MARKETS & ECONOMY

Economic Outlook: Recession may be what drives rates down in 2024

Does the rapid slowdown in the economy mean a recession is now inevitable in the new year, or is a 'soft landing' still possible? Economists are divided on the nation's economic outlook for 2024

Image by: Getty Images

BY MATT CARTER
Today, January 08, 2024

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say.

Interest rates have a way of defying predictions, but economists are also divided on the bigger picture for 2024. Does the rapid slowdown in the economy mean a recession is now inevitable, or can a "soft landing," without a surge in unemployment, still be achieved?

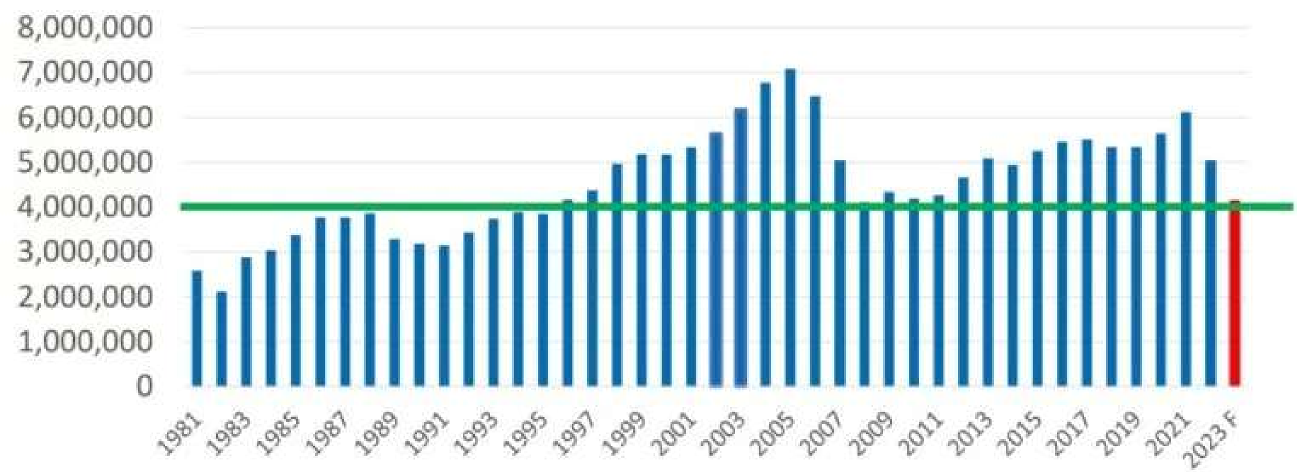
A soft landing for the economy as a whole might mean that the Fed doesn't start cutting rates until later this year, putting mortgage rates on a more gradual downward trajectory.

For real estate pros hoping for a rebound in home sales, the good news is that, regardless of whether they see a recession on the horizon, economists tend to agree that this year will be a better year for home sales than last.

That's mainly because 2023 was the slowest year for existing home sales since at least 2008 (and possibly even 1995), according to metrics tracked by the National Association of Realtors.

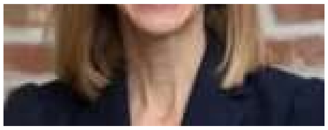
scarce inventory and elevated home prices were all to blame.

Existing home sales, 1981-2023



The National Association of Realtors estimates that 4.15 million homes changed hands in 2023, which might turn out to be the lowest sales volume in nearly 30 years, depending on final numbers for the fourth quarter. Source: NAR 2024 Economic & Real Estate Outlook.

"With housing affordability metrics at a 40-year low, combined with 75 percent of mortgages locked in at 4 percent or below, the U.S. housing market



Ginger Chambless

years, we think the housing market is one area of the economy that could perform better in 2024 than in 2023, even if trends remain soft in the near term."

A mild recession — as currently envisioned by economists at Fannie Mae and the Mortgage Bankers Association (MBA) — would almost certainly mean even lower mortgage rates in 2024.

