Domestic Economy Remains Strong, Global Growth Still Uncertain

*MBA Economic and Mortgage Finance Commentary: September 2015*

The economy is growing, and the job market continues to improve, but slower growth abroad and tighter financial conditions convinced Fed policymakers to wait at least one more meeting to increase rates. Real GDP growth for the second quarter was revised considerably higher than the advance estimate and indicators of consumer spending have been strong. The job market continues to show growth in payrolls along with declining unemployment, as job openings continue to reach record levels. However, global risks now dominate the outlook, most notably concerns over economic growth in China. Additionally, lower oil prices and a stronger US dollar have also contributed to downward pressure on US inflation.

The FOMC statement, which provided more definitive guidance stating that an increase will likely occur later this year, should help to reduce recent market volatility, which has been caused by the significant uncertainty about the Fed’s decision at this September meeting. However, even though a majority of Fed officials still expect a rate increase before the end of 2015, that number has decreased from 15 in June to 13 in September. There was one dissenting vote at this meeting from Richmond Fed President Jeff Lacker, which indicates that there continues to be disagreement regarding the pace of tightening that would best support growth while preventing inflation from creeping back into the economy.

In her press conference, Chair Yellen highlighted that the Fed remains data dependent, i.e. they will track a wide range of indicators to determine when they would raise rates. She also reminded the markets that the exact date of the initial increase is less important than the pace and ultimate endpoint of rate increases. She said that policy would remain highly accommodative and rate increases will be gradual. With regards to low inflation, Chair Yellen emphasized more than once that those factors holding inflation down are transitory and will likely dissipate over time.
We continue to expect that rates will trend up over the medium term. Mortgages rates, which have been just above 4 percent recently, are likely to end 2015 closer to 4.3 percent, and could reach 5 percent by the end of 2016. This increase in rates will lead to a reduction in refinance activity. However, the continued strengthening of the job market will more than offset the gradual increase in rates, and we continue to forecast stronger housing markets in the year ahead.

The US 10 Year yield had reached 2.3 percent earlier in the week prior to the FOMC statement, and fell from 2.21 percent the day of the announcement to 2.13 percent the day after the statement was released. We still expect an increasing trend in rates for the rest of the year as economic growth and labor conditions remain strong in the US, but expect shorter term volatility to remain as the global outlook continues to be murky. Our forecast is for the 10 Year to increase to 2.5 percent in the fourth quarter of 2015, averaging 2.3 percent for the year, then increasing to 2.9 percent in 2016.

The BEA’s second estimate of second quarter 2015 GDP growth showed that the US economy grew at a rate of 3.7 percent, significantly higher than the initial estimate of 2.3 percent, and quite an improvement from the 0.6 percent growth rate seen in the first quarter. 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 second quarter was 3.1 percent and that accounted for 2.11 percentage points of the overall growth rate of 3.7 percent. In terms of contribution to overall growth, spending on goods had the strongest quarter in a year as consumers continue to benefit from more stable employment conditions, a stronger dollar, and are more confident in their outlook for the future.
Businesses also picked up their spending in the second quarter, mostly in the area of intellectual property products and along with a slight increase in investment in structures, led to the strongest quarter of business investment since the third quarter of 2014. Residential fixed investment enjoyed another quarter of growth, and will likely be a slow and steady contributor to growth over the next few quarters as the housing sector continues its recovery. Net exports, which were expected to be a drag to growth, provided 0.23 percentage points to the increase in GDP in the second quarter as exports saw some resurgence. Additionally, there was a strong inventory component driving second quarter growth, although this will likely pull some growth from the third quarter forward.

We expect GDP growth to continue at a similar pace in the second half of 2015 and to be driven by consumer spending. Residential fixed investment is also expected to strengthen as household formation grows. Our forecast for GDP growth is 2.4 percent in 2015 and 2.4 percent in 2016.

The US economy added 173,000 jobs in August and has now averaged 212,000 jobs per month in 2015. The previous two months’ payroll totals were revised higher by a total of 44,000 jobs. While the 2015

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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. The unemployment remained decreased to 5.1 percent, which was the lowest level since April 2008. The labor force participation rate held at 62.6 percent for the third straight month, and remained at its lowest level since 1977. Labor force participation remained low as new entrants and reentrants to the labor force continued to run well below historical averages. The number of reentrants is at its lowest level since 2008. The U6 measure of labor underutilization inched lower to 10.3 percent, the lowest the measure has been post-recession.

Average Monthly Payroll Growth
Seasonally adjusted, 000s of jobs

Source: Bureau of Labor Statistics

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. In August, the spread tightened slightly, but still remains over two percent below the peak.

![Spread between Labor Underutilization Rate (U6) and Unemployment Rate](chart)

Source: Bureau of Labor Statistics

In the BLS’ job openings and turnover report, better known as JOLTS, job openings continue to increase into record territory, while hiring and quits slowed. Total job openings in August increased to 5.75 million, an increase of 430,000 openings, which was the largest single month increase since April 2010. The number of hires in August dropped to 4.98 million, the lowest level since August 2014. 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.
Overall inflation continues to be held down by low fuel prices but the year over year decrease in motor fuel prices has started to get smaller. Although fuel prices began to firm slightly over the past few months, they are still 23.4 percent lower than the same month a year ago. Core inflation, which excludes food and energy, increased 1.8 percent from a year ago in August, signaling that prices are not quite as weak as the headline number suggests. Growth in the shelter component leveled off a little in recent months, but picked up slightly in July and August, and remains high in terms of its year over year growth. While inflation is seeing downward pressure from a stronger US dollar and weaker growth overseas, these factors should dissipate over time and we expect overall prices to stabilize over the next year and edge back up to the 2 percent mark during 2016.
Mortgage applications continued to show a mix of results, with both purchase and refinance applications increasing slightly toward the end of August as rates decreased, but that was short lived as we saw applications decrease again in the first two weeks of September. Purchase applications remain almost higher on a year over year basis despite recent week to week declines. We expect that refinance activity will remain generally subdued as 85 percent of agency, 30 year fixed borrowers have a 4.5 percent rate or lower, leaving much fewer borrowers with an incentive to refinance. As short term rate volatility persists, we do expect small increases from time to time as borrowers who may still be repairing credit, employment, or income, or who may still be rebuilding home equity positions, return to the market when rates dip and the refinance opportunities arise.
With increasing home values and an improving job market, total home sales (new and existing) in July exceeded 6 million units, the long run average, for the first time since April 2007 on a seasonally adjusted annual basis. Over approximately the same time frame, the fed funds rate has been kept at the zero bound, although we do anticipate that the first rate hike will occur in December 2015.

Source: MBA compilation of data from JP Morgan and Deutsche Bank
We estimate a total of $1.39 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations will drive the increase, increasing to $801 billion in 2015 from $638 billion in 2014. Refinances are expected to be to $571 billion in 2015. For 2016, we expect $885 billion in purchase originations. However, rates will likely continue to rise and cause refinances to decline to $379 billion for a total of $1.26 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 through 2015 and 2016. However, even with the significant percentage increases in purchase volume expected, the level of purchase originations are still considerably below levels from 2000 to 2007.
Mortgage Originations History and Forecast

Source: MBA September 2015 Forecast

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