Fannie Mae chief economist's forecast for US economy, housing market in 2021

by David Kitai | 20 Jan 2021

We're not breaking any news when we say that January 01 of 2021 didn't bring an immediate end to the uncertainty, challenges, and global pandemic that defined much of 2020. The beginning of vaccine rollouts and a change in both the presidential administration and partisan control of the Senate do mean that 2021 is set to be a year of significant change, however. But what will those changes mean for a struggling US economy and a booming US housing market? How can mortgage professionals best position themselves to win in another year of flux?

Fannie Mae chief economist Douglas Duncan (pictured) believes that the US economic recovery is still marching to a tempo set by the pandemic. While he expects an economic recovery to take hold by the second half of this year, that prediction rests largely on the assumption of a successful vaccine rollout. Stimulus, too, will play a crucial role in that recovery and while aggregate losses ought to be made up by this year's end, Duncan noted that the damage done to certain sectors might make the recovery somewhat uneven. With the recovery underway, facilitated by a low-rate environment, Duncan expects a strong year for the mortgage business, but one that might not break the records set in 2020.

"The housing market we think is going to slow a little bit," Duncan said. "That doesn't mean it's declining, it just means the pace of appreciation will be slower. We still expect a very strong year, probably stronger than 2019. It's just that 2020 was completely historic. Last year's house prices appreciation was at about 10%, which is simply not sustainable, from an affordability perspective. We think house price [appreciation] will come down to about half of what it was over the year as builders catch up and people who could offer their homes for sale but were fearful of the virus start to list their homes."

Growth in a post-pandemic economy

Overall, Duncan and his team are estimating the economy shrank by 2.7% in 2020 and will end 2021 at a 5% growth rate. Key to that rebound will be both the rollout of the vaccine and a wider psychological shift among Americans, that they feel safer resuming life as normal once again.

Once the psychological and epidemiological burden of the virus is lifted, Duncan expects the economy, and potentially the housing market, can enjoy an additional lift when Americans start spending some of the money they've saved in the past year. He estimates that savings rates among Americans are roughly 50% higher than they would normally be, meaning there's a lot of capital on consumer balance sheets ready to be deployed.

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In addition to that private cash injection, Duncan noted the ongoing dovish stance the Fed is planning to take and the likelihood of Biden's historic $1.9 trillion stimulus package as likely to jumpstart economic growth in the year to come. While much of that spending and cash might prompt inflationary fears, Duncan said we might not see widespread inflation until 2022.

A slower, but still strong, housing market

In predicting a slower housing market and a correction in house prices this year, Duncan emphasized the truly unique conditions of 2020. The initial lockdowns of spring, he explained, upended the seasonality of the purchase market and pent up demand that would be released later in the year. He also expects rates to trickle upwards from their 2020 lows and, as we learned in 2013 and 2018, market-driven upticks of around 100 basis points can lead to 10% drops in home sales.

Duncan is still expecting positivity in the housing market, however, driven by a millennial generation that is entering peak homebuying age. That generation, too, skews towards the kind of salaried employment that usually results in homeownership.

Duncan expects housing demand to soften due to rate increases and the rising potential of inflation. At the same time, he predicts a strengthening in supply thanks to high rates of new home construction and the listing of new homes on the market by owners previously too afraid of the virus to move.

Where to look

In making these predictions, Duncan is focusing on a few key indicators that may point to whether or not his forecasts prove accurate. On the policy side he's looking to see whether policies are temporary or more permanent. Duncan cited past tax cuts during the Bush and Obama administrations that resulted in temporary changes in behaviour without altering market fundamentals.

On the market side, he's watching for inflation. While expectations of inflation have risen, question marks persist around whether they will be sustained. If they are

sustained, we will see just how far and for how long the Fed is willing to let inflation run.

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Looking directly at the housing market, Duncan is asking whether the shift in demand to low-density housing outside of urban centers is going to be a permanent change. That will be shaped by the re-emergence of major cities as attractive places to live again and by how so many people will eventually return to work.

“One of the questions about large suburban homes was when the boomers decided to downsize will there be anybody who wants to buy them given the family sizes among younger age groups have been falling,” Duncan said. “Well today, if a family has two incomes, even if they only have one child, they might still require four bedrooms, one for the parents, one for the child and two offices. That could be a cultural shift and a technological shift that leads to housing impact. We’ll be watching to see whether there is permanence to that.”

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