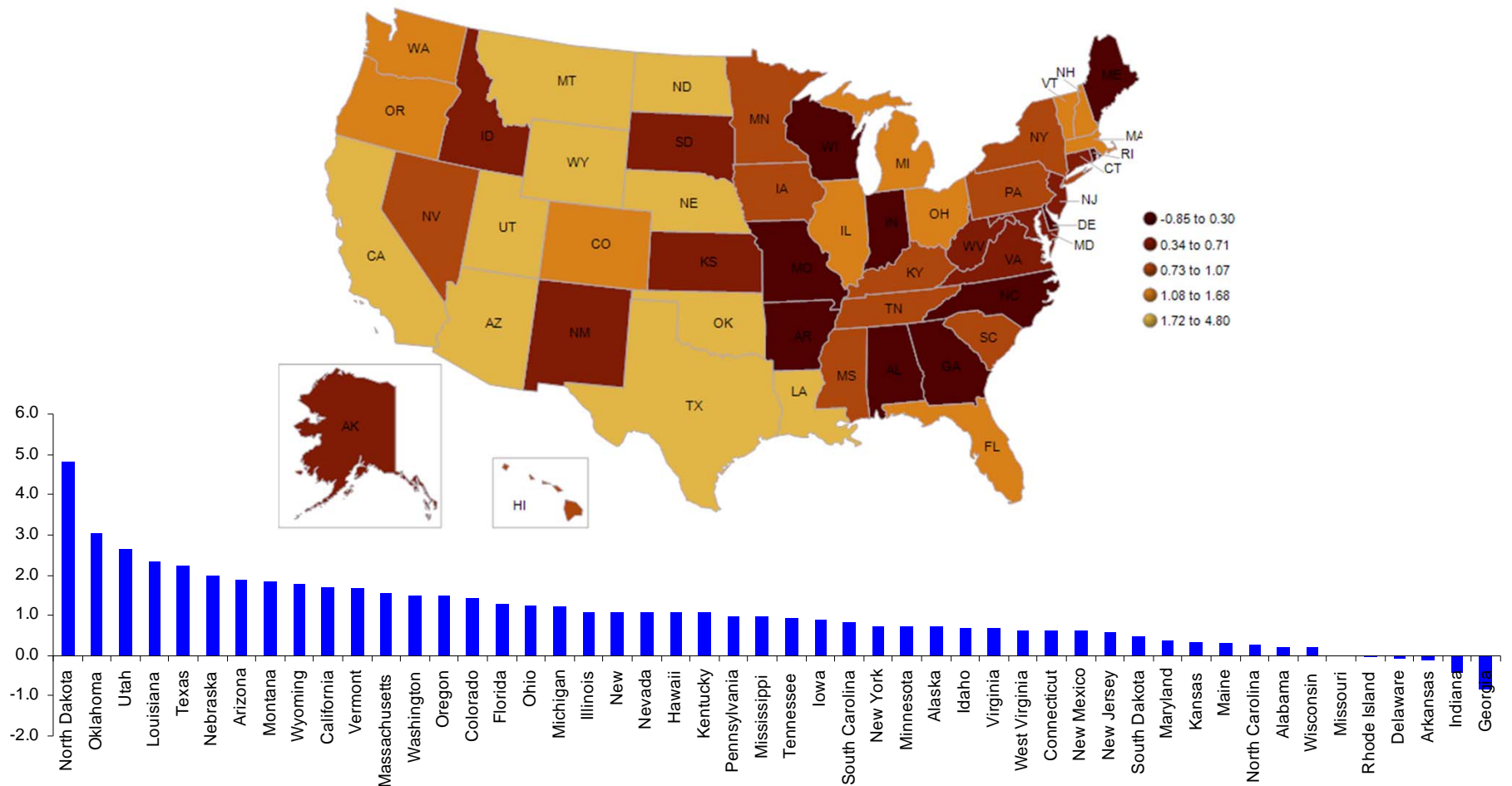
**Both hires and separations have trended up, but hires barely keep up with the pace of separations.**

Millions, SA



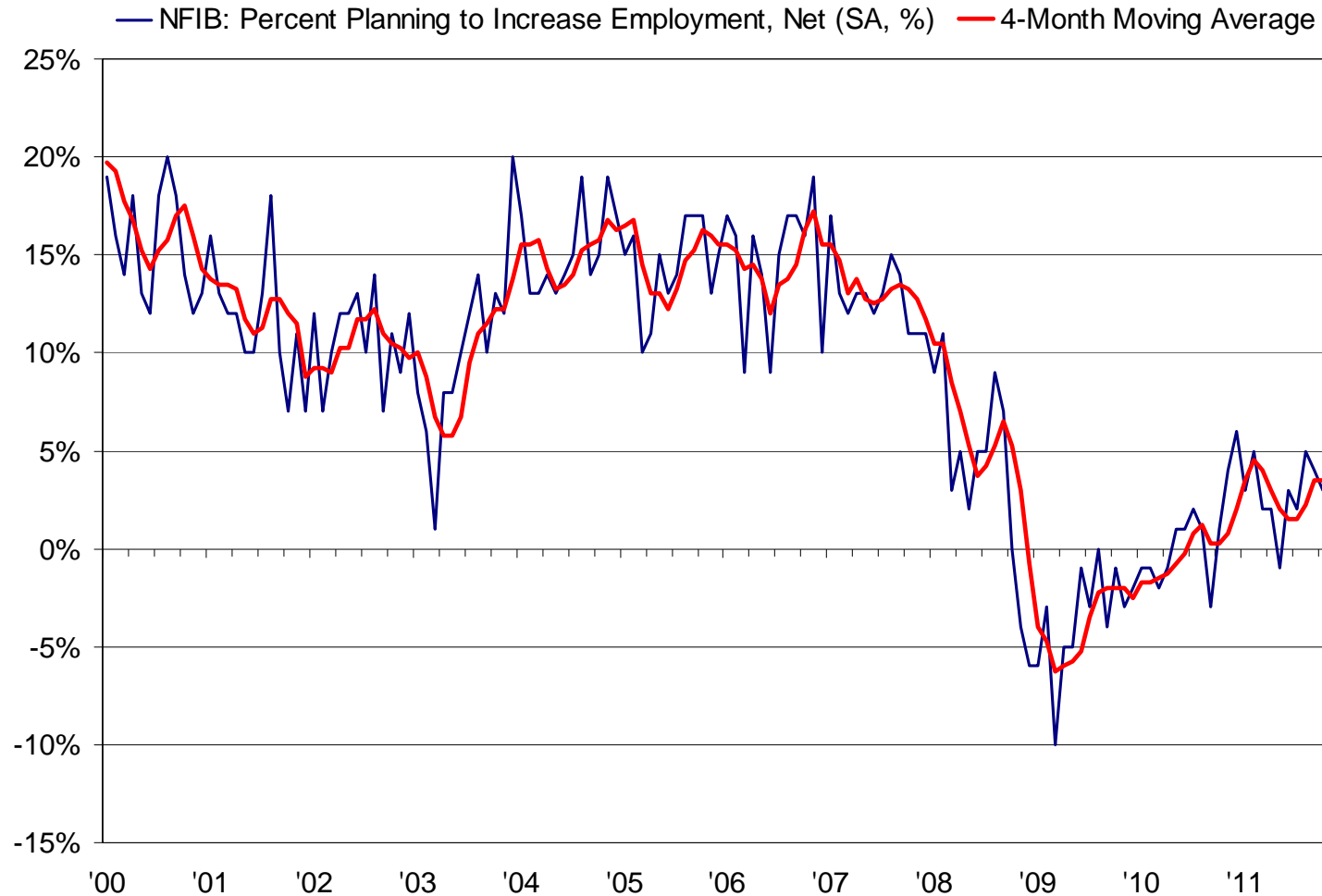
## Employment recovery varies by region.

Year-over-Year Employment Growth (Total Nonfarm Employment, NSA, Percent Change as of September, 2011)



## Small firms remain reluctant to hire.

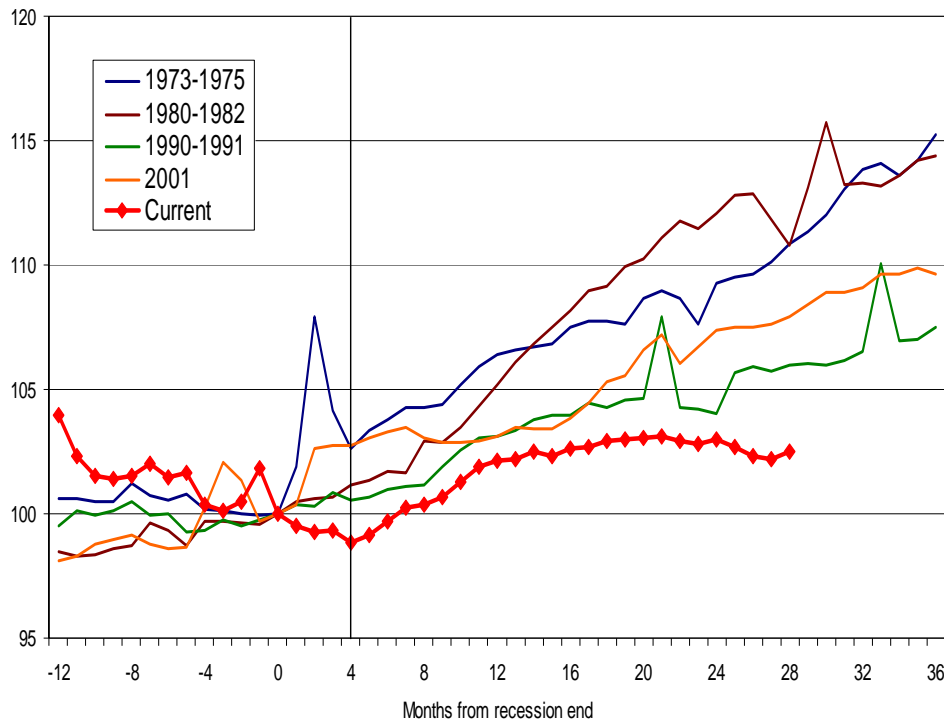
Percent Planning to Increase Employment, Net (SA, %)



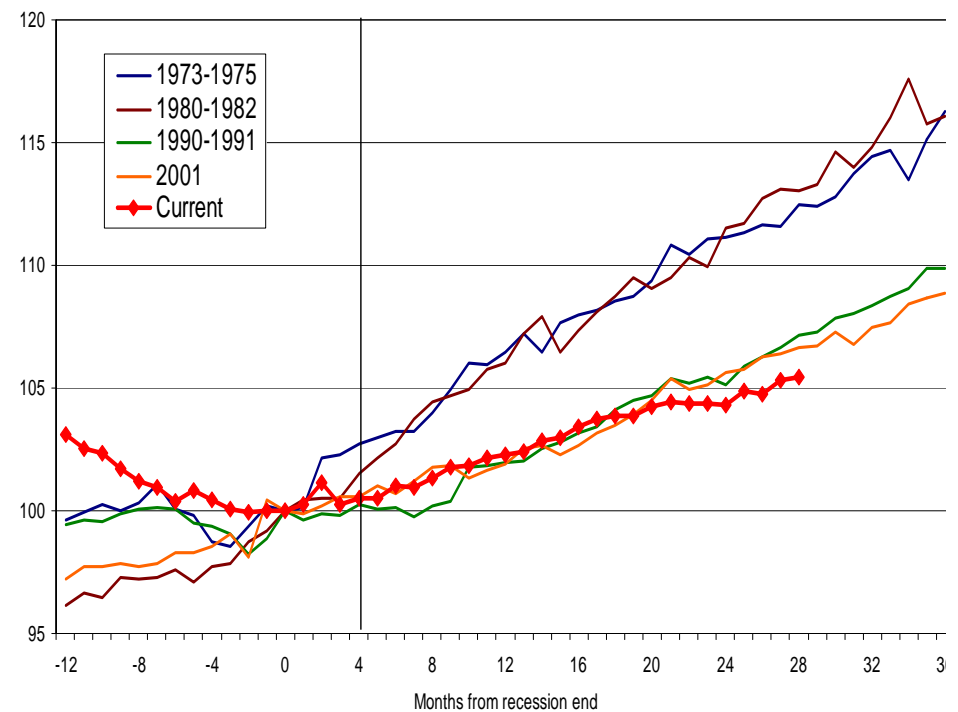
# Consumer income trend lags previous economic recoveries and has weighed on the growth of consumption.

