MBA

RESEARCH AND ECONOMICS

MBA Forecast Commentary

Joel Kan

Outlook for 2017

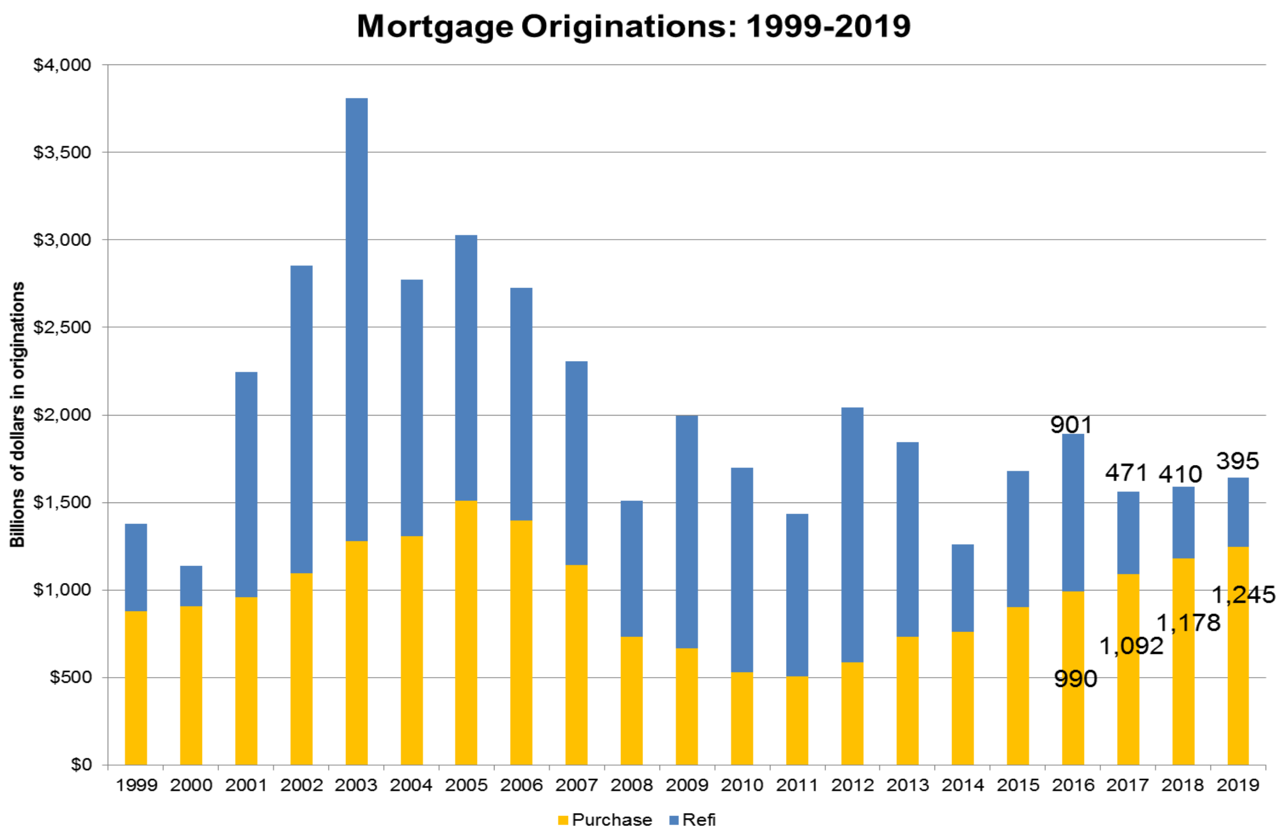
MBA Economic and Mortgage Finance Commentary: January 20, 2017

As we usher in a new presidential administration, much remains to be seen as to what the form, timing, and impact of proposed policies will be. Tax reform, health care reform, immigration reform, and infrastructure spending may all influence growth, positively or negatively depending on their specifics. Moreover, policy changes that could reduce international trade are a cloud on the horizon. We will continue to monitor these developments and will incorporate them into our forecast as and when the information is available.

