Fed on Hold, Global Outlook Weaker

MBA Economic and Mortgage Finance Commentary: March 25, 2019

The pace of global economic growth continues to slow. This slowdown is beginning to impact the US economy as well, with additional risks on the horizon due to ongoing concerns of a trade war with China, Brexit, and an increasing risk of a recession in the US. However, the job market remains strong, even though job growth slowed in February, wages are rising and mortgage rates have dropped to the lowest levels in a year. We remain guardedly optimistic about the housing market this year. Along with lower mortgage rates, prospective buyers in some markets have seen an increase in homes for sale, which provides more options and has stemmed some of the rapid home price growth that we have seen for so long. As rates have decreased to date in 2019, driven by some of the fears highlighted earlier, we have seen some refinance opportunities arise for borrowers who did not previously have the opportunity or incentive to refinance, or may now have a chance to withdraw equity through a cash-out refi. This has pushed our forecast for total originations in 2019 to show an increase over the year as opposed to a decline as in our previous forecast.

- After growing at a 3 percent rate in 2018, the strongest year for GDP growth since 2005, we forecast growth slowing to 2.0 percent in 2019, and 1.4 percent growth in 2020 and 2021. While we are not forecasting a recession for 2020, the slower growth means there is a heightened risk of a downturn, as global growth slows and we see some domestic pullback in consumer spending and business investment in plant and capital as the boost from the tax cuts wears off.

- Job growth slowed to 20,000 jobs added in February after exceeding 300,000 jobs in January, but we consider the slowdown likely to be at least partially reversed in the coming months. The unemployment rate remains low at 3.8 percent and we are seeing labor force participation pick up slightly. Perhaps more importantly for the job market, we are seeing more concrete signs of wage growth, especially for younger and prime age workers. We expect the unemployment rate will decrease to 3.6 percent by the end of 2019 and then rise slightly to 3.7 percent in 2020 and 3.8 percent 2021 as overall growth slows.

- As expected, the Federal Reserve left short-term rates unchanged at their March meeting. With the strength of the job market and inflation that has not picked up despite wage growth acceleration, officials seemed comfortable leaving rates at their current level.
The bigger news from the March meeting was the clear signal that the Fed will stop allowing their balance sheet to shrink, and will begin to allow it to grow again starting this fall. Fed officials have noted that they would like to return the balance sheet to primarily Treasury assets, meaning that MBS will continue to roll off, with the proceeds being invested in Treasury securities. The Fed also noted the potential to sell “residual holdings” of MBS at some point, but that they would give plenty of notice before doing so. Over time, these changes could put some upward pressure on mortgage-Treasury spreads – and ultimately – mortgage rates.

Looking ahead, we do expect that lower rates and rising entry-level supply should lead to more home sales and purchase originations – especially for first-time home buyers, who represent more than 30 percent of home sales. Existing-home sales bounced back in February after a sluggish start to the year in January. The 5.5 million sales pace last month was the strongest since March of last year, and is a sign that some buyers were able to shrug off some of the market uncertainty in late 2018 and early 2019. Fundamental drivers of purchase activity, like the strong job market and favorable demographics remain in place - there were 1.6 million additional owner-occupied households in 2018 – the largest annual increase since 2004. Thus, we expect moderate growth in home purchase mortgage originations in the coming years, with dollar volume increasing in about 5 percent to $1.24 trillion in 2019 from an estimated $1.19 trillion in 2018.

Total originations are now expected to increase to $1.66 trillion in 2019 from $1.64 trillion in 2018 as refinance volume has returned with the downward move in mortgage rates. We expect less of a drop in refinance volume in 2019 compared to 2018 than previously estimated and have lowered our forecast for rates, with the 30 year fixed mortgage rate topping out at around 4.8 percent through 2021.
Figure 1.

Mortgage Originations History and Forecast

Source: MBA
Figure 2.

U6 vs U3 Unemployment Rate

- **Civilian Unemployment Rate: 16 yr + (SA, %)**
- **Unempl+Margin Attach+Part Time Econ Reasons/CLF + Margin Attach (SA,%)**

Source: BLS
Figure 3.

**Selected Wage Growth Measures**

*Note - est Q1 2019 average based on Jan & Feb data*

Source: Atlanta Fed, BLS
Chart of the Week, March 15, 2019
Annual Change in Owner-Occupied and Renter Households

Source: Census