RESEARCH AND ECONOMICS

MBA Forecast Commentary

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Weak First Quarter, But Growth Expected to Recover

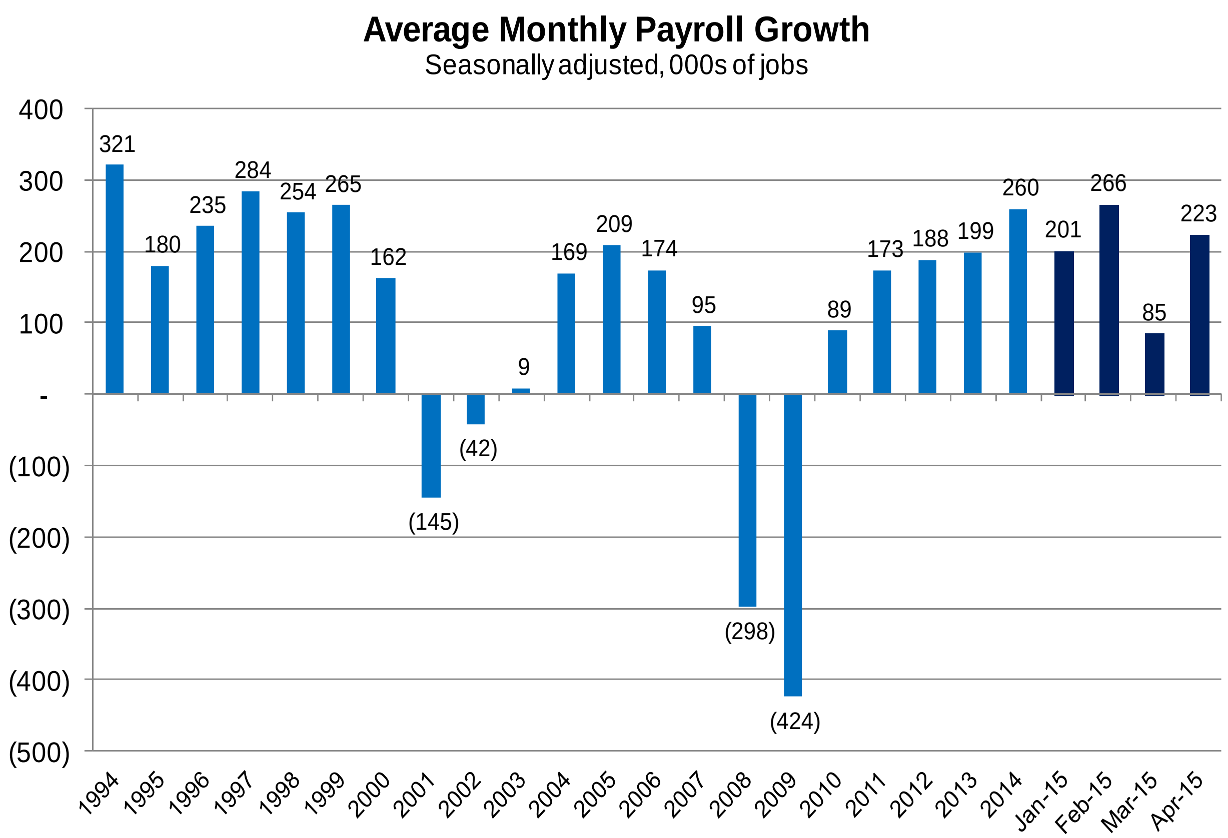
MBA Economic and Mortgage Finance Commentary: May 2015

Broad economic growth in the US got off to a slow start to 2015. The first quarter was impacted most significantly by the stronger US dollar, lower exports, as well as trade and inventory disruptions on the West Coast. However, weak retail sales are signaling that consumer spending was also slow in the first quarter, and declining industrial production might be a sign that businesses are seeing less incentive to ramp production up and invest thus far this year. We still believe that some of these are temporary factors and that domestic growth will pick up in the second quarter, given that the job market remains strong and there has been upward pressure on wage growth.

Because rates have been low for most of 2015 until recently, we revised our refinance originations estimate upward for both the first and second quarters due to higher than expected MBS issuance data and strong refinance applications in the months of February, March, and April. Refinances are expected to be $551 billion in 2015, compared to a previously estimated $510 billion. We now estimate a total of $1.28 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations are expected to increase to $730 billion in 2015 from $638 billion in 2014.

