Stewart Agency Financial Advisory Services

Economic Summary, 3Q24

At the half-year mark, optimism that the Fed will implement rate cuts in the third quarter is strengthening. This time with reason. After three consecutive months of a downward trend, continued inflation could be in the rear-view mirror. However, inflation followed a similar trend in September, October, and November last year, so pure, near-term optimism could still be a bit hasty.

In his recent testimony to Congress, Fed Chairman Jerome Powell stated that inflation reports covering the first three months of this year did not boost Fed officials' confidence that inflation was coming under control. However, he followed by saying, “The most recent monthly [inflation] readings have shown modest further progress and more good data would strengthen our confidence that inflation is moving sustainably toward 2%.” More good data? Is that one, two, three more months of positive inflation reports? Timing will be everything to impact the remainder of the year.

Additionally, Powell noted Fed officials must begin balancing both their mandates, inflation and unemployment, given that unemployment has continued to increase over the past 12 months. And, while unemployment helps cool the economy, he said, “Reducing policy restraint too late or too little could unduly weaken economic activity and employment.” So, with three months of positive inflation reports and continued increase in unemployment, at this point, the Fed at least appears open to considering rate cuts, a shift from the previous months' position.

It would be naïve and negligent, however, if we did not at least recognize this year is an election year bringing with it a tense and unprecedented political environment, creating concerns there will be undue influence on the Fed decisions. However, Jerome Powell has stated many times, most recently on July 10 to the House Financial Services Committee, that the Federal Reserves "undertaking is to make decisions when and as they need to be made, based on the data, the incoming data, the evolving outlook and the balance of risks, and not in consideration of other factors, and that would include political factors ... It's just not appropriate for us to get into the business of thinking about election cycles at all, one way or the other."

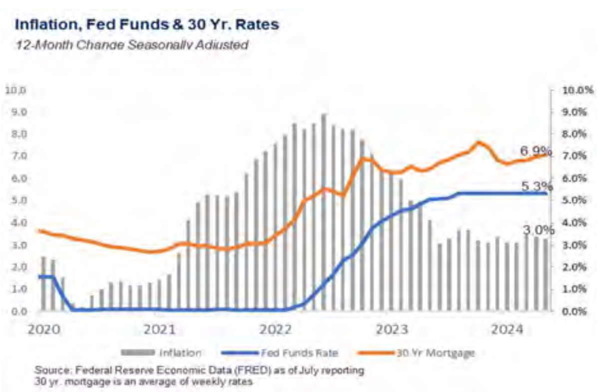
As for the data, the annual inflation rate for the United States is now **3.0 percent (as of the June 11 report), a decrease of 0.1 percent from the prior month's 3.1 percent**, making that the third consecutive month of inflation decrease. And the Fed officials project PCE inflation to be 2.6% at year-end 2024.

The **30-year mortgage rate sits at 6.78 percent** as of July 25, which is the lowest rate since April 4, 2023, although largely the same rate as July 2023. To continue the positive trend, the **10-year Treasury rate** has come down to **4.15** as of July 31 amid the growing optimism about the possibility of lower interest rates. The rate is still relatively high based on a five-year historical average of 2.54, **creating a 2.63 spread** to mortgages, a spread that is typically 1.50 to 1.70. However, an increase in mortgage-backed security buyers could also help the spread with the largest buyers, banks and the Fed, not as active in the market. Presumably, with lower inflation, pending rate cuts, and greater market confidence, the 10-year rate will further come down, off which the 30 yr. mortgage rate is based. With Fed rate cuts in sight and mortgage rates ticking down, the housing market may experience a needed late-in-the-year boost and capture some of the pent-up demand sitting on the sidelines.

After three months of a downward inflationary trend, rate cuts appear more likely ...

CPI for All Urban Consumers – US City Average

12-Month Change Seasonally Adjusted



10 yr Treasury and 10 Yr / Mortgage spread

The continued challenge, however, is that two-thirds of homeowners still have mortgages below 4 percent, which remains the driving force of low existing housing inventory and, to some extent, high prices, all creating an affordability issue. The median single-family home price continues to increase, landing at $426,900 in June, up 4.1 percent from June 2023, which is, at least, a lower increase than May's 5.8 percent. Existing home inventory levels remain low, although improved in June to a 3.8-month supply, better than May's 3.5 months and well above last year's June level of 2.9.

And the paramount question now is, how long it will take to work through this 'lock-in' effect (the reluctance of homeowners to sell their home given the financial impact of switching from a low mortgage rate to a much higher one)? Or is there a 'lock-in' effect? Will life events be enough to generate housing demand? Where the 30-year fixed rate largely stabilizes over a longer period, be it 6 percent, 5 percent or other, will dictate the duration of this 'work-out' period – higher interest rates will create a longer transition period while lower interest rates would enable a faster release. Since 1985, three years after the Great Inflation ended, the historical average for the 30-year fixed mortgage rate is 6.58 percent; inflation, 2.8 percent; and the 10-year treasury, 4.82 percent, all near where we are today.

