Economy & Labor Markets Strong Enough, First Rate Hike Expected in December

This month’s outlook largely mirrors what we had outlined in October, with the US economy growing at a slow and steady pace and the labor market with a slight bounce back after a couple months of weaker than expected data. Consumers are still spending and driving overall economic growth, as measured by the BEA’s advance estimate of third quarter GDP, and as light vehicle sales continue to surge.

Mortgage performance for the third quarter of 2015 improved yet again as the rate at which new foreclosures were initiated dropped to the lowest level in 10 years, and as overall delinquencies and foreclosure inventory rate declined. A combination of increasing home prices, much improved employment situation, and newer loans of higher credit quality have worked together to drive this improvement in mortgage performance.

Coincident with the strengthening economy and job market, we expect the Federal Reserve will begin to raise short-term rates in December 2015. However, it has been emphasized in various FOMC member communication that even after the initial rate hike, monetary policy will remain highly accommodative, so we may not see another rate increase until the second quarter of 2016. Due to the delay in raising rates and continued demand for safe assets, however, we expect that the 10-Year Treasury rate will stay below three percent through the end of 2016, and 30-year mortgage rates will stay below 5 percent until early 2017.

As stated last month, we project that home purchase originations will increase in 2016 as the US housing market continues on its path towards more typical levels of turnover based on steadily rising demand and improvements in the supply of homes for sale and under construction. We saw some bumps in the road from energy and export sectors, but the job market is near full employment, with other measures of employment under-utilization continuing to improve. However, states strongly tied to the energy sector are still on our radar as a potential source of weakness as the trend of lower fuel prices continues...
to play out. Generally, we expect that strong household formation, improving wages and a more liquid housing market will drive home sales and purchase originations in the coming years.

The BEA’s advance estimate of third quarter 2015 GDP growth showed that the US economy grew at a rate of 1.5 percent, down from a 3.9 percent growth rate in the second quarter. The second quarter growth rate however, was driven significantly by inventory buildup, which pulled some growth forward. The third quarter estimate still showed a robust 3.2 percent growth in personal consumption expenditures (PCE), and as seen in recent history, personal consumption expenditures (PCE) continues to drive growth and accounts for almost 70 percent of the overall level of GDP. PCE growth in the third quarter accounted for 2.2 percentage points of the overall growth rate. Consumers continue to benefit from more stable employment conditions, a stronger dollar and lower fuel prices.

Businesses saw an increase in spending in the third quarter as well, driven by investment in equipment, specifically information processing equipment such as computers. Investment in structures showed a decline for the quarter. Residential fixed investment saw positive growth for the sixth consecutive quarter and we expect this trend will continue over the next few quarters as the housing sector continues its recovery.

Net exports were essentially neutral in the third quarter, subtracting 3 basis points from the overall growth rate. Exports were relatively weak, but imports, which are a drag to growth, have been have been declining in terms of their negative contribution to GDP.

We expect GDP growth to finish stronger in the fourth quarter to bring the average for 2015 to 2.1 percent, with consumer spending and residential fixed investment driving growth. We also expect this trend to continue into 2016 and 2017, with GDP growth averaging 2.3 percent for both those years.

The US economy added 271,000 jobs in October, which brings the year-to-date average for 2015 back above 200,000 jobs per month. While the 2015 monthly average is lower than the average of 260,000 jobs per month in 2014, it is still the second strongest year for monthly job growth since 1999. Moreover, the unemployment rate continues to edge lower, hitting 5.0 percent in October. The labor force participation rate held at 62.4 percent for the second straight month, and remained at its lowest level since 1977. The employment to population ratio edged up to 59.3 percent in October, and is a little above the historical average of 59.2 percent, although this measure has shown a stronger upward trend since 2014. The U6 measure of labor underutilization inched lower to 9.8 percent, the lowest level since 2008.

© 2015 Mortgage Bankers Association
MBA Mortgage Finance and Economic Commentaries - each month MBA Research provides commentary on the current mortgage finance and economic climates. For more information, please contact Forecasts@mba.org.
While the headline unemployment rate has been low, the U6 measure of underutilization has lagged due to lingering numbers of workers who are discouraged and marginally attached to the workforce, as well as workers who are working part time. However, the spread between the two has trended lower since the end of the recession.

Source: Bureau of Labor Statistics

© 2015 Mortgage Bankers Association

MBA Mortgage Finance and Economic Commentaries - each month MBA Research provides commentary on the current mortgage finance and economic climates. For more information, please contact Forecasts@mba.org.
In the BLS’ job openings and turnover report, better known as JOLTS, job openings continue to outpace hiring. This divergence in openings and hiring indicates that employers are still having difficulty finding workers with the suitable skills to fill vacant positions. This is likely to be different across geographies and industries, but overall, this should translate to upward pressure in wages. The number of quits, which usually increases when workers are more confident in their job prospects, has been relatively flat over the past few months.
Overall inflation continues to be held down by low fuel but core inflation, which excludes food and energy, remains 1.9 percent higher than a year ago, signaling that prices are not quite as weak as the headline number suggests. Growth in the shelter component, which is mostly driven by rents, remains high in terms of its year over year growth at over 3 percent. While inflation is seeing downward pressure from a stronger US dollar and weaker growth overseas, these factors should dissipate and we expect overall prices to stabilize over the next year and edge back up to the 2 percent mark during 2016.
We expect an increasing trend in rates for 2016, but expect shorter term volatility to remain as global economic and political disturbances maintain downward pressure on US rates. Investors will likely remain cautious in their investments and continue to hold safer US assets. Our forecast is for the 10 Year to stay around 2.2 percent in the fourth quarter of 2015, staying below 3 percent for 2016, before increasing closer to 3.5 percent in 2017.