The BEA's advance estimate of first quarter growth was a paltry 0.2 percent, the slowest quarter of growth since the first quarter of 2014. (We and others are becoming increasingly skeptical that the government's seasonal adjustment process is fully capturing typical first quarter weakness. This is another reason we are less worried by slower reported growth in Q1.) Personal consumption expenditures, which comprise about 60 to 70 percent of GDP, grew at a pace of 1.9 percent in the first quarter, also the lowest growth rate in a year, as both spending on durable and non-durable goods slowed sharply. Nonresidential fixed investment saw negative growth for the first time since 2011, dragged down by a sharp decrease in investment spending on structures. Net exports were also lower, as port disruptions and still slow foreign consumption hampered exports. At the same time, imports, which are a drag to growth, decelerated.

We also saw a weak employment picture in the first quarter, at least on the surface, with job growth from January to March averaging 184,000 jobs added per month, which was significantly weaker than in 2014, where the monthly average was 260,000 jobs added. However, April's payroll numbers saw a rebound to 223,000 jobs, possibly a sign that the previous months' weakness is over.



Source: Bureau of Labor Statistics

Compensation, as captured by the Employment Cost Index, continued to increase, a sign of strength in the job market as companies look to fill vacant positions with qualified workers. Job openings continue to trend higher even as actual job hiring as slowed. This is possibly due to a skills mismatch between available workers and open positions. With the large number of long term unemployed workers still overhanging the job market, there has been some erosion of skills and "resume value" as workers struggle to find more secure positions that match their potential. The U6 measure of labor underutilization remains relatively high by historical standards.

