RESEARCH AND ECONOMICS

MBA Forecast Commentary

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Tax Reform Expected to Boost Growth

MBA Economic and Mortgage Finance Commentary: January 22, 2018

As discussed in last month's commentary, we still view the TCJA as boosting overall GDP for around a quarter of a percentage point in 2018 and 2019, and pushing inflation lower than previously estimated. Rates have moved higher over the month, not solely due to increased optimism following the passing of the TCJA, but also on stronger global growth, a job market that remains tight, and increased inflation expectations. Ten year treasury yields averaged 2.4 percent in December 2017 but averaged 2.54 percent to date in January 2018.

For housing, the impact of the tax plan is likely to be minimal for most of the country, perhaps more of a negative for some higher income borrowers in some of the highest cost markets in the Northeast and California. We have not changed our expectations for home price growth and still expect modest deceleration over the next couple of years. Supply constraints are still the driving factor behind home price growth.

Given some of the changes to MID, property taxes, etc., which are headwinds for the housing market, while the stronger economy will be a tailwind, we expect those factors to essentially offset each other, so our originations, home sales, and home price forecasts are little changed from the prior forecast.

We view it as positive that Congress kept the capital gains treatment for primary residences at current law. The prior bills would have extended the required hold period for these properties and that would have slowed move up buyers. On HELOCs, this is definitely a negative for demand, but we are already seeing outstanding HELOC balances shrinking.

The final employment situation report for 2017 released by the BLS reported a gain of 148,000 jobs for December. The 2017 average of 171,000 jobs added per month was the lowest since 2010, but it was still close to averages observed over the past six years. See figure 1. The unemployment rate was 4.1 percent in December, the third consecutive month at that level, and the lowest since 2000. Another main measure of unemployment and labor underutilization, the U6, increased slightly to 8.1 percent after being at 8.0 percent the prior two months. While the December payroll growth total was below average, it was closer to more sustainable levels of job growth given how low unemployment is.

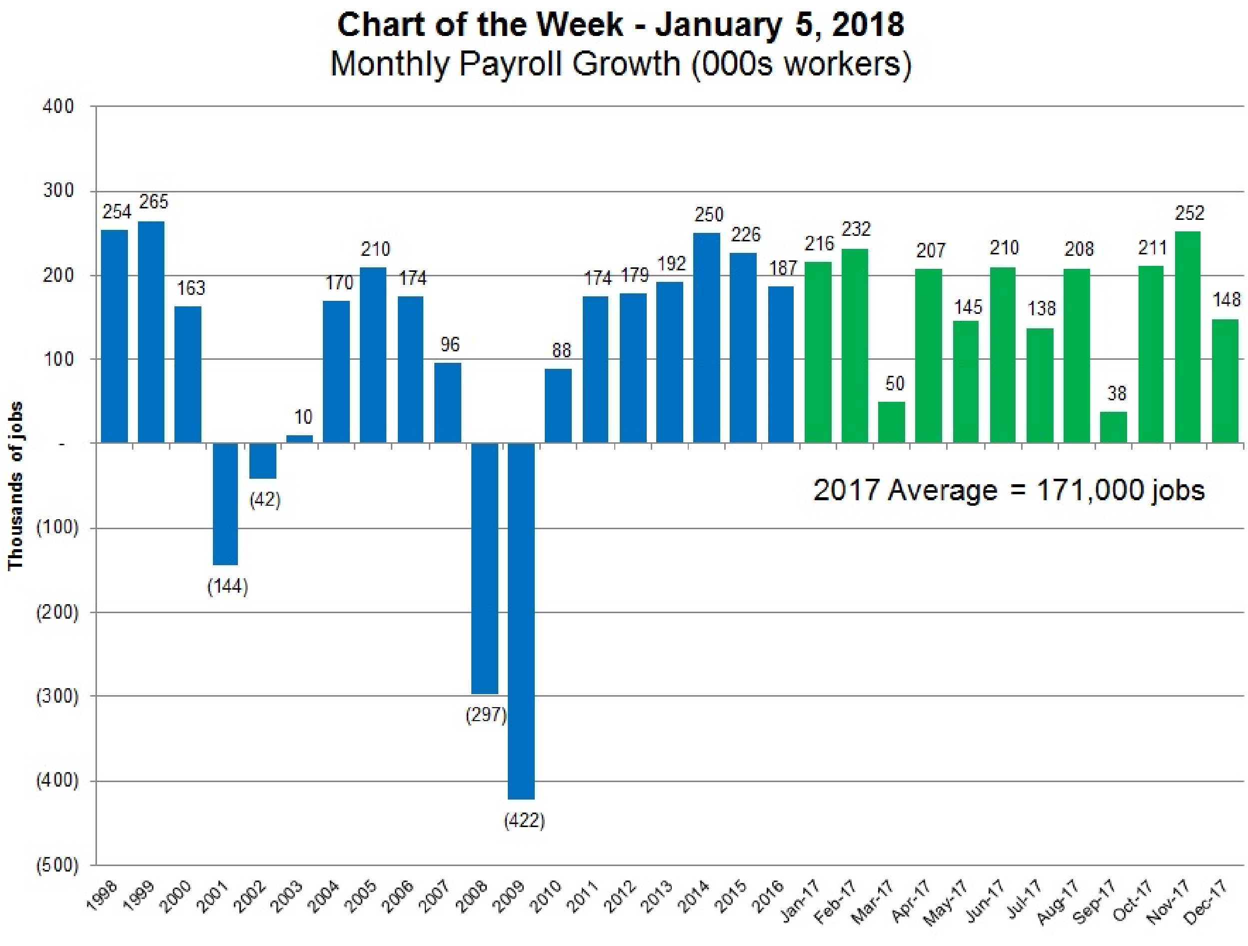
We expect job growth in the range of 150,000 per month in early 2018 and a slow deceleration to around 100,000 jobs per month by the end of 2018. Given the potential for growth spurred by the new tax reform plan, the unemployment rate is expected to decrease slowly through 2018, bottoming out at 3.7 percent in the fourth quarter of 2018. Additionally, according to data from the Atlanta Fed's measure, wage growth continues to grow slowly, led by prime age workers. Figure 2 shows how prime age workers are seeing a higher wage growth path than the overall workforce, illustrating compositional factors that may be holding overall wage growth lower.