"The question of whether inflation could be brought down without a meaningful rise in the unemployment rate appears to have been answered in the affirmative," Fannie Mae economists said in commentary accompanying their latest forecast. "However, we are not yet ready to declare that the window for a recession has passed."

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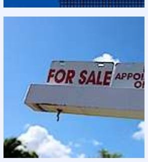
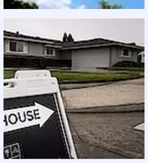
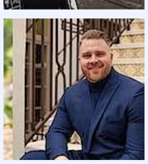


Falling mortgage rates haven't sparked homebuyer stampede



Homebuyers are now paying $400 less per month than in October



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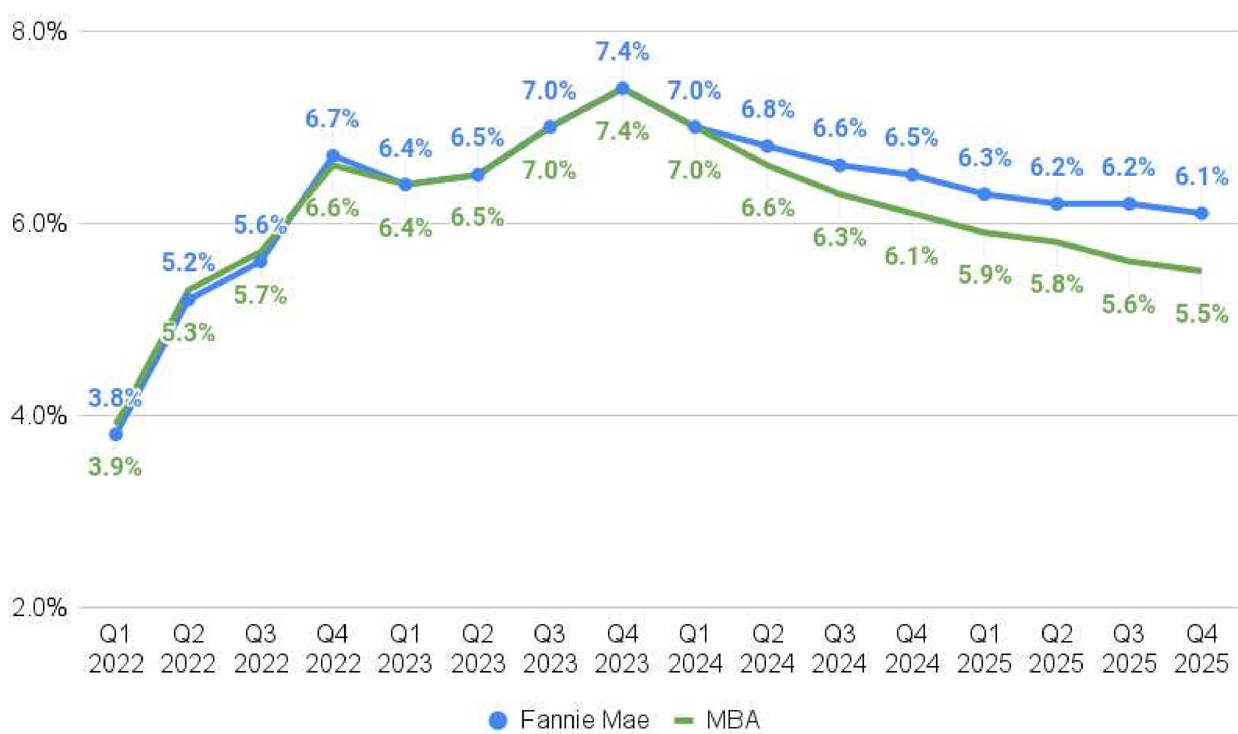
Lower mortgage rates forecast for 2024



Source: Fannie Mae and Mortgage Bankers Association forecasts, December 2023.

continuing to fall below 6 percent by Q1 2025.

Fannie Mae economists said in a Dec. 11 forecast they expect 30-year fixed-rate loans will dip to an average of 6.5 percent during Q4 2024, and fall to 6.1 percent by the final three months of 2025.

