## MBA Forecast Commentary

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# Strong Economic Growth, Rate Hikes to Continue

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Data have pointed to stronger than expected growth in the second quarter, as inventory growth and consumer spending are expected to push GDP growth for the quarter to over 4 percent. The job market continues to run hot, averaging over 200,000 jobs added per month so far in 2018, and with the unemployment rate decreasing to 3.8 percent in May. Other indicators of economic health such as the ISM indexes and retails sales have pointed to robust growth across most sectors of the economy. Emerging risks such as Italy's debt situation and the potential for a trade war are significant downside risks to our outlook later next year and into 2020.

With the economy growing even more quickly in response to the tax cut and more government spending, with the unemployment rate at an 18 year low, and with inflation picking up, the Fed continued to raise short-term rates. Following their June meeting, the Fed raised the federal funds target by another 25 basis points, and indicated that they are likely to hike two additional times this year, and three times in 2019, bringing the rate target above 3 percent by the end of 2019.

This projection is in line with MBA's forecast, thus we are not changing our macro or mortgage originations forecast significantly in response to this news. We still expect strong economic growth, with real GDP growth reaching almost 3 percent for 2018 and 2.3 percent in 2019, but with an increasing risk of a slowdown in 2020. With this growth expectation and the expected path of short-term rates, we expect mortgage rates will increase modestly, with the 30-year rate reaching close to 5 percent by the end of 2018, and 5.3 percent by the end of 2019.

Inflation is starting to pick up, and if it goes faster than currently anticipated, whether in response to an even lower unemployment rate or due to rising costs for other inputs to production, there is a chance the Fed could raise short-term rates even more quickly than they are currently projecting. A hint that they could be preparing for such an eventuality is the move to have press conferences following every FOMC meeting rather than every other meeting starting next January. Chairman Powell emphasized that this is really just an effort to increase transparency of the Fed's actions.

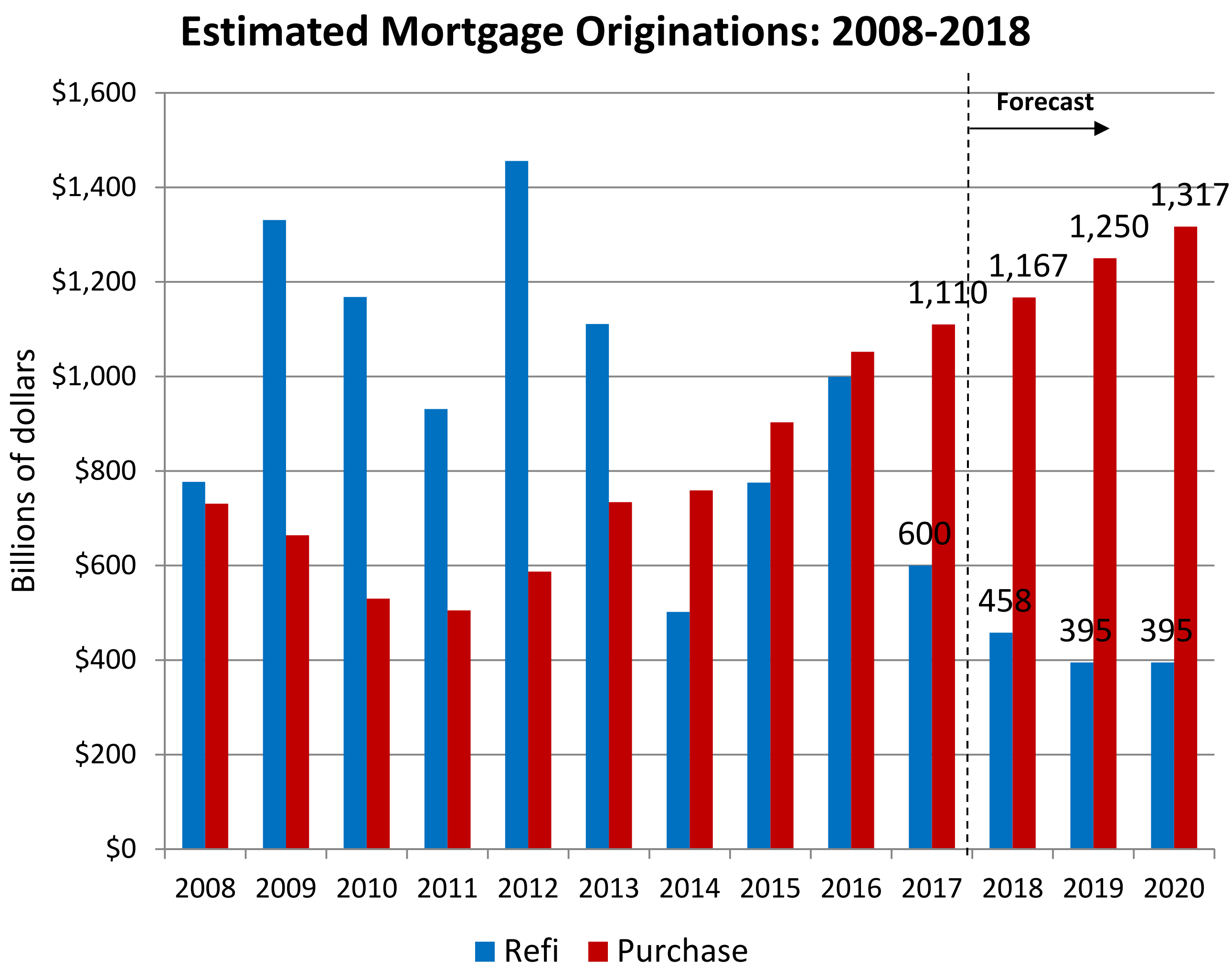
CPI inflation has increased, with headline inflation hitting 2.8 percent year over year growth, driven by a resurgence in motor fuel prices, but also another increase in shelter costs, which is a large portion of household spending. Core CPI inflation, which excludes food and energy costs, increased 2.2 percent from the same month a year ago, which was the highest since early 2017. See figure 2.

