MBA Forecast Commentary
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Fed Remains Cautious, Holding Rates For Now

*MBA Economic and Mortgage Finance Commentary: March 2016*

The US economy continues on a path of positive, but slow growth. The final estimate of GDP growth in the fourth quarter was a little stronger than expected, an annualized rate of 1.4 percent, but also is also likely to pull some growth forward from the first quarter of 2016. Drivers of growth were consumer spending and residential fixed investment. Strength in the labor market persists, and there are signs of wage increases by certain measures. Prices also continue to firm and provide hope that wage pressures will start to rise more rapidly. Global stresses and low oil prices however, push the risk to our forecast more to the downside.

Following the March FOMC meeting, the Federal Reserve announced that the fed funds rate would be held in the range of 0.25 percent to 0.50 percent. Federal Reserve officials had indicated previously that they would raise rates only gradually this year. Thus, even though job growth has been stronger than forecast, and inflation has picked up, it was not surprising that the FOMC did not raise their short-term rate target at their March meeting. Moreover, in line with MBA’s forecast, FOMC members are now projecting two rate hikes this year. We expect the first hike will be in June, so long as job growth continues and the recent pickup in inflation does not reverse. Subsequently, Chairwoman Yellen’s speech in late March was even more dovish than inferred from the FOMC meeting’s press release, putting downward pressure on 10 year Treasuries yields.

Job growth has continued into 2016, with the February employment report showing a gain of 242,000 nonfarm jobs across the US. Construction jobs continued to grow on a year over year basis, while mining and extraction saw yet another decline, the largest contraction for an industry group in the February data. The unemployment rate held at 4.9 percent and the U6 also decreased to 9.7 percent, the lowest since 2008. The spread between the unemployment rate and the U6 measure was 4.8 percent, closer to the historical average spread of 4.7 percent. This is a good sign that the labor market is moving in the right direction. Additionally, the labor force participation rate rose to 62.9 percent, the third straight monthly increase, a sign that workers are returning to the work force.
Wage growth has been a topic of interest of late since it has not picked up significantly by most measures, especially when considering how far the unemployment rate has fallen and how tight the job market has become. At the worst of the recession, there were almost 7 workers competing for each job opening, and in early 2016, that has fallen to 1.4 workers per job opening. With that level of competition, one would expect that wage growth would have shown more acceleration but that has not been the case. One possible explanation is the mix of workers being measured. The Atlanta Fed measured only prime age workers and found that this subset of workers has seen more meaningful wage increases compared to what other broader measures have showed. It is possible that since lower wage workers tend to exit the work force more quickly when economic conditions worsen, and reenter when economic growth is picking up, overall measures of wage growth have failed to account for the change in mix of the labor force.
Inflation slowed in February as oil prices held down headline inflation yet again, but core inflation, which excludes energy and food prices, picked up, increasing 2.3 percent, which was the strongest year over year growth since 2012. Motor fuel prices decreased 20.8 percent compared to a year ago, a trend that has persisted since late 2014. Prices paid by consumers for shelter maintained annual growth of over 3 percent, as vacancy rates remained low and kept upward pressure on rental rates. We expect that oil prices will rise slowly through 2016 but also that core inflation will gradually rise to 2 percent over the next 12 months.
The ISM’s gauge of manufacturing activity showed growth over the last two months, although at 49.5, the index remains at a level that is correlated with economic contraction. Component indexes such as the new orders index production index, and employment index showed a little improvement over the past two months as well, but remain relatively weak.

Industrial production decreased overall, but manufacturing production helped prevent a more severe slide in the February data. However, mining and utilities (gas and electric) both decreased, with mining actually falling for the sixth straight month to the lowest level since 2013. Industrial capacity utilization also decreased in the most recent data release, and at 76.7 percent is well below the historical average of around 80 percent. Mining utilization decreased to 77.5 percent, the lowest since the late 1980s and well below the historical average of 87 percent. It was also the seventh straight monthly decrease for the mining sector. Capacity utilization for utilities also fell, to 74.8 percent, the lowest level ever in the data series. Given these results, it is no surprise that investment in the equipment and structures has declined in the overall GDP calculations.

Housing starts increased 5.2 percent overall, but this was all driven by a 7 percent (55,000 units) increase in single family starts, which jumped to an annualized pace of 822,000 units, the highest since 2007. However, single family starts remain well below historical average of around one million units. Multifamily starts remained around the 350,000 pace in February. We continue to forecast an increase
in single family housing starts as inventory is still low and household formation picks up. 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.

Home prices at the national level, per the FHFA purchase only series have exceeded 2007’s peak in the past few months, however, data from CoreLogic show that home prices at the state and metro level continue to show a wide variation when looking at the cumulative peak to current percent change, which many metros still not back to peak level prices.

**Peak to Current Cumulative Home Price Growth for the Largest Metro Areas**

Source: CoreLogic
Purchase applications continue to increase slowly over the weeks, but have been running over 20 percent stronger than a year ago. The chart below shows how the purchase index has behaved in early 2016 compared to 2014 and 2015.

**Purchase Index by Year (NSA)**

Source: MBA Weekly Applications Survey

The refinance index has declined for 5 straight weeks as rates have inched up. The more dramatic response to a small increase in rates is symptomatic of fewer refinance opportunities remaining at these levels of mortgage rates. Around 75 percent of agency 30 year fixed borrowers have a mortgage of 4.5 percent or lower, so even as rates are just under 4 percent recent weeks, there is less of a demand response to movements in rates. However, we have seen increased sensitivity by borrowers who have higher loan balances, as the correlation between movements in rates and refi loan balances has become tighter. Average refinance loan balances have decreased for 5 weeks as well, in step with the overall refinance index.
New home sales have remained over a 500,000 unit since November 2015, and have been increasing, but the increase has been slow. The February total of 512,000 units was still close to early 1990s levels, despite increasing from 502,000 units in January. New homes for sale have been inching up as well, but similarly remain low by historical standards. Existing home sales in February fell to 5.08 million units from a 5.47 million unit pace the month before.

We expect $1.5 trillion in total mortgage originations in 2016, with purchase driving most of that number. Purchase originations are expected to increase in 2017 and 2018, as continued economic growth and household formation helps to boost housing demand. Additionally, rising rents may also push some households to purchase homes. Refinance originations will continue to decline as rates eventually rise, causing overall industry originations to show a decrease in 2017 and 2018.

Source: MBA Weekly Applications Survey
Mortgage Originations History and Forecast

Source: MBA Mortgage Finance Forecast