Following the Treasury rate outlook, mortgage rates are expected to stay close to the 4 percent mark to finish 2015 and then average 4.5 percent in 2016 and 5.2 percent in 2017. Even as mortgage rates have been close to historically low levels, refinance activity has been slow but for small pockets whenever rates dip. Most eligible borrowers have already refinanced and locked into lower rates and therefore it would take a much larger rate drop for another refinance wave to occur. Additionally, home prices are still around one percent below the peak seen in 2007. This implies that there are still borrowers
underwater who owe more than their homes are worth and thus may not be able to refinance. Borrowers typically require some amount of positive home equity to refinance or sell their homes.

**Source:** Federal Housing Finance Agency

According to the most recent data from MBA’s National Delinquency Survey, delinquency rates and the percentage of loans in foreclosure continued to fall in the third quarter of 2015 and are at their lowest levels since the first quarter of 2007. The new foreclosure starts rate reached the lowest level since 2005 as fewer loans are going delinquent, and even those that do are not rolling through into serious delinquency. The serious delinquency rate – measured by those loans that are 90 days or more delinquent or in the process of foreclosure – declined for nearly every state in the nation. The factors influencing this outcome include a nationwide housing market recovery, resolution of long-standing troubled loans that eventually proceeded through the foreclosure process, and an improving employment outlook that provided distressed borrowers viable alternatives to foreclosure.

Legacy loans continued to account for the majority of all troubled mortgages. Across all loans, 80 percent of the loans that were seriously delinquent were originated before the year 2009, even as the overall rate of serious delinquencies for those cohorts decreased.

© 2015 Mortgage Bankers Association

*MBA Mortgage Finance and Economic Commentaries* - each month MBA Research provides commentary on the current mortgage finance and economic climates. For more information, please contact *Forecasts@mba.org.*
While only 40 percent of loans serviced are in judicial states, these states account for a majority of loans in foreclosure. For states where the judicial process is more frequently used, 3.01 percent of loans serviced were in the foreclosure process, compared to 1.06 percent in non-judicial states. States that utilize both judicial and non-judicial foreclosure processes had a foreclosure inventory rate closer that of the non-judicial states at 1.26 percent.

Loans in Foreclosure by Dominant Process

Source: National Delinquency Survey

Since the fourth quarter of 2012, New Jersey, New York, and Florida have had the highest percentage of loans in foreclosure in the nation according to data from the MBA’s National Delinquency Survey. All three of these states primarily use a judicial foreclosure process.

The good news is that their foreclosure inventories continued to decrease. Relative to the same quarter one year ago, Florida led the way in reducing its foreclosure inventory, seeing a decrease of 266 basis points in the third quarter of 2015. While declines in New Jersey and New York depicted in the chart below were smaller over the year, their single quarter declines were particularly notable. New Jersey experienced the largest quarterly decline in the nation in the third quarter of 2015 as its foreclosure
inventory fell by 84 basis points. Similarly, New York saw the largest quarterly decline in its history, falling by 54 basis points.

The large decrease in Florida’s loans in foreclosure over the last year has been aided by house price appreciation and employment growth above the national average. Both New Jersey and New York reported positive, but below average, gains.

### Loans in Foreclosure Process
As percent of loans serviced

![Chart showing percent of loans in foreclosure process from Q3-2014 to Q3-2015 for NY, NJ, FL, and US.]

**Source:** National Delinquency Survey

In our Weekly Applications Survey, there was some volatility in both purchase and refinance trends at the beginning of October as lenders saw a rush of activity in advance of the “Know Before You Owe” regulation implementation deadline. This pulled forward mortgage application activity that might have happened later in October. We view this as a temporary distortion to applications activity and that the weekly signals will revert back to more normal trends as lenders work to smooth the implementation process.

© 2015 Mortgage Bankers Association

*MBA Mortgage Finance and Economic Commentaries* - each month MBA Research provides commentary on the current mortgage finance and economic climates. For more information, please contact Forecasts@mba.org.
As low rates drove refinance activity earlier in the year and we see the purchase market continue to recover, we estimate a total of $1.47 trillion in mortgage originations for 2015, compared to $1.26 trillion in 2014. Purchase originations will drive the increase, increasing to $821 billion in 2015 from $759 billion in 2014. Refinances are expected to be to $645 billion in 2015. For 2016, we expect $905 billion in purchase originations. However, rates will likely continue to rise and cause refinances to decline to $415 billion for a total of $1.32 trillion in origination volume in 2016. The chart below shows historical mortgage originations estimates as well as our forecast. Even with the significant percentage increases in purchase volume expected, the level of purchase originations in 2016 is expected to just match the level of purchase originations in 2000, considerably below levels from 2007. From 2016 on, we expect that the level of purchase originations will continue to increase before reaching the $1 trillion mark in 2018.
$Billion

**Mortgage Originations History and Forecast**

Source: MBA November 2015 Forecast

© 2015 Mortgage Bankers Association

*MBA Mortgage Finance and Economic Commentaries* - each month MBA Research provides commentary on the current mortgage finance and economic climates. For more information, please contact [Forecasts@mba.org](mailto:Forecasts@mba.org).