RESEARCH AND ECONOMICS

MBA Forecast Commentary

Mike Fratantoni, Joel Kan

Housing Supply Holding Back Originations

MBA Economic and Mortgage Finance Commentary: March 22, 2018

The job market is red hot – supported by steady economic growth and the positive impact from the recent tax cuts and budget agreement. The unemployment rate continues to drop, as the economy has added jobs at around 180,000 per month in 2017, and started 2018 by adding an average of 276,000 jobs per month over the first two months. Housing supply constraints continue to hold back the pace of home sales, as buyers struggle to find and afford homes, but purchase applications are running ahead of their 2017 pace thus far in 2018 due to the underlying strength of the economy, even as rates have risen.

Chairman Powell's first FOMC meeting met market expectations of a 25 basis point hike in the federal funds target rate, a move to continue to remove accommodation from an economy that is at full employment. However, it was noted that changes to the Fed's forecast indicate that FOMC members are now anticipating faster economic growth, a stronger job market, and potentially a faster pace of hikes this year and next than had previously been communicated. We believe that this is warranted given the red hot job market we are experiencing, and the potential for additional tailwinds over the next two years from the tax cuts and additional government spending.

We continue to anticipate that 30-year mortgage rates will get close to 5 percent by the end of the year, pushed up by the Fed's moves, growing deficits, and the strong economy. Stronger wage growth is likely to overcome this further increase in mortgage rates, thus we're still forecasting about 5 percent growth in purchase origination volume this year. However, refinance volume will be down close to 30 percent from 2017 as the 30 year fixed rate mortgage has increase over 40 basis points year to date. Most borrowers who were in a position to refinance have taken advantage of lower rates over the past few years, and as rates increase, the benefits to refinance are reduced.

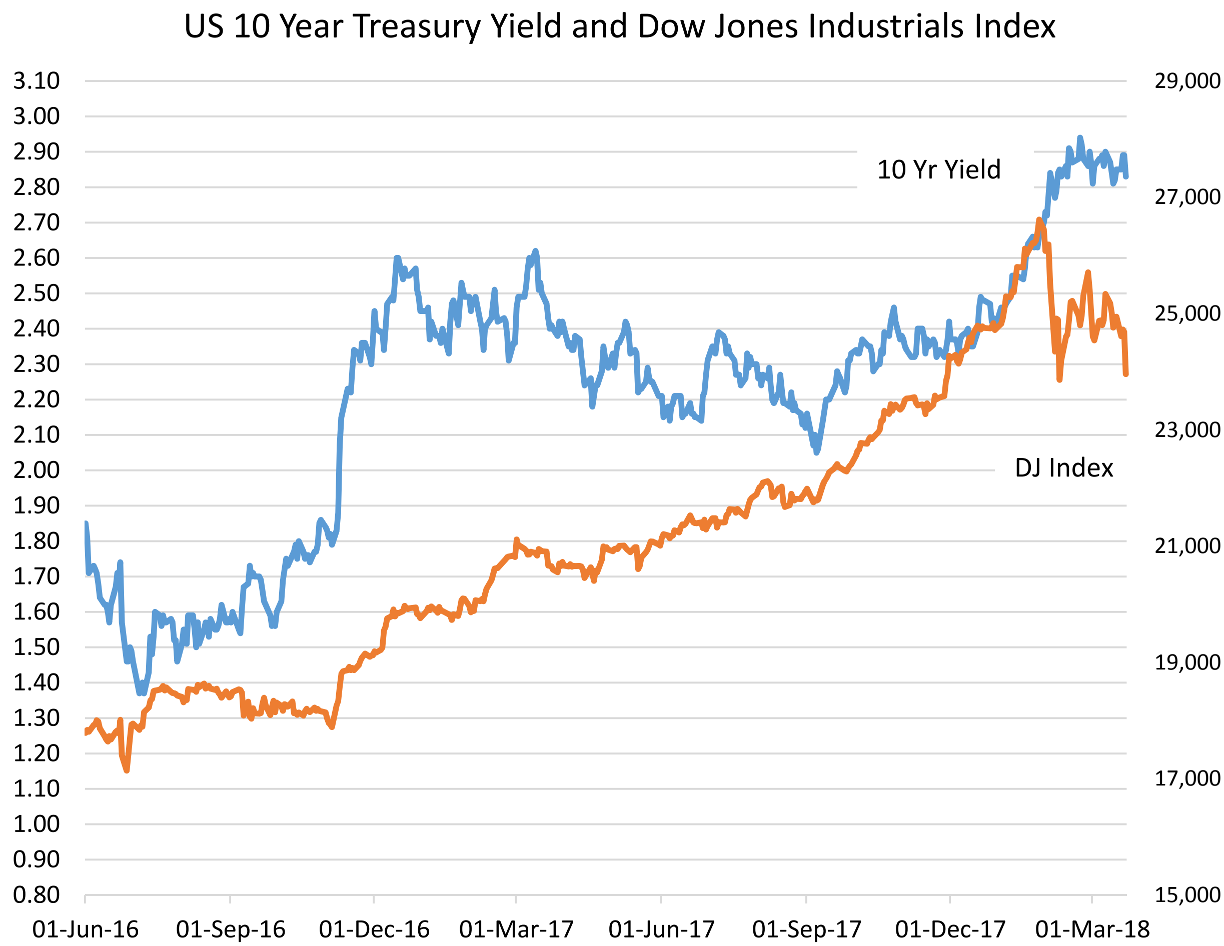
One potential risk to the forecast is connected to how volatile the stock market has been in its reaction to political and economic news. Figure 1 shows how much the Dow Jones index has oscillated in recent months, which has also caused the 10 year Treasury rate to flatten out slightly. While the Dow Jones is still close to its recent high, we believe a significant stock market correction is a risk to the forecast given how consumer spending and wealth could be impacted.