From a macroeconomic perspective, while GPD growth slowed in the first quarter of this year at 1.4 percent, which at the time quietly triggered concerns about stagflation, the second quarter grew at a surprisingly robust 2.8 percent, driven by consumer spending, not only negating concerns of stagflation but dampening the risk of recession spurred on by the interest rate hikes. The economy remains relatively strong, not too hot but not too cold, either. Let's hope it is just balanced enough not to create an inflation uptick in July or August and create further uncertainty around the Federal Reserve rate cuts. Unemployment increased slightly in June to 4.1 percent, helping to cool the economy. And the twelve-month monthly increase is providing new input to the Fed's rate cut decisions. The S&P continues to increase and at a similar pace to the first quarter at 3.5 percent, driven by hopes the Federal Reserve will cut interest rates soon.

With this economic backdrop, it does appear that the economy is cooling and not at an alarming pace, inflation is finally responding to the Fed's actions, and we may, just maybe, experience the allusive 'soft landing' the market hoped for months ago. 2025 may stabilize and bring with it some tempered optimism that will likely be the theme as agencies enter the 2025 strategy and budgeting season. Are you starting to think about your 2025 strategy and budget?

While both Fannie Mae and MBA continue to see interest rates coming down slightly through the end of the year, their forecast rates also continue to be higher than each subsequent report. Consistently since March, neither Fannie Mae nor MBA see a dip below 6 percent this year. And, in fact, residential interest rates are no longer forecasted to drop below 6 percent in 2025. Although higher than we would like, these rates are still better than in April and May and could come down further than Fannie Mae and MBA suggest, if there is a rate cut in September. However, a rate cut in November may be too little, too late for 2024, but would set the stage nicely for an improved first quarter of 2025, another data point for agencies to consider when working through their 2025 budget.

Residential interest rates not forecast to drop below 6 percent in 2025, which should be considered as Agencies enter the 2025 strategy and budgeting season.

Residential Interest Rate Forecast June 2024

30-Year Fixed-Rate Conventional Mortgages

Fannie Mae

	Q1	Q2	Q3	Q4
2022	3.8%	5.2%	5.6%	6.7%
2023	6.4%	6.5%	7.0%	7.3%
2024	6.7%	7.0%	6.8%	6.7%
2025	6.5%	6.4%	6.3%	6.2%

MBA

	Q1	Q2	Q3	Q4
2022	3.9%	5.3%	5.7%	6.6%
2023	6.4%	6.5%	7.0%	7.3%
2024	6.7%	7.0%	6.8%	6.6%
2025	6.4%	6.3%	6.2%	6.0%

As for sales volume in 2024, Fannie Mae and MBA residential real estate forecasts suggest a 2.6 percent average increase over 2023, which came down from last quarter's prediction of 4.6 percent. However, forecasts for 2025 are in the 7 percent range, presumably buoyed by interest rate optimism.

From a home price perspective, the average forecast is now 5.2 percent for 2024 which is a significant increase from April's forecast of 1.8 percent. Based on National Association of Realtors data, the average existing home price has increased 2.4 percent a month since January 2024 and an average monthly year-over-year increase of 5 percent for the same period. Home prices continue to rise even though supply appears to be increasing. The question is whether life events and somewhat lower interest rates will help clear out the supply and encourage the market to move, or will the 'lock-in' effect continue to suppress the market? Higher home prices may contribute to a longer 'work-out' period or could a clearing of the recent uptick in inventory suggest an ephemeral 'lock-in' effect that may not have existed at all? Time will tell.

On a quarterly basis, both MBA and Fannie Mae suggest a positive YoY increase in the third quarter and a strong fourth quarter at an average of 13.3 percent. 2025 is averaging 8 percent growth with a strong second quarter, likely reflecting an assumption around additional rate cuts in the first quarter of 2025.

As assumptions around rate cuts begin to solidify, fourth quarter and 2025 YoY performance forecast to improve.