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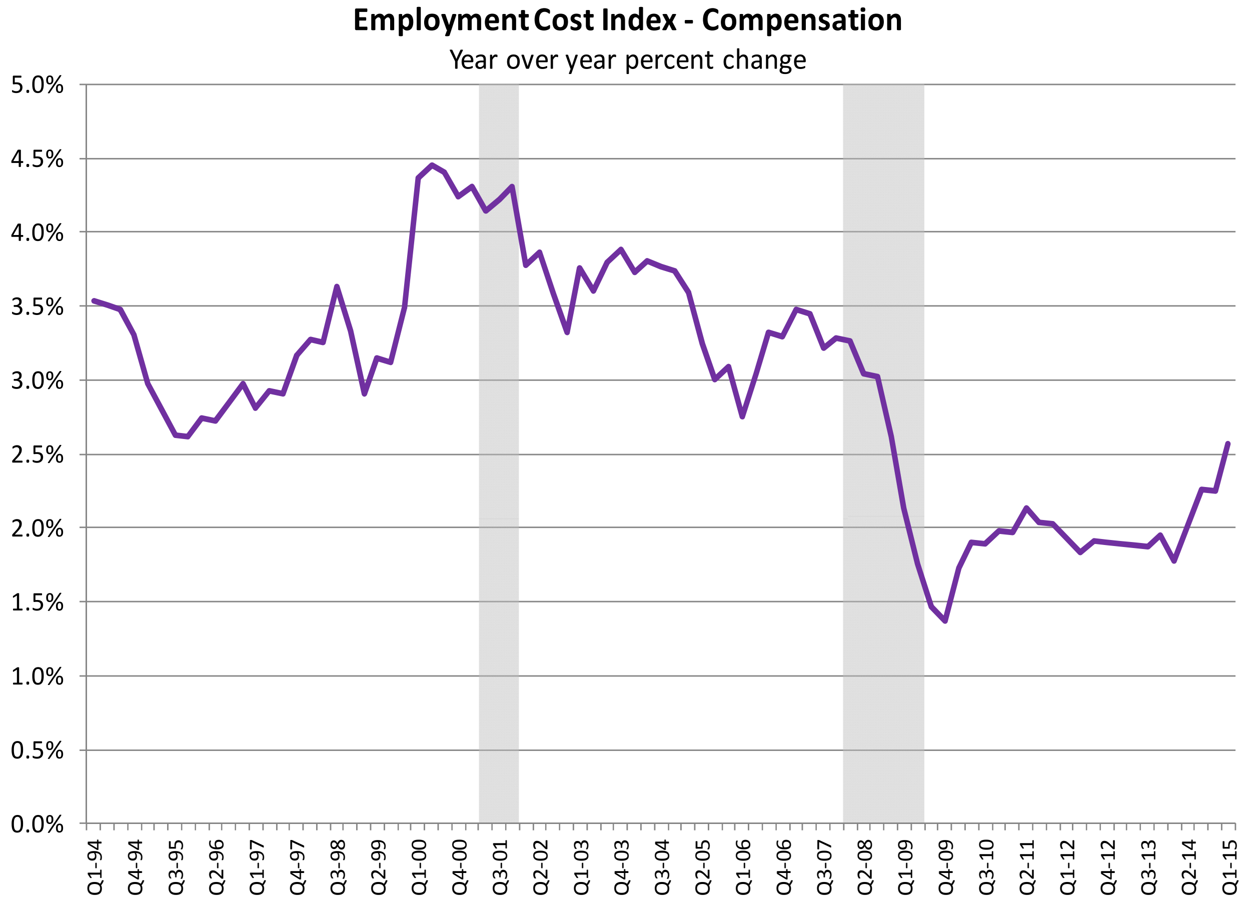
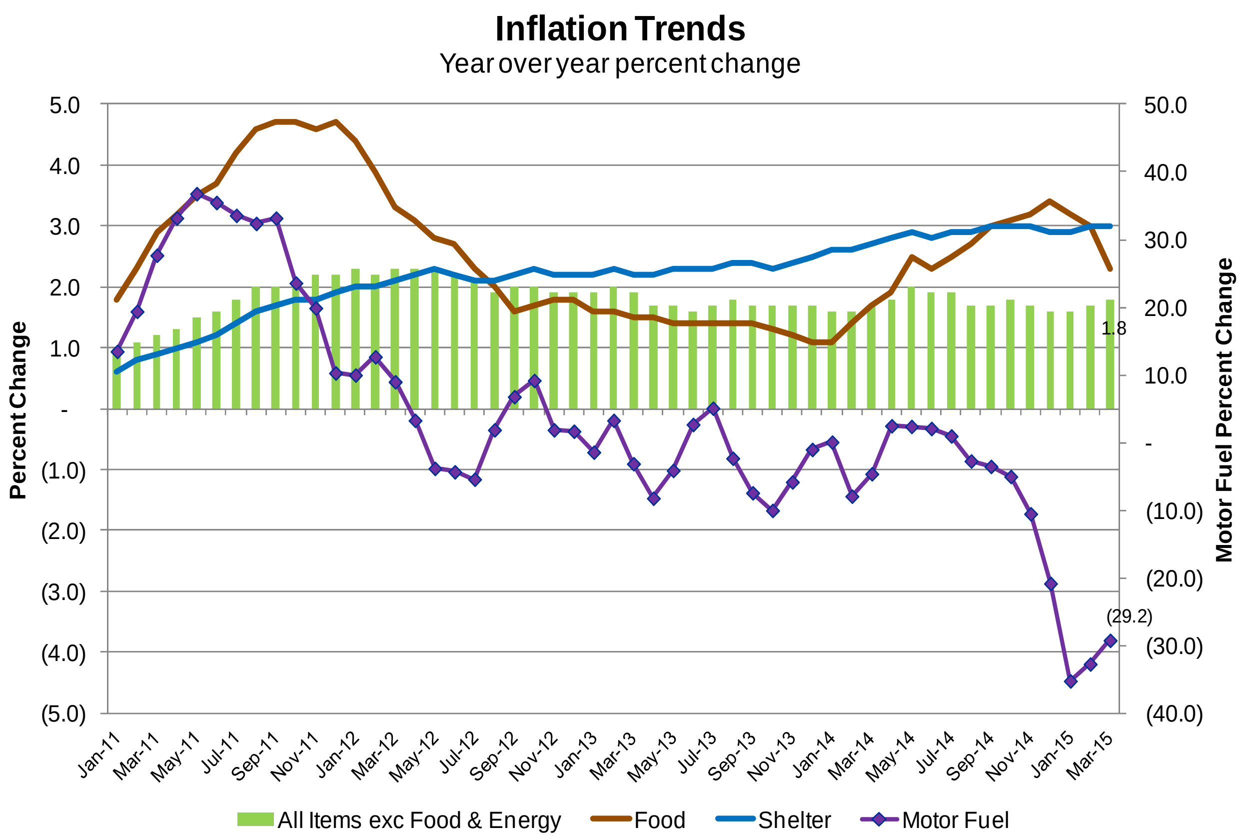