The employment situation reports for 2018 thus far have been strong, showing gains of 239,000 and 313,000 jobs in each of the past two months. The unemployment rate was 4.1 percent in February, the fifth consecutive month at that level, while the labor force participation rate increased slightly to 63 percent. Another main measure of unemployment and labor underutilization, the U6, increased slightly to 8.2 percent. Average hourly earnings increased to 2.5 percent relative to the same month a year ago, the strongest growth rate since September 2017. Even though the growth in wages has been slow, we still expect a more meaningful increase in the near future, as unemployment is low and job openings remains elevated relative to the number of actual hires, and companies need to raise wages to attract more talent and retain current staff. The number of job openings has exceeded the number of hires for nine of the past 10 months, as seen in Figure 2.

We expect that the unemployment rate will continue to decrease slowly, reaching a low of 3.7 percent in the third quarter of 2018, and staying at that level through 2019 before increasing slightly 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 jobs per month in 2019.

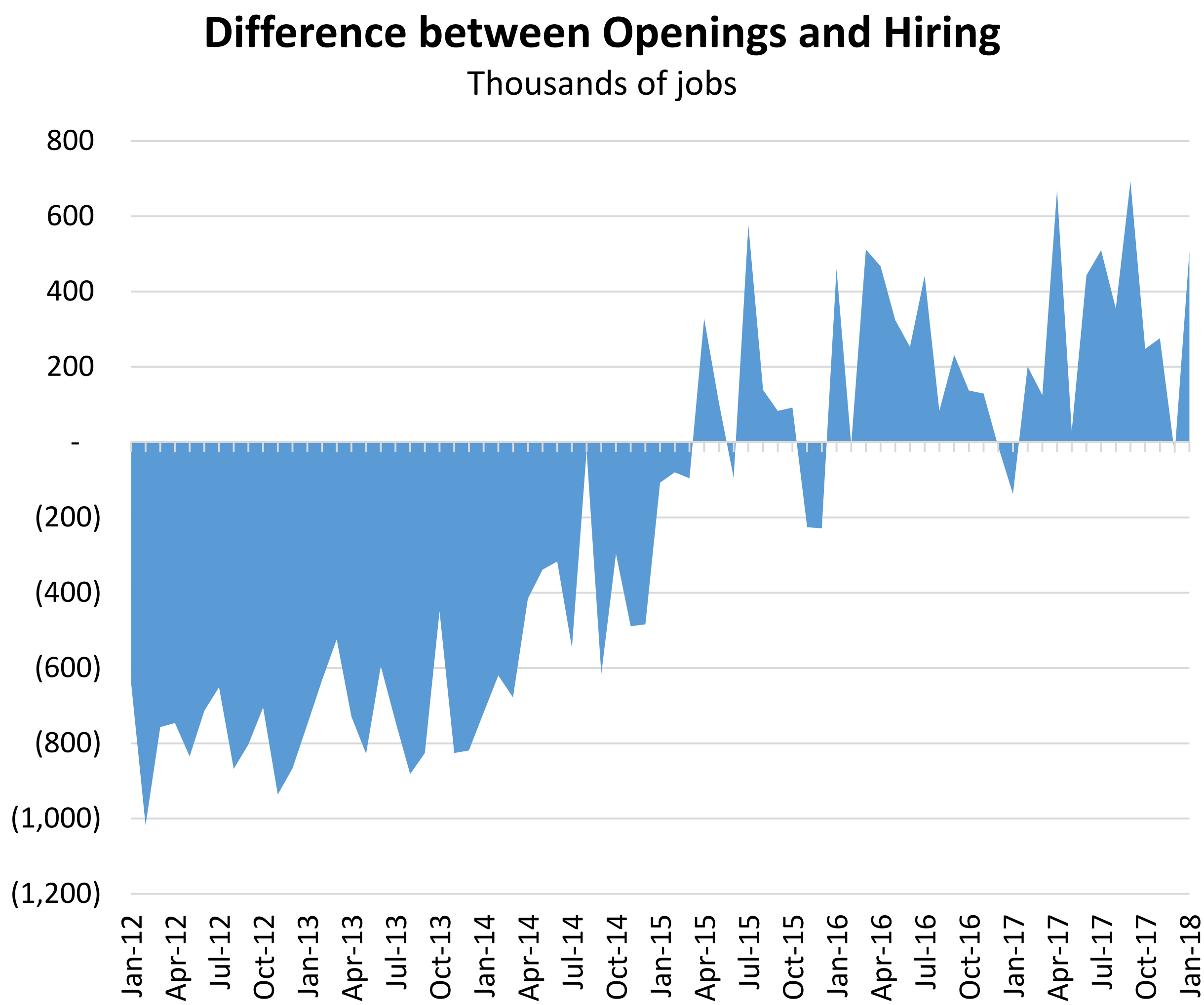
With our forecast of GDP growth at 2.4 percent in 2018 and 2.3 percent in 2019, coupled with the strong job market, upward wage pressures, and demographics bringing in another cohort of homeowners, we believe that the demand for housing is enough to generate increasing purchase originations for 2018, 2019, and 2020. However, much of this growth is held back by the inventory of homes for sales, both for new and existing homes. Figure 3 shows how much both the inventory of existing home sales has declined, along with the months' supply of homes for sale. The months' supply metric takes into account the current sales pace, and is showing that given the current pace of home sales, if housing inventory remains unchanged, all the inventory will be sold in just over three months. This is in stark contrast to the record highs of 10 months during the recession, but even during the preceding early to mid-2000s period of strong home sales the months' supply was still between four to five months. Even with home builder still facing labor shortages and building materials price increases, we expect housing starts to increase to meet the inventory needs, albeit at a somewhat more restrained pace. We have also started to see home purchase applications increase in 2018 relative to 2017, as shown in Figure 4, which has kept our purchase originations forecast at around 6 percent in 2018 and closer to 7 percent in 2019.

