Economic growth continues to advance at a slow but positive pace, increasing 1.9 percent in the fourth quarter of 2016, according to the BEA’s advance estimate released at the end of January. This was only slightly lower than our forecast for 2 percent growth. Employment growth started 2017 with a bang, with the economy adding 227,000 jobs in January 2017, the strongest reading in six months, while average hourly wage growth moderated slightly, increasing 2.5 percent over the year. However, inflation rose sharply in January, with overall CPI inflation increasing faster than core inflation for the first time since 2014. Additionally, the 2.5 percent year over year increase in the CPI was the strongest since 2012. The core CPI measure, which excludes energy and good prices, also ticked up to its highest in six months. In combination, these factors point to rising rates in the US, even though external, international factors continue to exert downward pressure on rates, as well as some near term volatility. Our outlook is for these trends to continue for 2017 and 2018.

In its first meeting of 2017, the Federal Reserve voted unanimously to maintain their current monetary policy stance, keeping short-term rates unchanged, and maintaining their reinvestments for MBS and longer-term Treasuries. Given the continued improvements in the job market and the increases in inflation, we are holding to our forecast of three Fed rate hikes for 2017, with the first hike most likely coming in June, but could happen as early as their next meeting in March. We also expect that Federal Reserve officials will be talking much more in 2017 about tapering or stopping reinvestments, which could lead to wider mortgage-Treasury spreads. Additionally, in answering questions before the Senate Banking Committee last week, Chair Yellen said “The FOMC has announced that its longer run goal is to shrink our balance sheet to levels consistent with the efficient and effective implementation of monetary policy”, and surrounded that with more commentary on the Fed’s desire to not only carry a smaller balance sheet, but not rely on the balance as a monetary policy tool. She alluded to the reliance on short term overnight rates as the Fed’s traditional tool instead.

In our February 2017 forecast, we estimate that total originations will decrease to $1.57 trillion in 2017 from $1.89 trillion in 2016. This total will increase slightly in 2018 as a growing purchase market is offset by more declines in refinance activity as rates rise. We expect the 30 year mortgage rate will hit 4.7
percent by the end of 2017, reach 5 percent by the second half of 2018 and increase further to 5.5 percent by the end of 2019. With a large segment of borrowers having taken advantage of sub-4 percent rates in recent years, refinance volume will decrease even though rates in the 5 percent range are still very low by historical standards. Purchase growth is expected to be driven by accelerating household formation, which will in turn create more housing demand.

Source: MBA Forecast

GDP growth in the US for the fourth quarter of 2016 was 1.9 percent, based on the advanced estimate from the BEA, which is preliminary and based on an incomplete set of data. Economic growth is forecasted to be around 2.1 percent for 2017, then fall slightly to 1.9 percent in 2018 and 1.8 in 2019. We are still of the view that trend growth for the US economy is in the range of 2 percent.

Nonfarm payrolls grew by 227,000 jobs in January, higher than most analysts had expected. The annual revisions for 2016 were also released and 2016 totals were adjusted upward slightly in aggregate. Given the strong start to the year, we now expect that monthly job growth will be slightly higher than 150,000 jobs per month in 2017 even as the economy is essentially at full employment. The average hourly wage paid to workers increased by 2.5 percent on a year over year basis, a slight deceleration from December.
The unemployment rate increased to 4.8 percent from 4.7 percent in January 2017. Labor force participation moved up slightly to 62.9 percent as well. Labor force participation remains low relative to historical averages, but has increased slightly over the past two months. The U6 measure of labor underutilization, which accounts for the unemployed workers in the economy along with those marginally attached to the work force and those working part time jobs, increased to 9.4 percent from 9.2 percent. The U6 measure is well below its historical average of 10.6 percent, and the spread between the U6 and the unemployment rate has narrowed, and it is tighter than the long run average.

Overall CPI growth in January 2017 grew at a pace of 2.5 percent on a year over year basis, the fastest pace since 2012, as energy prices surged. Headline CPI exceeded core CPI, which excludes the volatile food and energy components, for the first time since 2014. Core inflation increased slightly to 2.3 percent, its strongest year over year increase in six months. Motor fuel prices increased 20.2 percent over the year, the largest annual increase since late 2011. Oil prices started to slide in late 2014 and have only recently begun to recover. Shelter prices, which are dominated heavily by rental costs, increased 3.5 percent in January compared to the year before. Shelter costs have been growing in the range of 3 to 3.5 percent since mid-2015. Sustained increases in rental costs have burdened renters since 2007 and are often blamed for preventing future homeowners from being able to save for a down payment on a home.

These results are particularly significant because accelerating inflation is often tied to an economy that is picking up, along with upward wage pressures. Additionally, with the recent discussion and
speculation surrounding when the Federal Reserve might next raise rates, more rapidly rising inflation provides more impetus for a rate hike, especially since the job market has been strong for some time now.

CPI and Selected Components
Year over year percent change

Source: BLS

The final point to highlight in this month’s commentary is that of mortgage performance. In the MBA’s National Delinquency Survey for the fourth quarter of 2016, the overall delinquency rate was 4.80 percent of loans serviced, an increase of 28 basis points from the previous quarter. This was the first increase in the delinquency rate since 2013 and was largely driven by an increase in 30 day delinquencies for FHA loans, even after adjusting for typical seasonal effects. We are not yet certain if this is the start of a trend or simply a one period blip, as the 30 day delinquency measure can be volatile.

The good news is that both foreclosure starts and loans in foreclosure continued to decrease. The percentage of loans on which foreclosure actions were started during the fourth quarter was 0.28 percent, a decrease of two basis points from the previous quarter, and this was the lowest rate of new foreclosures started since the fourth quarter of 1988. The percentage of loans in the foreclosure process at the end of the fourth quarter was 1.53 percent, down two basis points from the third quarter and was the lowest foreclosure inventory rate since the second quarter of 2007.
The serious delinquency rate, which captures the percentage of loans that are 90 days or more past due or in the process of foreclosure, increased to 3.13 percent from 2.96 percent in the third quarter, when the rate was at its lowest level since 2007. The increase in the fourth quarter was driven by an increase in loans 90+ days past due, even though loans in foreclosure continued to decrease. Over 70 percent of seriously delinquent loans were attributable to loans originated in 2007 and earlier.

Source: MBA National Delinquency Survey