Source: Bureau of Labor Statistics

Interest rates have been low for some time, mainly on concerns about economic growth abroad and aggressive monetary policy moves by the European Central Bank and the Bank of Japan. However, we have seen the US Treasury rate pick up over the last few weeks as some of those concerns ease. We expect rates to increase through the course of the 2015 and that the Fed will raise rates in September as the economy and job market continue to strengthen.

A strong job market leading to sustained wage growth is a factor that drives household formation and that is expected to pick up this year, providing a lift for housing. We now look to the purchase market to drive the overall housing outlook. Rental vacancies remain low and rents continue to increase, and with home prices still increasing, it is likely that more buyers and sellers will return to the market in the short term. However, a differentiated purchase market remains, as higher loan size tiers are growing more rapidly than the lower loan tiers, a sign that entry level and first time buyers still face hurdles. Even though lower rates have brought additional refinance borrowers into the market and caused us to raise our originations estimates for 2015, refinance activity has been extremely low in recent weeks, as mortgage rates hovered around the 4 percent level.

Overall inflation continues to be held down by fuel prices, fuel prices begun to firm slightly over the past two months. Core inflation, which excludes food and energy, increased 1.8 percent from a year ago in March, signaling that prices are not quite as weak as the headline number (a decline of 0.1 percent from a year ago) suggests. The shelter component has leveled off a little in recent months, but is still high in terms of its year over year growth. We expect overall prices to stabilize over the next year and edge back up to the 2 percent mark during 2016.



Source: Bureau of Labor Statistics

Our projection for overall US economic growth is 2.1 percent in 2015 and 2.5 in 2016, which will be driven mainly by strong consumer spending as wages increase. Housing will also likely provide a cushion for growth if we see households form as expected. Headwinds from the run up in the US dollar should dissipate slowly, but low oil prices remain a concern even if lower fuel prices do provide some additional disposable income for households.

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There were promising signs in the housing market as the Census Bureau reported that housing starts in April hit the highest level since late 2007 as both single family and multifamily starts increased over the month. Single family starts increased to a seasonally adjusted annual pace of 733,000 units, the highest pace since 2008, while multifamily starts increased to an annual pace of 402,000 units, the quickest pace since July 2014. Given the weakness in the prior months, part of the increase could simply be some catching up by builders in April, but permits also picked up, another positive sign for the months to come.

Additionally, MBA's Builder Application Survey data showed that mortgage applications for new home purchases increased 0.3 percent in April relative to March (not seasonally adjusted). Although applications were essential flat in April, March and April builder applications were at their highest levels since the data series began in August 2012. On a year over year basis, applications to builders for new home mortgages were up 16 percent. The MBA estimates new single-family home sales were running at a seasonally adjusted annual rate of 487,000 units in April. While this estimate is down 4.5 percent from March, it is up more than 16 percent from April a year ago. The average loan size for builder mortgage applications has be trending higher and reached a survey high of $315,670 in April, a similar trend to what has been observed in the Weekly Applications Survey, which includes purchase applications on both new and existing home transactions. By product type for the year to date, conventional loans comprised 66 percent of builder applications, while FHA loans represented about 19 percent, VA loans 13 percent and USDA loans 1 percent. Average shares for the same period a year ago were 3 percent higher for conventional loans and 3 percent lower for FHA loans.

Mortgage credit availability has been modestly increasing in 2015. The MCAI increased 0.5 percent to 122.0 in April and is up 3.6 percent year to date. Of the four component indices in April, the Government MCAI saw the greatest easing (up 1.1 percent over the month). The increase in the Government MCAI was driven by new offerings of FHA's 203K home improvement program and new VA offerings. While credit is still significantly tighter than the mid 2000s due to the currently regulatory landscape, mortgage credit conditions have generally improved over the past two years.