(Levels are rebased and set equal to 100 at the end of the recession.)

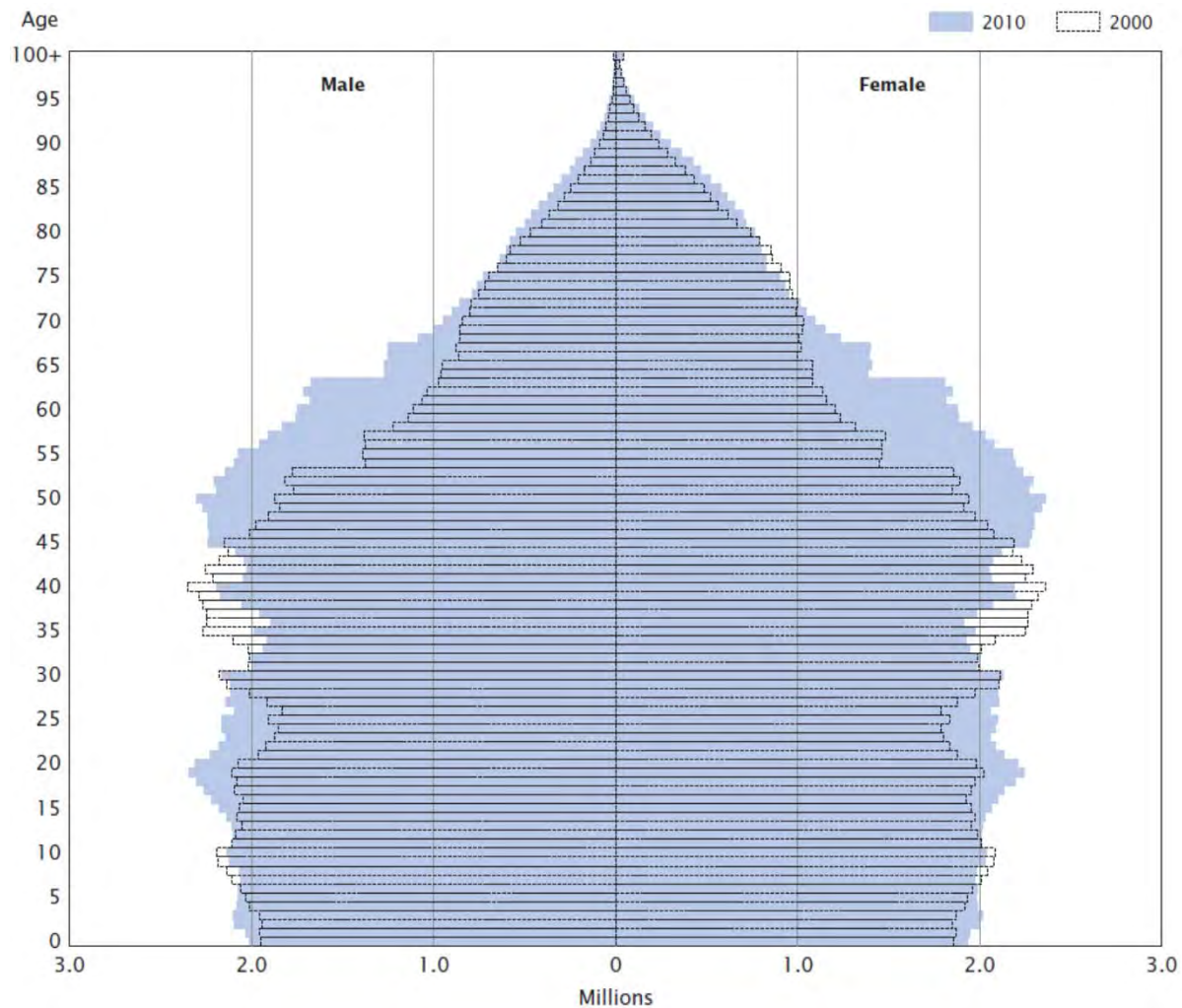
Real Disposable Personal Income



Real Personal Consumption Expenditures

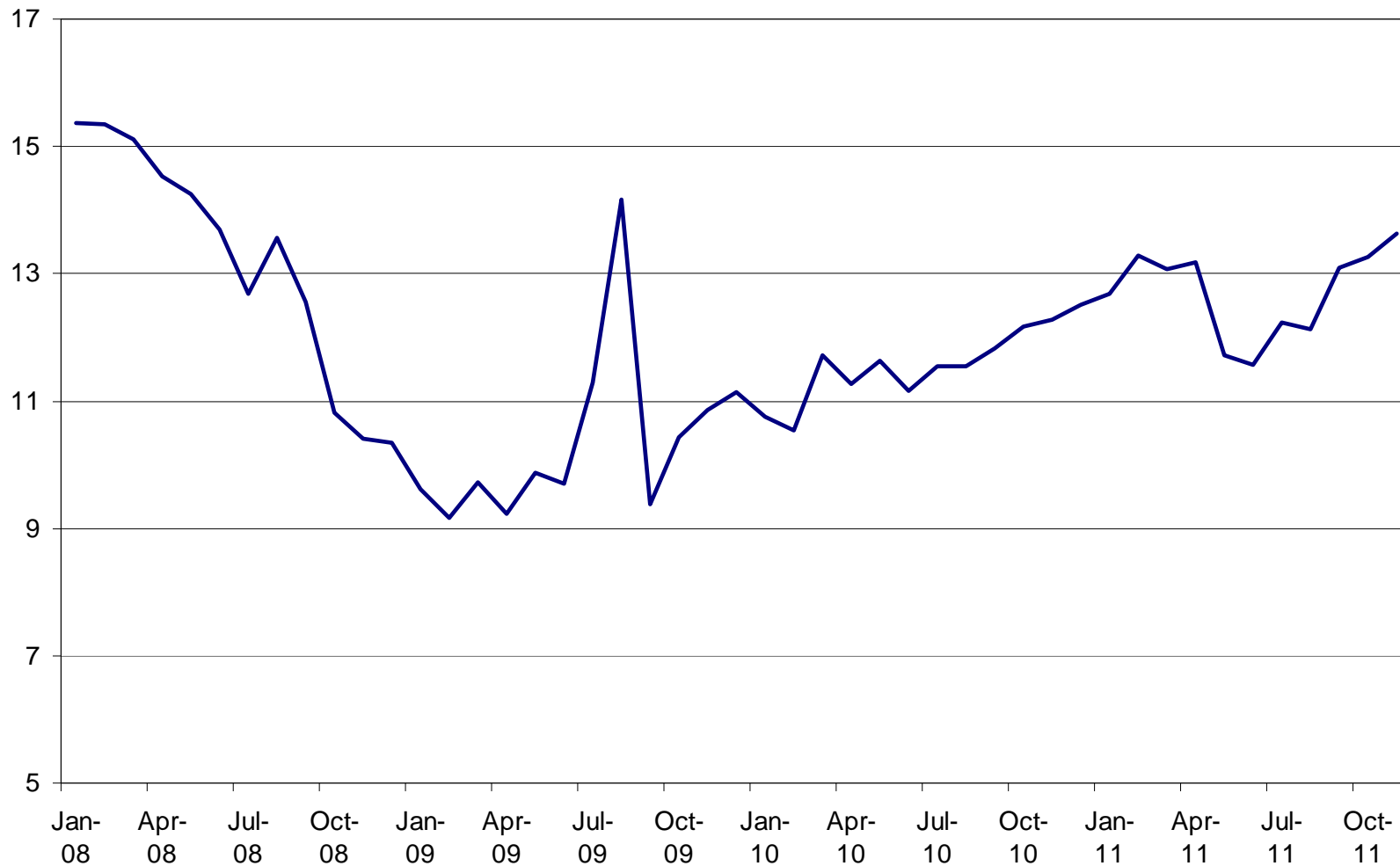


# The U.S. population is aging, but the age distribution is more uniform than many think.



## Vehicle sales start the fourth quarter on a strong note.

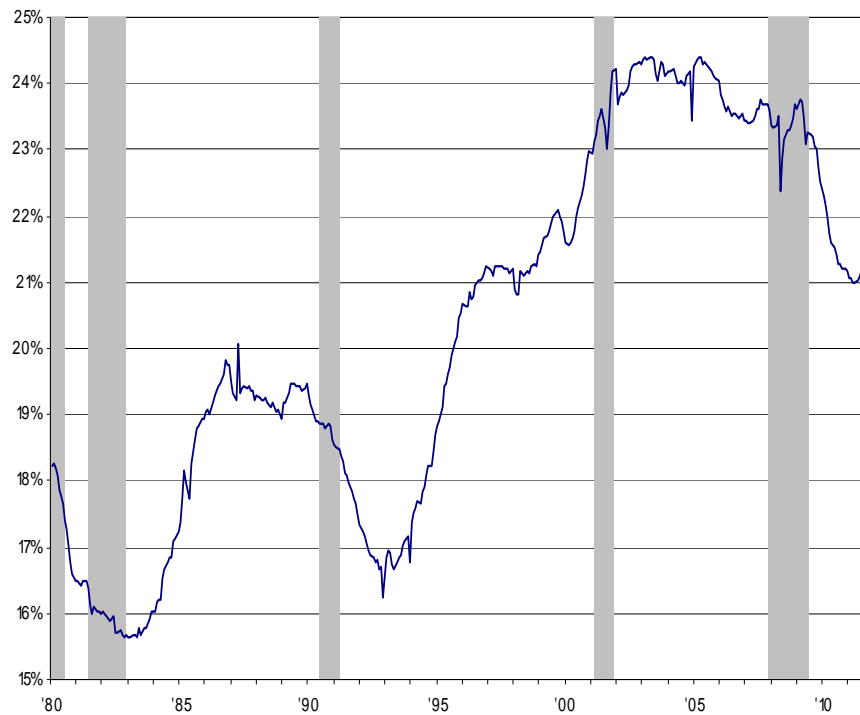
Total Light Vehicle Retail Sales (SAAR, Millions of Units, Imported and Domestic)



## Household Financial Conditions: Done Reducing Leverage?

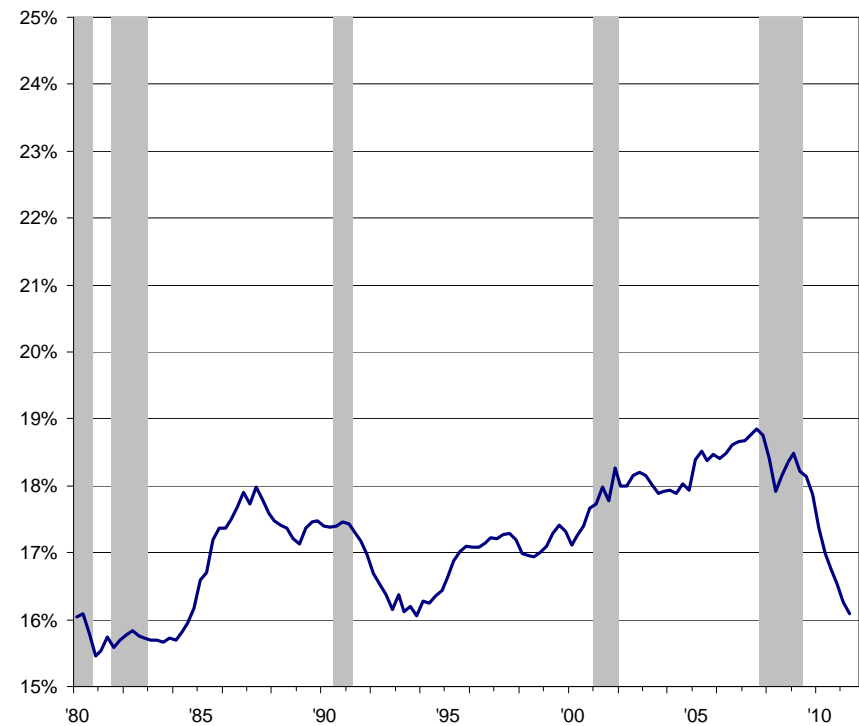
## Household debt is declining and still has further to go.

Consumer Credit / Disposable Personal Income (%)



Covers most short- and intermediate-term credit extended to individuals, excluding loans secured by real estate.