Existing Home Sales Forecast

July 2024

Sales -- Thousands *Annual*

	2022	2023	2024	2025
Fannie Mae	5,030	4,090	4,168	4,538
MBA	5,099	4,099	4,228	4,490
Average	5,065	4,095	4,198	4,514

Percent Change - *Year-Over-Year*

	2022	2023	2024	2025
Fannie Mae	-17.9%	-18.7%	1.9%	8.9%
MBA	-16.8%	-19.6%	3.1%	6.2%

Median Price Forecast

July 2024

Median Price -- *$ Thousands*

	2022	2023	2024	2025
Fannie Mae	$ 378.8	$ 402.3	$ 428.8	$ 441.7
MBA	$ 384.0	$ 388.1	$ 402.9	$ 403.9
Average	$ 381.4	$ 395.2	$ 415.9	$ 422.8

Percent Change - *Year-Over-Year*

	2022	2023	2024	2025
Fannie Mae	9.1%	6.2%	6.6%	3.0%
MBA	10.4%	1.1%	3.8%	0.2%

Sales Forecast by Quarter

Existing Home Sales Forecast

July 2024

Sales -- Thousands *Seasonally Adjusted Annualized Rate*

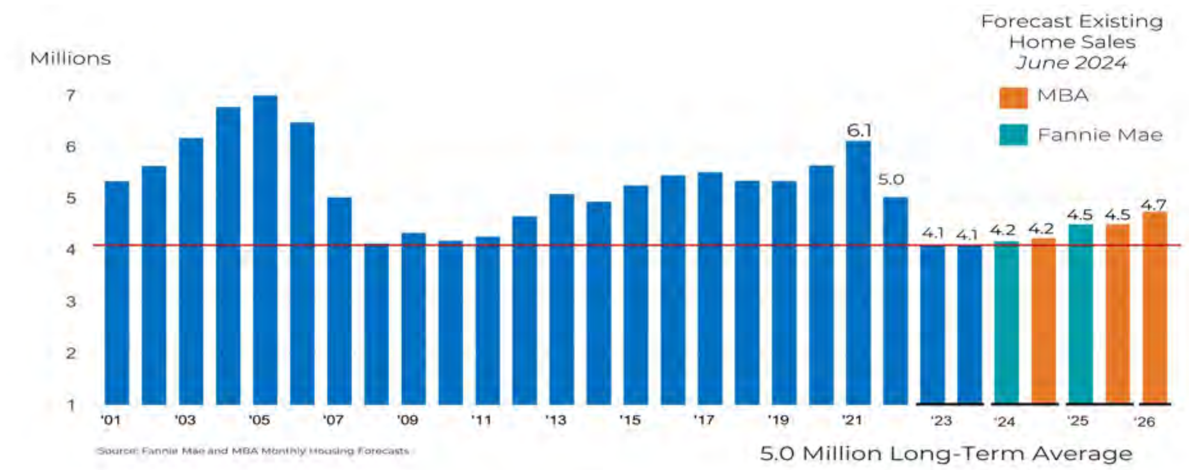
	2024				2025			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Fannie Mae	4,200	4,068	4,109	4,295	4,398	4,499	4,576	4,680
MBA	4,190	4,039	4,280	4,404	4,448	4,442	4,486	4,582
Average	4,195	4,054	4,195	4,350	4,423	4,471	4,531	4,631

Percent Change - *Year-Over-Year*

	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Fannie Mae	-2.7%	-2.8%	2.2%	10.7%	4.7%	10.6%	11.4%	9.0%
MBA	-3.2%	-5.0%	6.5%	16.0%	6.2%	10.0%	4.8%	4.0%
Average	-2.9%	-3.9%	4.3%	13.3%	5.4%	10.3%	8.0%	6.5%

Considering the broader picture and as agencies begin to develop their budgets, 2025 will be a slightly improved market, but could largely be viewed as still a transitional year into the more normal 5 million existing home sales market. Recently, the 5 million home sales target has slipped further out into 2027. As of June, existing home sales prediction came to 4.2 million in 2024 and 4.5 million in 2025.

US existing home sales slowly trending to a more normal 5 million sales level



Stewart View

All signs point toward pending rate cuts – three-month downward trend in inflation (although not yet under 3 percent), a cooling GPD (although not at an alarming pace) and increasing unemployment (positive only from a rate cut perspective). What the Fed defines as 'more positive data' and balanced GDP growth are likely the keys to the Fed's future rate actions. Depending on timing, the rate cuts may be too late to impact 2024, but should bring a welcome relief to the market and thus provide an enthusiastic kickoff to 2025. Unknown still is what the Fed's cadence might be for additional rate cuts in 2025. We must be aware, though that as interest rates come down and sideline demand enters the market, prices may continue to increase, which could somewhat temper the impact of lower interest rates. Therefore, as agencies enter the strategy and budgeting season (are you thinking about your budget?), while 30-year mortgage rates may come down (although maybe not below 6 percent) and inventory appears to improve, consideration must be given to the potential for higher prices and the duration of a workout period for the lock-in effect, shifting homeowners out of their sub 4-percent mortgages back to a broader historical norm of 6 to 6.5 percent. How long will that workout take and at what pace? Are there homeowners who don't consider themselves 'locked-in?' Yes. Can rates go lower? Absolutely.