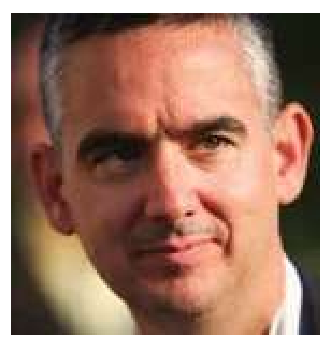
But lower rates wouldn't necessarily serve as a panacea for housing markets if inventory remains scarce, and many first-time homebuyers remain priced out of the market, economists say.

NAR Chief Economist Lawrence Yun predicts existing home sales will grow by 13.5 percent next year, to 4.71 million.


Lawrence Yun

As one of the forecasters who thinks the U.S. can avoid a recession this year, Yun sees mortgage rates averaging 6.3 percent in 2024. But he thinks that would be enough of a dip that many homeowners who have been reluctant to sell would no longer feel like they're locked into the low rate on their existing mortgages, potentially boosting for-sale inventory by 30 percent this year.

MBA economists see a mild recession coming in the first half of the year but still think existing home sales could grow by 6 percent, to 4.37 million, as mortgage rates drop to an average of 6.1 percent during the fourth quarter.


Mike Fratantoni

"The lock-in effect will continue to suppress existing inventory, which opens the opportunity for builders to provide a higher share of total sales," MBA Chief Economist Mike Fratantoni said in commentary accompanying the group's 2024 Outlook.

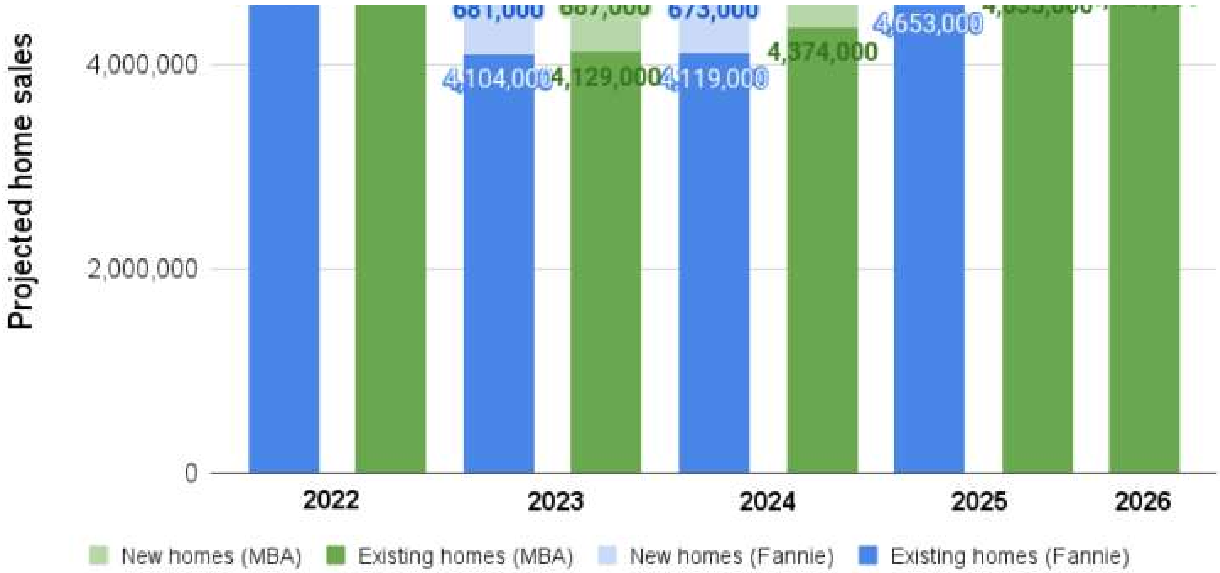
The MBA expects new home sales to grow by 10 percent in 2024, to 756,000. But it's harder for Realtors to get excited year almost exactly where they started, according to loan lock data tracked by Optimal Blue. That's a drop of 1.27 percentage points from a 2023 peak of 7.83 percent registered Oct. 25.

