MBA Forecast Commentary
Joel Kan, jkan@mba.org

Weaker First Quarter, But Growth to Pick Back Up

MBA Economic and Mortgage Finance Commentary: April 2015

Highlights from this month’s outlook:

1. Weak first quarter for US economic growth, but we expect growth to strengthen in the second quarter.
2. In March, net job growth came in below 200,000 for the first time in over a year. Nonetheless, we think the job market is strengthening given the very high level of job openings, level participation rate, and signs that wages are beginning to increase more rapidly.
3. Continuing low rates boosted refinance activity last month, causing us to revise our refinance estimates higher.

Most economic indicators pointed to a weaker period of growth in the first quarter of 2015. The fourth quarter’s growth rate was 2.2 percent, which was already slightly disappointing, but still above trend growth of 2 percent. We expect that the first quarter slowdown is due to temporary factors (for example, the port labor dispute) and that a bounce back will occur in the second quarter and through the rest of 2015. Oil prices remain low, leading to lower fuel prices for households, providing more disposable income. However, consumer spending data such as retail sales showed less growth than expected. Business activity slowed toward the end of 2014 and continued to see a slow start into 2015. New orders of core capital goods decreased for six straight months, as of the February 2015 release, while shipments of core capital goods saw a small increase, although shipments have fallen in three of the previous five months. Industrial production in March fell for the third time in four months, dragged down mainly by a pull back in gas and electric utilities production. Overall capacity utilization decreased for the fourth straight month.

Employment growth was strong to start the year but a slowdown in job growth in March, in addition to downward revisions of the January and February numbers, raised concerns that the labor market is not as strong as previously thought. However, it is likely that the slowdown in March was caused by a
mismatch in the skills sought by employers to those possessed by the workers looking for jobs, and less from broader hiring slowdowns. Job openings continue to increase and at a fairly rapid pace, an obvious sign that companies want to hire. That being said, the drop in oil prices is starting to impact job markets in oil dependent states like Texas, and will likely become more significant in coming months.

US housing slowed in the first quarter, with both single family and multi-family housing starts coming in lower than expected in February and March. Again, this was blamed on severe winter weather, and anecdotal and qualitative survey data such as the NAHB’s builder sentiment index indicate that home building activity may rebound later in the spring. Existing home sales, which make up a bulk of home sales, were also weak in the first two months of the year.

Interest rates remain low, primarily on concerns about economic growth abroad and aggressive monetary policy moves by the ECB and BOJ. This helped keep mortgage rates low and has propped up some refinance activity. We saw more refinance applications than expected in March, and we have raised our second quarter mortgage originations estimates slightly as a result.

A strong economy, job growth, and increasing wages should provide the push for more household formation, and consequently, a lift for housing overall. 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 begun to tail off in recent weeks, even with mortgage rates still below 4 percent. We now look to the purchase market to help lift mortgage originations for the next two years, as new households form and entry-level buyers return to the market.

Overall inflation continues to be held down by fuel prices, but we expect these prices to stabilize over the next year and edge back up to the 2 percent mark. Fuel prices have 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 suggests. The shelter component has leveled off a little in recent months, but is still generally high in terms of its year over year growth.

Our projection for overall US economic growth is 2.5 percent in 2015 and 2.5 in 2016, which will be driven mainly by strong consumer spending and steady business fixed investment. As shown in the chart below, consumer spending is still a very important component of growth and will continue to account for most of US economic growth over the next two years.

© 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.
Interest rates trended down throughout 2014 and as noted earlier, have started out low in 2015 as well. Continuing their flight to quality, global investors have put downward pressure on longer-term Treasury yields. Our forecast for the 10 Year Treasury yield is 2.2 percent for 2015 and 3.0 percent for 2016, and our forecast for the 30 Year Fixed mortgage rate is for 4.0 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 now expect that the “data dependent” Federal Reserve will make its first increase of the fed funds rate in September 2015.

After the March employment situation report, payroll growth in the US averaged a little less than 200,000 jobs per month in 2015, compared to an average of 260,000 jobs per month in 2014. However, other measures of labor market health, such as data on job openings and voluntary quits continue to show positive signs. The number of job openings continues to increase, as does the quit rate. Over the last year both job openings and the rate at which individuals voluntarily quit their job have been increasing at a faster rate than firms can hire. Quits are viewed as a favorable indicator of job market prospects and are positively correlated with consumer sentiment. Total separations include quits, layoffs and discharges, and new jobs are calculated as hires less separations over the course of a month.
With job openings still on the rise but actual hiring slowing, it is possible that employers are having difficulties filling open positions with workers who have the desired skill set.

An increasing quit rate is seen as a positive development because it implies that workers are feeling secure enough in their job prospects that they are willing to quit their current jobs to find a new job, presumably one that is better paying or with better conditions in general. Conversely, quit rates tend to drop during recessions or times of deteriorating job market conditions because employed workers tend to stay in their secured positions longer.

![Chart of the Week - April 10, 2015 Private Job Openings, Hires and Quits](image)

Source: BLS

We forecast monthly job growth will average 220,000 per month in 2015, and that the unemployment rate will decrease to 5.3 percent by the end of 2015 and 5.0 percent by year end 2016. We expect the unemployment rate to bottom out at around 5 percent because labor force participation is expected to increase once wages rise and hiring becomes more competitive. Increasing labor force participation generally exerts upward pressure on the unemployment rate.
Despite lower than expected rates and a growing economy, mortgage credit remains tight by historical standards, although we have seen an increase in the supply of mortgage credit over the past two months. Freddie Mac’s introduction of their 97 LTV program (Fannie Mae’s was implemented in December), additional loosening of parameters on jumbo loan programs, an increase in offerings of cash-out refinance loans, and continued expansion of the FHA streamline refinance and VA Interest Rate Reduction Refinance Loan (IRRRL) programs all contributed to growth in overall credit availability in March.

Source: MBA Mortgage Credit Availability Index

A notable piece of news from our Weekly Application Survey was that FHA activity has seen a sustained increase in recent months following the announcement of MIP reductions in mid-January. Even though the FHA refinance index decreased from its recent peak, it remains more than twice the pre-MIP reduction level. FHA purchase applications did not increase quite as dramatically, but remain around 25 percent higher than before the MIP was reduced.
We estimate a total of $1.2 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations will drive the increase, increasing to $729 billion in 2015 from $638 billion in 2014. Refinances are expected to be to $512 billion in 2015. We revised our refinance estimate upward again in response to strong refinance applications in March. For 2016, we expect $791 billion in purchase originations. However, rates will likely continue to rise and cause refinance 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.
Mortgage Originations History and Forecast

Source: MBA March 2015 Forecast