2016 ECONOMIC & HOUSING FORECAST

WINDERMERE REAL ESTATE | **MATTHEW GARDNER, CHIEF ECONOMIST** JANUARY 2016

THE NATIONAL ECONOMIC FORECAST

1. THE U.S. WILL CONTINUE TO EXPAND WITH REAL GDP GROWTH OF 2.3% IN 2016.

Although a positive number, the forecasted rate of growth suggests that we will be modestly underperforming in 2016. On a positive note, oil prices are likely to remain well below long-term averages, which puts more money into consumers' pockets in terms of disposable incomes. However, I believe that consumers are likely to continue to save rather than spend which will constrain growth. That said, there is certainly no recession on the horizon—at least not yet—and a strong dollar will act as a bit of an anchor.

2. EMPLOYMENT WILL CONTINUE TO EXPAND BUT THE RATE OF GROWTH WILL SLOW. LOOK FOR AN INCREASE OF 1.6% IN 2016.

We are rapidly approaching full employment (generally considered to be when the unemployment rate drops below 5 percent). As such, growth in employment has to be driven more by population growth rather than a return to employment. 2015 saw an average of around 210,000 jobs created per month and I believe that this is likely to slow to an average monthly gain of 190,000 new jobs.

3. THE U.S. UNEMPLOYMENT RATE WILL CONTINUE TO DROP AND END 2016 AT 4.8%.

As mentioned above, we are heading toward full employment and, as such, the national unemployment rate cannot trend much lower. That said, the less acknowledged U-6 rate (which includes those working part-time and those marginally attached to the workforce) will remain elevated at around 8%, signifying that there is still some slack in the economy and room for the rate to drop a little further.

4. INFLATION WILL REMAIN IN CHECK WITH THE CONSUMER PRICE INDEX AT 1.9%.

The Federal Reserve has begun the long-awaited tightening of monetary policy and we will likely see the Fed Funds Rate continue to move higher over the next two years. Inflation has yet to respond to the low unemployment rate, but it will.

The core rate of inflation should remain in check and the overall rate could stay below long-term averages as a function of stubbornly low energy costs. Should we see a shift in OPEC's position relative to oil supply, the overall rate of inflation could rise more rapidly. Oil prices, therefore, will remain in focus during 2016.

THE NATIONAL HOUSING MARKET FORECAST

5. MORTGAGE RATES WILL RISE, BUT WE WILL STILL END 2016 WITH THE AVERAGE 30-YEAR FIXED RATE BELOW 5%.

I am taking the Fed at its word when it says that monetary tightening in 2016 will be gradual and heavily data dependent. Accordingly, I expect only a modest uptick in long-term rates in 2016. Furthermore, as long as the Federal Reserve continues to reinvest the dividends that it is receiving from their bond holdings—which is highly likely—the yield on the key 10-year treasury will remain low and hold mortgage rates in check. This is only likely to change after the general election, therefore suggesting that rates will remain very attractive relative to their long-term averages.

6. CREDIT QUALITY—WHICH HAD BEEN REMARKABLY STRINGENT—WILL RELAX A LITTLE.

Access to credit, specifically mortgage instruments, has not been easy for many would-be homebuyers but that is set to change. I believe that we will see some improvement, specifically for borrowers with "near-prime" credit. This will be of some assistance to first-time buyers; however, credit quality will still be higher than it needs to be.

7. EXISTING HOME SALES WILL RISE MODESTLY TO AN ANNUAL RATE OF 5.53 MILLION UNITS WITH EXISTING HOME PRICES UP BY 4.7%.

I anticipate that we will see some improvement in overall transactional velocities in 2016, but unfortunately, demand will still exceed supply. Prices will continue to rise, but at a more constrained pace than seen over the past few years. This will be a function of modestly rising interest rates as well as slightly improving levels of inventory. I anticipate that we will see more listings come online as more households return to positions of positive equity in their homes.

8. NEW HOME SALES WILL JUMP AND BE ONE OF THE BIGGEST STORIES FOR 2016. LOOK FOR A 23% INCREASE IN SALES AND PRICES RISING BY 3.4%.

I believe that builders will start to build to the entry-level buyer, filling a huge void. Additionally, I see the total number of new home starts increase quite dramatically in 2016 as banks start to ease lending and builders start to believe that the downward trend in homeownership has come to an end. This will help to absorb some of the pent-up demand currently in the market.

9. FORECLOSURES WILL CONTINUE TO TREND DOWN TO "PRE-BUBBLE" AVERAGES.

Any story regarding foreclosures will be a non-story as the rate will continue to trend down toward historic averages. However, we will see the occasional uptick as banks work their way through their existing inventory of foreclosed homes. Move along. There's nothing to see here.

10. THE MILLENNIALS WILL START TO ENTER THE MARKET.

There are several substantial reasons to expect an increase in Millennial buyers. Firstly, early Millennials are getting older and starting to settle down, and even with modestly higher mortgage rates, rents are likely to continue to trend upward, and this will pull many into homeownership.

Secondly, more favorable mortgage insurance premiums, additional supply from downsizing boomers, and growing confidence in the housing market will lead to palpable growth in demand from this important—and substantial—demographic.

To conclude, it appears to me that 2016 will be a year of few surprises—at least until the general election! Because it is an election year, I do not expect to see any significant governmental moves that would have major impacts on the U.S. economy or housing markets.

MATTHEW GARDNER is the Chief Economist for Windermere Real Estate, specializing in residential market analysis, commercial/industrial market analysis, financial analysis, and land use and regional economics. He is the former Principal of Gardner Economics, and has over 25 years of professional experience both in the U.S. and U.K.

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