As mentioned earlier, the job market remains healthy, averaging more than 200,000 jobs added per month in 2018 thus far, following an average of 220,000 jobs in the fourth quarter. We expect job growth to slow slightly as companies report increasing difficulty filling open positions, and as labor force participation remains flat. Data from a separate BLS survey (JOLTS) showed that job openings continue to run faster than hiring, continuation of a longer trend over the last couple of years. We expect that the unemployment rate will continue to decrease slowly, reaching a low of 3.6 percent in the third quarter of 2018, and staying at that level through 2019 before increasing in 2020. With the economy at full employment, monthly job growth will slow to around 150,000 jobs for the rest of 2018 before decreasing further to 100,000 to 120,000 jobs per month in 2019.

We forecast that 30-year mortgage rates will reach 5 percent by late 2018 or early 2019, pushed up by firming inflation, growing deficits, and the strong economy. Faster wage growth is likely to overcome any headwind of increasing mortgage rates, but more home price appreciation in combination with the housing inventory shortage could put a damper on purchase market growth. We saw credit availability expand in recent months, particularly in the jumbo segment of the market, and saw FHA endorsement credit scores start to drop and DTI ratios increase. We still expect purchase origination volume to increase around 5 percent for 2018 but refinance volume is expected to decline more than 20 percent from 2017 as mortgage rates increase and fewer borrowers can take advance of rate/term refinances. The share of cash-out refinances started to increase earlier this year, but home equity debt outstanding remains low, so households have yet to tap into their home equity, utilizing other forms of borrowing instead, such as auto loans and credit cards.

