Higher Refinance Volume Expected for 2016

*MBA Economic and Mortgage Finance Commentary: August 22, 2016*

We have revised our projections for when and by how much rates will increase over the next two years. As noted in past commentary, the Brexit vote from June upset most markets, and as a result, Treasury rates plummeted to record lows in the weeks following. We are still seeing some lingering effects from this as rates have remained low since then. While the direct impact from Brexit on the US economy is likely to be minimal, there is still significant political uncertainty with regards to the path forward post-vote, as there was pre-vote. Our interest rate forecast has been revised lower once again, as investors around the world seek safety in US Treasury securities due to the murkiness around Brexit and other global growth concerns. We expect that the Fed will raise the Fed Funds rate only once this year, most likely in December.

Given the potential for broader financial market volatility, we also expect that rates will be lower for a longer period of time, and this will continue to support more refinance activity. Additionally, jumbo rates are at record lows for MBA’s series, which started in 2011, giving more borrowers with large loan balances financial benefits from refinancing. The on-going increase in refinance volume increases our forecast of refinance activity to $835 billion for 2016 relative to $749 billion in 2015, an 11 percent increase over the year. The refinance estimate is a $75 billion increase over our forecast from July.

In addition to the increase in refinance activity, lower rates also seem to be helping potential homebuyers enter the market. Even though financial market volatility may be causing some anxiety, the combination of low rates and a still strong job market in the US appear to be outweighing those fears for these homebuyers. Purchase originations are expected increase 11 percent in 2016 as well, totaling $981 billion, compared to $881 billion in 2015. Overall origination volume for 2016 is thus expected to be a total of $1.82 trillion compared to $1.63 trillion in 2015.

US GDP was lower than expected in the second quarter of 2016, with the second estimate for growth coming in at 1.2 percent for the quarter compared to our previous estimate of 2.3 percent, but we expect that will be made up in the third and fourth quarters. Most of the shortfall in the second quarter forecast was due to inventory investment that was likely pushed back and will add to growth in the third quarter. Consumer spending, which is over 60 percent of the level of GDP, continues to grow at a
healthy pace. Our forecast is for 2016 to realize 1.8 percent growth in real GDP, increasing to 2.2 percent in 2017.

One main reason that we remain optimistic on US growth and housing market health in general is the strong employment outlook in the US. The BLS reported a gain of 255,000 jobs in July, along with upward revisions for the prior two months, bringing the average job growth for the 3-month period to 190,000 jobs per month. Since a disappointing 24,000 total in May, which had caused some concern, payroll growth in June and July have been well over the 200,000 job mark. The unemployment rate remained unchanged at 4.9 percent in July, close to the lowest level since the start of the Great Recession in the 2008 and 2009 period. Labor force participation was also still low by historical standards at 62.8 percent, but ticked up slightly from the previous month. The U6 measure of labor underutilization, which accounts for labor potential outside the work force, moved up slightly to 9.7 percent, remaining near its lowest level since 2008.

Additionally, average hourly wage growth has started to accelerate, with the 2.64 percent year over year growth rate the strongest since December 2015. Beyond that, this rate of growth was the highest rate seen since 2009. We also saw a pickup in the Employment Cost Index for Wages in the second quarter of 2016, which showed a 2.45 percent year over year increase. The ECI for Wages had been showing growth of around 2 percent or less for all but one quarter since 2009. With a tight job market, we expect to see wage growth accelerate, which will help support the higher rate of consumer spending that is driving overall growth. This will also bode well for housing demand and mortgage performance.

![Average Hourly Earnings](chart)

**Average Hourly Earnings**  
Year over year percent change

Source: BLS
In a recent Chart of the Week, we thought it would be interesting to look at the profile of conventional purchase mortgages in our “new normal” housing market. Comparing data for the month of June going back five years, we saw average loan balances on conventional, home purchase applications increase steadily for 30 year fixed rate mortgages and for hybrid adjustable rate mortgages (ARM). Hybrid ARM loans typically have a 3, 5, 7, or 10 year fixed period. In June 2016, 30 year fixed products accounted for almost 88 percent of conventional purchase applications compared to 85 percent in June 2012, while the 15 year fixed and hybrid ARM loans accounted for around five percent each, compared to seven percent and five percent respectively in June 2012. Traditional 1 year ARMs and other fixed products accounted for around 2 percent.