While the recent declines in mortgage rates might make a 2024 rebound in existing home sales seem almost inevitable, some forecasters expect 2024 growth will be anemic.

"Mortgage applications are now rebounding as rates fall, but it's far too soon to declare that the housing market is on a sustainable road to recovery," forecasters at Pantheon Macroeconomics warned in their Jan. 2 U.S. Economic Monitor. "Mortgage applications signal a modest increase in total home sales over the next couple months, but to a level that is some 22 percent below the pre-COVID trend."

Economists at mortgage giant Fannie Mae see existing home sales growing by less than 1 percent in 2024, and that new home sales will shrink by 1.2 percent.

2024 home sales forecasts



Source: Fannie Mae and Mortgage Bankers Association forecasts, December 2023.

Realtors like to point out that real estate markets are local, and NAR expects that the 10 markets with the strongest buyer and seller demand in 2024 will be concentrated in the Midwest, South and East.

"Metro markets in southern states will likely outperform others due to faster job increases, while markets in the Midwest will experience gains from being in the most affordable region," Yun said in commentary accompanying his 2024 outlook.

Top 10 markets for pent-up housing demand

- Austin-Round Rock-Georgetown, Texas
- Dallas-Fort Worth-Arlington, Texas
- Dayton-Kettering, Ohio
- Durham-Chapel Hill, North Carolina
- Harrisburg-Carlisle, Pennsylvania
- Houston-The Woodlands-Sugar Land, Texas

- Portland-South Portland, Maine
- Washington-Arlington-Alexandria, D.C.-Virginia-Maryland-West Virginia

Source: National Association of Realtors

Interest rate cuts: Sooner or later?

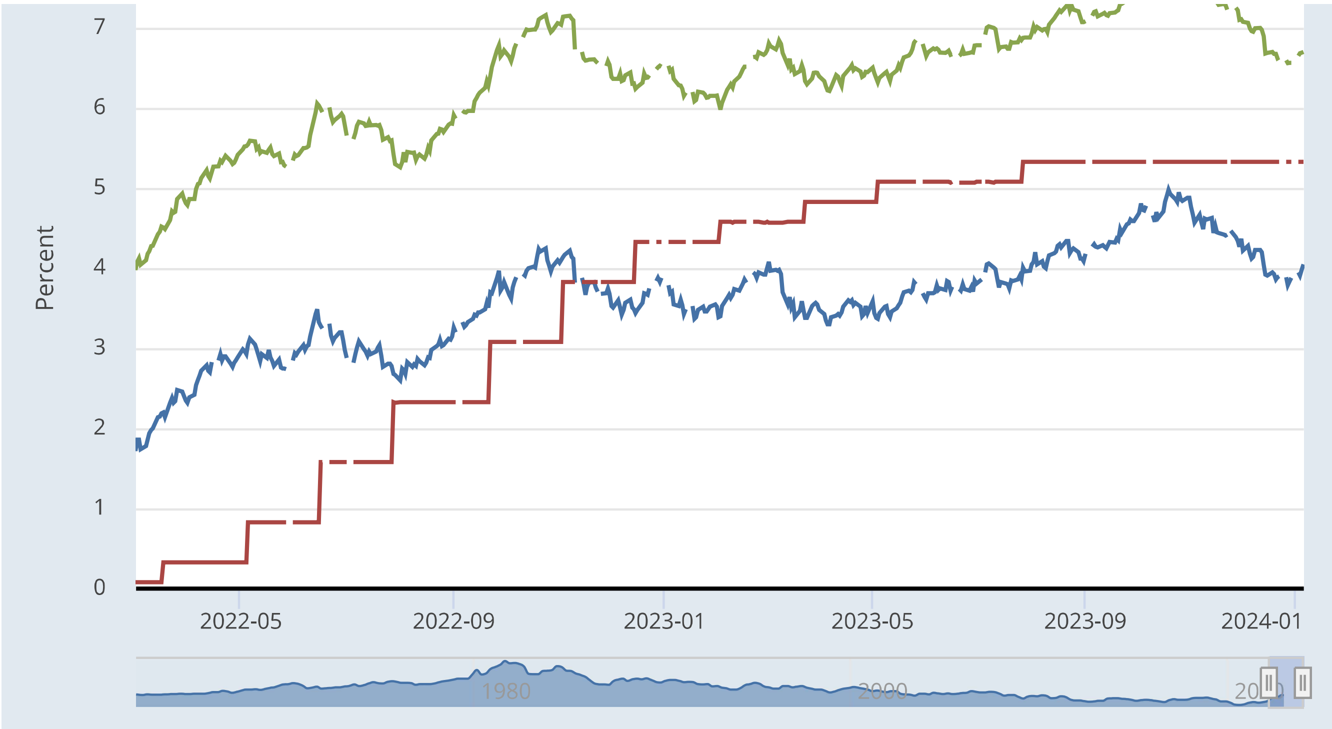
In wrapping up their final meeting of the year on Dec. 13, Fed policymakers signaled that they expect to cut rates three times next year, by a total of 75 basis points. That would bring the Fed's target for the short-term federal funds rate to between 4,5 percent and 4.75 percent, down from the current target of 5.25 to 5.5 percent approved in July. The 11 rate increases the Fed implemented starting in March 2022 brought the federal funds rate to a 22-year high.