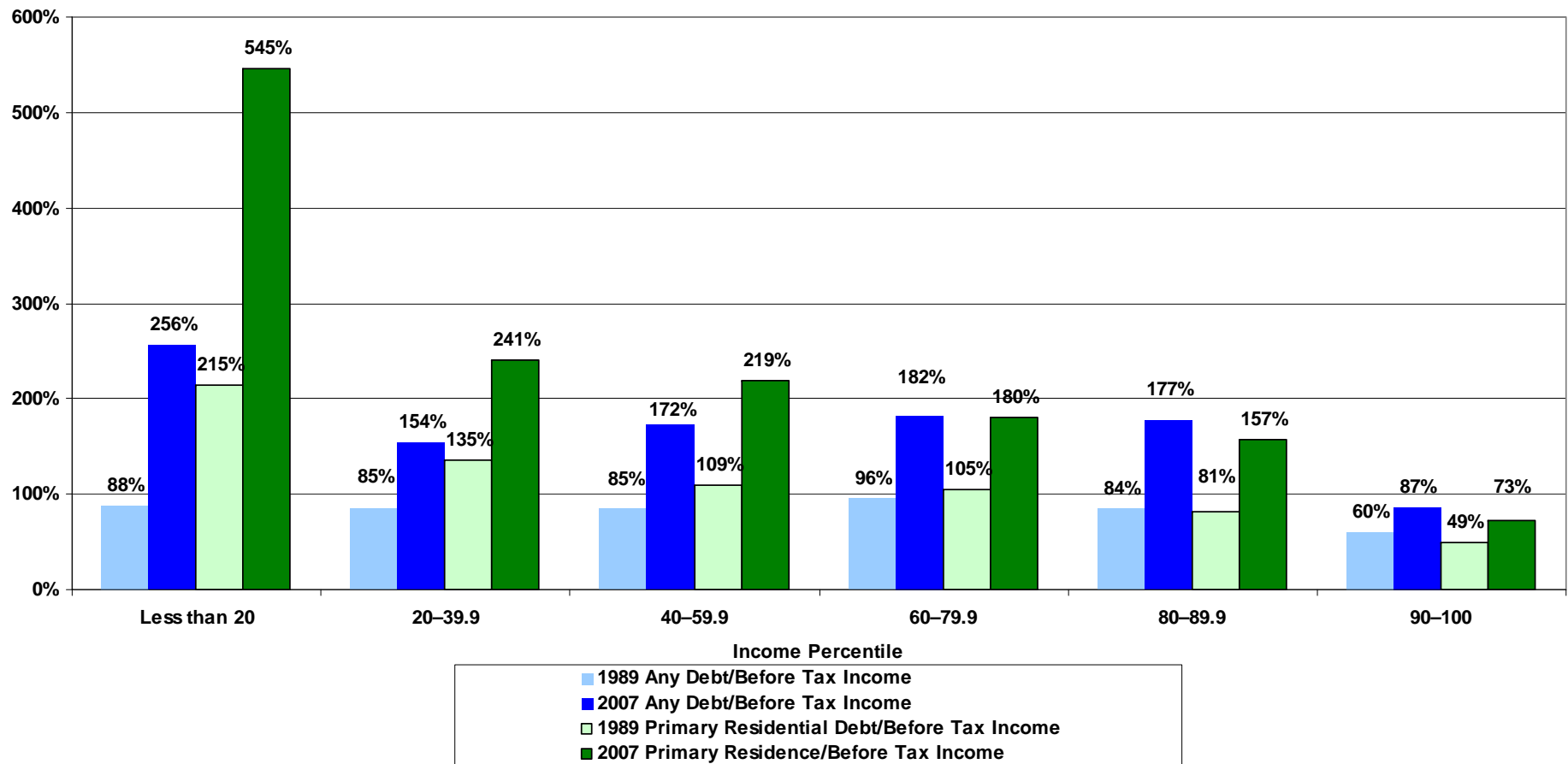
Household Financial Obligation Ratio (Financial Obligations / Disposable Personal Income, %)



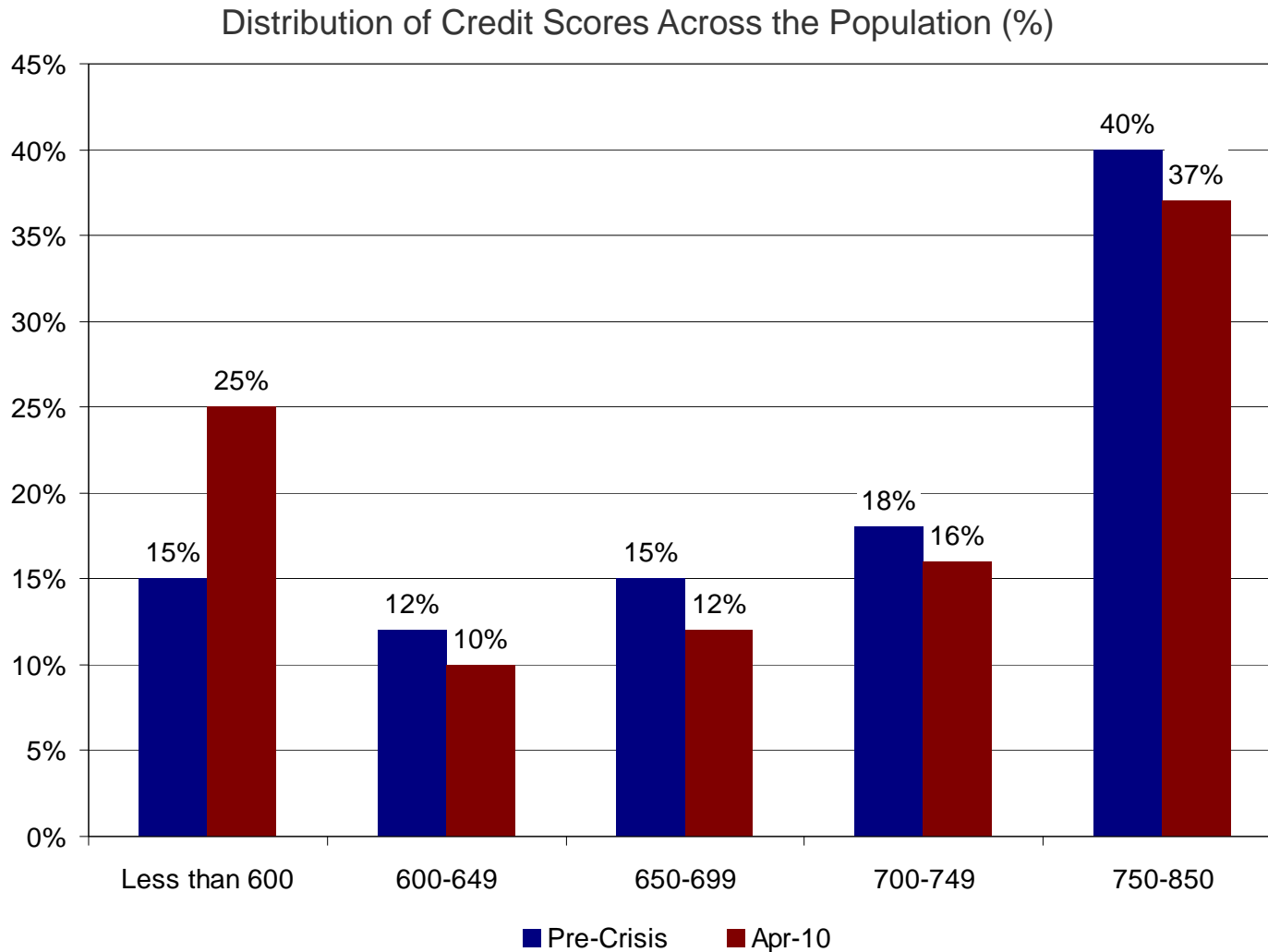
\*Financial Obligations include monthly mortgage payments, consumer debt payments, automobile lease payments, rental payments on tenant-occupied property, homeowners' insurance, and property tax payments.

# Over-leveraged households at lower income levels indicate stronger rental demand relative to ownership.

Mean Debt to Before-Tax Income Ratio



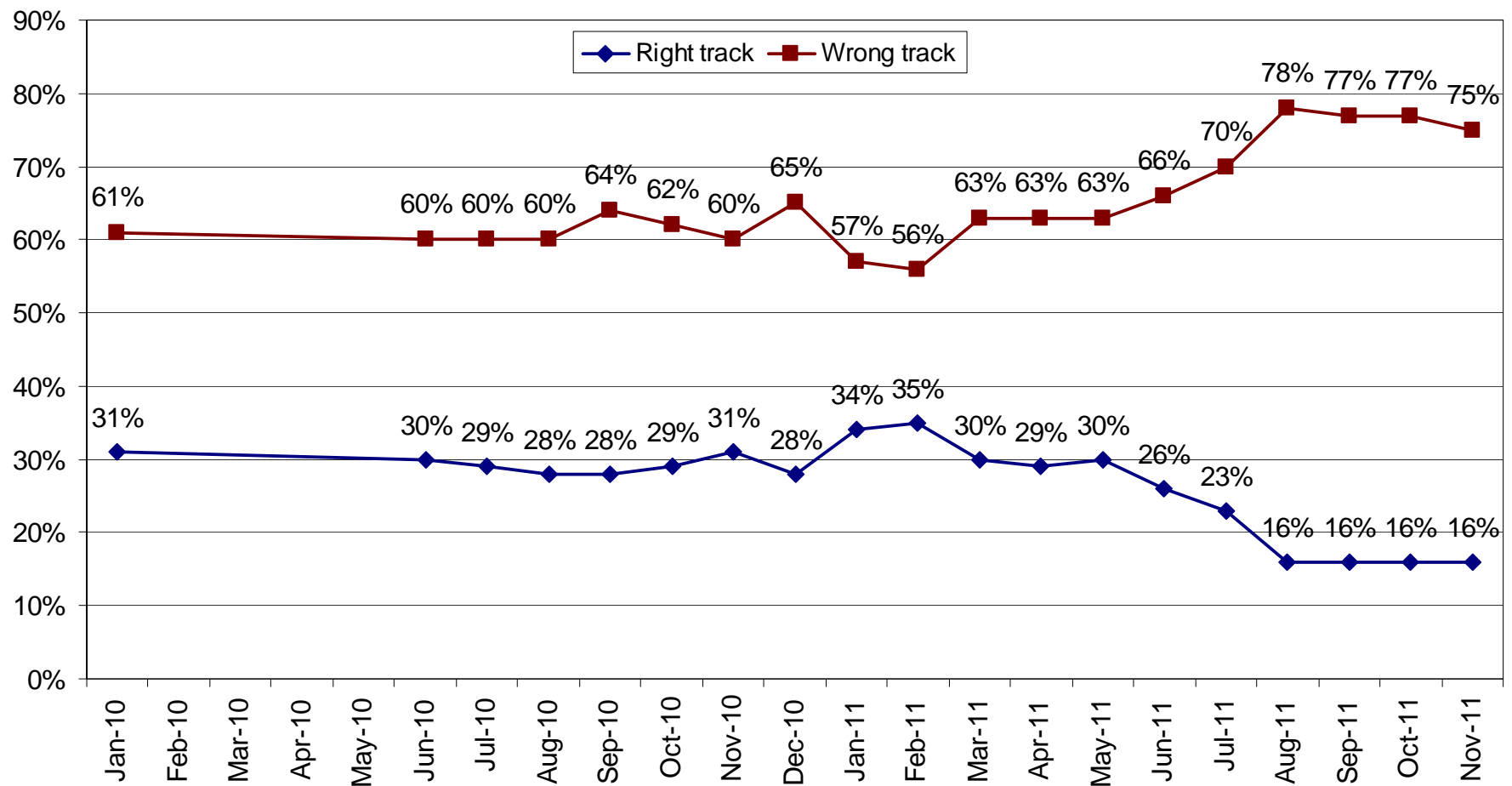
## Recession impaired consumers' ability to qualify for credit.



