

MBA Forecast Commentary: August 2023

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MBA's Outlook for 2023 and 2024

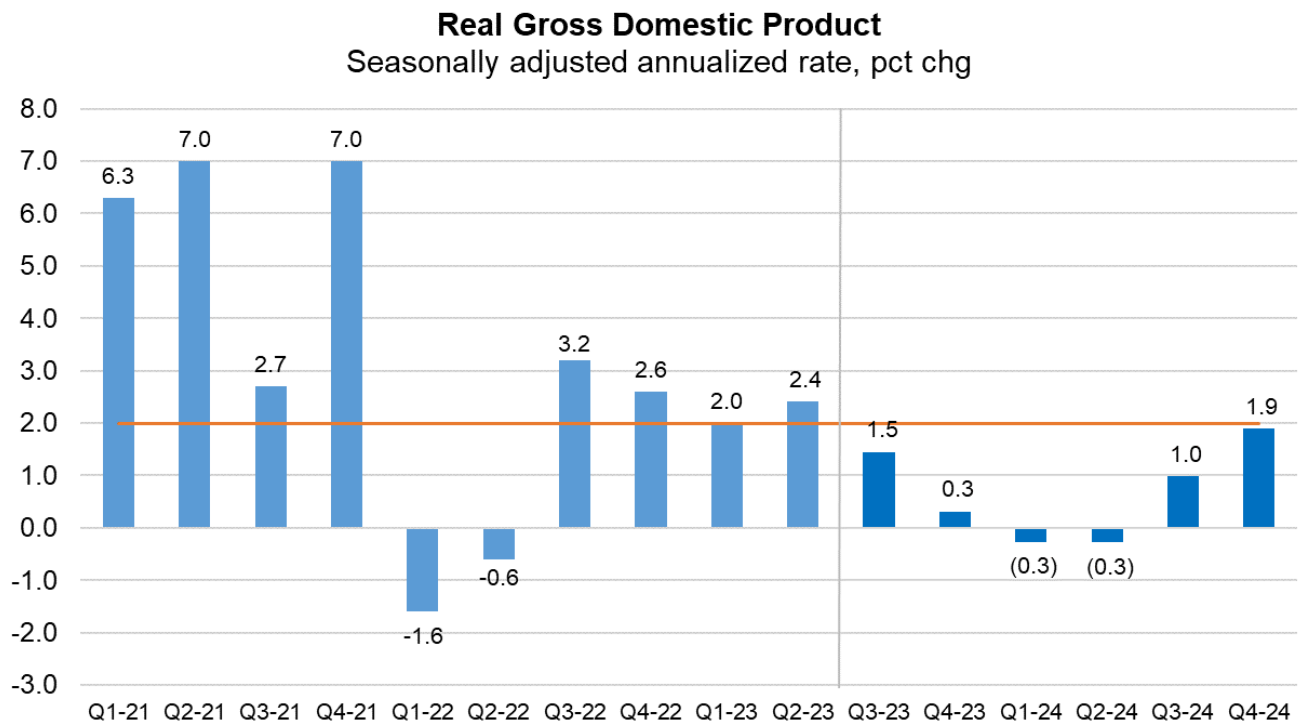
Summary of the August 2023 forecast

- We are expecting the economy to slow towards the end of 2023 and to enter a mild recession in the first half of 2024, which will result in the unemployment rate increasing from 3.5 percent in July 2023 to 4.9 percent in mid-2024.
- Inflation is coming down slowly, with headline CPI inflation growing at 3.2 percent year-over-year, but the core CPI index remains at 4.7 percent. Shelter and non-shelter service inflation continue to exert upward pressure on overall inflation measures, but those should start to turn lower in the coming months as the rental housing market loosens and as wage growth cools.
- The FOMC raised rates in July and the meeting minutes revealed concerns over the upside risk in inflation given that the broader economy and job market are performing better than expected. Nevertheless, we expect that the Fed is at the top of its rate hiking cycle and will likely hold the funds rate at its current level at least until the second quarter of 2024.
- Despite a picture of cooler inflation, long-term rates continue to push higher, potentially driven by events abroad, along with concerns about US Treasury refunding and budget deficits. The 30-year mortgage rate has moved higher in response, and at 7.16 percent in our most recent survey, has matched its October 2022 high. Assuming the spread between the mortgage rate and Treasury rates narrows as rate volatility settles and the monetary policy outlook becomes less uncertain, and as the US economy slows, we expect mortgage rates to decline gradually at the end of 2023.
- Mortgage origination volume is expected to decrease 26 percent in 2023 to \$1.7 trillion, with a 15 percent decline in purchase and a 52 percent drop in refinance volume. In terms of units, we forecast a 32 percent drop in the total number of loans originated, driven by a 20 percent decrease in purchase loans and 55 percent decrease in refinance loans.
- Existing home sales and incoming purchase application activity has been slow as there is limited for-sale inventory, while affordability remains challenging in many markets due to the combination of high rates and home price growth that has remained strong.
- Refinance activity continues to run at extremely low levels, as most borrowers have no incentive for a rate/term or cash out refinance at rates this high.

