Continued Growth in the Economy; Mortgage Performance Improving

MBA Economic and Mortgage Finance Commentary: February 2015

Highlights from this month’s outlook:

1. Given solid US economic and job market growth, we are anticipating that housing is poised for stronger growth in 2015.
2. Despite a positive outlook for the economy, rates continue to stay low, as worries over global economic weakness continue to attract investors to US Treasuries.
3. With lower than expected rates and increased refinance activity, our originations estimates were raised slightly for the first two quarters of 2015.

The US economy is continuing on a path of steady growth. 2014 resulted in the highest payroll growth since 1999. The number of unemployed workers per job opening is about 1.7 workers, significantly lower than 6.8 unemployed workers per job at the height of the recession. Consumer spending remains robust and has been the driver of recent quarters’ growth, supported by employment growth and the beginnings of upward pressure on wages. Lower oil prices have reduced costs for households, and a stronger US dollar has also resulted in lower import costs.

There remain concerns over global economic weakness and political unrest, which have had the impact of sustained downward pressure on interest rates. A strong economy, job growth, and increasing wages should lead to further increases in household formation, the most important fundamental for housing overall.

Real GDP in the fourth quarter of 2014 was estimated to have grown at a rate of 2.6 percent, following a 5.0 percent growth rate in the third quarter. Growth in PCE was 4.3 percent and that accounted for 2.9 percent of the growth rate. Nonresidential fixed investment saw positive growth, but was the weakest in three quarter. We expect the fixed investment component to pick up back to as businesses spend on
new plant and equipment to keep pace with consumer spending over the next few quarters. Federal government spending decreased significantly for the quarter, which was mostly payback for exceptionally strong third quarter defense spending.

Industrial production in the US increased slightly in January, with increases in the manufacturing and utilities sectors. Overall capacity utilization was unchanged from the previous month, as slight increases in utilization for manufacturing and utilities were offset by a decrease in the mining sector.

The ISM manufacturing index decreased in January 2015 to its lowest level in a year, but remained above 50, solidly in expansion territory. The anecdotal responses from the ISM survey were that consumer demand was strong, while West Coast port disruptions continued to weigh on businesses. Shipments and new orders of core capital goods, which are nondefense capital goods, excluding aircraft, have both trended lower in recent months. The advance report for December showed that new orders have declined for four consecutive months now, while shipments showed a small positive increase after two months of declines. These are indicators of current and future business fixed investment, thus contributing to our estimate of slightly lower business fixed investment at the end of 2014 and leading into 2015.

Falling oil prices and the stronger dollar have caused us to reduce our forecast for consumer price inflation to 1.4 percent for 2015 as we think that oil prices will remain low for a longer period of time. The shelter component of GDP, which had been increasing until the last month or so, is still exhibiting much stronger year over year growth than the overall index.
The US labor market has been strong, as job openings in both private and government sectors have increased steadily, and initial claims for unemployment insurance remain relatively low. In the January employment report from the BLS, non-farm payrolls grew by 257,000 jobs over the month. Government payrolls shrank by 10,000 jobs, following seven months of growth. The report also included sizeable upward revisions to the previous two months’ totaling 147,000 jobs. This report also reflected the annual benchmarking done by the BLS, and in summary, the average monthly payroll growth for 2014 was revised up to 260,000 jobs per month from 246,000 jobs as previously reported. The labor force participation rate increased to 62.9 percent and the unemployment rate increased to 5.7 percent. A synchronized uptick in both these rates is usually a positive sign that workers are returning to the workforce to seek employment.

While data on wage growth have been relatively disappointing, alternative measures of labor costs, such as the BLS Employment Cost Index (ECI) have shown an increase in compensation for civilian workers. While the year over year increases in the ECI are not back to historical averages, the 2.3 percent increases in the third and fourth quarters of 2014 were the biggest increases since 2008 and the recent trend has been in an upward direction. There has also been a significant improvement at the macro level in terms of job availability, with the ratio of unemployed workers to job openings continuing to
decrease, reaching the lowest since 2007. This is a useful, supplemental gauge of labor market health, showing that generally, the supply of jobs has improved, but does not account for any skill or occupational mismatches or geographic market differences.

**Ratio of Unemployed Workers Per Job Opening**

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 yearend 2016.