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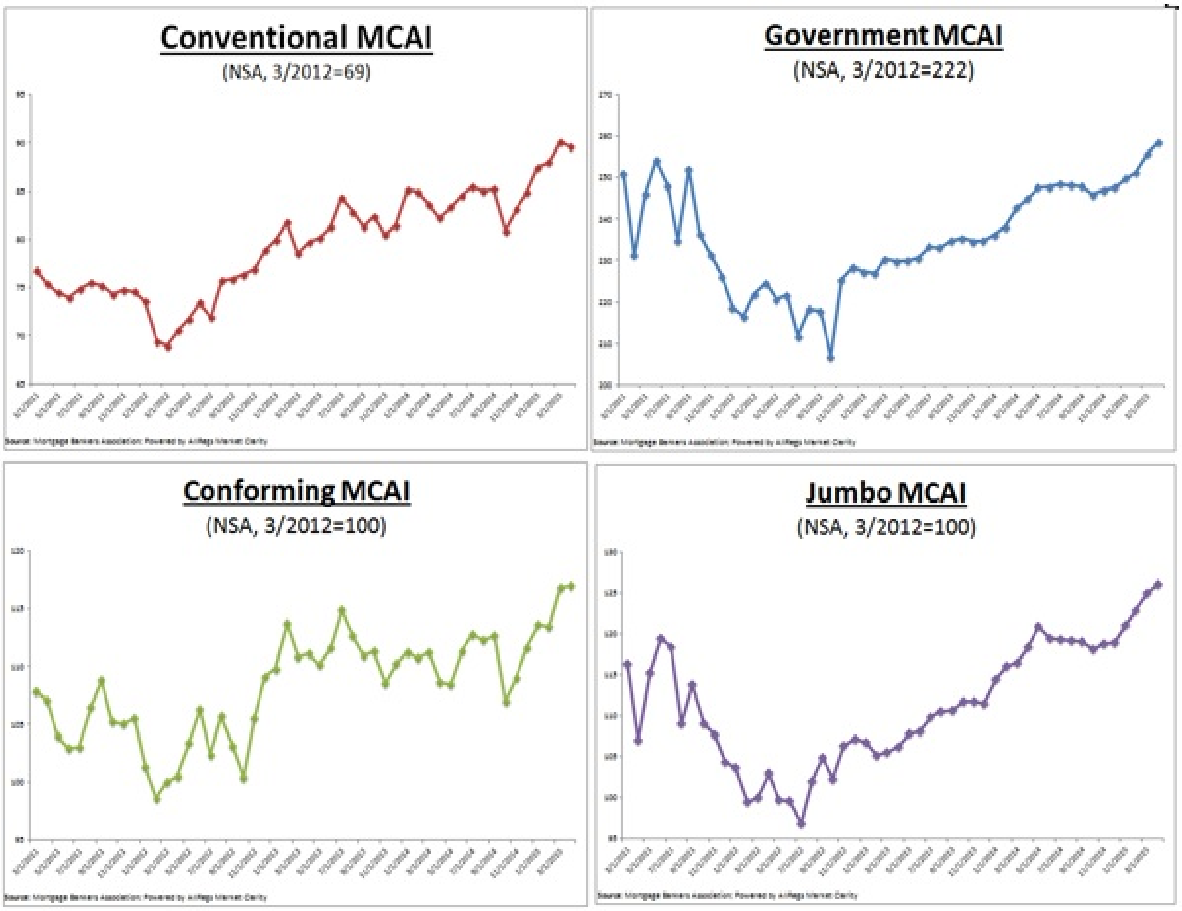
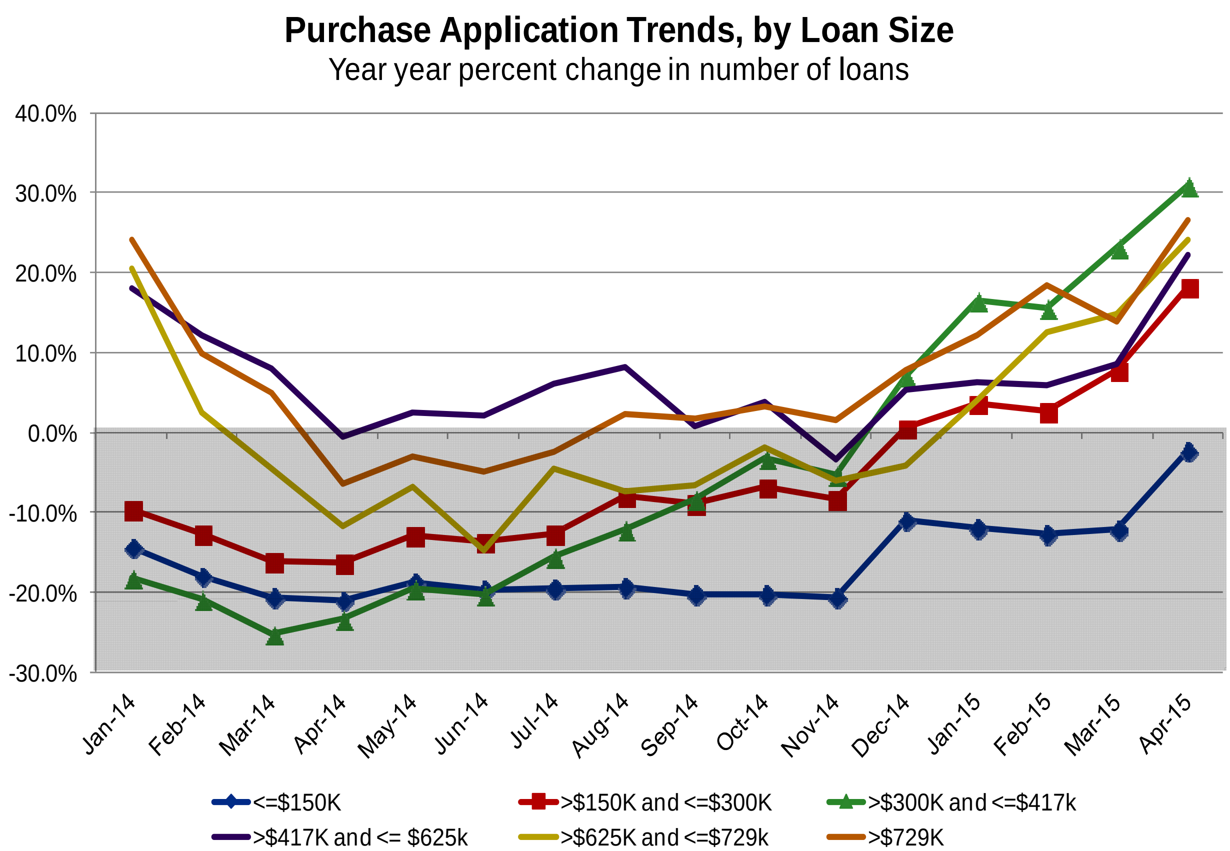