- New home purchase activity continues to be a bright spot in housing. New home inventory accounts for almost a third of for-sale inventory, single-family housing starts and permitting activity continue to inch higher, and data from our Builders Applications Survey have shown annual gains for the past several months. We expect an annual new home sales pace of 692,000 units in 2023, an 8 percent increase, in contrast to a forecasted 16 percent decline in existing home sales.
- With the release of the 2022 HMDA data, we raised our estimate to \$2.305 trillion in total originations from \$2.245 trillion previously. Additionally, the updated data also suggests that average loan sizes were lower than previously estimated, which pushed our unit count estimates to 6.7 million loans originated from 5.9 million loans in previous forecasts.

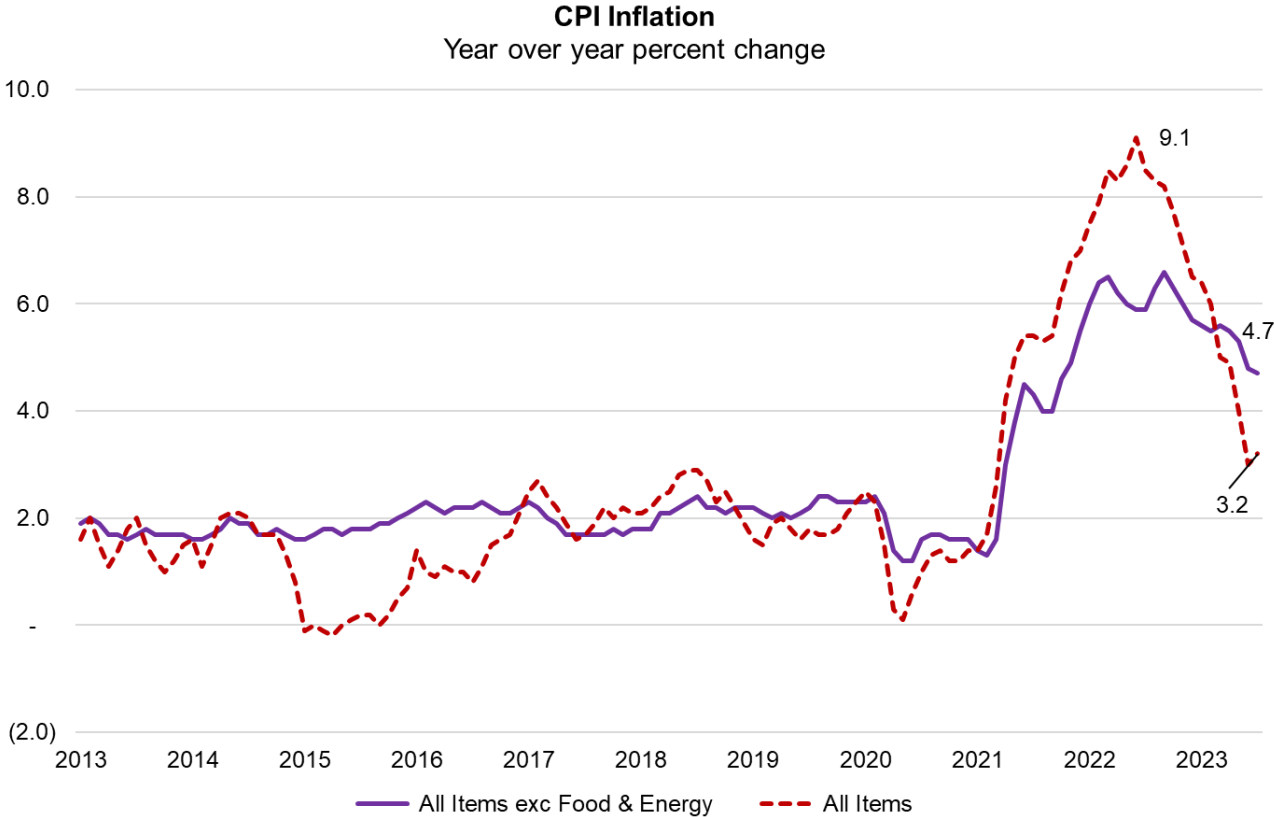
Forecast and Outlook Details

GDP growth in the first half of 2023 has outperformed expectations, averaging over two percent for each of the two quarters. Much of this growth was driven by consumer spending, still fueled by high levels of