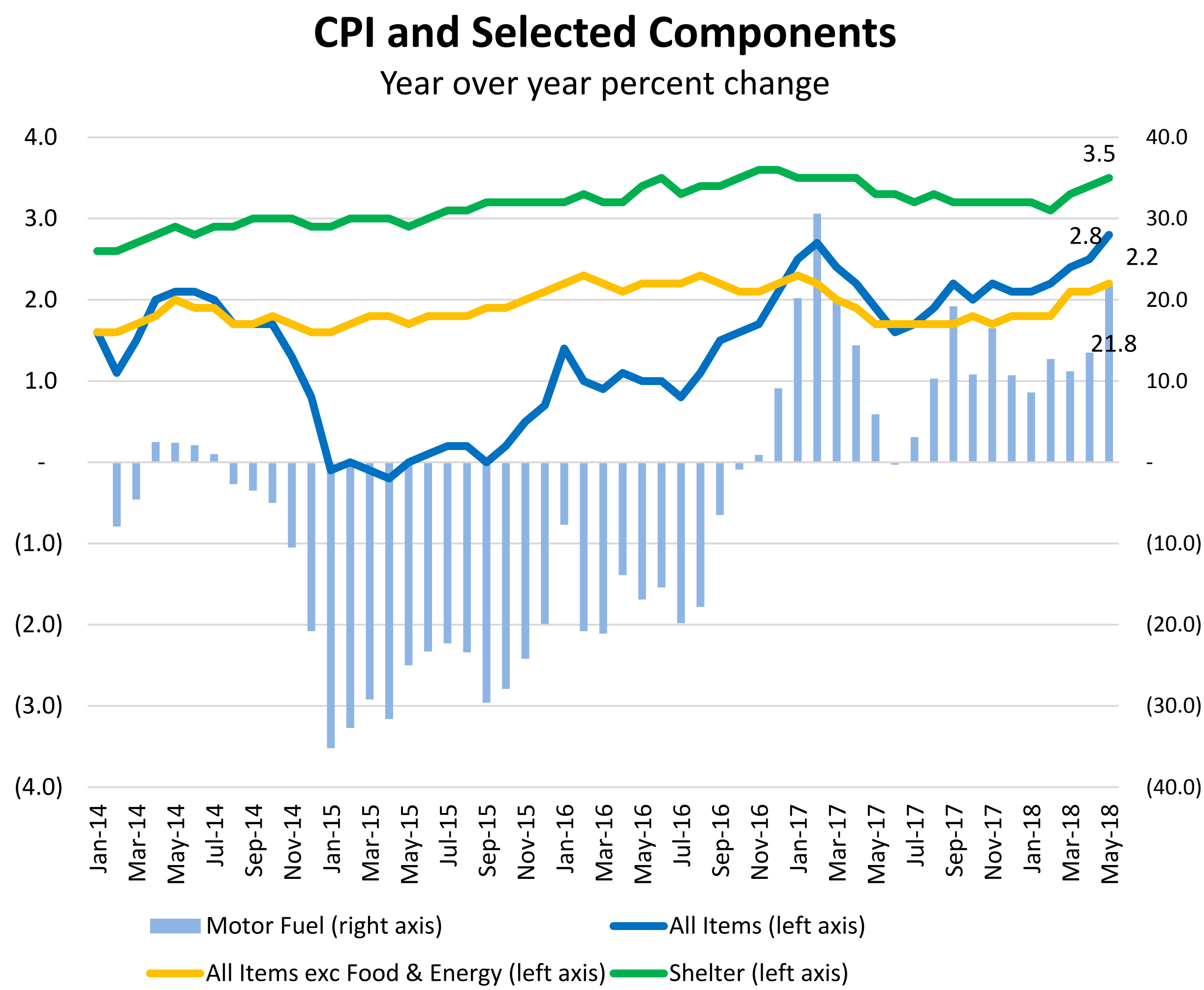
While the economy was strong, a significant portion of the industry struggled to remain profitable in the first quarter of 2018. Independent mortgage banks and mortgage subsidiaries of chartered banks reported a net loss of $118 on each loan they originated in the first quarter of 2018, down from a reported gain of $237 per loan in the fourth quarter of 2017, based on data from the MBA's Quarterly Mortgage Bankers Performance Report. Declining volume for these firms drove net production profitability into the red for only the second time since the third quarter of 2008, when the data were first started to be tracked. Production revenues per loan actually increased in the first quarter, but production expenses increased to $8,957 per loan, as fixed costs of lending were distributed across fewer loans. Figure 3, featured as a recent Chart of the Week, shows average pre-tax production gains/losses in basis point, and how that has compared to origination volume. For the sample as a whole, there were losses of 8 basis points (a loss of $118 on each loan they originated) in the first quarter of 2018, down from 9 basis points ($237 per loan) in the fourth quarter of 2017.