**Consumer Attitudes:  
Why Do You Think This is a Good Time To  
Borrow \$200K to Buy a House?**

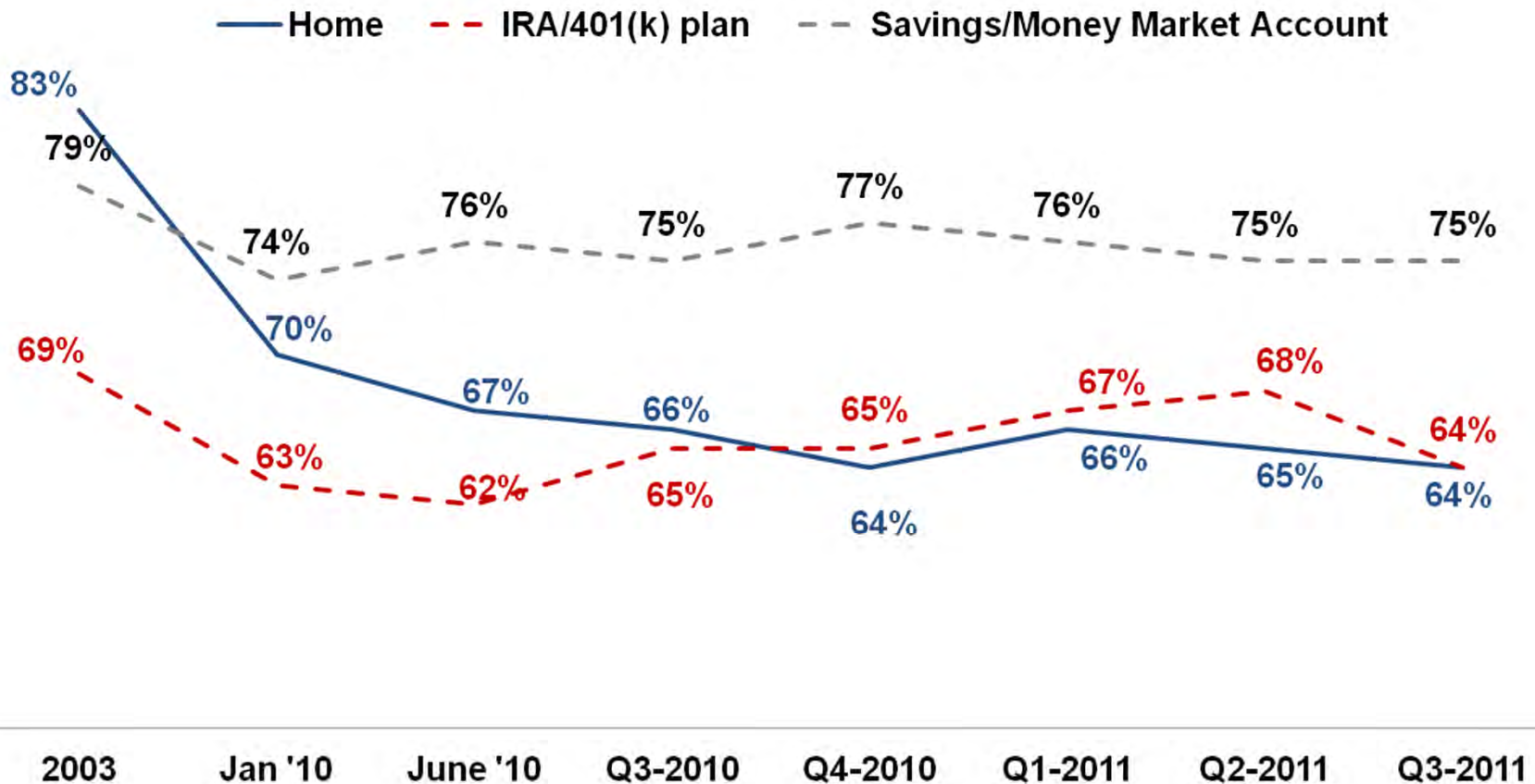
## The share of consumers unsatisfied with the direction of the economy stuck at extremely high levels.

*In general, do you think our economy is on the right track or is it off on the wrong track?  
( % of total survey respondents)*



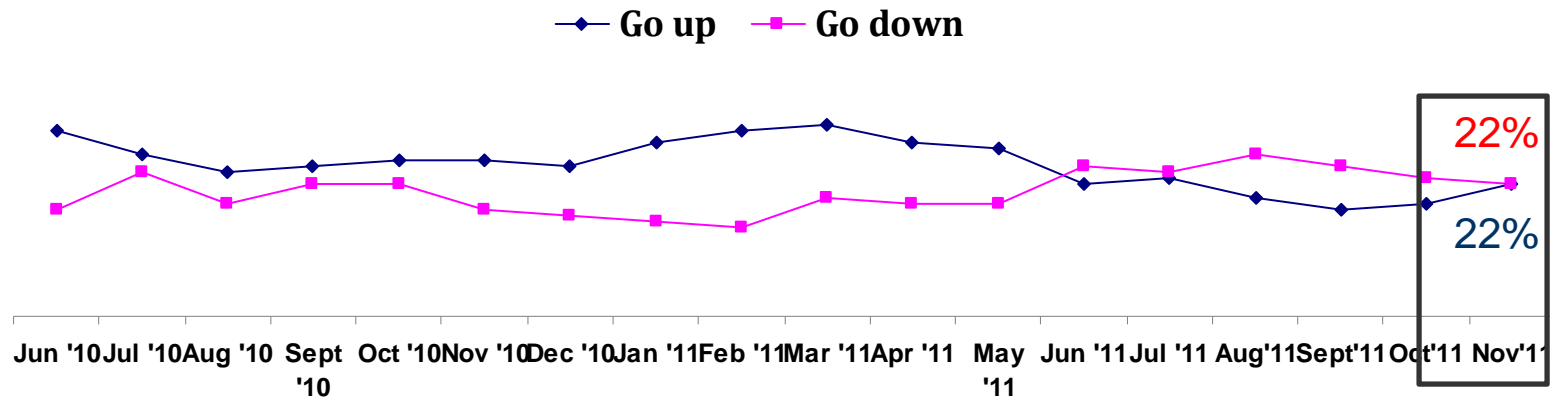
## Over time the perceived safety of homeownership has declined more than other investments.

Do you think this investment is...? Showing % Safe (Among GP)

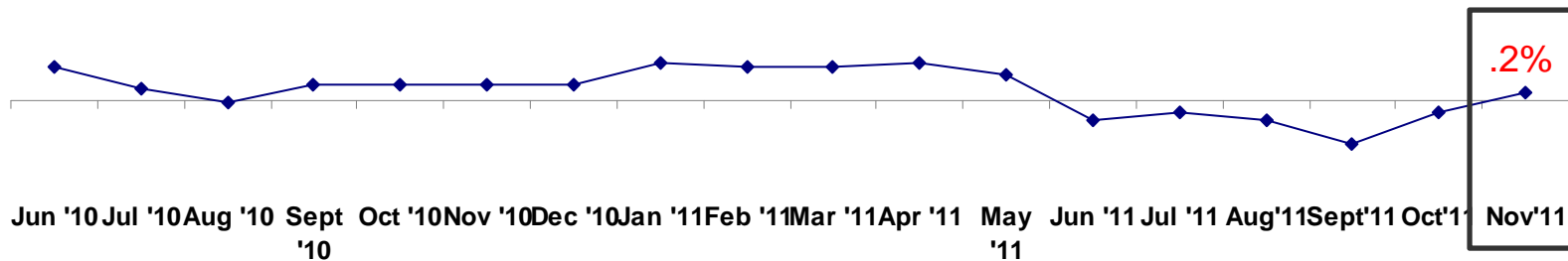


# House Prices: Consumers more cautious now than 6 months ago.

*During the next 12 months, do you think home prices in general will go up, go down, or stay the same as where they are now? Showing % General Population*

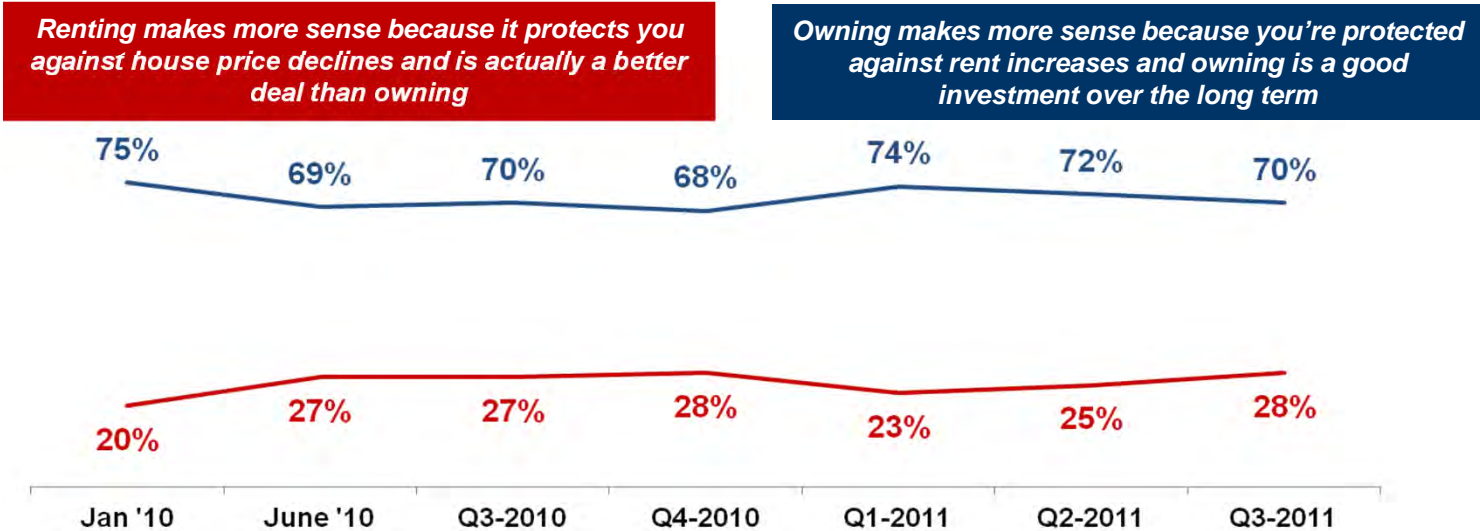


Respondents who said house prices would go up or go down were asked to estimate by what percent.



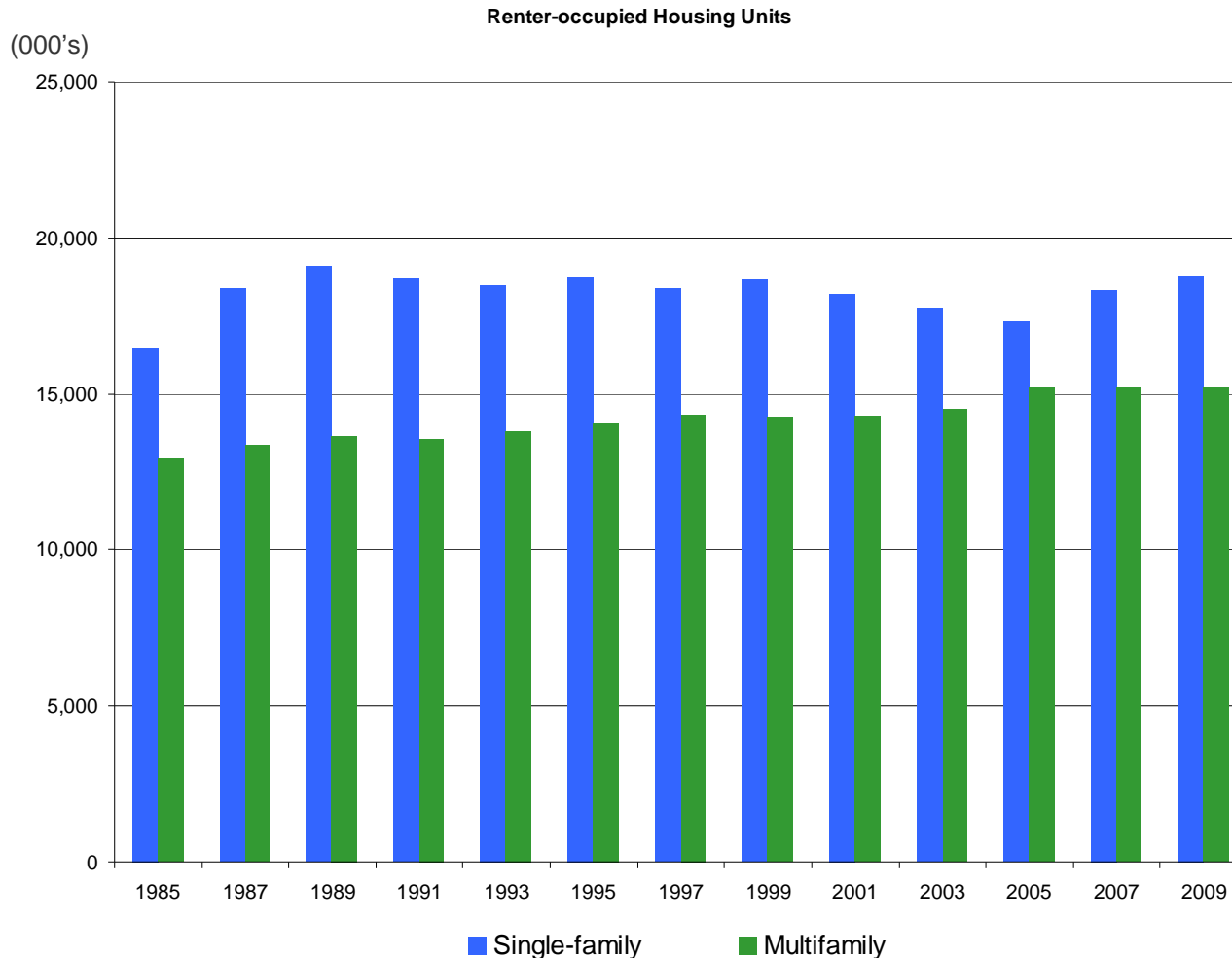
# Slight increase among Renters who consider renting to be superior to ownership...

