MBA Forecast Commentary

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Silver Lining in Refinance Activity

*MBA Economic and Mortgage Finance Commentary: June 23, 2016*

**NOTE:**

This commentary was originally published on June 23, 2016. However, following the June 24th Brexit voting results, MBA expects that the Fed will hike only once this year, possibly in December. If the financial market disruption from Brexit persists, the likelihood of even a December hike would be reduced. Financial markets reacted severely to the Brexit, with Treasury rates dropping about 20 basis points initially. It is still unclear whether this will be a short term disruption or whether it will have a longer term impact. At this point, the likely impact on the mortgage market will be to keep mortgage rates lower for longer, likely leading to another pickup in refinance activity. The economic forecast for the US is largely unchanged. We still expect about 2 percent GDP growth and about 150,000 jobs added to the economy per month.

Despite more positive news on the US economy, we continue to see volatility in both equities and rates over the past month. Investors are still preferring US assets as a safe haven, and this drove rates sharply lower in recent weeks, although it seems just as likely that the pendulum will swing the other way. The silver lining is that lower rates has caused an increase in refinance applications and prompted us to raise our estimates for refinance originations. With the increased expectations for refinancing activity, we now estimate an increase in total originations for 2016 compared to 2015. US GDP growth for the first quarter of 2016 was revised slightly higher, and data have signaled that we are on track for a stronger second quarter. However, job growth decelerated dramatically in May to the slowest pace in six years.

Given the weak job market report for May, it was no surprise that the FOMC decided to hold the fed funds rate target unchanged following their June 2016 meeting. The Committee noted that the pace of economic activity has picked up and there continued to be positive news with respect to the housing sector and consumer spending, but that the pace of job growth has slowed significantly. In comments at the press conference following the meeting, Chair Yellen noted that the potential for the UK leaving the European Union (“Brexit”) has the potential to negatively impact the US economy. The pending Brexit vote this week has already brought US interest rates lower again, with 10-year Treasury rates down more than 30 basis points from their recent peak. Unlike in previous meetings, there were no dissents
from voting members of the FOMC in the decision to keep rates unchanged. The FOMC’s economic projections showed a slightly less optimistic outlook compared to the March projections, with fewer members predicting two rate hikes for 2016.

We still expect that the Fed will raise rates twice this year, once in July and once in December, given how well the rest of the economy is doing – we expect real GDP growth of over 2 percent for the remainder of 2016 - and if job growth is able to rebound in coming months. However, the longer term path of rate hikes will still be gradual and accommodative. There is still significant uncertainty about the broader implications of Brexit which will no doubt cause more market volatility in the coming weeks, along with concerns about broader global economic growth.

![US 10 Year Treasury Yield and Dow Jones Industrials Index](image)

Source: Federal Reserve, NYSE

Job growth in May totaled 38,000 jobs, the weakest month since 2010, and on top of that, the payroll numbers for April were revised down to a gain of 123,000 jobs (compared to the initial estimate of 160,000 new jobs added). This sudden slowdown in payroll growth factored into the Fed’s decision to hold the fed funds rate unchanged for at least one more meeting. The unemployment did decrease to 4.7 percent in May from 5.0 percent in April, but labor force participation also decreased. Average hourly earnings by private industry workers increased 2.5 percent compared to the same month a year ago, which was essentially unchanged from April. We expect that job growth will bounce back slightly
but with a low unemployment rate and still-low participation rate, monthly job growth will only average a little over 100,000 jobs per month over the next year.

In a separate survey, job openings continued to increase while hiring fell in April. This is likely being caused by a mismatch in skills sought after by employers compared to the skills possessed by job seekers. This disconnect between openings and hiring will likely maintain upward pressure on wages in the coming months. The number of voluntary quits fell in April, but remained close to pre-recession levels. An increasing trend in the number of quits is typically a positive sign as workers typically start to leave their jobs when employment conditions are favorable, and there are other job prospects available to them.

**Average Monthly Payroll Growth**

*Seasonally adjusted, 000s of jobs*

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

Source: BLS

Overall CPI inflation dipped slightly to 1.0 percent on a year over year basis as oil prices decreased and the energy component, especially motor fuel, showed a greater decrease over the year compared to the previous month. Core inflation, which excludes food and energy, was at 2.2 percent. Motor fuel prices decreased around 17 percent compared to a year ago, a trend that has persisted since late 2014. Prices paid by consumers for shelter maintained annual growth of 3.4 percent, as vacancy rates remained low and kept upward pressure on rental rates. The growth rate of shelter prices is at its highest level since
We expect that oil prices will rise slowly through 2016 and for core inflation to continue at over two percent growth.

Inflation by Select CPI Components
Year over year percent change

Source: BLS

Housing starts for May were essentially unchanged from April, with single family starts remaining slightly over 760,000 units and multifamily starts in the 400,000 units range, on a seasonally adjusted annual rate. Single family starts for April were revised lower and remained well below historical average of around one million units. We continue to forecast an increase in single family housing starts as inventory is still low and household demand firms, driven by a strong labor market. Multifamily starts are expected to increase as well, but will likely not be too far above the 400,000 unit mark, which is only slightly lower than the historical average for this measure.
Purchase applications have been declining on a week to week basis, but remain solidly above previous year’s levels (when compared to 2014 and 2015). We have seen home purchase application activity in the range of 10 to 15 percent above last year’s, and these increases have been across all loan size categories. In 2014 and for most of 2015, most of the growth in the purchase market was only in the higher end of the market, which has a much smaller share of transactions. Slow growth in the lower end of the purchase market means there were fewer first time and entry level buyers, and also fewer opportunities for “move up” buying.

Applications to refinance have not been as high as we saw in February this year, but are still occasional surges whenever rates fall. As noted in previous commentaries, there has been a stronger relationship between refinance loan balances and rate movements in 2016 – refinancing of larger loan balances tends to occur for a given drop in rates. We have seen the average loan size increase whenever rates fall, implying that borrowers with larger loans stand to gain more by refinancing and may not need as large of a rate incentive than borrowers with lower loan balances. Many borrowers also continue to recover in their home equity positions as home prices increase, and this home price recovery has been uneven across states and cities. There may also be additional cash out refinancing occurring as rates remain low and home equity holdings increase.
Source: MBA Weekly Applications Survey

Our estimates for mortgage originations have increased compared to last month’s forecast, as rates decreased yet again, which will likely lead to more refinancing activity. We expect $1.66 trillion in total mortgage originations in 2016, with around $970 billion coming from purchase and $690 billion from refinances. The overall originations total for 2016 now exceeds the 2015 estimated total of $1.63 trillion. Purchase originations are expected to increase gradually in 2017 and 2018, as continued economic growth and a strong job market will support household formation. Household formation in turn is likely to boost housing demand. Additionally, rising rents may also push some households to purchase homes. Refinance originations is expected to decline as rates eventually rise, and with a majority of borrowers refinancing into lower rate, longer term fixed mortgages, the decrease in refineses is likely to cause overall industry originations to show a decrease in 2017 and 2018.
Mortgage Originations History and Forecast

Source: MBA Mortgage Finance Forecast