Figure 1.



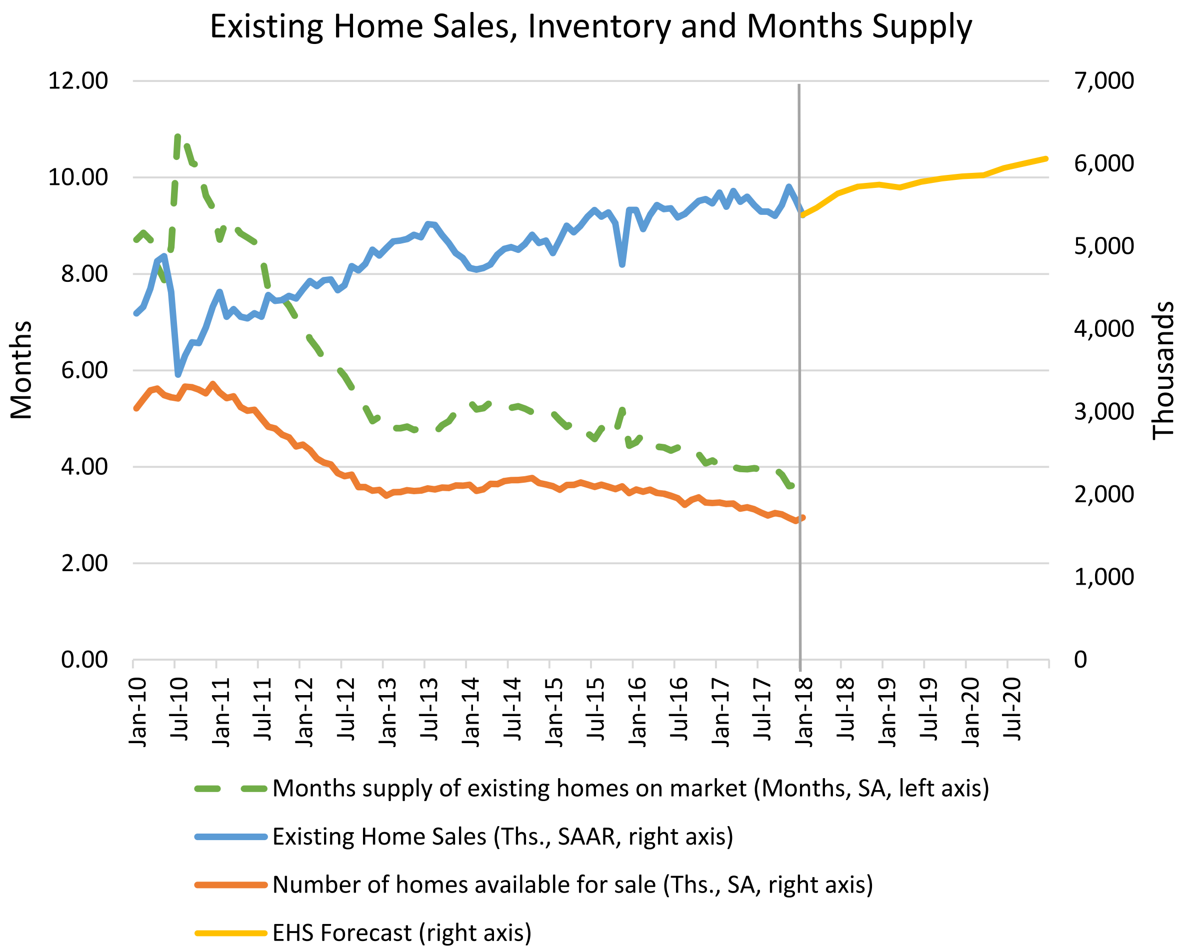
Source: Federal Research, NYSE

Figure 2.