Source: MBA powered by Ellie Mae's ALLREGS Market Clarity

In terms of mortgage applications, for the week ending May 8, the Market Composite Index decreased 3.5 percent on a seasonally adjusted basis from one week earlier. The Refinance Index decreased 6 percent from the previous week as rates increased. The average contract interest rate for 30-year fixed-rate mortgages with conforming loan balances ($417,000 or less) increased to 4.00 percent, its highest level since March 2015. The seasonally adjusted Purchase Index decreased 0.2 percent from one week earlier. The unadjusted Purchase Index was 12 percent higher than the same week one year ago. Year to date, applications have increased on a year over year basis for all but the smallest loan sizes (of less than $150,000). Last week, the average loan size of a purchase application reached $298,500, the highest level in the survey, further pointing to more rapid growth at the higher end of the market. Similarly, monthly data on purchase applications by loan size (see chart below), showed that all loan size categories except the lowest loan sizes showed year over year increases in April. Each of the lowest two loan size categories have historically been about 35 percent of all purchase applications, and are thus a majority of purchase loans. Considering that these are the price tiers where most first time and entry level buyers will enter the market, any meaningful growth in the housing market will have to start here.



Source: Monthly Profile of Mortgage Activity

Interest rates trended down throughout 2014, started out low in 2015, but have trended higher in recent weeks. Our forecast for the 10 Year Treasury yield is 2.3 percent for 2015 and 3.0 percent for 2016, and our forecast for the 30 Year Fixed mortgage rate is for 4.1 percent in 2015 and 4.9 percent in 2016. Given a weaker first quarter of 2015 in terms of economic and job market indicators, we expect that the Federal Reserve will make its first increase of the fed funds rate in September 2015.

