Holding Steady

*MBA Economic and Mortgage Finance Commentary: August 2015*

Our outlook for this month is little changed from July. While the BEA revised its first quarter 2015 GDP growth estimate higher to show small positive growth instead of contraction, the advance estimate for the second quarter growth was lower than expected at 2.3 percent. However, recent data indicators have signaled that second quarter growth may have been stronger than the advance estimates showed, but the expectation is that some of that growth might have pulled forward from the third quarter. We expect GDP growth in the range of 2.7 to 2.8 percent in the second half of 2015, and have maintained our view that consumer spending will be a major driver of growth, especially if an acceleration in wage growth is realized. We also see residential fixed investment providing more of a lift to the economy as household formation recovers and residential construction gathers steam. Additionally, US payrolls continue to grow at over 200,000 jobs per month and measures of unemployment and underemployment continue to improve.

Global risks continue to dominate the outlook, as the market has been repeatedly buffeted by shocks from abroad over the past couple of years, fiscal crises in Greece, war in the Middle East and Ukraine, and most recently stock market drops and currency volatility in China. Each of these events has put downward pressure on US Treasury rates following a flight to quality by global investors. If any of these events were to worsen appreciably, it could damage business, consumer, and investor confidence.

The US 10 Year yield increased through June and dipped a little in July, and then continued to fall in August given some of the concerns above. We still expect an increasing trend to resume for the rest of the year as economic growth and labor conditions remain strong in the US, but expect shorter term volatility to remain. Our forecast is for the 10 Year to increase to 2.6 percent in the fourth quarter of 2015, averaging 2.3 percent for the year, then increasing to 3.1 percent in 2016.

Given recent indicators of prices and the condition of the labor market, we expect a September lift off in the fed funds rate. The unemployment rate continues to linger around the 5 percent mark and core
inflation, despite not yet breaching 2 percent, remains firm. The FOMC appears to have left the possibly of a September rate increase open and Fed officials continue to communicate that any rate increases will be gradual in nature, and that any rate increase schedule will not be fixed but instead will involve timely and data dependent judgment.

The BEA’s advance estimate of second quarter 2015 GDP growth showed that the US economy grew at a rate of 2.3 percent, a significant improvement from the 0.6 percent growth rate seen in the first quarter. The first quarter’s growth rate was revised up from a previously estimated contraction of 0.2 percent, but growth rates for 2012 and 2013 were revised lower. In terms of the first quarter revision, one major driver of the upward adjustment were business fixed investment, which went from subtracting 0.05 percentage points of growth to adding 0.52 percentage points to growth. In terms of quarterly growth, business investment was revised from a decrease of 0.3 percent to an increase of 3.3 percent. The second factor was the change in private inventory investment, which was revised to add an additional 0.42 percentage points of growth to the first quarter’s growth rate. For the second quarter of 2015, personal consumption expenditure (PCE) contributed 1.99 percent to the overall 2.3 percent growth rate, and that was split roughly evenly between goods and services spending. Business fixed investment was weak in the second quarter, providing a 0.07 percent drag to growth, its first negative contribution since the second quarter of 2012. After being a drag to growth for four of the previous five quarters, net exports contributed 0.13 percent to growth in the second quarter.

In terms of growth rates, PCE grew at a pace of 2.9 percent in the second quarter after a 1.8 percent growth rate in the first quarter. Nonresidential fixed investment decreased by 4.1 percent, the second decline in three quarters, as investment in both structures and equipment decreased.

As noted earlier, we expect GDP growth to pick up in the second half of 2015 and to be driven by consumer spending. Residential fixed investment is also expected to strengthen as household formation grows. Our forecast for GDP growth is 2.1 percent in 2015 and 2.4 percent in 2016.

The US economy added 215,000 jobs in July and has now averaged 211,000 jobs per month in 2015. While this is lower than the average of 260,000 jobs per month in 2014, it is still the second strongest year for monthly job growth since 1999. The majority of the increase in payrolls was in the private service-providing sector, while the goods producing and government sectors contributed smaller gains over the month. The unemployment remained unchanged at 5.3 percent, which was the lowest level since 2008. The labor force participation rate also held at 62.6 percent, its lowest level since 1977. The U6 measure of labor underutilization inched lower to 10.4 percent, the lowest the measure has been post-recession.
While the headline unemployment rate has been low, the U6 measure of underutilization has lagged due to lingering numbers of workers who are discouraged and marginally attached to the workforce, as well as workers who are working part time. However, the spread between the two seems to be shrinking at a faster rate in recent months.