Our projection for overall US economic growth is 2.7 percent in 2015 and 2.5 in 2016, which will be driven mainly by strong consumer spending and steady business fixed investment, while the stronger dollar will weaken exports and start to cause some drag to growth. 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 in the next two years.
Interest rates trended down throughout 2014 and have started out low in 2015 as well. Continuing their flight to quality, global investors have put downward pressure on longer-term Treasury yields. We have lowered our forecast for the 10 Year Treasury yield to 2.3 percent for 2015 and 3.1 for 2015, our forecast for the 30 Year Fixed mortgage rate has declined to 4.2 percent in 2015 and 5.0 percent in 2016.

As a result of these low rates, specifically the 30 year fixed mortgage rate dipping below the four percent market for a few weeks, we saw a resurgence of refinance activity, although as rates have slowly started to climb in recent weeks, that surge has largely dissipated. There was however, enough refinancing for us to revise our first and second quarter originations estimates upward slightly.

Additionally, the FHA announced a 50 basis point reduction in its mortgage insurance premiums which have caused applications for FHA loans to increase. The chart below shows how FHA refinance application volume increased due to the combination of low rates and the MIP reduction announcement.
Despite lower than expected rates and a steadily growing economy, mortgage credit remains tight. While we have seen credit availability improve over the past year, much of that has been driven by the non-conforming jumbo market as shown in the chart below. This has included lenders offering more jumbo products to borrowers, which has been in line with increased purchase mortgage application activity for mortgages of higher loan balances, especially those exceeding \$625,000. Mortgage products in the agency conforming space have been approximately flat for most of 2014, and these levels are well below pre-recession levels. With the recent introduction, or reintroduction in some cases, of GSE 97 percent LTV products, we will be watching developments within our MCAI data very closely in coming months.

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In terms of mortgage performance, MBA’s recently released National Delinquency Survey reported that the delinquency rate for mortgage loans on one-to-four-unit residential properties decreased to a seasonally adjusted 5.68 percent in the fourth quarter of 2014. This was the lowest level since the third quarter of 2007, and was a 17 basis point decrease from the previous quarter, and 71 basis points from one year ago. The percentage of loans in the foreclosure process at the end of the fourth quarter was 2.27 percent, down 12 basis points from the third quarter and 59 basis points lower than the same quarter one year ago. This was the lowest foreclosure inventory rate seen since the fourth quarter of 2007. The percentage of loans on which foreclosure actions were started during the fourth quarter was 0.46 percent, an increase of two basis points from the previous quarter, but was eight basis points below the level of the fourth quarter of 2013.

The foreclosure inventory rate has decreased every quarter since the second quarter of 2012, and is now at the lowest level since the fourth quarter of 2007. Foreclosure starts ticked up two basis points,
after being flat last quarter, largely due to state-level fluctuations in the speed of the foreclosure process. Compared to the same quarter last year, foreclosure starts are down eight basis points.

**Mortgage Delinquency Rates**
Seasonally adjusted, excludes loans in foreclosure

Source: MBA National Delinquency Survey

At the state level, 45 states saw a decline in loans in their foreclosure inventory rates over the quarter, although judicial states continue to account for a disproportionately high share. Foreclosures starts increased in 28 states, but this has become more volatile with recent state-level mediation requirements and changing laws, as well as servicer procedures, dictating the changes from quarter to quarter. States that utilize a judicial foreclosure process continue to have a foreclosure inventory rate that is roughly three times that of non-judicial states.

Legacy loans continue to account for the bulk of all troubled mortgages. More recent loan cohorts, specifically loans originated in 2012 and later, continue to exhibit low serious delinquency rates. As

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credit quality has improved, and in a better economy and job market, we expect mortgage performance to improve in coming quarters.

**Seriously Delinquent Rate by Vintage Year: 2008 - 2010**

![Graph showing Seriously Delinquent Rate by Vintage Year: 2008 - 2010]

**Seriously Delinquent Rate by Vintage Year: 2011 - 2014**

![Graph showing Seriously Delinquent Rate by Vintage Year: 2011 - 2014]

Source: MBA National Delinquency Survey

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In closing, 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 $731 billion in 2015 from $638 billion in 2014. Refinances are expected to be to $491 billion in 2015, an upward adjustment from $471 billion previously reported. For 2016, where above-trend economic growth is still expected, the improvement in the housing and mortgage markets should continue, leading to $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 visually portrays 2014 as the first purchase dominated market since the mid 2000s, with that trend likely to continue into 2015 and 2016.

Source: MBA February 2015 Forecast

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