We estimate a total of $1.28 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations will drive the increase, increasing to $730 billion in 2015 from $638 billion

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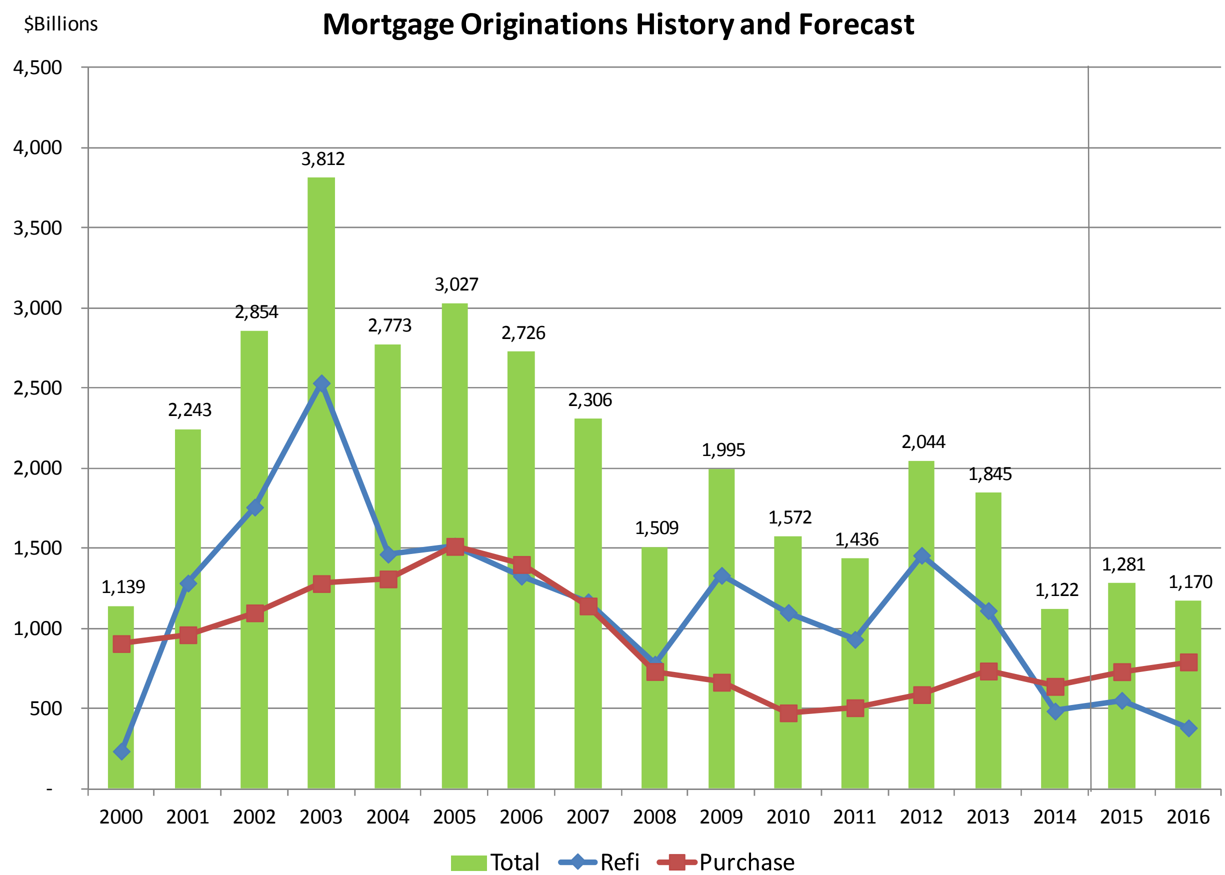
in 2014. Refinances are expected to be to $551 billion in 2015. As mentioned earlier in the text, we revised our refinance estimate upward for both the first and second quarters in response to higher than expected issuance data and strong refinance applications in the months of February, March, and April. For 2016, we expect $791 billion in purchase originations. However, rates will likely continue to rise and cause refinances to decline to $379 billion for a total of $1.17 trillion in origination volume in 2016. The chart below shows historical mortgage originations estimates as well as our forecast, and also reveals 2014 as the first purchase dominated market since the mid 2000s, with that trend likely to continue into 2015 and 2016.



Source: MBA May 2015 Forecast

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