In last month's commentary, the Fed's December statement and Chair Yellen's remarks at the following press conference confirmed our expectation for three rate hikes in 2017, as they projected at least three hikes in each of the next three years. Chair Yellen also indicated that in addition to a more upbeat forecast regarding the economy, some FOMC members also incorporated into their projections some chance of a tax cut or other stimulative policy from the incoming administration. The published minutes from the December meeting confirm and in fact reinforce the messages delivered in December, as do recent speeches by other Fed officials.

Employment growth is healthy, wage growth is picking up, as is Inflation. In combination, these factors point to rising rates in the in 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.

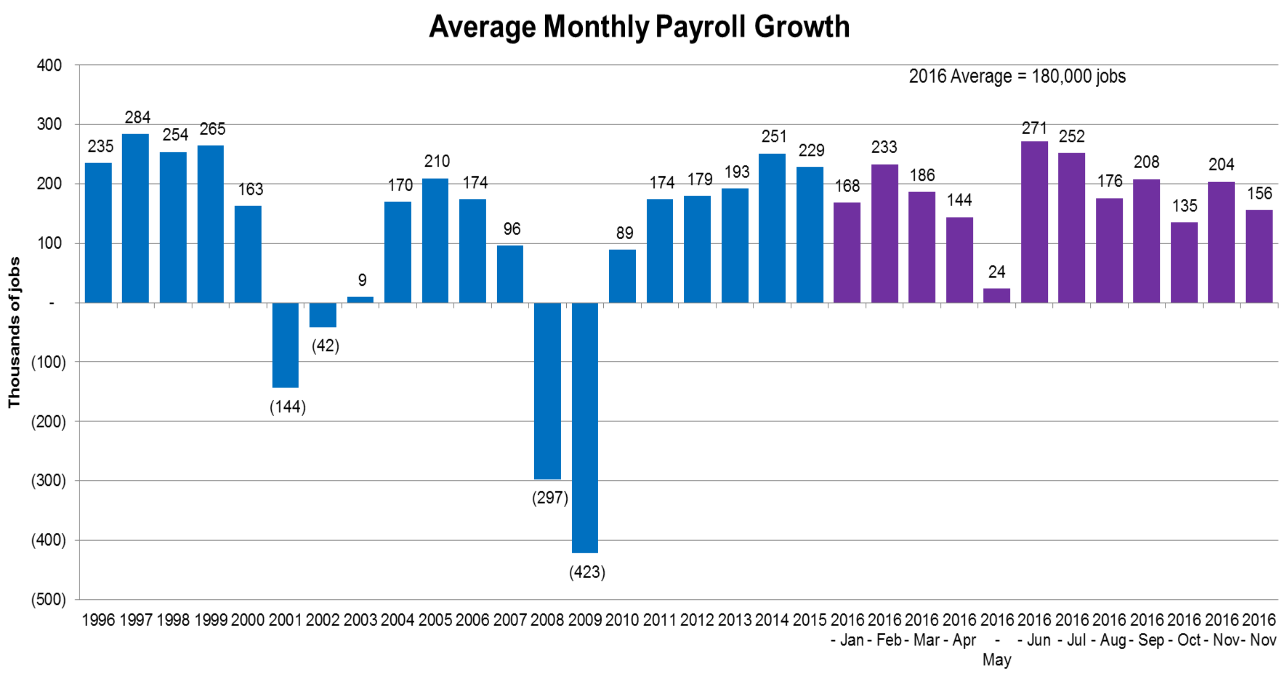
In our January forecast, we estimate that total originations will decrease to $1.56 trillion in 2017 from $1.89 trillion in 2016. This total will increase slightly in 2018 as a growing purchase market is offset by more declines in refinance activity as rates rise. We expect the 30 year mortgage rate 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.



