Fed Rate Cuts, Not Hikes, Now on the Table

MBA Economic and Mortgage Finance Commentary: June 21, 2019

The global economy is slowing to an even greater extent than we had anticipated. We have updated our forecast to show weaker growth in 2020 and a job market that will also start to show some strain despite how low unemployment has been. US economic growth is expected to slow to around 2 percent this year, and then closer to 1 percent in 2020. Trade tensions, stock market volatility, and slower economic growth all are factors that could impact overall consumer confidence and housing demand. The highly publicized trade dispute has already caused a significant decline in business and consumer sentiment, but may also have been responsible for a slowdown in capital expenditures and investment in late 2018 and early 2019. The lower rates that we have been seeing in recent weeks may be here to stay, and we have significantly lowered our rate path for 2019 and beyond. These lower rates have drawn increased refinance activity into the market, moving us to raise our originations forecast, but we still expect that the potential for at true refi boom is limited given the low rates on many outstanding loans.

In the Federal Reserve’s statement following the June meeting, they recognized that the economic outlook has become much more uncertain, particularly given the weakening of business activity in recent months, both in the US and abroad. While the statement makes no suggestion that a rate cut is imminent, it does repeat Chairman Powell’s phrase that the central bank will “act as appropriate to sustain the expansion”. However, the economic projections produced by the FOMC in conjunction with the meeting, tell a somewhat different story. Looking at the range of forecasts, there are a number of members who are considering cuts as warranted in both this year and next, while others continue to hold to a forecast of flat rates for the next two years. Markets are going to have a difficult time digesting these mixed messages, as it indicates that the Fed recognizes the slowdown, but is not yet committed to cut rates this year. We expect that Fed speakers will be active in the weeks ahead, attempting to tell a coherent story amidst these mixed messages.

MBA is forecasting two rate cuts by the Fed later this year, believing that the slowdown will continue and will eventually force the Fed to act in line with market expectations. Markets are expecting that the Fed might move as soon as their next meeting in July. Longer-term rates are likely already pricing in
several rate cuts. Thus, mortgage rates may be more volatile in the months ahead, which could both provide refinance opportunities for some homeowners, while causing potential homebuyers to pause amidst the uncertainty. While purchase application activity continues to move at a pace ahead of 2018’s, housing starts are still insufficient to keep pace with demand as home builders still face labor and cost challenges.

- After growing at a 3 percent rate in 2018, the strongest year for GDP growth since 2005, we forecast growth will slow to 2.0 percent in 2019, 1.1 percent in 2020 and 1.4 percent 2021. The U.S. economy grew at a 3.1 percent rate in the first quarter of 2019 – faster than anticipated, as consumer spending growth remained at a healthy pace. However, as mentioned earlier, we expected more of a slowdown in the coming quarters.

- Monthly payroll growth slowed to 75,000 jobs in May and has averaged 164,000 jobs per month in 2019 thus far. The unemployment rate was unchanged at 3.6 percent. However, the slower pace of job growth in May, downward revisions in prior months, and a leveling out of wage growth, are signs that we are beginning to see the impacts of a broader slowdown in economic growth. The job market remains tight, but this report, coupled with other recent data, shows a distinct cooling of the economy this spring. We expect the unemployment rate will start to increase, reaching 4.1 percent in 2020 and 2021 as overall growth slows.

- The data on existing-home sales for May showed a number of positive trends. First, on an unadjusted basis, the level of sales increased relative to last year at this time, which is in line with what we have been seeing in MBA’s purchase applications data. The year-over-year growth was strongest in the South, which typically accounts for the largest portion of sales nationally. Second, the inventory of homes on the market increased, both in raw numbers and in terms of month’s supply. Tight inventories remain a constraint on the pace of sales, but it is good to see more supply coming onto the market. Finally, home prices continue to increase, but still at a slower pace than in recent years, and more in line with the rate of income growth. Combined with lower mortgage rates, these trends should help additional first-time homebuyers enter the market.

- With the recent decline in mortgage rates, we saw a significant pick up in refinance applications, particularly in the higher loan balance categories, which caused us to revise our refinance volume estimates higher for 2019. We raised the estimate for the third quarter of 2019 to $145B from $100B and as a result, we are now showing an increase in refinance volume in 2019 relative to 2018. However, with many loans outstanding now with lower rates, we do not expect a prolonged boost to refinance activity unless rates fall even lower. We still expect moderate growth in home purchase mortgage originations in the coming years, with dollar volume increasing about 5 percent to $1.25 trillion in 2019 from an estimated $1.19 trillion in 2018. Total originations are expected to increase to $1.74 trillion in 2019 from $1.64 trillion in 2018 as a result of the upward adjustment to refinance volume.
Figure 1.

Recent Originations and Forecast

$Billions


Total Refi Purchase

Source: MBA Forecast
Figure 2.

Monthly Payroll Growth and Unemployment Rate

Payroll Growth (000s workers)  Civilian Unemployment Rate: 16 yr + (SA, %)

Source: BLS
Figure 3.

**Purchase Mortgage Applications Index**
(by week of the year, NSA)

Source: MBA Weekly Applications Survey
Figure 4.

Refinance Application Trends, by Loan Size
Non seasonally adjusted, year over year percent change

Source: Census