Figure 1.



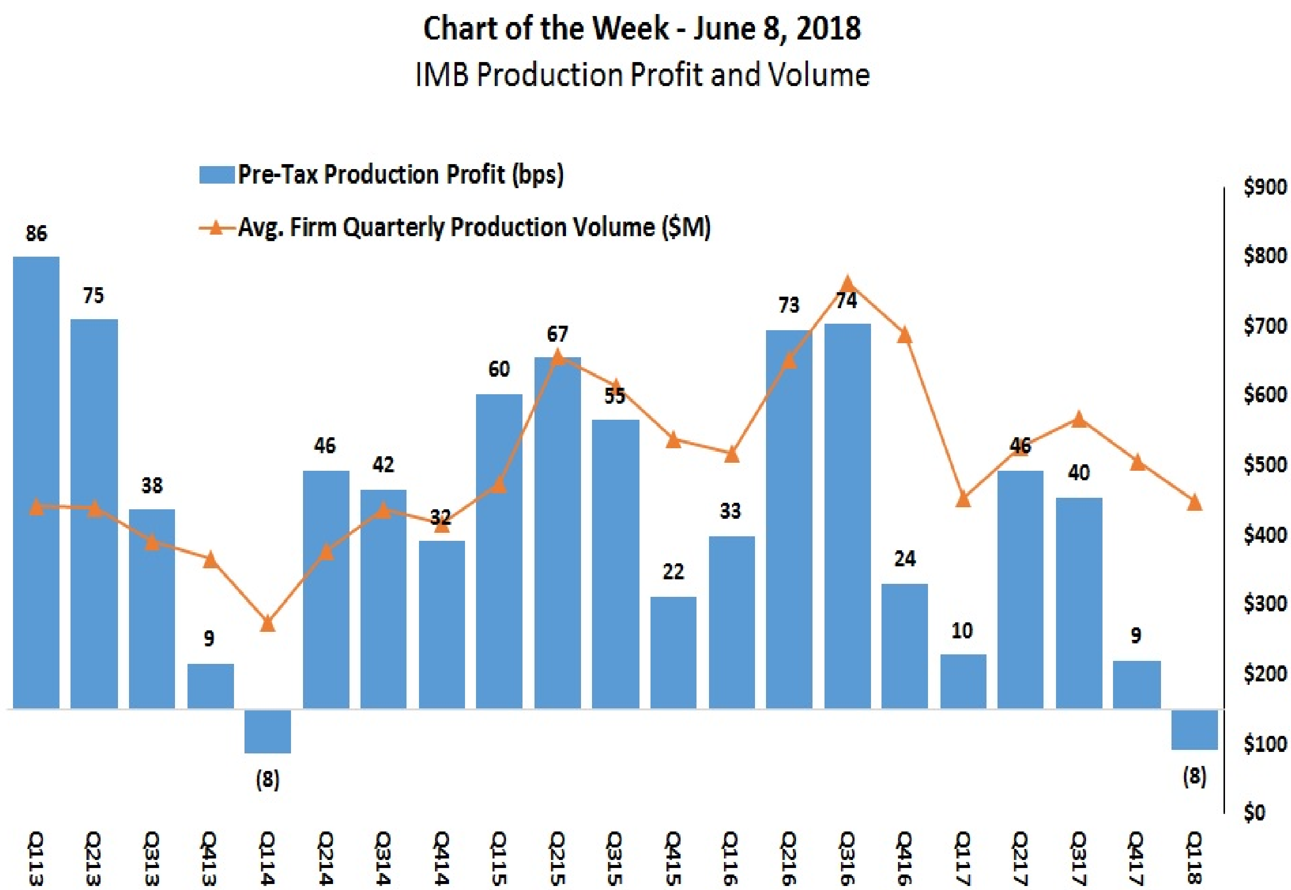

Source: MBA Forecast

Figure 2.




Source: BLS

Figure 3.




Source: Quarterly Mortgage Bankers Performance Report