Given the boost to growth, we have moved to four Fed hikes in 2018 (same as our December forecast) and higher ultimate rate for the Fed funds target, and a lower unemployment rate path. All in, we think tax reform is a net positive for the macro economy. The Fed is allowing their holdings of Treasury securities to roll off at an increasing rate over time. With each increase in the run-off cap, the likelihood goes up that interest rates could rise and the spread between 10 year treasuries and mortgage interest rates could widen, as additional alternative investors must be attracted to these securities.

Additionally, inflation and a rising budget deficit continue to exert some upward pressure on rates. CPI data for December showed core inflation that increased slightly to 1.8 percent from 1.7 percent, while overall inflation dipped slightly following a decline in motor fuel prices. Figure 3 shows the CPI trends as well as some major components that drive the indexes. We expect rates to reach 3.0 percent by the end of 2018 and increase further to 3.4 percent by the end of 2019.

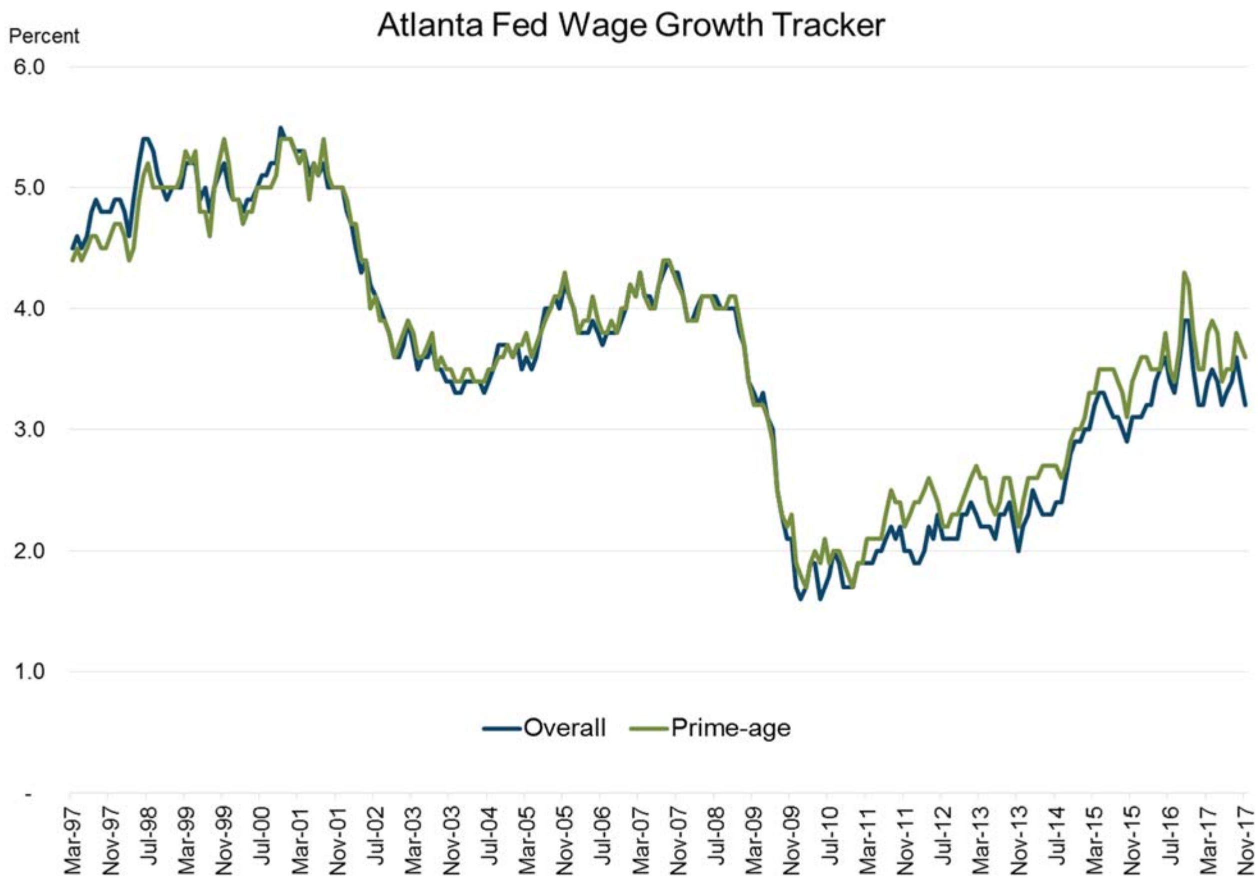
Similar to our December forecast, mortgage originations are expected to decrease in 2018 relative to 2017, led by a continuing slowdown in refinance originations, which are forecast to drop to $426 billion from $600 billion in 2017. Purchase volume is expected to increase to $1.18T from $1.11T, as supply continues to limit growth, even as housing demand remains strong and demographic factors favorable.

