Cold Start to 2016

In recent months, concerns about falling oil prices and economic slowdown in China have dominated the headlines. The market reaction, as measured by Dow Jones Industrial Index, has been a 20 percent decline in stock equity value, while the yield on US 10 year Treasury notes has fallen around 30 basis points as risk averse investors moved to safer assets. Domestically, there was a slight deceleration in growth at the end of last year as trade, inventory investment, and less investment on nonresidential structures held overall growth down.

Despite near term market turmoil and volatility, our outlook is for the US economy to return to trend growth levels of about 2 percent in 2016. We expect consumer spending to continue to drive economic growth, along with a gradual increase in residential fixed investment as housing demand grows. Despite still-slow wage growth, wage rates are expected to pick up as labor market conditions remain strong. Monthly payrolls are growing at over 200,000 jobs per month and the unemployment rate is down to 5 percent, while weekly unemployment claims are still trending down.

In its statement following the January meeting, the FOMC provided a slightly more cautious tone on the outlook, and held fed funds rates in the 0.25 percent to 0.50 percent range. We had been expecting two rate hikes in 2016 previously, and our view has not changed, although it is possible that the rate increases might be pushed later into the year. The Fed plans to continue to reinvesting proceeds from its securities holdings until the rate increases are well under way, and current market and financial conditions might push that back further.
The advanced estimate of GDP growth for the fourth quarter of 2015 reported a growth rate of 0.7 percent, the slowest rate since the first quarter of 2015. The main drags to growth in the fourth quarter were exports, business fixed investment, and inventory investment. Exports fell as weaker global economic conditions and a stronger US dollar impacted demand for US goods. Investment by businesses contracted for the first time since 2012, and for only the third time since 2009, the last year of the recession. Most of the decline in business investment was due to a drop in investment on structures.

Despite the slowdown in the fourth quarter, we expect GDP growth to recover to 2.3 percent in the first quarter, and finishing 2016 and 2017 at around that level as well, driven by consumer spending and residential investment.

Payroll employment, one of the most broadly watched job market indicators in the US, grew by 292,000 jobs in December 2015 and was accompanied by upward revisions totaling 50,000 jobs for the two months prior. The average monthly job growth count for 2015 was 214,000 jobs, marking 2015 as the second strongest year for job growth since 1999. In the fourth quarter of 2015, payroll growth averaged
over 280,000 jobs. The unemployment rate decreased from 5.7 percent in January 2015 to finish the year at 5.0 percent in December 2015, however the labor force participation also decreased from 62.9 percent to 62.5 percent over the same time frame. While the decline of the unemployment rate and measures of underutilization have been encouraging and signaled a stronger job market, the participation rate remains a concern.

Weekly unemployment claims, another key gauge of job market health, declined steadily through 2015. The quarterly average decreased from around 290,000 claims per week to 270,000 claims per week in in the fourth quarter of 2015.

The ratio of unemployed workers to job openings has dropped to the lowest level since early 2007. At the height of the recession, there were an average of 6.8 unemployed workers per job opening, but in the second half of 2015 that ratio is fallen to around 1.5 unemployed workers per opening. While this does not account for underutilization, this is a positive result nevertheless, as it signals a healthier job market.

Source: BLS

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market and increases the likelihood of more meaningful wage increases in the near future. The Employment Cost Index that the BLS publishes on the quarterly basis showed an increase of 1.95 percent in the fourth quarter of 2015 (compared to the same quarter a year ago), a slight increase from the 1.88 percent growth rate the previous quarter. This was still well below the historical average of 3.44 percent.

**Ratio of Unemployed Workers Per Job Opening**

Source: BLS

Inflation continues to be a key concern as a stronger dollar, lower oil prices, and lower import prices pushed most inflation measures lower than expected. In the most recent report on consumer prices from the BLS for December 2015, the overall CPI grew 0.7 percent on a year over year basis, the strongest growth since December 2014. Core CPI inflation, which excludes food and energy, grew at a pace of 2.1 percent compared to the same month a year ago, the first time core inflation has been greater than 2.0 percent since 2012. Motor fuel prices have seen their decline ease, but still remain around 20
percent lower than a year ago. Prices on shelter continued to remain firm and contributed to the upward pressure on the broader CPI measures. Slow inflation growth is another reason we expect that the Fed may delay its next rate increase, even though some of these factors are seen to be temporary.

