Economic Growth Expected to Increase in Second Half of 2016

MBA Economic and Mortgage Finance Commentary: September 12, 2016

Despite a weaker than expected first half of 2016, we expect that economic growth will increase more rapidly in the second half of the year. Consumer spending, which accounts for over 60 percent of US GDP, grew at a fairly rapid pace in the first two quarters of 2016, but businesses did not invest in or replenish their inventory at a matching pace, and this held growth down somewhat. This inventory investment is expected to pick back up in the second half of the year, which will provide a boost to growth. Further improvement in wage growth along with an already strong job market will help to support consumer spending, although the pace of job market improvement may be slowing slightly. Our forecast is for GDP growth in 2016 to be around 1.8 percent, increasing to 2.1 percent in 2017 and 2.0 percent in 2018.

With the strength in economic growth also comes upward pressure on rates, however, concerns over global growth and financial markets will continue to keep rates lower and for a longer period of time. There is still a significant amount of volatility in rates given how edgy markets are around key economic data, the Fed’s upcoming rate increase, and oil prices. For example, the US 10 Year yield jumped 12 basis points in a span of four days last week, reaching the highest level since before the Brexit vote, on two main news items; first, that the ECB would not be adding further stimulus measures and second, an unexpected increase in oil prices. Our expectation is that the 10 Year yield will continue to rise slowly in 2016, finishing at 1.8 percent for the year, before increasing to 2.3 percent in 2017 and 2.7 percent in 2018.

There has been much speculation of a September rate hike from the Fed both in the media and from analysts watching the Fed’s actions and the potential impact markets. Recent communication and speeches by key Fed officials have sent both hawkish and dovish overtones, so it has been relatively more difficult to predict a September outcome. While we think that a September rate hike is still a possibility, the odds are low and we expect that the Fed will most likely raise the Fed Funds rate in December. Given how close the November FOMC meeting is to the presidential election, we think it is highly unlikely that there will be a November rate increase.
There also seems to be increasing uncertainty around the next US presidential election, due to be held in November 2016. Markets seem to have their doubts over both candidates and the policies they will bring to the table, causing a little more concern than in past elections. We think that the recent weakness in ISM business sentiment indicators are a consequence of this uncertainty and there will be more of such an impact showing up in the data in coming months.

With still-low mortgage rates and a generally healthier home equity picture in the housing market, our current estimate of refinance origination volume for 2016 is $857 billion compared to $749 billion in 2015, a 14 percent increase over the year. With recent mortgage rates around 3.7 percent according to the MBA Weekly Applications Survey, and in comparing this to information on agency 30 year fixed mortgages outstanding, there remains a portion of borrowers who have a rate incentive to refinance. However, due to reasons such as insufficient home equity, credit, or employment, to name a few, these borrowers have not acted or not been able to act. As rates start to increase, it will be more difficult for refinancing activity and we expect a fairly steep drop off in refinance volume as a result. We expect the 30 year fixed mortgage rate will still be below 4 percent until early 2017, but to increase to 4.2 percent for the full year 2017 and 4.6 percent in 2018.

In addition to the sustained refinance volume, lower rates also seem to be helping potential homebuyers enter the market, although purchase activity has eased in recent weeks. The combination of low rates and a strong job market will drive purchase originations. Potential homeowners with a plan to purchase may decide to act earlier to take advantage of lower rates, and the security of employment and potential for increasing wages will support household formation and home purchases in the longer run.

Purchase originations are expected increase 11 percent in 2016 as well, totaling $981 billion, compared to $881 billion in 2015. The gains in the purchase market are generally broad based, occurring in all loan size tiers, although the high loan balance segments are still growing faster than the lower balance segments. Overall origination volume for 2016 is thus expected to total $1.84 trillion compared to $1.63 trillion in 2015.

As noted earlier, the US job market remains strong. The BLS reported a gain of 151,000 jobs in August, following two straight months of adding around 270,000 jobs. The average number of job gains per month has been over 180,000 jobs, and that included an anomalous month in May, where the economy only gained 24,000 jobs. In all the other months of 2016 thus far, job growth has averaged over 200,000 jobs per month. Additionally, most major industries have seen payroll growth over the year, with mining and utilities, which includes oil related payrolls, seeing the biggest losses as oil prices have oscillated close to 10 year lows. The arts and entertainment, professional and technical, and construction sectors have led the increases in recent months (on a year over year basis). The gains in the construction sector, both residential and nonresidential construction, are particularly encouraging to the housing sector, as this typically signals some near term confidence in the market.
Average Monthly Payroll Growth

Seasonally adjusted, 000s of jobs

August 2016 Change By Industry Group

YOY Pct Chg in Payrolls

Source: BLS
The unemployment rate remained unchanged at 4.9 percent in August for the third straight month, close to the lowest level since the start of the Great Recession in the 2008 and 2009 period. Labor force participation was also still low by historical standards at 62.8 percent. The U6 measure of labor underutilization, which accounts for labor potential outside the work force, was at 9.7 percent, remaining near its lowest level since 2008. We expect the unemployment rate to decrease further to 4.6 percent by late 2017, but remain at that level through 2018 as labor force participation recovers.

Additionally, average hourly wage growth has started to firm. The increase over the year in August was 2.4 percent, down from 2.7 percent in July, but for 2016 thus far, we have seen the strongest year for wage growth since the recession. As noted in last month’s commentary, we also saw a pickup in the Employment Cost Index for Wages in the second quarter of 2016, which showed a 2.5 percent year over year increase. The ECI for Wages had been showing growth of around 2 percent or less for all but one quarter since 2009. In the most recent JOLTS data, job openings increased again and outpaced hiring for the fifth straight month, a sign that employers may not filling open positions as quickly as they would like, which will likely lead to more upward pressure in wages. We expect to see wage growth start to pick up more significantly in coming months, which will help support the higher rate of consumer spending, along with household formation and housing demand.

Finally, the chart below shows how mortgage originations have trended since 1990, along with our forecast for 2016, 2017, and 2018. As outlined earlier in the commentary, our estimates for mortgage originations have increased slightly compared to last month’s forecast. We expect $1.84 trillion in total mortgage originations in 2016, with around $980 billion coming from purchase and $857 billion from refinances. Our estimates for purchase originations in 2017 and 2018 are expected to continue to grow relative to 2016, as continued economic growth and a strong job market will support household formation. Household formation in turn will boost housing demand, as we see the millennial generation age and move closer to homeownership age, and as minority households grow as well. Incentives to refinance may stick around a little longer if rates continue to surprise on the low side, but will still be sensitive to rate movements as the pool of potential borrowers who can refinance or benefit from refinancing is relatively small.
Estimated Mortgage Originations: 1990-2018

Source: MBA Mortgage Finance Forecast