MBA Forecast Commentary
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Stronger Data Lead to Upward Revisions in Purchase Originations Forecast for 2015 and 2016

MBA Economic and Mortgage Finance Commentary: July 2015

The housing market recovery has shifted to a higher gear. We have revised upwards our estimates and forecasts for home sales and home prices, and the cash share of purchases has declined. All of these factors point to higher levels of purchase originations. Revisions to our purchase origination forecast in July result from changes in our expectations about the rate at which purchase applications and housing sales translate into dollars of mortgage originations. Overall, we believe that pull-through rates have increased, reflecting incremental but important changes in borrower behavior and lender underwriting practices, as well as changing average loan sizes and falling cash shares.

As a result of the changes outlined, purchase originations are now expected to increase to $801 billion in 2015, an upward revision from $730 billion in last month’s forecast, and from $638 billion in 2014. For 2016, we increased our forecast to $885 billion in purchase originations.

More sales are being financed, and more applications are being approved. And we expect that this trend will continue into 2016 and beyond, as the broader economy and job market continue to improve. The stronger job market and somewhat higher levels of inflation will lead the Fed to hike in September, and we expect that mortgage rates will hit 4.5 percent by the end of the year. However, the positive of the stronger job market will outweigh any negative of somewhat higher mortgage rates.

The increase in rates will continue to nudge refinance volume down as expected. Our forecast for refinance mortgage originations remains the same as last month. Refinances are expected to be $551 billion in 2015, compared to $484 billion in 2014.

As a result, total originations are expected to be $1.35 trillion in 2015 and $1.26 trillion in 2016, compared to $1.12 trillion in 2014.
Following a weak first quarter where US economic growth was estimated to have contracted by 0.2 percent, the second quarter has provided a more solid growth picture. Industrial production and the manufacturing sector have started to reverse their first quarter declines, and consumer spending had been encouraging until a slight setback in June. Labor and housing market indicators have also reflected trends of sustained growth. Payrolls returned to more healthy growth levels after some weakness in March and April, the unemployment rate is at a seven year low, and weekly unemployment claims continue to move lower. If there is any cause for concern in the job market, it might be that the participation rate dropped to the lowest level since 1977, however, the employment to population ratio is still higher now than it was back then. New and existing home sales moved up in recent months, as did housing starts, as we see a stronger economy supporting more housing activity again.

Global risks continue to dominate the outlook, as the debt crisis in Greece has still not been fully resolved, with the possibility of contagion effects to other European countries still lingering, and a slide in the Chinese stock market that has renewed concerns of a bigger slowdown in Chinese economic growth. Overall, these concerns will continue to keep US longer term rates lower than they otherwise would be.

The US 10 Year yield continued to increase given a path of stronger growth and the concerns above, and the June average of 2.36 was at the highest level since September 2014, and 48 basis points higher than the low point of the year, when the rate averaged 1.88 in January 2015.

The FOMC still has left the door open to increase the fed funds rates in September 2015. While we expect a September lift off in the fed funds rate, Chairwoman Yellen communicated again in recent testimony that any rate increases will be gradual in nature, and that the committee remains data dependent and will not pursue a rate increase schedule that is “mechanical” in nature, and we expect that this approach will be favored once they decide to act.
Delving a little deeper into the BEA’s final estimate of first quarter 2015 GDP, which showed that the US economy contracted at a rate of 0.2 percent, we find that the economy underperformed for most major GDP categories except residential fixed investment and imports. Personal consumption expenditures (PCE), which accounts for 60 to 70 percent of GDP and the largest driver of GDP growth, saw a significant deceleration in growth from 4.4 percent in the fourth quarter of 2014 to 2.1 percent in the first quarter. The 2.1 percent growth rate was the lowest since the first quarter of 2014. The deceleration was caused by slowdowns in purchases of both durable and non-durable goods, with durables however, being the more severe impact. Growth in durable goods spending was 1.3 percent in the first quarter, the worst rate since the second quarter of 2011 when durable goods spending contracted 2.6 percent. Given our forecast for a stronger employment picture in the second quarter and upward pressure on wages, PCE growth should start to move back toward the three percent level in the coming quarters.

Nonresidential fixed investment was a drag to GDP growth in the first quarter, showing a decline of 2.0 percent, the first decline since 2011, and the worst decline since late 2009. This quarter of contraction was driven by an 18.8 percent decrease in investment in structures. Another large drag to growth came

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from net exports, where the exports component dropped 5.9 percent in the first quarter after three straight quarters of growth. As headwinds from the rapid appreciation of the dollar abate, exports should improve, however, this will be offset by potentially weaker growth in Europe (if the Greek crisis continues and spreads) and in China.

Residential fixed investment provided some good news, as the rate of growth increased to 6.5 percent in the first quarter. With the current pace of housing starts and permits, we expect that the residential component will contribute more to growth in the near term.

Source: BEA, MBA

The US economy added 223,000 jobs in June and that was the second month of greater than 200,000 job gains following a slow spell in March and April. The majority of the increase in payrolls was in the private service-providing sector, while the government sector was essentially unchanged over the

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month. The US economy has now added an average of 208,000 jobs per month in 2015, which is still strong relative to the last ten years. The unemployment dropped to 5.3 percent, and was the lowest level since 2008, although that was accompanied by a drop in the labor force participation rate to its lowest level since 1977. The U6 measure of labor underutilization decreased to 10.5 percent, the lowest the measure has been post-recession.