savings in previous years, and a job market that is benefiting from robust hiring and low unemployment. We expect that will start to change soon, as high rates and tighter credit conditions start to take their toll on households and businesses. Our forecast is for growth to slow through the end of 2023, and for a mild recession in the first half of 2024, with negative growth in the first half of the year. However, this will be a short-lived, mild recession and a return to trend growth in 2025.



Source: Bureau of Economic Analysis

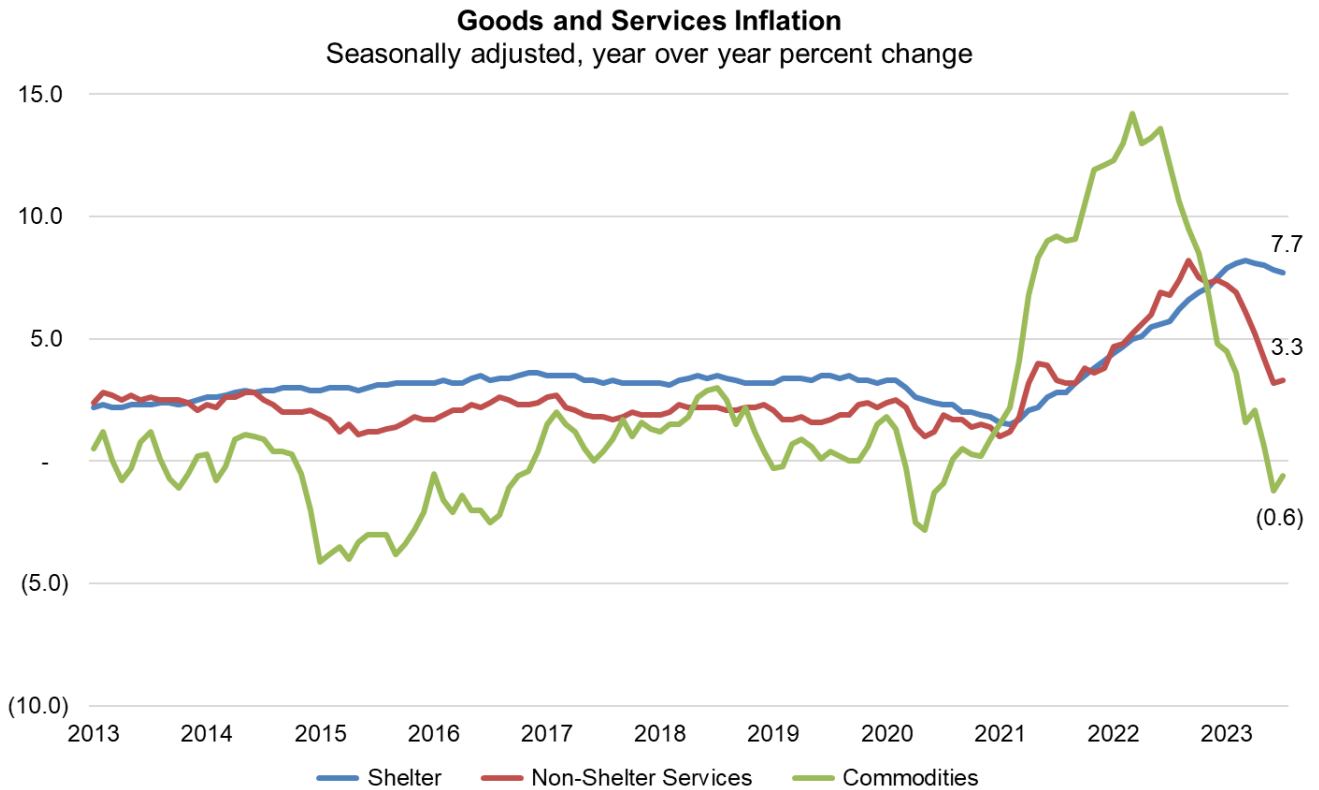
Inflation continues to be one of the most important data points to watch, given the Federal Reserve’s actions over the past year and a half to tame inflation and the resulting impact on the economy. The July CPI number showed a 3.2 percent 12- month change, still above the Fed’s 2-percent target, but substantial progress from its 9 percent peak in 2022. However, the core CPI, which excludes the more volatile food and energy components, remains stubbornly high at 4.7 percent, although that too has shown improvement from its recent peak.