Source: MBA Forecast

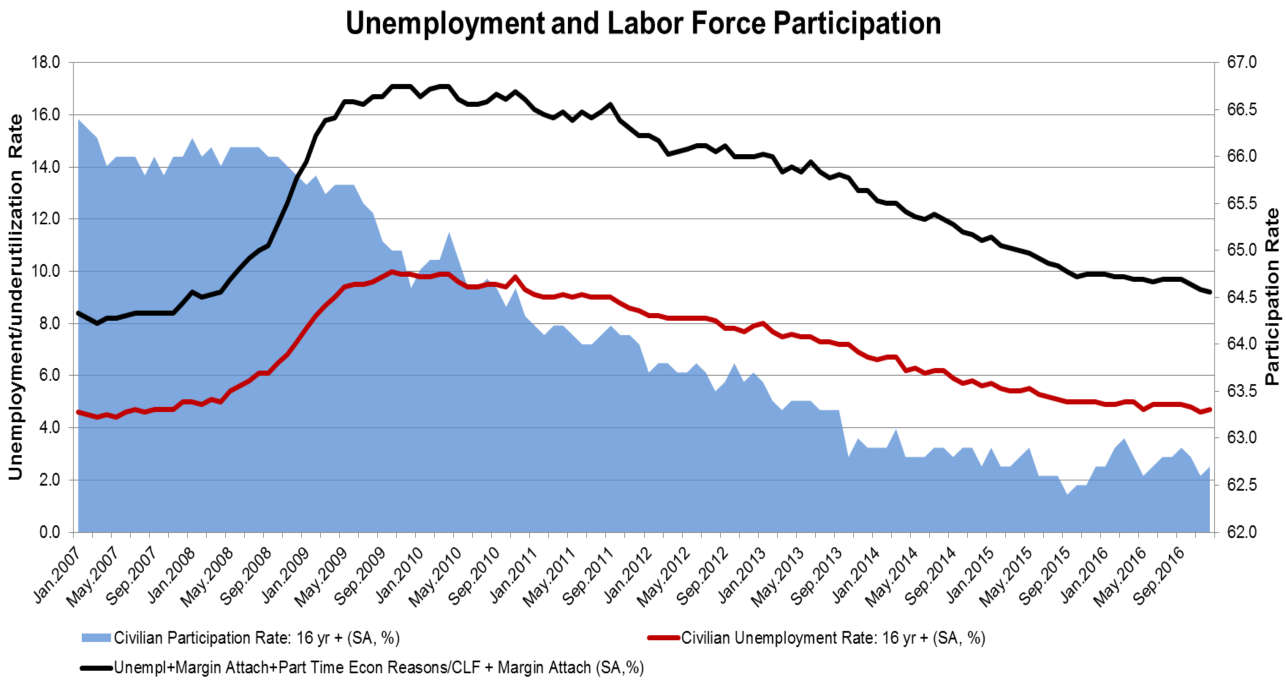
GDP growth in the US for the third quarter of 2016 was estimated to be 3.5 percent, an upward revision from the 3.2 percent growth rate previously published. This was the fastest pace of expansion since 2014. Consumer spending continued to show positive growth, driven by strong durable goods consumption, while residential fixed investment saw a second straight quarter of negative growth. Solid employment conditions along with increasing consumer confidence and sentiment will continue to drive consumer spending. While there is still uncertainty over the policy landscape, businesses should start to get more concrete information once the new administration is in, and may start to be more confident in making capital investment decisions. 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 156,000 jobs in December, with November's total revised upward to just over 200,000 jobs from the 178,000 jobs previously reported. The average monthly job gain for 2016 was 180,000 jobs, still a solid year by recent standards. We anticipate that monthly job growth will remain in the 150,000 jobs per month range or slightly lower in 2017 as the economy is essentially at full employment. The average hourly wage paid to workers increased to 2.9 percent on a year over year basis, marking the strongest month of wage growth since 2009. This may also be a sign that we may see a more sustained trend of wage growth in 2017. For certain positions within the mortgage industry, companies have started to increase wages to attract and retain workers who have the appropriate skillset. Nationally and across all industries, hiring continues to lag the number of job openings that employers are trying to fill, so on aggregate, we expect a continuation of this trend of faster wage growth.