Mortgage rates have already come down in anticipation of Fed rate cuts of that magnitude. The question now is whether the Fed will need to make more drastic cuts and start bringing rates down sooner than later.

As a forecaster who expects a soft landing, J.P. Morgan's Chambless doesn't expect the Federal Reserve to begin cutting interest rates until June. But Chambless thinks the Fed policymakers will then proceed to lower the federal funds rate by a quarter of a percentage point at each of their five remaining meetings in 2024, bringing the short-term benchmark rate down by a full 1.25 percentage points.

The CME FedWatch Tool, which tracks futures markets to predict the odds of future Fed moves, shows investors think the odds are better than even that the benchmark interest rate will be even lower than that by the end of the year.

Fed paused rate hikes in July



Sources: Board of Governors; New York Fed; Optimal Blue

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Forecasters at Pantheon Macroeconomics expect the Fed will start bringing rates down in March — in time for the spring homebuying season — and that the federal funds rate will be at 3.87 percent by the end of the year.

Ian Shepherdson

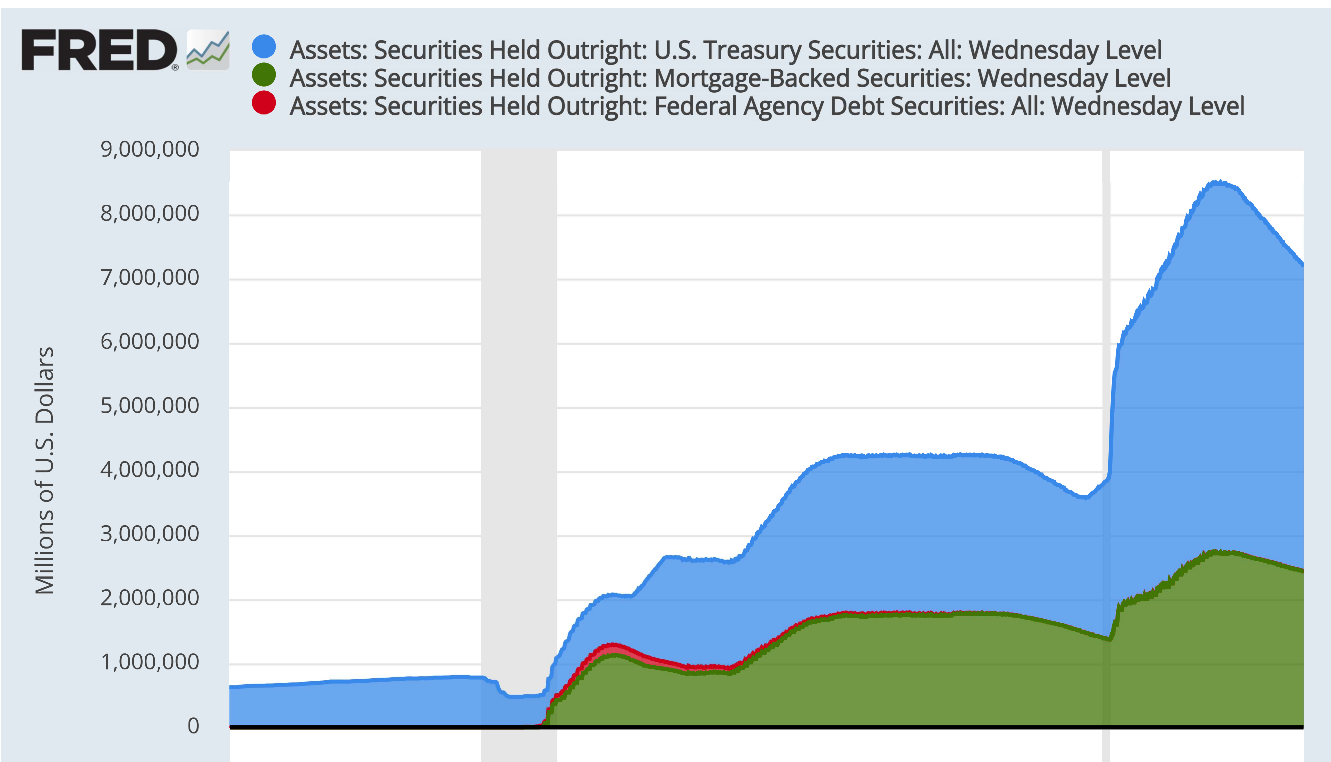
"We continue to expect the first Fed rate cut as early as March, regardless of what anyone thought back in mid-December," Pantheon economists Ian Shepherdson and Kieran Clancy said in their Jan. 2 U.S. Economic Monitor.

While Pantheon's forecast is in line with bets placed on futures markets, it's about twice as aggressive as the schedule Fed policymakers said they envisioned at their final meeting of 2023.

The federal funds rate isn't the only monetary policy tool Fed policymakers have at their disposal. While the central bank doesn't have direct control over notes and $40 billion in mortgage-backed securities (MBS) every month. The central bank's $120 billion in monthly "quantitative easing" helped push mortgage rates to record lows — and the Fed's balance sheet to record highs.