**Average Monthly Payroll Growth**

Seasonally adjusted, 000s of jobs

![Average Monthly Payroll Growth Graph](chart.png)

Source: Bureau of Labor Statistics

The manufacturing sector, as measured by the ISM’s series of diffusion indexes, has improved over the last two months. Since the sector exhibited two months of slower growth in March and April, the index has returned to its January 2015 level. New orders have picked up over the last three months, but the production and employment components remain weak. The Federal Reserve’s industrial production index has been relative stable on the surface over the past few months, but the components have showed different trends in recent months. Manufacturing production has generally increased over the
past year, while mining has decreased since December 2014. Utilities production has increased since a recent low point in July 2014, but has been volatile compared to the other two components. Capacity utilization at 77.8 percent is still lower than the historical average of 80.5 percent, but has shown a steady upward trend since the recent trough of 67.2 percent during the Great Recession.

Overall inflation continues to be held down by low fuel prices but the year over year decrease in motor fuel prices has started to get smaller. Although fuel prices began to firm slightly over the past few months, they are still 23 percent lower than the same month a year ago. Core inflation, which excludes food and energy, increased 1.8 percent from a year ago in June, signaling that prices are not quite as weak as the headline number suggests. Growth in the shelter component has leveled off a little in recent months, but is still high in terms of its year over year growth. We expect overall prices to stabilize over the next year and edge back up to the 2 percent mark during 2016.

![Inflation Trends](image)

Source: Bureau of Labor Statistics

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Our projection for overall US economic growth is 2.1 percent in 2015, as we expect growth to pick up in the second quarter through year end despite the weak first quarter, and reach 2.4 percent in 2016, which will be driven mainly by strong consumer spending as wages increase. Housing will also likely provide a cushion for growth if we see new household formation realized, but business fixed investment seems likely to remain fairly restrained in the near future as core capital goods shipments and new orders slowed in recent months.

Housing starts in June increased after a dip in May, as multifamily starts shot up by 29 percent to 489,000 units, the highest pace since 1988. Single family starts dropped less than a percent to a pace of 685,000 units, the second straight monthly decline. However, permits picked up for both single and multifamily construction. Housing starts are expected to continue their increase over the forecast horizon as we also expect household formation to grow again. We saw an increase in total households toward the end of 2014 and expect to see increasing growth in owner households during the balance of 2015 and into 2016.

Source: Census, MBA
Following a period of low rates earlier in 2015, refinance applications have trended lower since rates have started to increase in recent months. Even though mortgages rates, at 4.23 percent in the most recent week’s survey, are still low by historical standards, they have increased by more than 50 basis points since the recent low observed around the middle of January 2015. This has resulted in a 50 percent drop in refinance applications over the same period of time. With fewer borrowers who are “in the money” with an incentive to refinance, and a portion of borrowers still repairing credit and home equity, we expect refinance activity will continue to remain at low levels. There may be upside risk in the form of borrowers returning to more cash-out refinancing, but at this point, we expect that will not be meaningful boost to overall refinance volume.

Source: MBA
Purchase application growth has not been spectacular, but continues to increase on a year over year basis, increasing at an average rate of 14 percent compared to the same week last year for the past two months. We have finally started to see growth in the bottom tier of purchase loan amounts (less than $150,000), however, which historically accounts for around 35 percent of all purchase activity, and could provide a spark for increased “move up” buying. Average loan amounts, especially on the purchase side, had been trending higher until around May and have started to move lower since then, another sign that there has been some change in the mix of loan amounts, and that borrowers who are applying for lower loan amounts are starting to make their way back into the market.

**Purchase Application Trends, by Loan Size**

*Year year percent change in number of loans*

![Graph showing purchase application trends by loan size](image)

Source: MBA

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Existing home sales increased to a 5.49 million unit annual pace in June, an increase of 3 percent from the previous month and more than 9 percent higher than the same month a year ago. Both new and existing home sales levels are still below historical averages, but with the recent strength in the economy and job market, we expect the upward drift in sales to continue. The second quarter average for existing home sales was 5.30 million units, slightly below our forecast of 5.34 million units. The June data for new home sales are not yet available, but new home sales ran at a pace of 546,000 units in May 2015, up 2 percent from the previous month and up 19 percent year over year. The pace of new home sales is the highest since 2008.

We estimate a total of $1.36 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations will drive the increase, increasing to $801 billion in 2015 from $638 billion in 2014. Refinances are expected to be to $551 billion in 2015. For 2016, we expect $885 billion in purchase originations. However, rates will likely continue to rise and cause refinances to decline to $379 billion for a total of $1.26 trillion in origination volume in 2016. The chart below shows historical mortgage originations estimates as well as our forecast, and also reveals 2014 as the first purchase dominated market since the mid-2000s, with that trend likely to continue through 2015 and 2016.

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Mortgage Originations History and Forecast

Source: MBA July 2015 Forecast