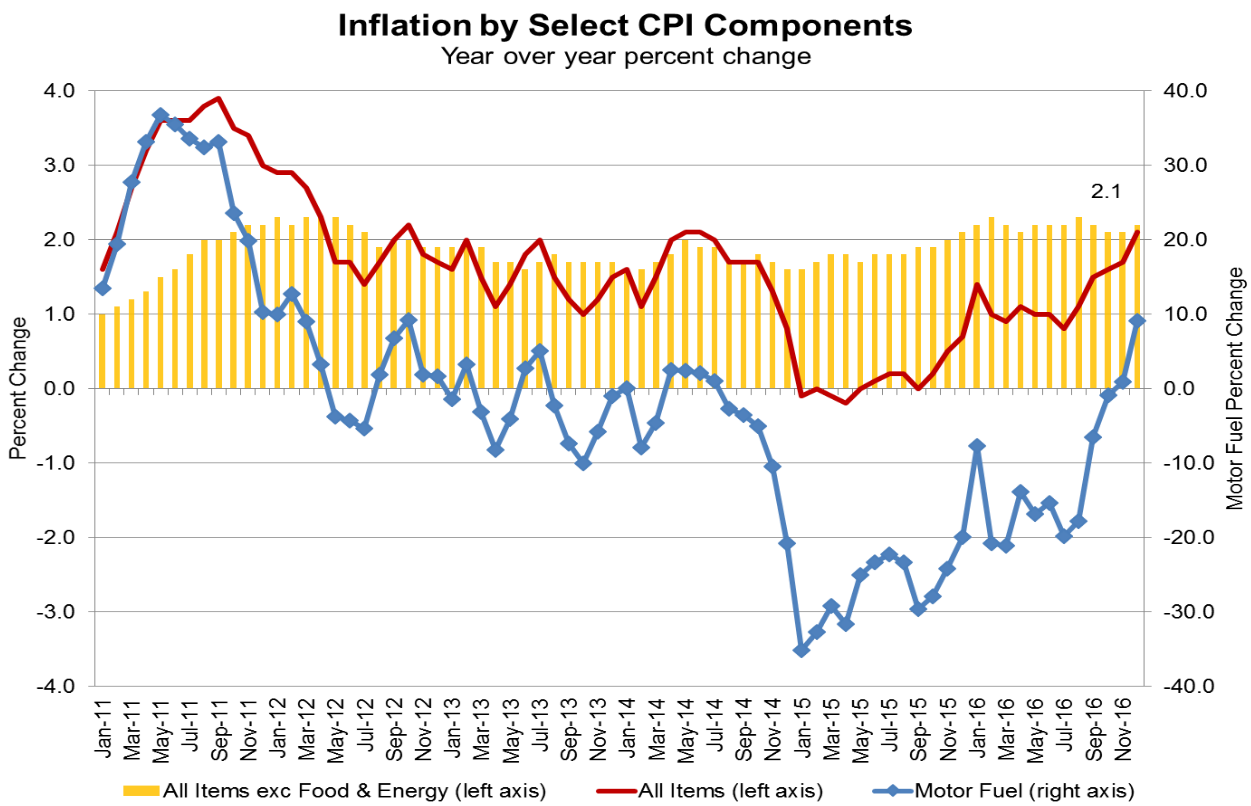
Source: BLS

The unemployment rate increased to 4.7 percent from 4.6 percent in November. Labor force participation moved up slightly to 62.7 percent, but the employment to population ratio remained unchanged at 59.7 percent. Labor force participation remains low for most educational attainment groups, and especially for workers between 16 to 19 years of age. 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, decreased to 9.2 percent from 9.3 percent. The U6 measure is now well below its historical average of 10.6 percent, and the spread between the U6 and the unemployment rate is down to 4.5 percent, 20 basis points tighter that the long run average.