**Headline and Core Inflation Trends**

*Year over year percent change*

![Graph showing headline and core inflation trends from January 2008 to September 2015. The graph displays the percent change in the Consumer Price Index (CPI) for all items and all items excluding food and energy. The graph shows a strong upward trend from early 2008 to mid-2009, followed by a decline until early 2010. From mid-2010 to early 2012, the trend is relatively flat, with a slight increase in early 2012. From mid-2012 to early 2013, the trend shows a decline, followed by a slight increase in early 2013. From mid-2013 to early 2014, the trend is relatively flat, with a slight increase in early 2014. From mid-2014 to early 2015, the trend shows a decline, followed by a slight increase in early 2015. The graph ends in September 2015.*

Source: BLS

Most housing measures rebounded in December following a weak November readings. Existing home sales for December 2015 increased to 5.46 million SAAR, a 14.7 percent increase from 4.76 million units in November. On a non-adjusted basis, home sales were 6.1 percent higher than a year ago. Even with the increase, the December pace is only the highest since September 2015. Previous months’ numbers were unrevised. The share of first time homebuyers (as a percent of existing home sales) increased to 32 percent in December from 30 percent in November, and this was the highest share since August 2015.

The December total brings the Q4 average to 5.18 million units, compared to our forecast of 5.1 million units. The average annual pace for 2015 was 5.23 million units and was the strongest year since 2006.

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Census reported that new home sales for December were a SAAR of 544,000 units. This was a 10.8 percent increase from the 491,000 unit pace in November. On a non-seasonally adjusted basis, sales were up 8.6 percent YOY to 38,000 units (vs 34,000 units in November), the 3rd straight month of YOY increases. This brought the 2015 average to 502,000 units compared to our forecast of 496,000 units.

The Census reported that single family starts declined in December from an upwardly revised November number, but permits increased. Single family starts decreased 3 percent to 768,000 from 794,000 starts (upwardly revised from 768,000 units). Decreases were across all regions. Multifamily starts had a small decrease, dropping to 381,000 units from 385,000 units, and permits decreased substantially, going to 492,000 permits from 555,000 permits. The 555,000 level in November was likely more of an outlier, since that was the highest since June 2015. These results bring the Q4 2015 single family number to 759,000 units vs our forecast of 745,000 units, and 374,000 units vs our forecast of 380,000 units for multifamily.

The chart below is a summary of seasonally adjusted purchase applications, existing home sales, and new home sales trends over the course of 2015. All three measures were benchmarked to start at the same point (index = 100) in January 2015. By the end of 2015, all three series saw positive growth, but growth in new home sales was the weakest by this measure.

Source: Census, MBA, NAR
The 30 year fixed mortgage rate is expected to average around 4.3 percent in 2016, compared to 3.9 percent in 2015. Our forecast is for the mortgage rate to continue to increase to 4.9 percent in 2017 and 5.4 percent in 2018.

We estimate close to $1.5 trillion in mortgage originations for 2015, compared to $1.26 trillion in 2014. However, rates will likely continue to rise and cause refinances to decline for a total of $1.4 trillion in origination volume in 2016. Even though rates received yet another reprieve this month, we do not expect a significant bump up in refinance activity as the pool of eligible borrowers remains small.

The chart below shows historical mortgage originations estimates as well as our forecast. Even with the significant percentage increases in purchase volume expected, the level of purchase originations in 2016 is expected to just match the level of purchase originations in 2000, considerably below levels from 2007. From 2016 on, we expect that the level of purchase originations will continue to increase before reaching the $1 trillion mark in 2018.

![Mortgage Originations History and Forecast](chart.png)

Source: MBA Jan 2016 Forecast

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