With inflation still running hotter than the Fed would like, the central bank has reversed course and is now engaged in "quantitative tightening," allowing $35 billion in maturing MBS and $60 billion in Treasurys to roll off the central bank's balance sheet each month.

Fed trimming its balance sheet



Source: Board of Governors of the Federal Reserve System, Federal Reserve Bank of St. Louis

While real estate industry trade groups have pleaded with the Fed to suspend the runoff of its mortgage holdings, those calls have gone unheeded.

the economy next year.

Chambless sees tighter lending standards for the commercial real estate sector, driven by challenges at small and regional banks, as another potential headwind.

"With nearly $550 billion of maturing commercial real estate debt over the next year, losses are expected to mount for lenders and investors," Chambless said. "While we do not expect this to be a systemic issue, reduced lending activity and potential investor losses could be an economic headwind."

The see-saw impacts of the pandemic and Russia's invasion of Ukraine illustrate the sizable impacts global events can have on the U.S. economy. After first threatening to plunge the world into a global recession, the pandemic ultimately ignited inflation as central banks launched massive stimulus efforts to keep the economy on track. The war in Ukraine exacerbated inflation by sending energy prices soaring.

"Elevated trade tensions with China, the ongoing Russia-Ukraine war, and conflict in the Middle East all point to continued uncertainties and risks heading into 2024," Chambless noted. "While direct U.S. economic impact has been limited thus far, the larger risk is for a supply shock of a critical commodity or good — energy, food, semiconductors — that triggers significant market disruption."

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