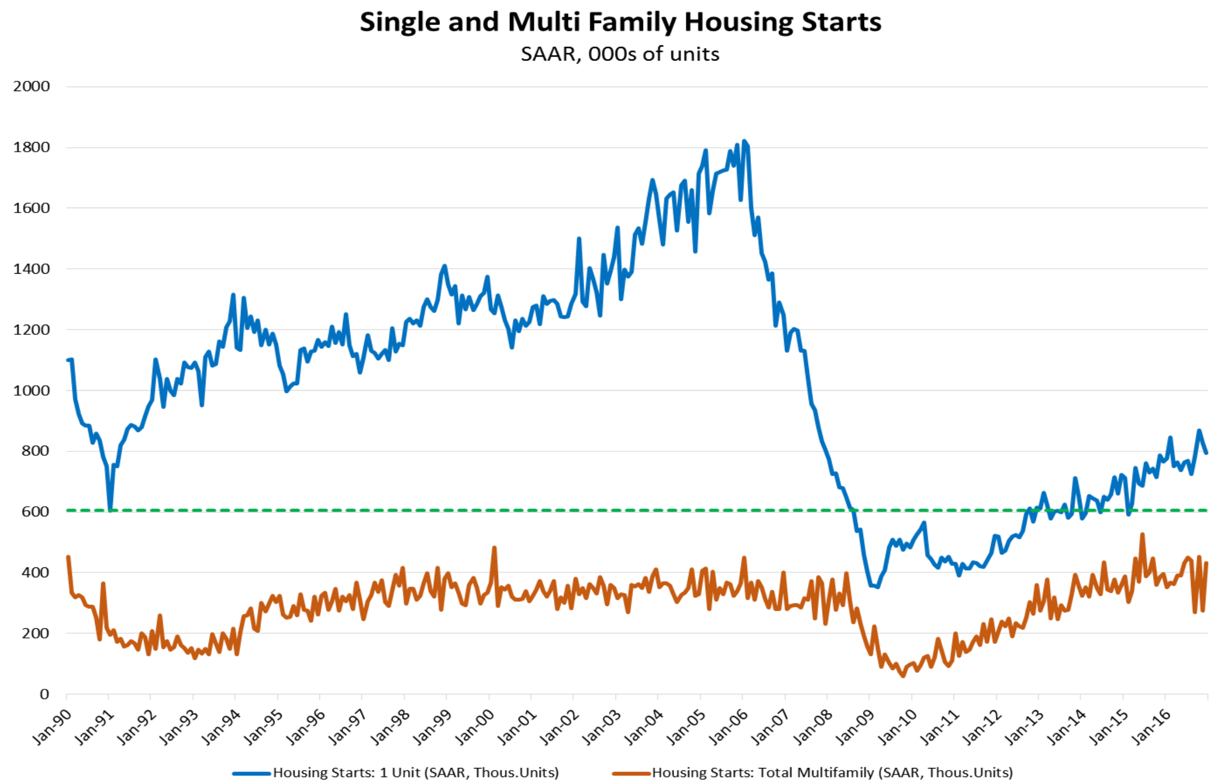
Source: BLS

Headline CPI growth in December 2016 on a year over year basis hit 2 percent for the first time since 2014, which coincided with the slide in oil prices. Energy prices increased 5.4 percent over the year, and this was driven by the motor fuel component, which increased 9.1 percent. This was the second consecutive increase in motor fuel prices, and the largest increase since 2012. Shelter prices, which are dominated heavily by rental costs, increased at 3.6 percent rate in December compared to the year before. This was the second straight month were shelter prices increased at that rate, and the increase in shelter costs were the largest since 2007. Core inflation, which excludes energy and food prices, increased slightly to 2.2 percent.