Hybrid ARM loans have historically a product preferred by jumbo borrowers, who typically preferred the lowest possible monthly payment before either selling their homes or refinancing later on, particularly if ARM rates provide a substantially lower payment. However, with an extended period of low mortgage rates, the vast majority of borrowers have sought fixed rate loans instead, leaving only the highest loan amounts in the hybrid ARM space.

![Chart of the Week - August 12, 2016
Conventional Purchase Applications - Average Loan Size by Product](chart.png)

Data as of June 2016

Source: MBA Weekly Applications Survey, Monthly Profile of Mortgage Activity
Because applications for higher balance home purchase loans grew faster than for lower balance loans in recent years, average loan sizes on 30 year fixed loans were driven up as well. The 15 year fixed loan tends to be more popular with refinance borrowers, who have paid down more of their principal and/or who can afford higher monthly payments, which is why the average loan amount for this product was relatively flat.

As outlined at the beginning of the commentary, our estimates for mortgage originations have increased compared to last month’s forecast. We expect $1.82 trillion in total mortgage originations in 2016, with around $980 billion coming from purchase and $835 billion from refinances. The overall originations total for 2016 now exceeds the 2015 estimated total of $1.63 trillion, as does the refinance total. We also increased our estimates for purchase originations in 2017 and 2018, which are expected to continue to grow relative to 2016, as continued economic growth and a strong job market will support household formation. Household formation in turn is likely to boost housing demand. Incentives to refinance are expected to stick around a little longer with lower rates, but will still be sensitive to rate movements as the pool of potential borrowers who can refinance or benefit from refinancing is relatively small.

Source: MBA Mortgage Finance Forecast
Finally, an update on mortgage performance. In light of lower unemployment and continued job growth, we have seen a sustained trend of improvement in mortgage delinquencies and foreclosures, based on data from our National Delinquency Survey. The second quarter of 2016 did not see a major change in this improving trend but several key indicators hit historic lows. The mortgage delinquency rate of 4.66 percent was the lowest level since 2006, and well below the historical average for the period of 1979 to the present, which was 5.36 percent. The foreclosure starts rate of 0.32 percent was at its lowest level since the second quarter of 2000, and foreclosure inventory rate was at its lowest level since the second quarter of 2007. The seriously delinquent rate, loans that are 90 or days more past due or in the process of foreclosure, was at its lowest level since the third quarter of 2007. The FHA delinquency rate dropped to 8.46 percent, its lowest level since 2000. The FHA foreclosure inventory rate dropped 26 basis points from the previous quarter to 2.15 percent, its lowest level since 2001. Overall, the percentage of new foreclosures on FHA loans hit 0.48 percent, its lowest level since 1993. Based on these results, it is clear that mortgage performance has more than recovered from the housing crisis and Great Recession.

![Mortgage Delinquency Rate and Unemployment Rate](chart.png)

**Mortgage Delinquency Rate and Unemployment Rate**  
Seasonally adjusted, percent

Source: BLS, MBA National Delinquency Survey

However, as we noted in our most recent Chart of the Week, mortgage performance trends will continue to vary by geography as each market will see different cyclical impacts depending in their unique home price and employment trends, among other factors. For example, Texas experienced only
a modest run-up in real prices prior to 2007 and, buoyed by a then-strong market for oil, house prices did not fall very much in the years following, capping the rise in foreclosures. Contrast that with Florida, which had a large boom in prices and legal constraints on the foreclosure process which impeded the rate at which foreclosures were completed, causing a much more pronounced increase and accumulation of housing stock in foreclosure.

At the national level, recent loan vintages have shown much lower serious delinquency rates than older vintages, even as they start to season. Given tighter, more prudent underwriting and favorable economic conditions in recent years, we expect these trends to continue.

Source: MBA National Delinquency Survey