MBA Economic and Mortgage Finance Commentary: June 2015

Still Optimistic About Growth for 2015

The BEA’s second estimate of GDP growth for the first quarter showed a contraction of 0.7 percent, a significant downward revision from the advance estimate of 0.2 percent growth. However, data on retail sales, factory orders, payroll growth, and unemployment claims seem to paint a stronger picture of growth. Even if the US economy did contract in the first quarter, we are not expecting that weakness to persist through the rest of 2015. The first quarter was impacted most significantly by the rapid appreciation of the US dollar, lower exports, as well as trade and inventory disruptions on the West Coast. These are likely temporary hurdles to growth that will dissipate over the course of 2015.

While weak retail sales did provide some cause for concern from December through February, the data indicated encouraging increases in both March and May. This was a positive sign for overall growth as 60 to 70 percent of GDP consists of consumer spending on goods and services. Additionally, continued strength in the job market will support consumer spending through increased job prospects and upward pressure on wages and compensation. Our forecast is that growth in consumer spending will continue to outpace and drive broader US growth through 2016.

Interest rates have been low for some time, mainly on concerns about economic growth abroad and aggressive monetary policy moves by the European Central Bank and the Bank of Japan. However, the 10-year Treasury yield jumped up over the last few weeks in part because German bond yields have improved, due to signs of growth and increasing inflation in Europe. We expect rates to increase through the course of the 2015, with the 10-year Treasury yield reaching around 3 percent by the middle of 2016. Rates are likely to be quite volatile through the remainder of the year given the uncertainty regarding the Fed’s path going forward.

The FOMC is still awaiting “more decisive signs” of an economic recovery, according to the most recent FOMC statement following the committee’s June meeting and Chairwoman Yellen’s press conference remarks. While we still expect a September 2015 lift off in the fed funds rate, Chairwoman Yellen
communicated 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.

Our forecast for mortgage originations remains the same as last month. Refinances are expected to be $551 billion in 2015, compared to $484 billion in 2014. Purchase originations are expected to increase to $730 billion in 2015 from $638 billion in 2014. The total is expected to be $1.28 trillion in mortgage originations, compared to $1.12 trillion in 2014.

As more data have been released, it appears that the weakness in payrolls that we saw in March was an anomaly. Payroll growth in April and May averaged 250,000 jobs per month, and in the JOLTS data, job openings continue to trend upward, reaching the highest number of openings in the survey’s history. US nonfarm payrolls increased by 280,000 jobs in May and the unemployment rate ticked up to 5.5 percent as the labor force participation increased a little as well. Potentially better and more job opportunities likely brought some workers back into the labor force, which caused the increase in participation. We expect job growth at a pace above 200,000 jobs per month for 2015, and that the unemployment rate will decrease slowly to around 5.2 percent by the end of the year. Similar improvements in 2016 are expected to bring the unemployment rate below 5.0 percent in 2016.

Source: Bureau of Labor Statistics

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The manufacturing sector, as measured by the ISM’s series of diffusion indexes, is still showing growth, but at levels lower than at the same point a year ago. New orders have picked up over the last two months, but the production and employment components remain weak, with the employment index dipping into contractionary territory in April. Similarly, the Federal Reserve’s industrial production index has been on a declining trend since December, primarily driven by a slide in mining production. Capacity utilization has also fallen, declining from a recent high of 79.8 percent in November 2014 to 78.1 percent in May 2015, the lowest level since January 2014.

Shipments of nondefense capital goods excluding aircraft, which are a proxy of current business fixed investment in the GDP calculations, increased in the Mach and April, a sign that businesses have resumed some capital investment after a slow start to the year. However, new orders for these core

Source: Bureau of Labor Statistics

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capital goods remain somewhat muted, a sign that businesses remain cautious about their outlook for the coming months.

![Core Capital Goods](image)

Source: Census

Overall inflation continues to be held down by low fuel prices. Although fuel prices began to firm slightly over the past two months, they are still 25 percent lower than the same month a year ago. Core inflation, which excludes food and energy, increased 1.7 percent from a year ago in May, 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.
Our projection for overall US economic growth is 1.8 percent in 2015, mostly held down by the weak first quarter, and 2.5 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, but business fixed investment is likely to remain fairly restrained. Net exports will remain a drag to growth as the US dollar maintains its current strength and we see more divergence from other currencies, especially those of European countries.
Housing starts in May dipped after a strong showing in April, however, permits picked up for both single and multifamily units, another sign that more potential growth is around the corner. At 680,000 units (SAAR) in May, single family housing starts continue to run at a pace well below the historical average of just over 1 million units. Multifamily starts dropped to a pace of 356,000 units, which is also below the historical average of 417,000 units. Single family starts and housing in general should begin to pick up again as economic growth continues at its current pace and as wage pressures increase, leading to increased household formation. Household formation, especially owner households, is one of the most significant drivers of purchase activity in the housing market. 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.
In the mortgage market, recent rate volatility has produced similar swings in mortgage application activity. Following a period of low rates earlier in 2015, refinance applications have predominantly fallen since rates have started to increase in recent months. Even though mortgage rates, at 4.22 percent in the most recent week’s survey, are still low by historical standards, they have increased by almost 40 basis points in the last two months. This has resulted in a 30 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 decline.

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. Importantly, purchase applications for loan sizes between $150,000 and $417,000 (the conforming loan limit) have increased sharply relative to last year. We still see contraction in the bottom tier of purchase loan amounts (less than $150,000), however, which historically accounts for around 35 percent of all purchase activity.
We estimate a total of $1.28 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations will drive the increase, increasing to $730 billion in 2015 from $638 billion in 2014. Refinances are expected to be to $551 billion in 2015. For 2016, we expect $791 billion in purchase originations. However, rates will likely continue to rise and cause refinances to decline to $379 billion for a total of $1.17 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.

Source: MBA
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