Source: BLS

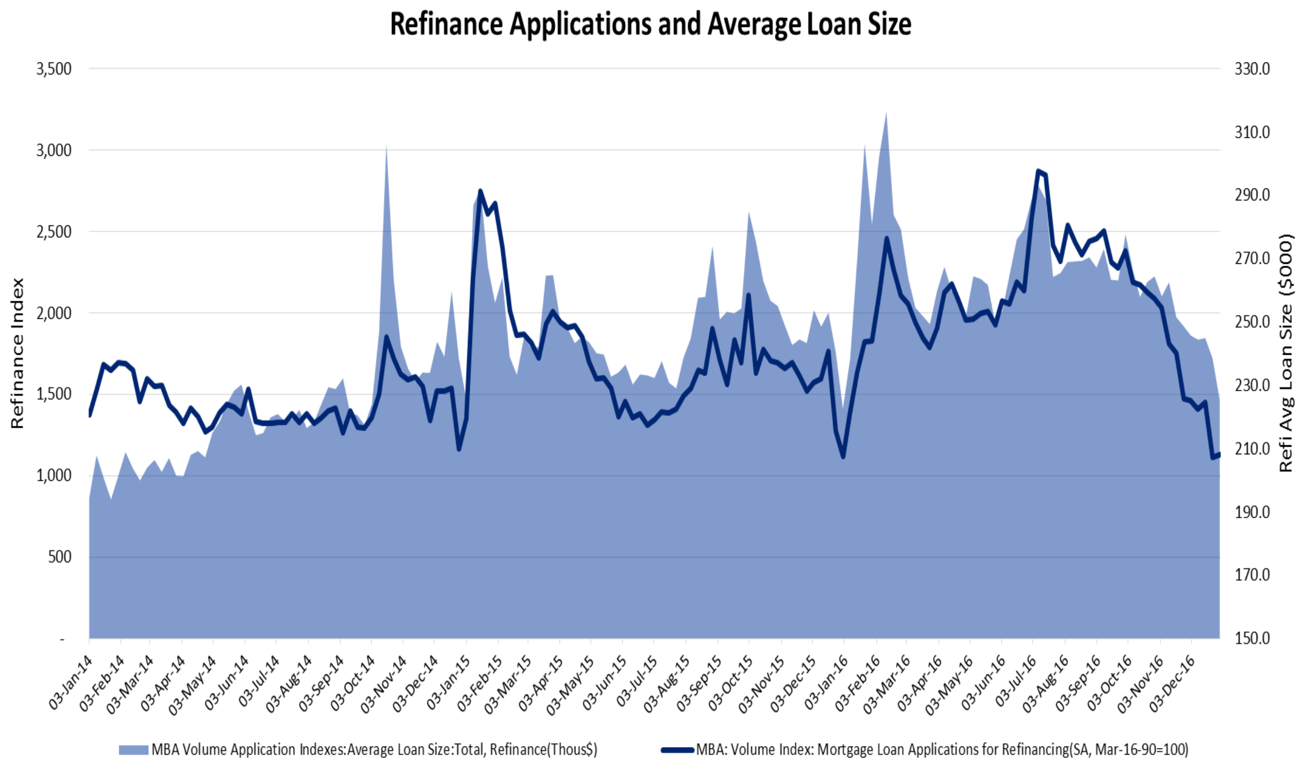
Single family housing starts remained strong in the fourth quarter, up almost 10 percent from a year ago, while multifamily starts, despite some volatility, were 1.6 percent higher than the fourth quarter a year ago. Single family starts did decline in November and December, but averaged 830,000 units for the quarter, the strongest quarter since 2007. Multifamily zigzagged their way through the fourth quarter, bouncing between 270,000 and 450,000 units. We have started to see a leveling off of multifamily starts in recent months. Single family starts however, increased in December and that contributed to the strongest month and quarter since 2007 for permits. However, even with the strong finish to 2016, single family starts remain well below the levels seen in the 1990s and early 2000s. We expect that single family housing starts will continue to increase gradually over the next two years, reaching 1.36 million units in 2018, but that multifamily starts will level off around the 400,000 unit mark.