Source: Bureau of Labor Statistics

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Overall inflation continues to be held down by low fuel prices but the year over year decrease in motor fuel prices has started to get smaller. Although fuel prices began to firm slightly over the past few months, they are still 22 percent lower than the same month a year ago. Core inflation, which excludes food and energy, increased 1.8 percent from a year ago in July, signaling that prices are not quite as weak as the headline number suggests. Growth in the shelter component leveled off a little in recent months, but picked up slightly in July, and remains high in terms of its year over year growth. We expect overall prices to stabilize over the next year and edge back up to the 2 percent mark during 2016.
Single family starts in July surged to the highest level since 2007, with a 12.8 percent increase over the month. Multifamily starts dropped 17.0 percent, but only after a 36.3 percent increase the previous month. Permits were down for both the single family and multifamily sectors, but multifamily permits went from 645,000 permits in June to 440,000 permits in July, a decrease of more than 30 percent. We saw an increase in total households toward the end of 2014 and expect to see increasing growth in owner households during the balance of 2015 and into 2016. Therefore, our outlook for housing starts is still that of an increasing trend, with single family starts averaging 712,000 units for 2015 and multifamily starts averaging almost 400,000 units. This growth is expected to continue into 2016, with single family starts reaching around 840,000 units and multifamily starts increasing to 410,000 units for the year.

Mortgage applications showed mixed results of late, with purchase applications seeing more muted activity, while refinancing picked up slightly as rates have fallen. Purchase applications remain almost 20
percent higher on a year over year basis despite recent week to week declines. Rates have decreased 15 bps over the past two months and the refinance index increased around 25 percent as a result.

Shifting gears to mortgage performance, MBA’s National Delinquency Survey results for the second quarter of 2015 showed a continuation in improving delinquency and foreclosure trends. Overall delinquency rates and the percentage of loans in foreclosure decreased in the second quarter and were at their lowest levels since 2007. Essentially every state in the nation reported a decrease in foreclosure inventory rates over the second quarter, reflecting a nationwide housing market recovery. The improvement also reinforced the positive impact of a strong job market on mortgage performance. Improving home prices and a stronger economy and employment situation provided opportunities for distressed loans to be resolved rather than be put into foreclosure.

The delinquency rate decreased to a seasonally adjusted rate of 5.30 percent, the lowest level since the second quarter of 2007, and a decrease of 24 basis points from the previous quarter, and 74 basis points from one year ago. The percentage of loans in the foreclosure process at the end of the second quarter was 2.09 percent, down 13 basis points from the first quarter and 40 basis points lower than the same quarter one year ago. This was the lowest foreclosure inventory rate since the fourth quarter of 2007, although this measure has not yet reached pre-recession levels, as backlogged and slow processes in judicial states continue to hold loans in the foreclosure process. The percentage of loans on which foreclosure actions were started during the second quarter was 0.40 percent, a decrease of five basis points from the previous quarter. The foreclosure starts rate was unchanged related relative to the second quarter of 2014.
Loans in Foreclosure and New Foreclosures
Started
Non-seasonally adjusted, percent

Source: MBA National Delinquency Survey

While only 40 percent of loans serviced are in judicial states, these states still accounted for a growing majority of loans in foreclosure, with around 67 percent of loans in foreclosure attributable to judicial states. For states where the judicial process is more frequently used, 3.41 percent of loans serviced were in the foreclosure process, compared to 1.15 percent in non-judicial states. States that utilize both judicial and non-judicial foreclosure processes had a foreclosure inventory rate closer that of the non-judicial states at 1.36 percent.

Recent mortgage vintages continue to perform well and much of the troubled loans are legacy loans that were originated prior to 2008. Combined with a stronger economy, healthier job market and rising house prices, we expect that delinquencies and foreclosures will continue to decline over time.

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We estimate a total of $1.37 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations will drive the increase, increasing to $801 billion in 2015 from $638 billion in 2014. Refinances are expected to be to $551 billion in 2015. For 2016, we expect $885 billion in purchase originations. However, rates will likely continue to rise and cause refinances to decline to $379 billion for a total of $1.26 trillion in origination volume in 2016. The chart below shows historical mortgage originations estimates as well as our forecast, and also reveals 2014 as the first purchase dominated market since the mid-2000s, with that trend likely to continue through 2015 and 2016.
Mortgage Originations History and Forecast

Source: MBA August 2015 Forecast