Figure 1.



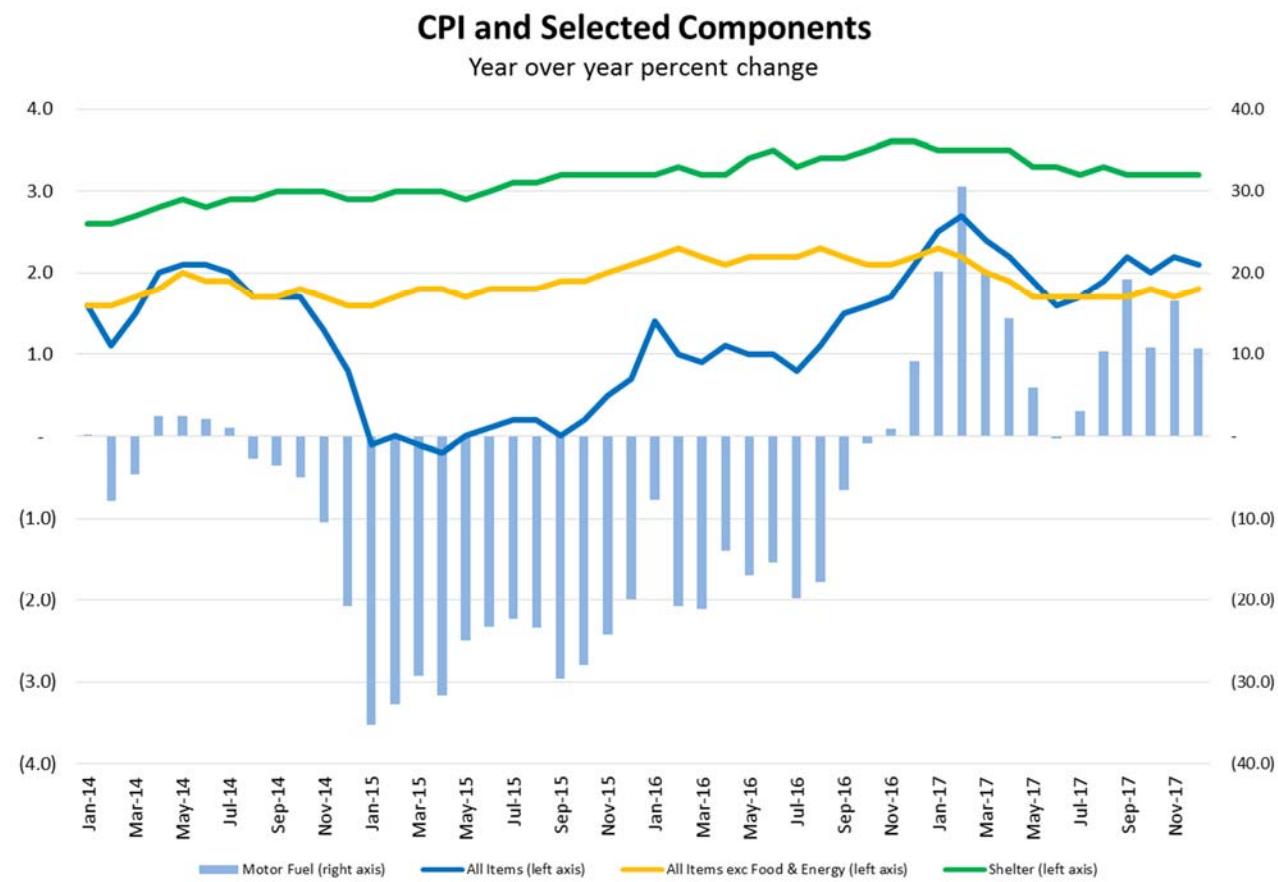
Source: BLS

Figure 2.



Source: Federal Reserve Bank of Atlanta

Figure 3.



Source: BLS