Source: Bureau of Labor Statistics

Within that headline number, the prices for many goods are now beginning to decline, Shelter costs as measured by the BLS are decelerating on a monthly basis and seem to have leveled off on an annual basis. However, the level of shelter inflation is still just under 8 percent on a year-over-year basis, well above its longer run average of around 3 percent. We expect that the recent slowing in market rental rates will begin to show up in the CPI data as more leases are renewed and this will push the inflation rate lower. Additionally, with over one million multifamily housing units under construction, the inflow of new rental units should act to raise vacancy rates and lower rents further. Inflation for non-shelter services is still too high, at 3.3 percent in July, but still an improvement from a peak of 8.2 percent in September 2022. Easing wage pressures have helped as the job market cools, with lower levels of hiring, fewer vacant job openings, and less competition for workers, but current levels of wage growth are still

too high for non-shelter service inflation to come down significantly.

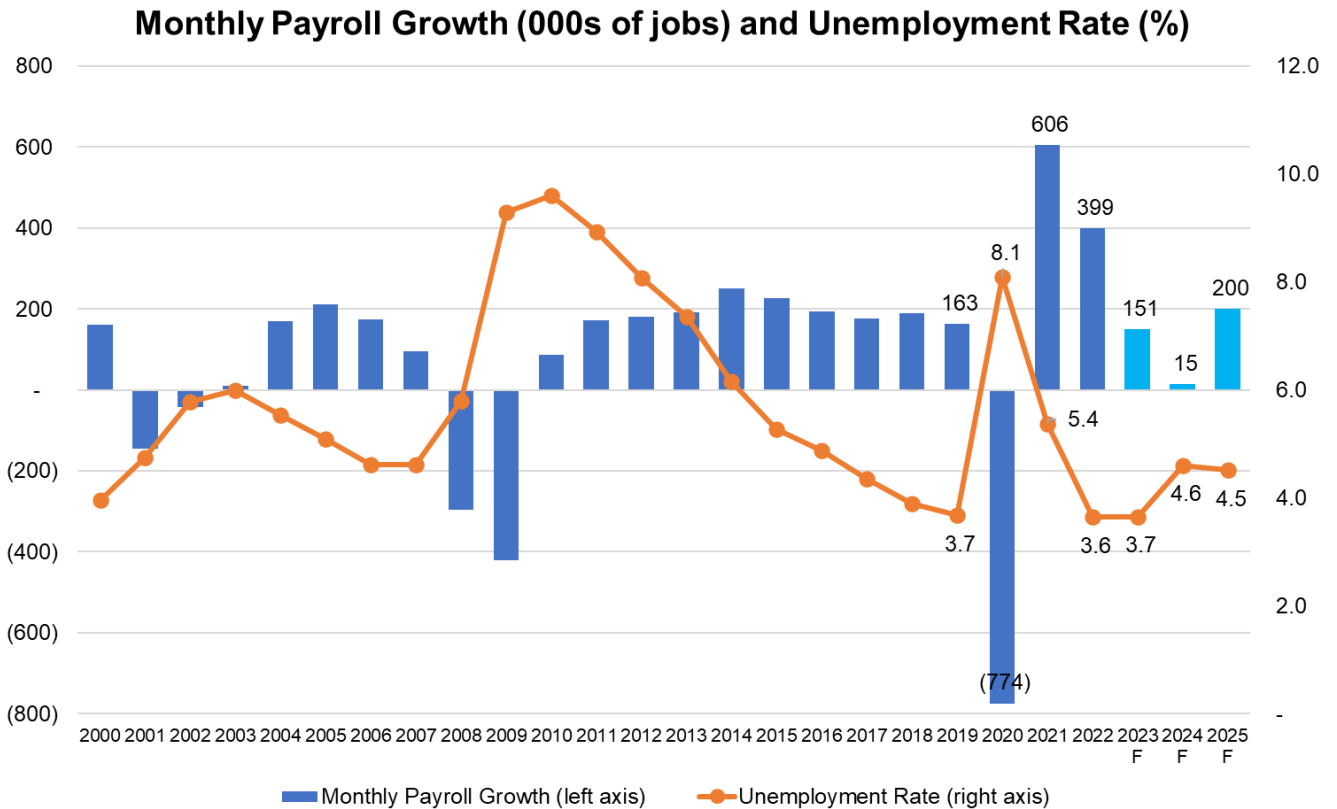


Source: Bureau of Labor Statistics

While inflation has moved in the desired direction for the Federal Reserve, recent meeting minutes showed that they are still concerned with the broader resiliency of the economy and the risk that it may spark an unexpected increase in prices again.