Which is closer to your view? *Showing % Renters*



Wave (% Renting /Owning)	GP %	Mortgage %	Underwater %	Owner %	Renter %
<b>Q3-2011</b>	<b>14/84</b>	<b>8/90</b>	<b>7/92</b>	<b>6/92</b>	<b>28/70</b>
Q2-2011	13/85	7/90	10/87	8/90	25/72
Q1-2011	11/87	7/92	8/91	5/92	23/74
Q4-2010	14/84	7/91	8/89	8/90	28/68
Q3-2010	13/84	7/91	7/92	5/92	27/70
June '10	12/84	6/92	6/91	7/91	27/69
January '10	13/85	6/92	7/90	7/89	20/75

**...and as a result, we are seeing more single-family homes moving back into rental stock.**

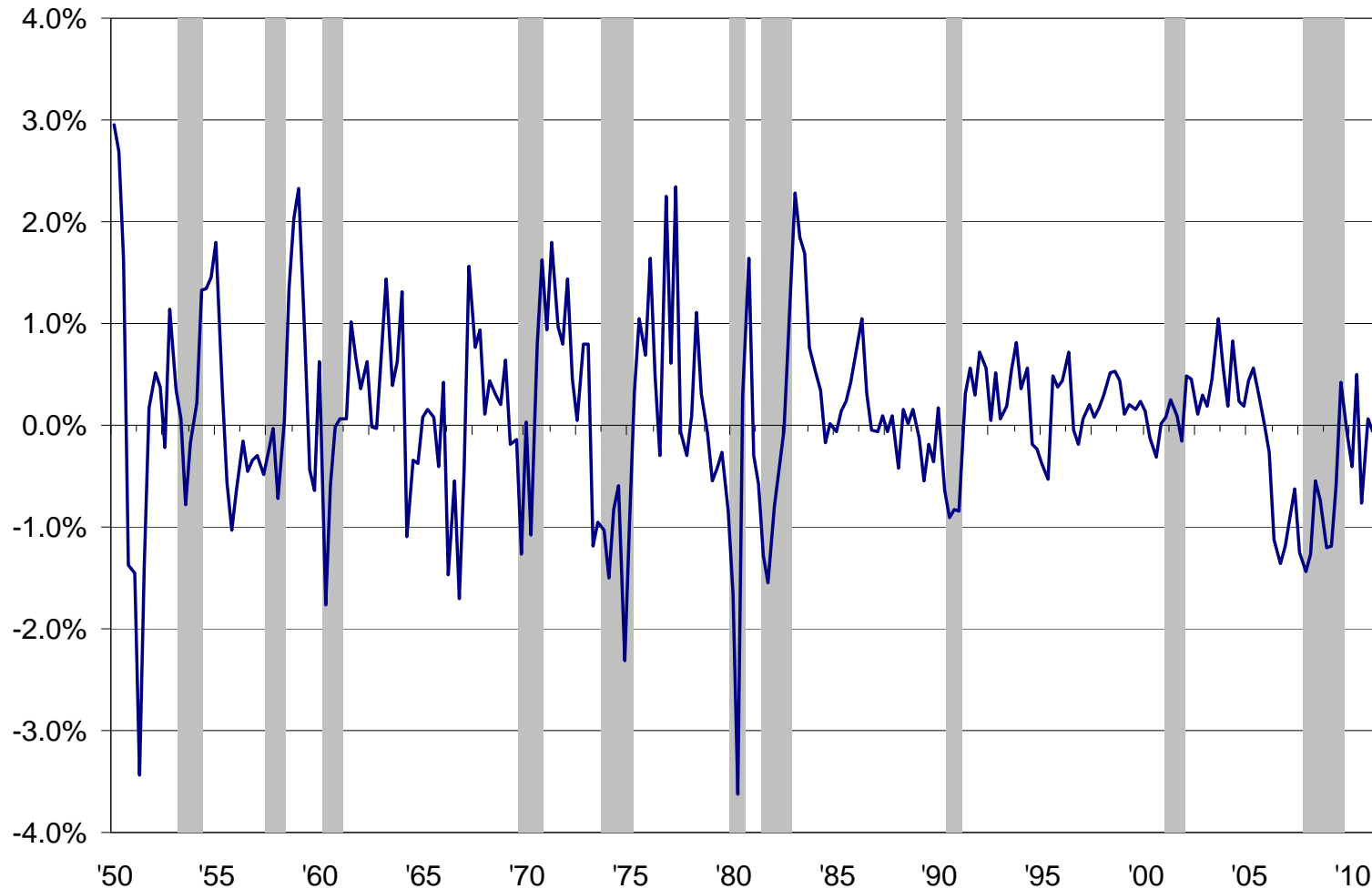


Note: Single-family includes properties consisting of up-to 4 units

## **The State(s) of Housing: Weakest In Decades**

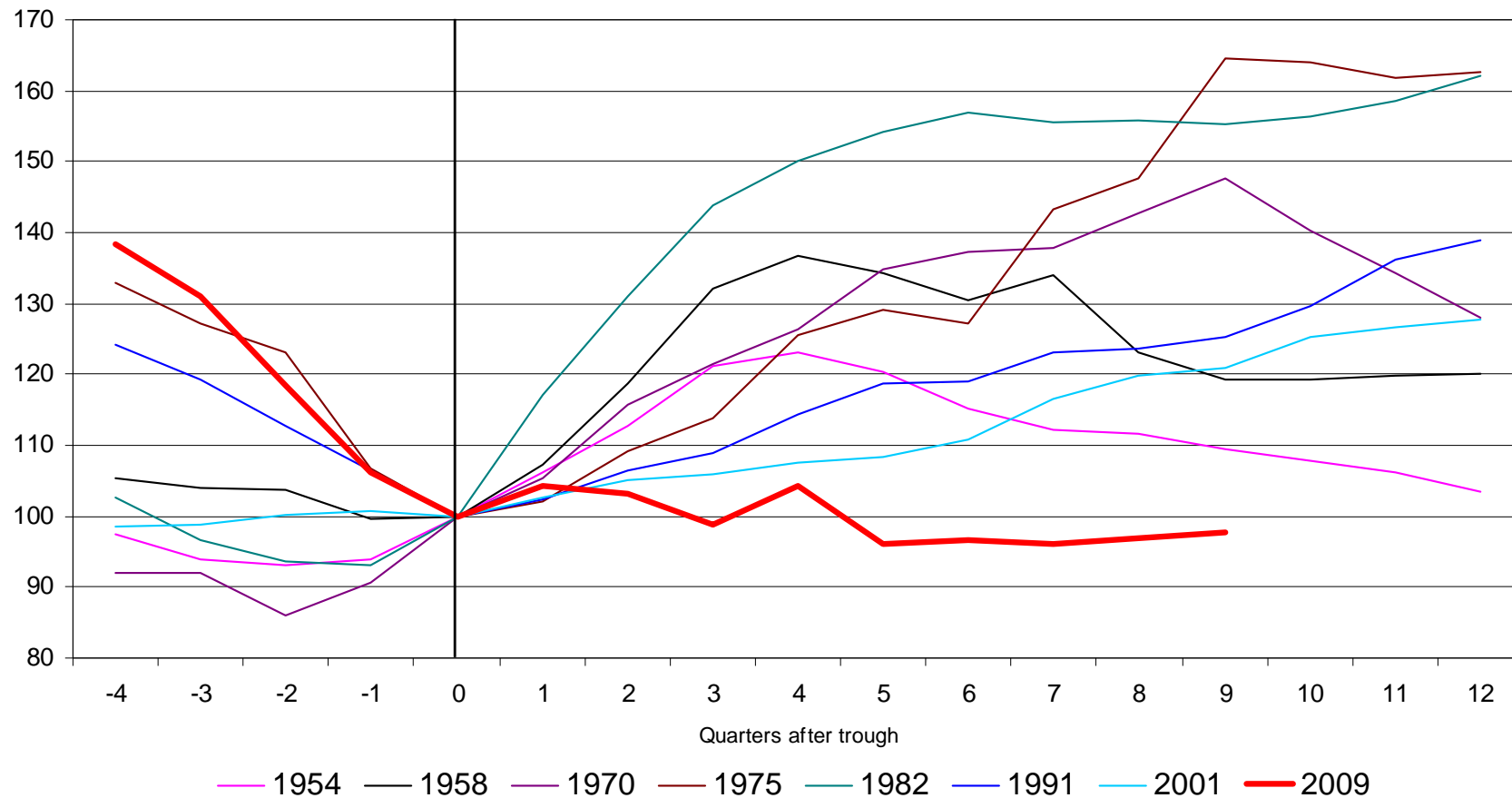
## Importance of residential investment to the economy declines to record lows.

Residential Fixed Investment Contribution to GDP (SAAR)



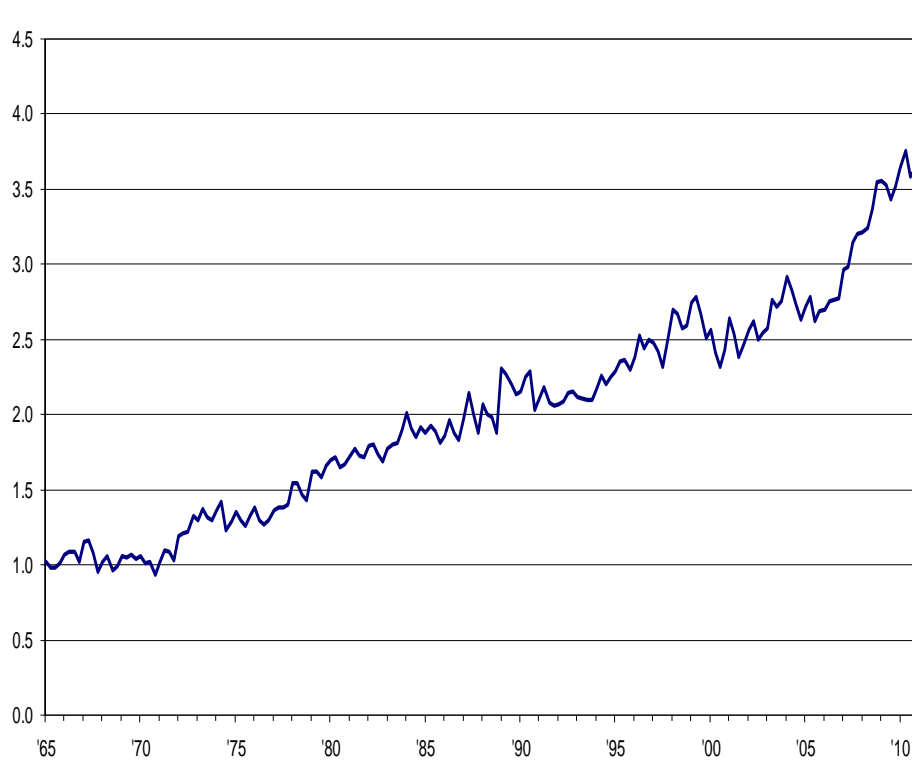
# Current housing recovery underperforms previous recoveries.