Source: Census

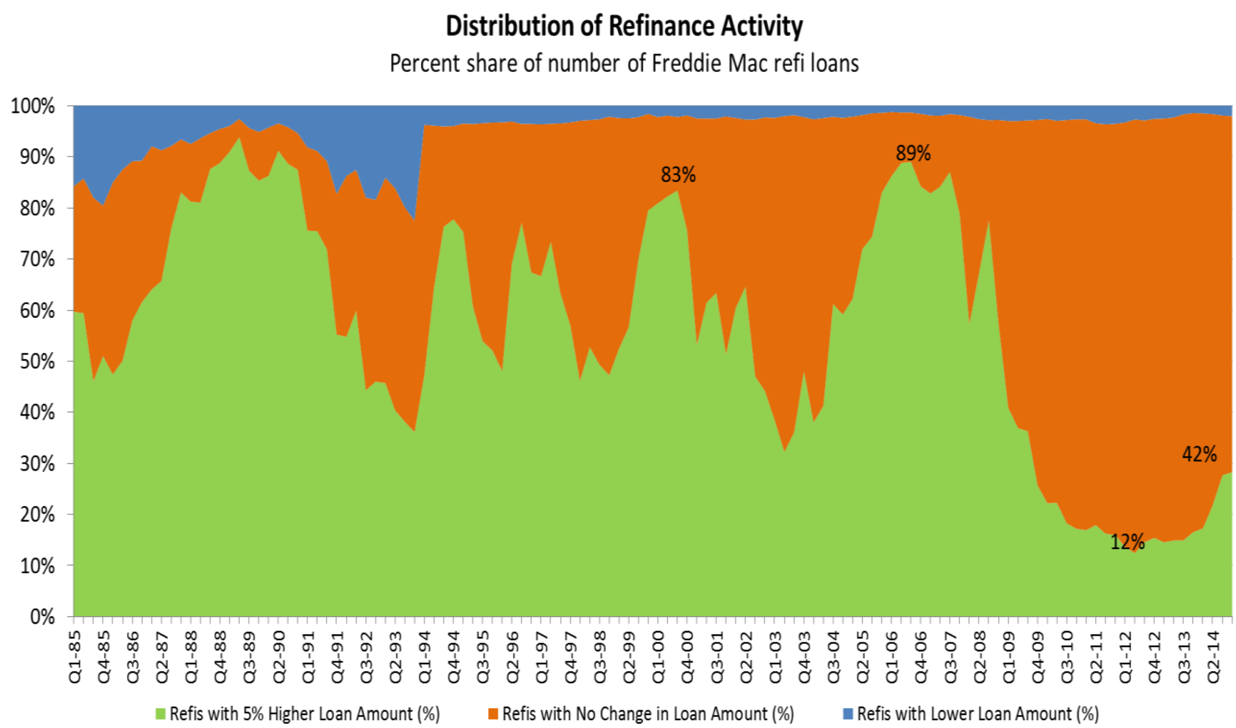
Applications for home purchase loans saw small gains in November and December, on a seasonally adjusted basis. However, on a non-adjusted basis, purchase applications were down compared to December 2015, the first year over year decline since December 2014, even if it was only by 0.5 percent.

Refinance applications in December came in much lower than we had previously expected, decreasing 25.7 percent as rates increased 50 basis points since early November following the presidential election. This prompted us to lower our first quarter 2017 refinance originations slightly. We noted how much more sensitive to rate movements were earlier in the year following a long period of historically low rates so the drop did not come as too big of a surprise. Additionally, the size of refinance loans were extremely dependent on rates in 2016 and we saw more of that relationship in recent weeks as the number of applications for higher loan balance refinances dropped as rates increased.



Source: MBA Weekly Applications Survey

As discussed earlier in the commentary, home purchase volume will be supported by a robust job market, a younger generation slowly moving toward homeownership age, and as increased housing transactions will facilitate more move-up buying. Refinance volume is expect to continue to slide, decreasing to $471 billion from $901 billion in 2016, as rates increase around 80 basis points on average from 2016 to 2017. After previous waves of refinancing over past three years, a large portion of borrowers have locked into lower rates and there are fewer left to take advantage of current rate levels. We expect that remaining refinance borrowing will be from borrowers still rebuilding home equity or borrowers who might want a cash-out refinance. However, as rates begin to rise, existing borrowers with record low interest rates may be hesitant to use cash-out refinancing as a means of accessing their home equity. This may lead to greater use of closed-end seconds, HELOCs, personal loans, or other debt to finance home improvements and other big ticket items. As shown in the chart below, the share of cash-out refinances within Freddie Mac loans has started to pick up, albeit from low levels.



Source: Freddie Mac