As highlighted in the summary, we expect the job market to weaken as we make our way through the second half of 2023 as the economy grinds its way toward a mild recession. The unemployment rate for July inched down to 3.5 percent over the month but remained close to its year-to-date average. We forecast the unemployment rate will rise gradually over the next few months as the economy weakens, peaking at around 4.9 percent in mid-2024.

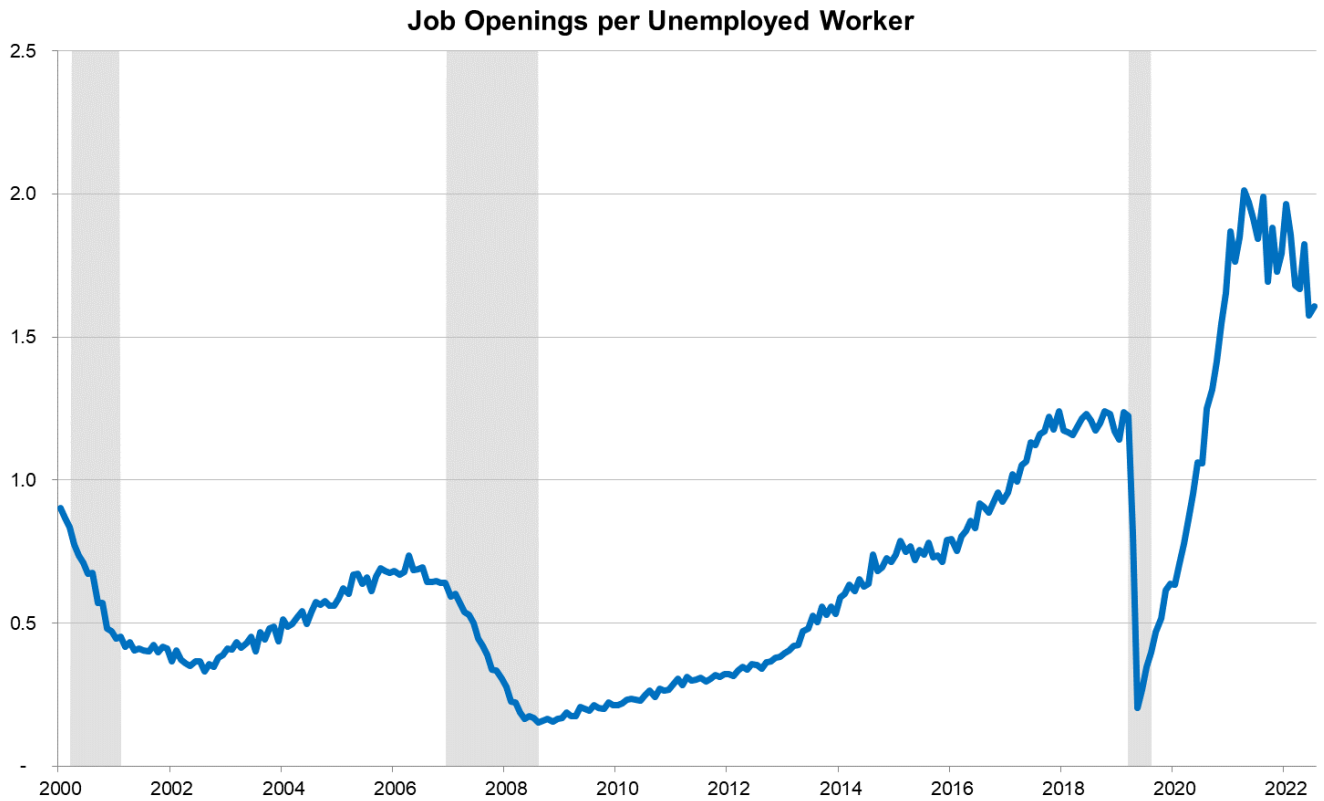
Job growth has averaged 258,000 per month so far in 2023, but July's job gains totaled 187,000, driven largely by growth in industries such as wholesale and retail trade, education and health services, and leisure and hospitality. Revisions to the prior two months resulted in 49,000 fewer jobs added than previously reported. We expect this slowing in monthly payroll growth to continue as businesses feel the impact of higher rates, tighter credit conditions, and slowing consumer demand.