Real Residential Fixed Investment (Index, recession trough = 100)

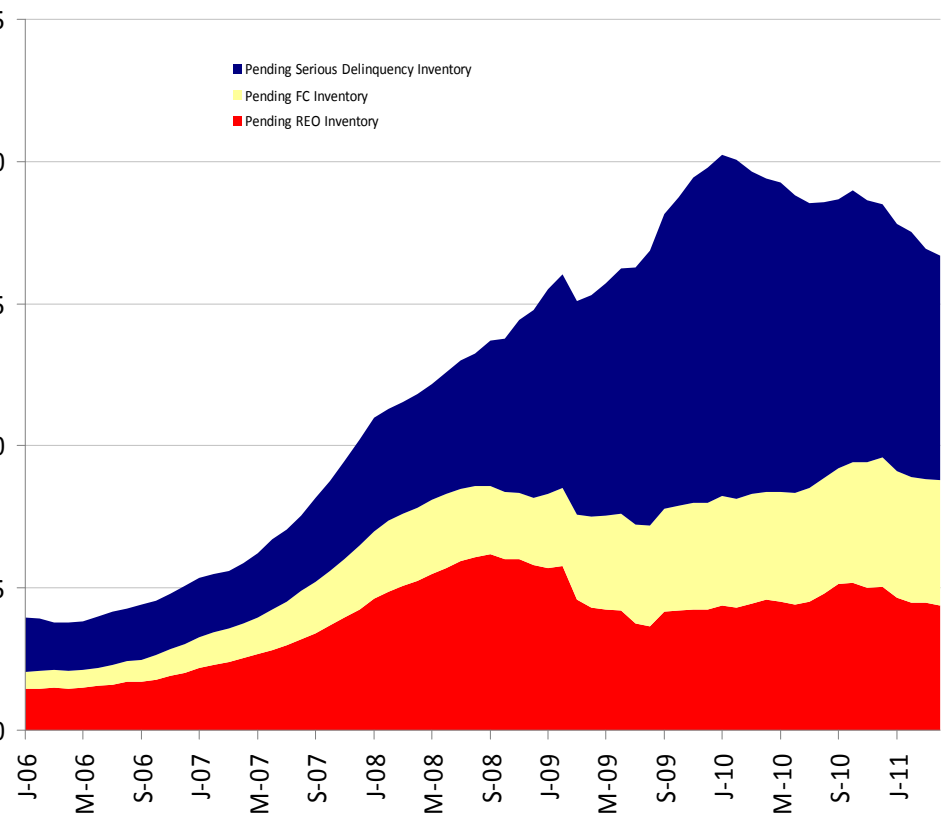


# Shadow supply of housing has remained elevated.

Vacant homes held off the market for other reasons\* (Millions)



Seriously delinquent loan and distressed housing inventory (Millions)



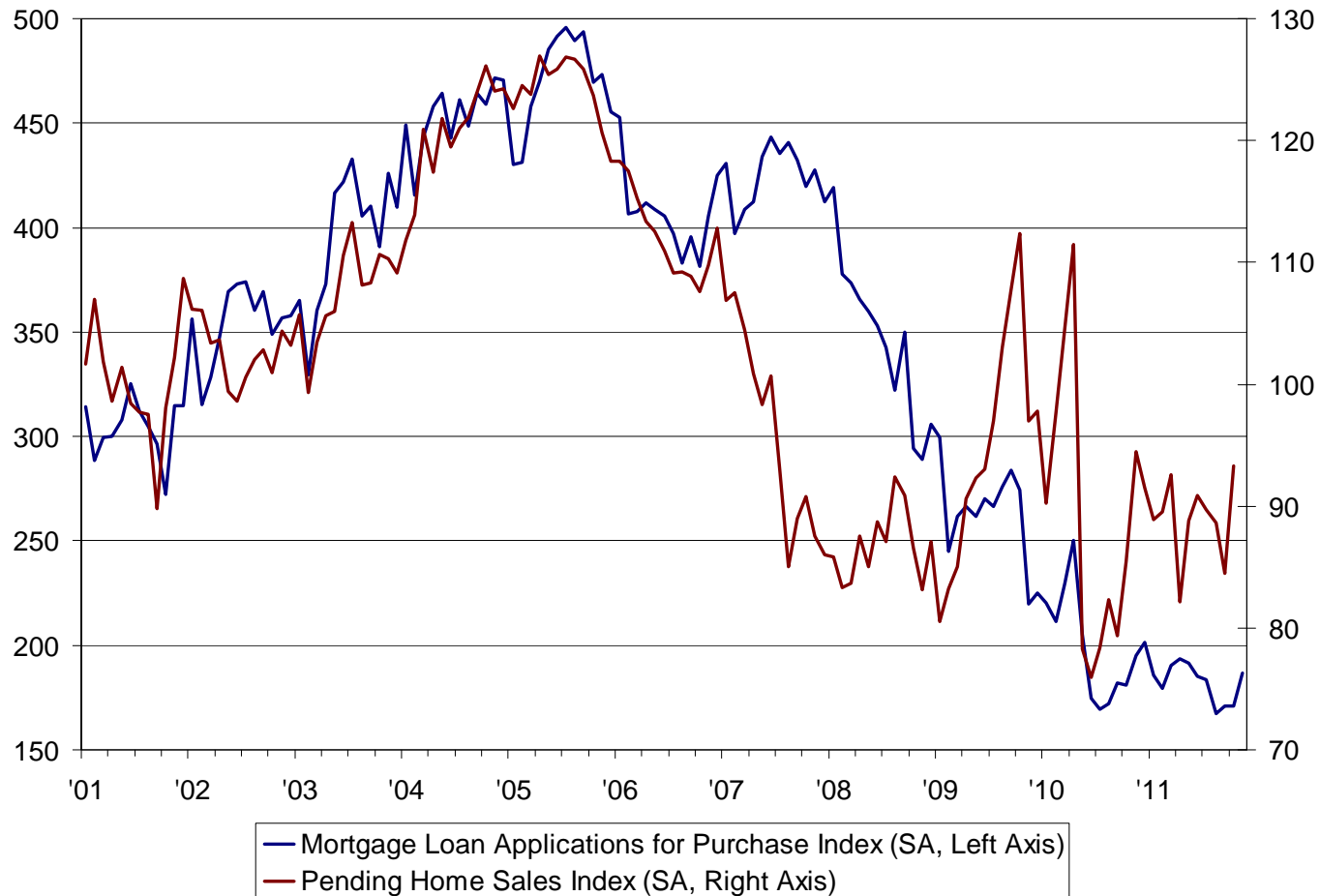
\*Held off the market for reasons other than occasional use or temporarily occupied by persons with usual residence elsewhere.

## Will the improvement in SDQs persist?

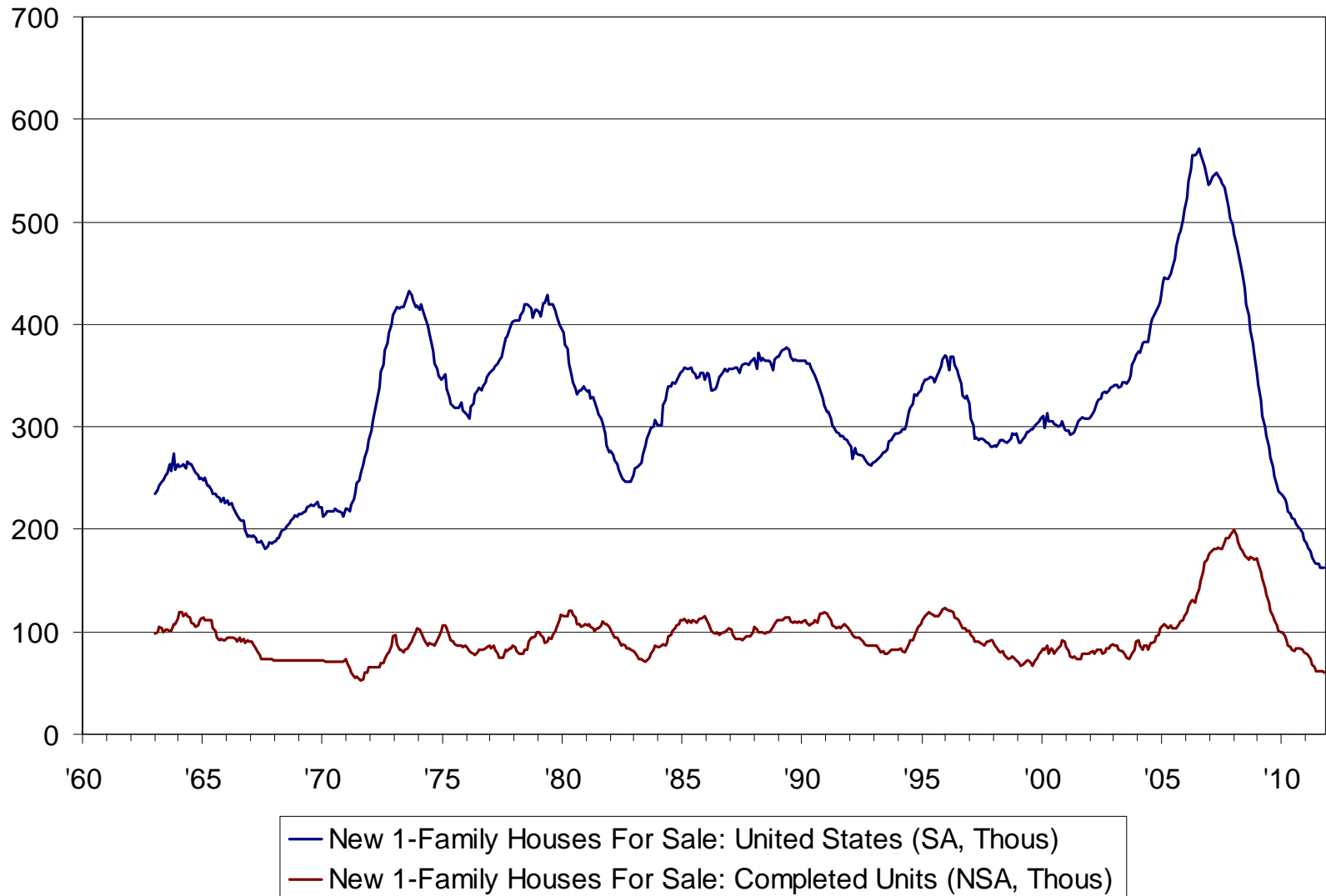


MBA defines “seriously delinquent mortgages” as mortgages with payments 90 days and over past due in addition to mortgages in the foreclosure process.

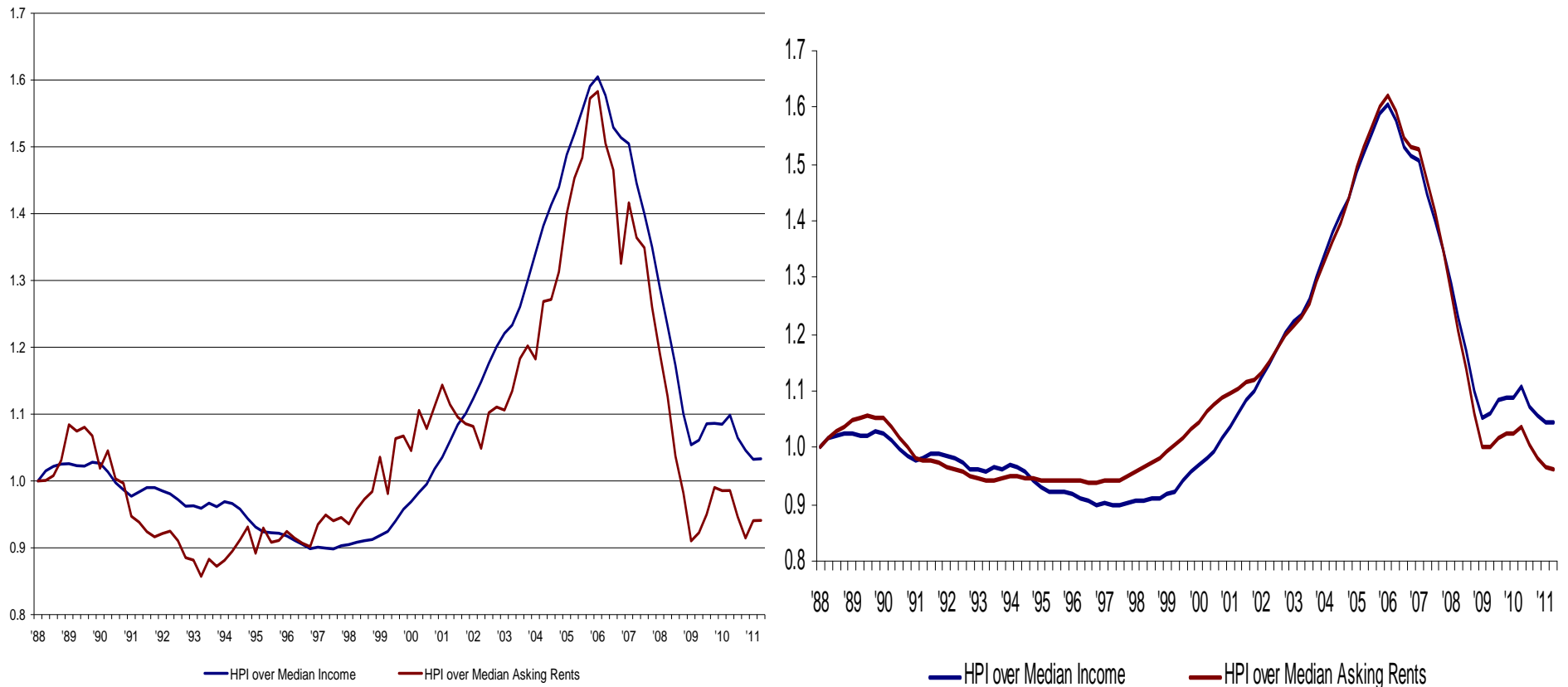
## Do leading indicators point to a stalled market ahead?