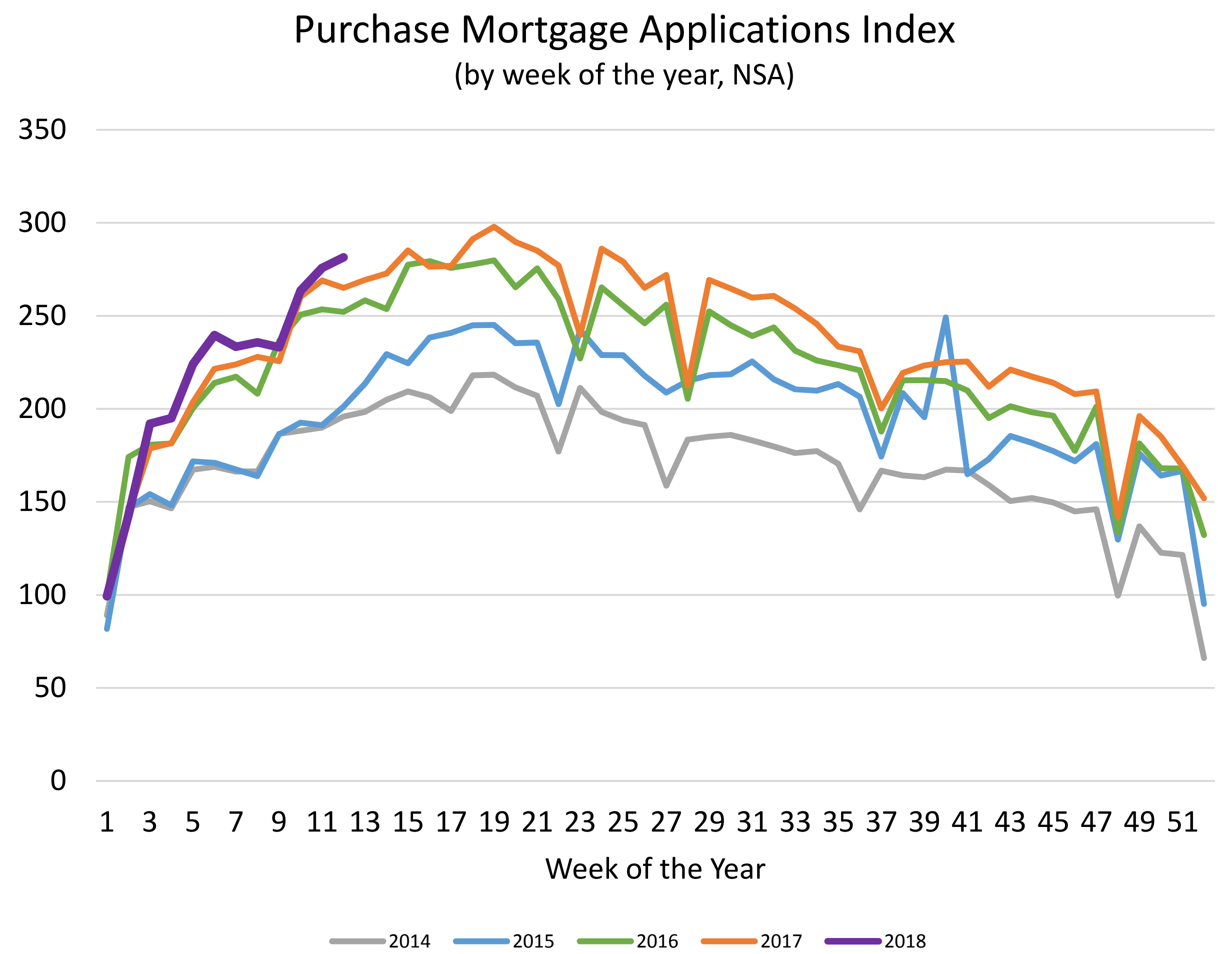
Source: BLS

Figure 3.



Source: NAR, MBA

Figure 4.



Source: MBA Weekly Applications Survey