Source: Bureau of Labor Statistics

The diffusion index, which captures the breadth of job growth, has shown that a smaller proportion of industry sectors have been adding jobs over the past year. The July reading was 57.2 percent – the sixth consecutive month of a reading less than 60 percent and less than 2022’s average of 69 percent. This measure indicates that a narrower band of sectors are adding jobs, and historically, downward trends in this metric have been consistent with recessions or weakening economic growth.

The number of job openings is still elevated but has decreased by almost two million since its 2022 peak, while the number of voluntary quits continues to decline, an indicator that workers are seeing fewer job prospects to leave current jobs for. There are still around 1.6 job openings per unemployed workers, compared to the 20-year average of 0.7 openings, which means that this labor market is still extremely tight.



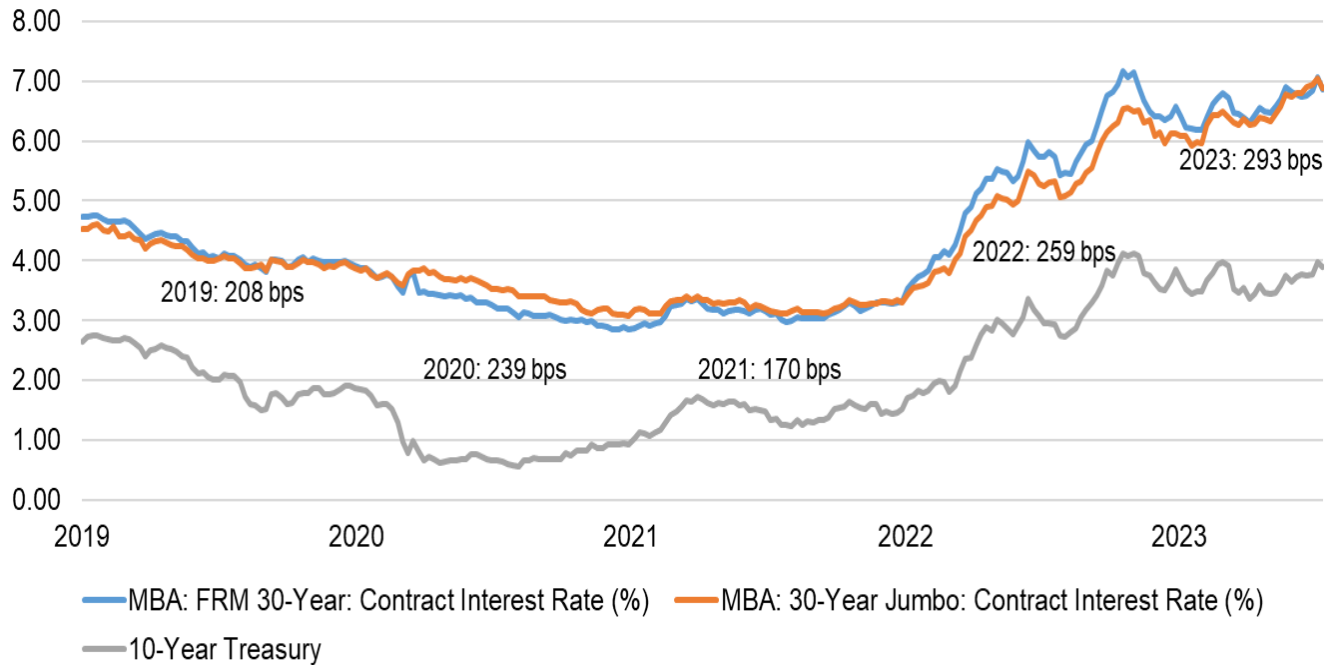
Source: Bureau of Labor Statistics

One key aspect of the current environment has been the extremely wide spread of mortgage rates relative to Treasury rates. This spread has historically averaged around 180 basis points, but since the spring of 2022 has averaged over 250 basis points, reaching a high of over 300 basis points. The exceedingly high level of interest rate volatility, the Fed’s balance sheet reduction/quantitative tightening (QT), and large asset/MBS sales from recently failed depository institutions are mainly responsible for these wider spreads. Beyond this effect, investors have been wary of the Fed’s eventual plans to move from passive roll-off of their large MBS portfolio to a period of active MBS sales, which we think is unlikely in the near term.

We are forecasting that the mortgage-Treasury spread will narrow slightly through the course of 2023 as investors realize this relative value, but do not expect that this spread returns to its more typical level below 200 basis points until later in the forecast horizon. Our forecast is that the 30-year fixed-rate is expected to drift down and end 2023 at just over 6 percent, as both Treasury yields and the spread narrow.