## New homes for sale at all-time low, new completed homes for sale the lowest since 1971.



## Ratios of national HPI to income\* and rents approach historical norms. (Indexed, 1988 Q1 = 100)

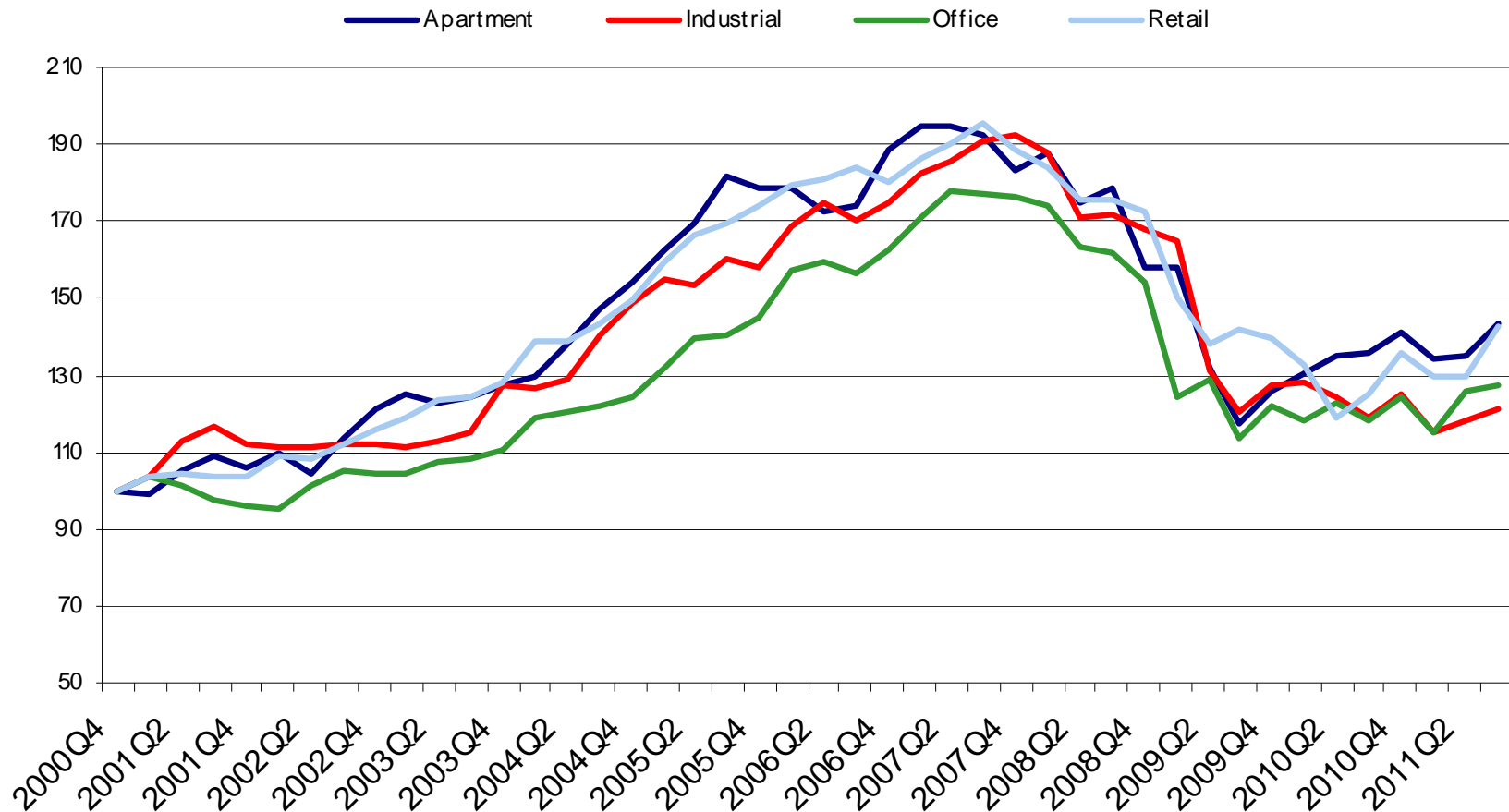


\*Median household income estimated by Fannie Mae from 2009 on.

# Commercial Real Estate: Signs of Recovery?

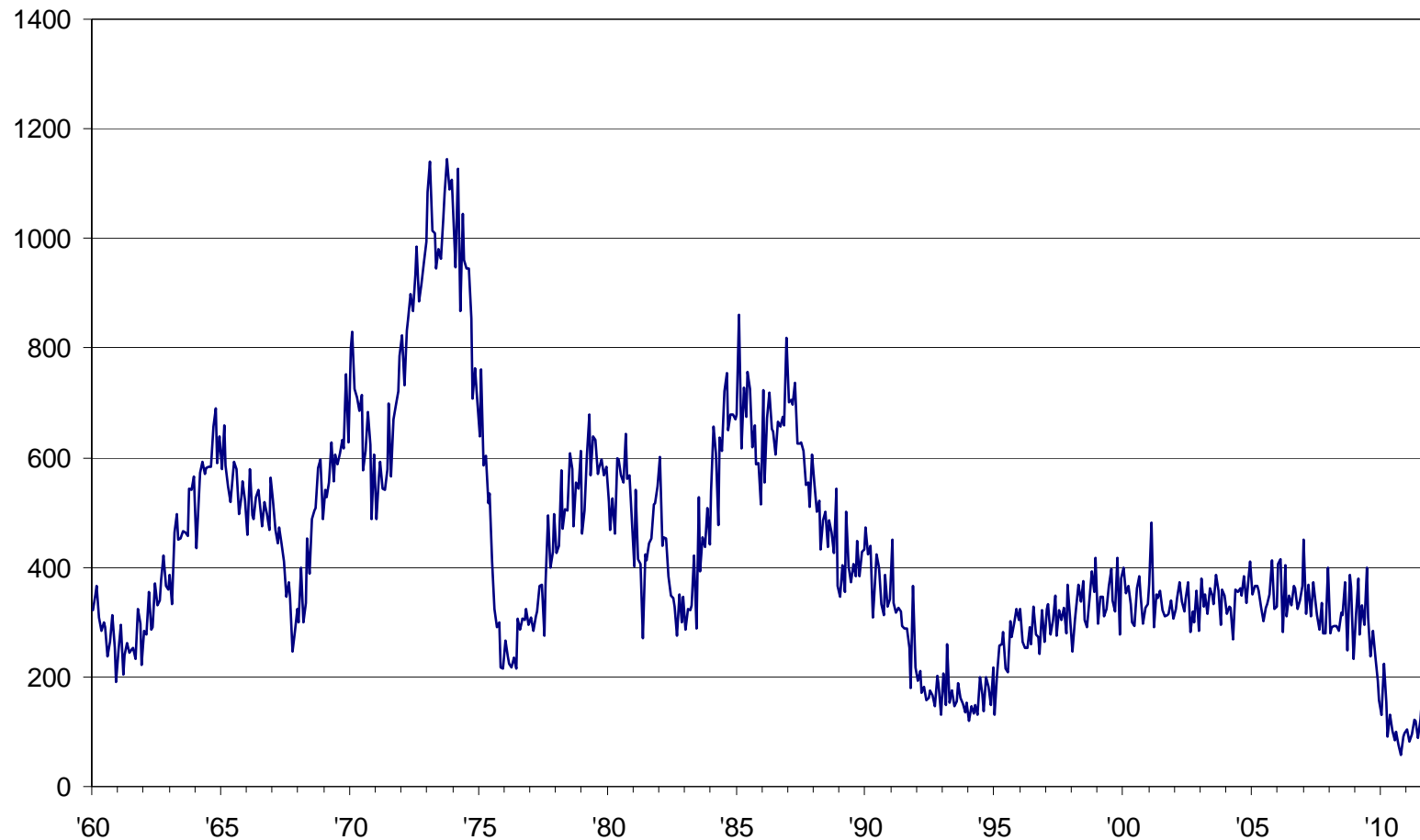
# Apartment prices leading commercial real estate recovery.

Moody's, REAL Commercial Property Price Index (Q4 2000 = 100)



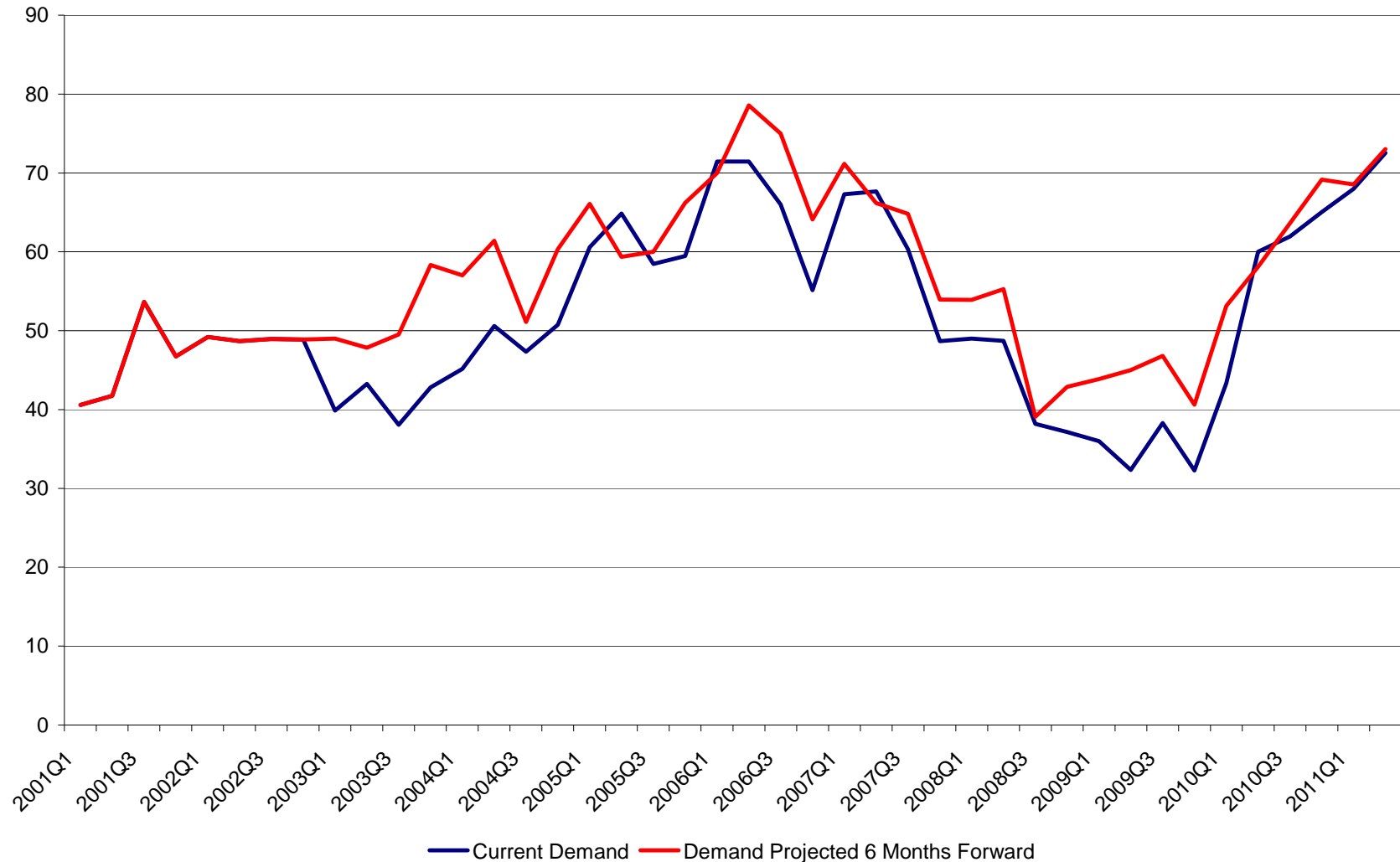
## Multifamily housing starts remain near record lows...