30-Year Fixed Rates and 10-Year Treasury Yield

Average Conforming-Treasury Spread from 2009 to 2018: 184 bps



Source: Mortgage Bankers Association, US Treasury

Given the current rate environment, refinance application volume remains stuck close to lows not seen since the early 2000s and our forecast is for a 52 percent decline in refinance volume to \$333 billion in 2023 from \$686 billion in 2022, and a 55 percent decline in refinance loan counts. Home equity lending could be a real source of growth for many lenders, as the millions of homeowners, with rates on their first mortgage below 4 percent, are not going to be interested in giving up those low rates, but still need to finance home improvements and other major expenditures.

With mortgage rates over 7 percent, purchase applications have been running close to 30 percent behind last year's pace. As a result, we have lowered our forecast for purchase origination volume for the forecast period. Purchase originations are expected to decline 15 percent by dollar volume to \$1.37 trillion from \$1.62 trillion in 2022. Purchase loan counts are expected to decline by 20 percent in 2023.

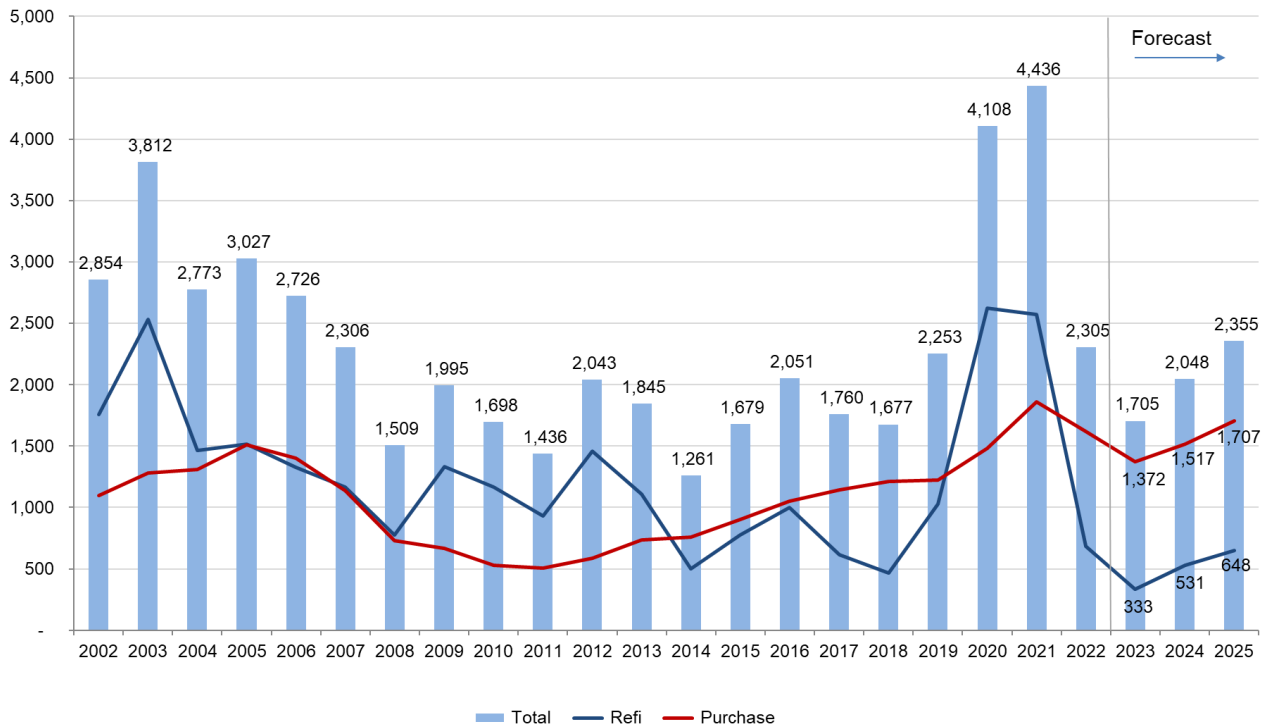
However, we retain our medium run optimism around housing demand: there are 50 million 28–38-year-olds in the US population right now. Household formation should remain robust for years, and many of these young people are at or approaching peak first-time homebuyer age. Demand should tilt towards first-time home buyers (FTHB) as many move-up buyers will be somewhat reluctant to leave low rates behind.

The composition of sales, however, is changing, with new home sales accounting for a larger share of home sales and available inventory. With rates at their current levels and existing homeowners staying

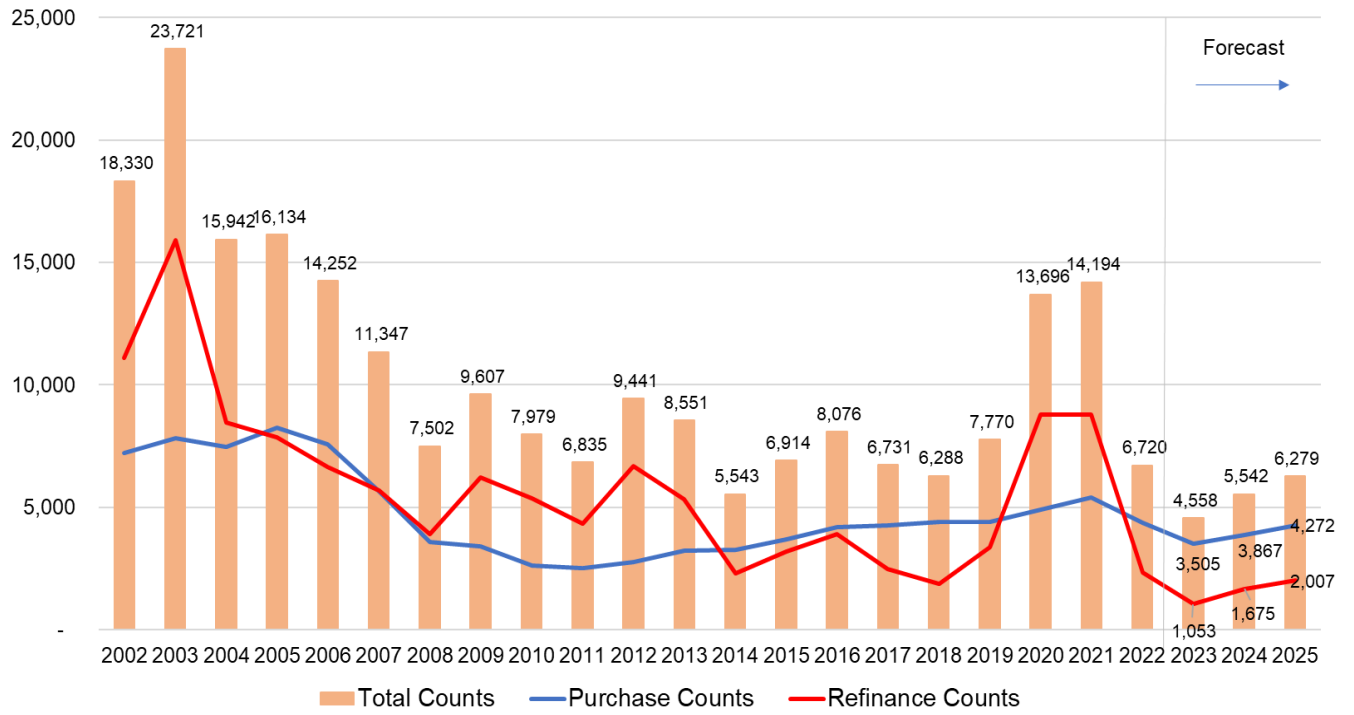
put, there are around 1 million existing homes for sale, compared to the 2000 to 2020 average of 2.4 million units. Current home buyers have turned to newly constructed homes as home builders continue to meet much of the demand, with single-family housing starts and permits on upward trends. From a recent Chart of the Week, we highlighted data from our [Builder Applications Survey](#) (BAS), which captures home purchase applications on newly constructed homes taken by mortgage companies affiliated with home builders, and the [Weekly Applications Survey](#) (WAS), which covers a broader sample of lenders who originate loans in the retail and consumer direct channels. The purchase applications from the WAS are predominantly for existing homes. The contrast in recent results is stark – the BAS, as of July 2023, shows a 35% annual increase in purchase applications, the sixth consecutive month of annual growth, while the WAS purchase index continues to show annual declines, with the July level of applications down almost 25% relative to a year ago.

The strength in the new home sales market will continue to support purchase growth until more existing inventory is freed up, either as rates decrease or as existing homeowners who need to move also turn to a newly constructed home, freeing up their home for sales. Our forecast for 2024 and 2025 is for gradual growth in purchase originations.

Mortgage Originations History and Forecast
\$billions



Annual Origination Counts (Thousands)



Source: MBA Forecast