Multifamily Housing Starts (Thousands of Units, SAAR)



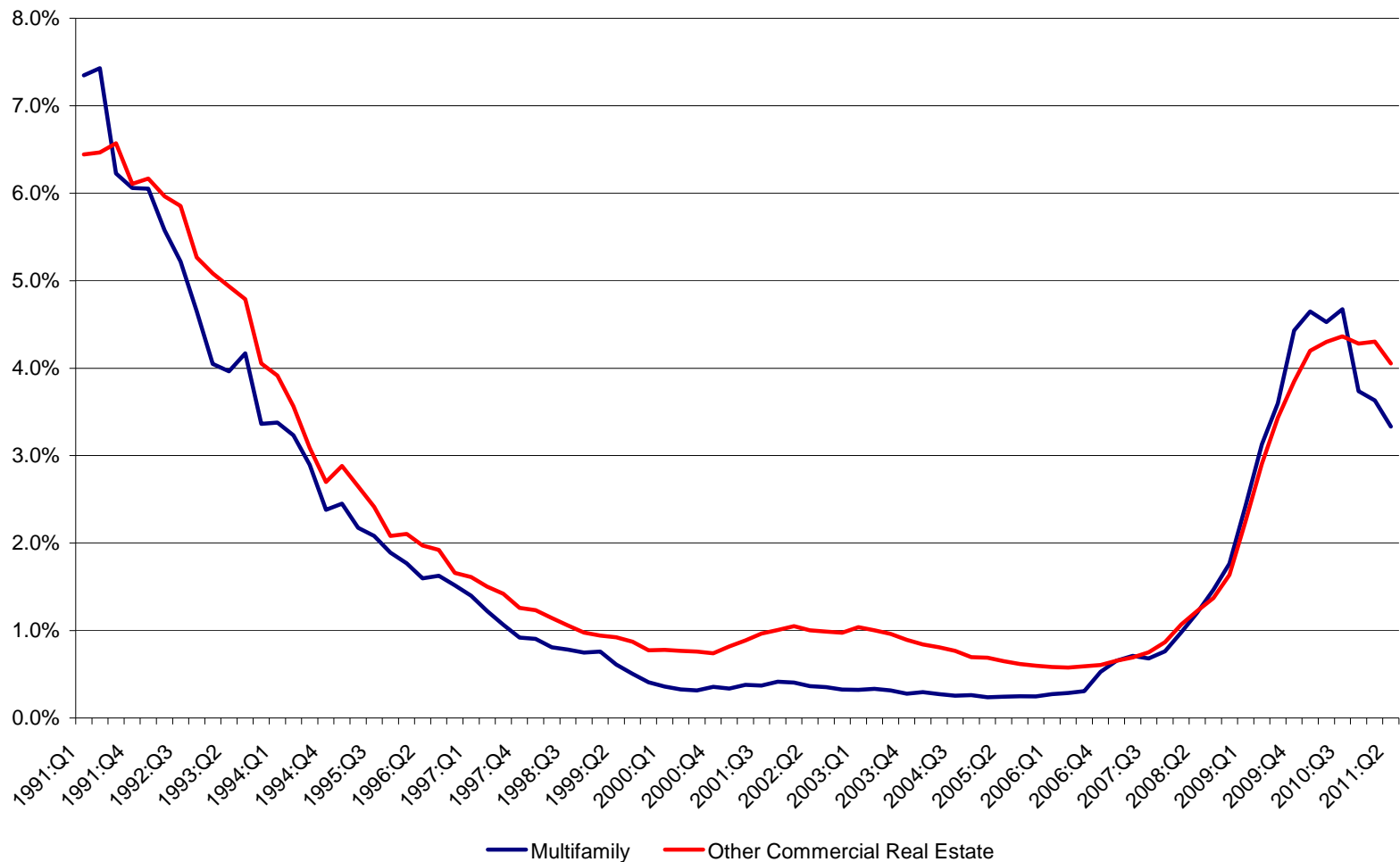
## ...while rental occupancy demand has picked up.

Multifamily Housing Market Index: Rental Occupancy: Class B Apartments



# Commercial real estate loan performance improving at banks.

Commercial Real Estate Loans Non-current Rate



**Policy:  
All You Ever Asked For – And More**

## Policy Update – Super Committee Failure

“Automatic” cuts after impasse:

- \$1.2 trillion in budget "sequesters" from FY 2013-2021, evenly dispersed annually
- \$600 billion from defense budget not including Iraq/Afghanistan wind-down
- \$600 billion from discretionary non-defense non-Medicare/Medicaid (with the exception to physician payments)
- Many analysts think these cuts are unlikely

## Monetary policy is easy.

Short rates remain low and yield curve is steep.



## Fiscal policy – unpalatable choices from here on.

### Federal Government

Receipts and Outlays as a Percent of GDP

	Receipts	Outlays	Deficit
<u>Historical</u>			
1946 to 2010	17.7	19.7	-2.0
Standard deviation	1.2	2.5	
<u>Forecast</u>			
2011 to 2016	17.7	23.1	-5.4

#### Policy Choices

- Higher Taxes
- Less Spending
- Growth
- Inflation

## U.S. fiscal policy threatens our economic status.

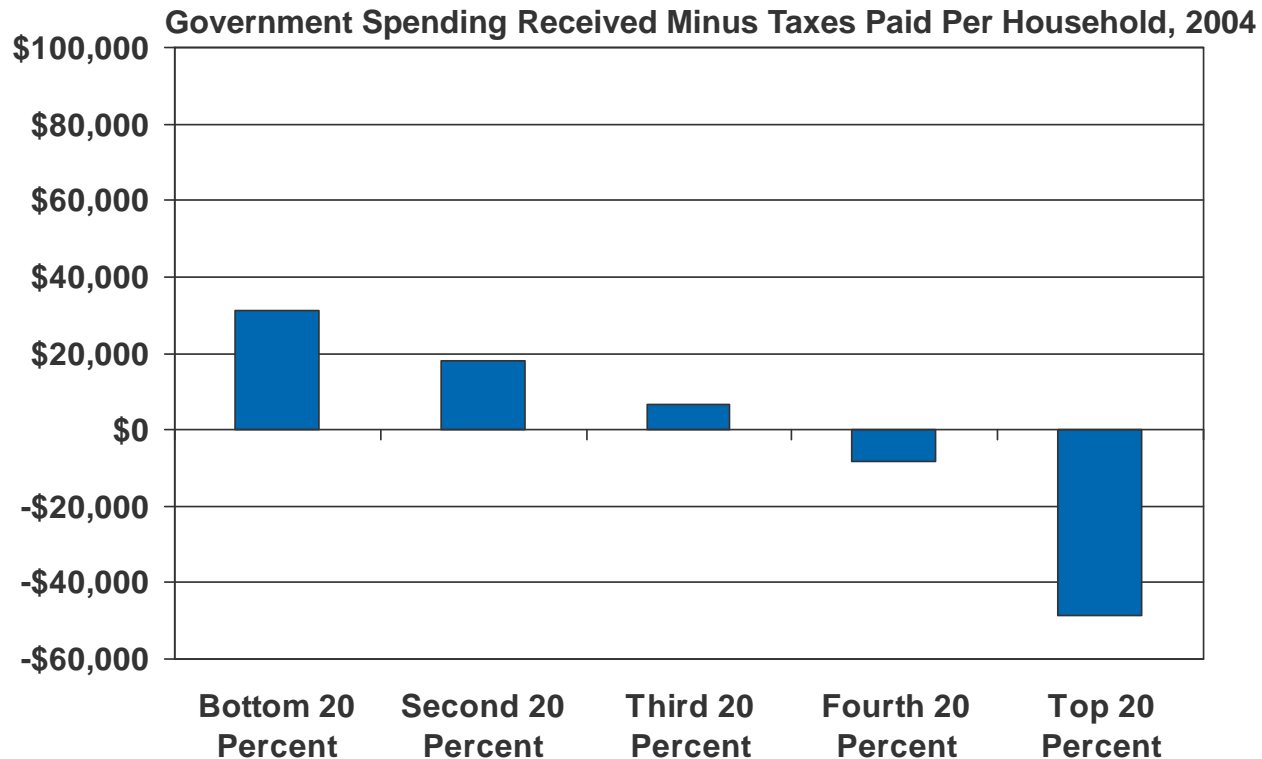
Losing ground relative to other developed economies

OECD projections of fiscal balances and debt assuming modest cuts

*As percentage of nominal GDP (unless otherwise specified)*

	Underlying fiscal balance 2012	Financial balances			Net financial liabilities			Gross financial liabilities			Long term interest rate (%)		
		2007	2010	2026	2007	2010	2026	2007	2010	2026	2007	2010	2026
Greece	-1.4	-6.7	-10.4	-4.4	80	114	117	113	147	146	4.5	9.1	7.9
Iceland	-1.0	5.4	-7.8	-2.5	-1	43	41	53	120	118	9.8	5.0	6.6
Ireland	-4.0	0.1	-32.4	-4.0	0	59	81	29	102	131	4.3	6.0	6.9
Italy	-1.3	-1.5	-4.5	-3.1	87	99	93	113	127	122	4.5	4.0	6.5
Japan	-5.9	-2.4	-8.1	-5.0	81	116	162	167	200	248	1.7	1.1	4.9
Portugal	-0.9	-3.2	-9.2	-1.1	50	69	59	75	103	95	4.4	5.4	5.9
Spain	-1.2	1.9	-9.2	-2.4	19	40	52	42	66	78	4.3	4.2	4.7
United Kingdom	-5.7	-2.8	-10.3	-3.7	28	56	83	47	82	109	5.0	3.6	5.6
<b>United States</b>	<b>-8.2</b>	<b>-2.9</b>	<b>-10.6</b>	<b>-6.0</b>	<b>43</b>	<b>67</b>	<b>122</b>	<b>62</b>	<b>94</b>	<b>148</b>	<b>4.6</b>	<b>3.2</b>	<b>7.2</b>
Euro Area	-1.9	-0.7	-6.0	-2.4	42	58	61	72	93	96	4.3	3.6	5.4
<b>OECD</b>	<b>-5.0</b>	<b>-1.3</b>	<b>-7.6</b>	<b>-3.5</b>	<b>38</b>	<b>58</b>	<b>83</b>	<b>73</b>	<b>98</b>	<b>122</b>	<b>4.8</b>	<b>3.5</b>	<b>6.2</b>

## Net benefit to tax payers by income quartile shows strong progressivity in current tax system.



Income Quintile	Bottom 20%	Second 20 %	Middle 20%	Fourth 20%	Top 20%
2004 Upper Income Bound	\$23,700	\$42,305	\$65,001	\$99,502	No Upper Bound

## State and local fiscal challenges also are significant.

### Cyclical Challenges

Recession led to a decline in

- Income taxes
- Sales taxes
- RE taxes and fees

Increased demand for

- Healthcare
- Education
- Social services

Close the gap with

- One-time cuts and funds
- Federal stimulus
- Tax and fee increase

### Structural Problems

Pension Liability

- Union contracts with defined benefit plans
- Decline in share of plans that are fully funded
- Aggressive return assumptions

Healthcare costs are ballooning

- Flexibility under Medicaid rules
- State and local employees

Impact on future tax rates and services affects current ability to attract jobs

*James Madison writing in Federalist 62 (1788):*

In another point of view, great injury results from an unstable government. The want of confidence in the public councils damps every useful undertaking, the success and profit of which may depend on a continuance of existing arrangements. What prudent merchant will hazard his fortunes in any new branch of commerce when he knows not but that his plans may be rendered unlawful before they can be executed? What farmer or manufacturer will lay himself out for the encouragement given to any particular cultivation or establishment, when he can have no assurance that his preparatory labors and advances will not render him a victim to an inconstant government? In a word, no great improvement or laudable enterprise can go forward which requires the auspices of a steady system of national policy.

## **Contact Information**

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