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MBA Forecast Commentary

Mike Fratantoni, Joel Kan

2019 Refinance Wave Continues as Rates Continue to Decline

MBA Economic and Mortgage Finance Commentary: August 19, 2019

The most significant development over the past month has been the precipitous drop in US Treasury yields and mortgage rates. Widespread investor concern over slowing economic growth in the US and in other major global economies, along with an escalating US-China trade have been two major contributors to this market angst. This has driven investors into government bonds all over the world, perceived as safer investments, to the point that we are seeing large amounts of negative yielding bonds in much of the sovereign debt outside of the US. Lower rates globally have in turn pushed US Treasury yields significantly lower and mortgage rates have followed, although not step for step.

Since hitting a recent high of over 5 percent in November 2018, the 30 year fixed mortgage rate has fallen more than a percentage point, and homeowners have responded strongly to the drop in rates, as more borrowers are now “in the money” and have a rate incentive to refinance. In the second quarter alone, refinance applications increased 30 percent from the first quarter and in the first two weeks of August, refinance applications surged another 50 percent, which will lead to higher than anticipated origination volume for the third and fourth quarters of 2019. We have now revised our forecast for refinance originations to increase 38 percent this year to $633 billion (chart 1).

In July, the Federal Reserve lowered short-term rates for the first time since 2008, citing factors similar to those mentioned above - ongoing uncertainty around trade, lower-than-expected inflation, and weakness in the global economy. They also left room for additional cuts at upcoming meetings, but noted that this was likely to be a mid-cycle adjustment, rather than a sustained move to much lower rates. The landscape has not changed much since then, and we expect that the Fed will cut rates one more time in 2019 and again in early 2020 as growth weakens.

An inverted yield curve is seen by many as the precursor to a recession, as it indicates that investors see a sharp slowdown in growth ahead. As shown in the chart below, the spread between the 10- and 2-year has averaged around 120 basis points since 1998, with the 10-year rate typically higher than the 2-year rate as investors are compensated for the higher risk of holding a longer term bond. Over the past two years, this spread has dropped below its average and in early August 2019, the curves inverted as the spread went negative. The spread between the 2-year and 3-month bonds averaged around 50 basis

points for the charted period until narrowing sharply in December 2018 and going negative in March 2019 through August 2019. This inversion is a clear signal that a further economic slowdown is likely. The question is whether growth will slow to a halt in early 2020, per our forecast, or whether the economy will enter a recession.

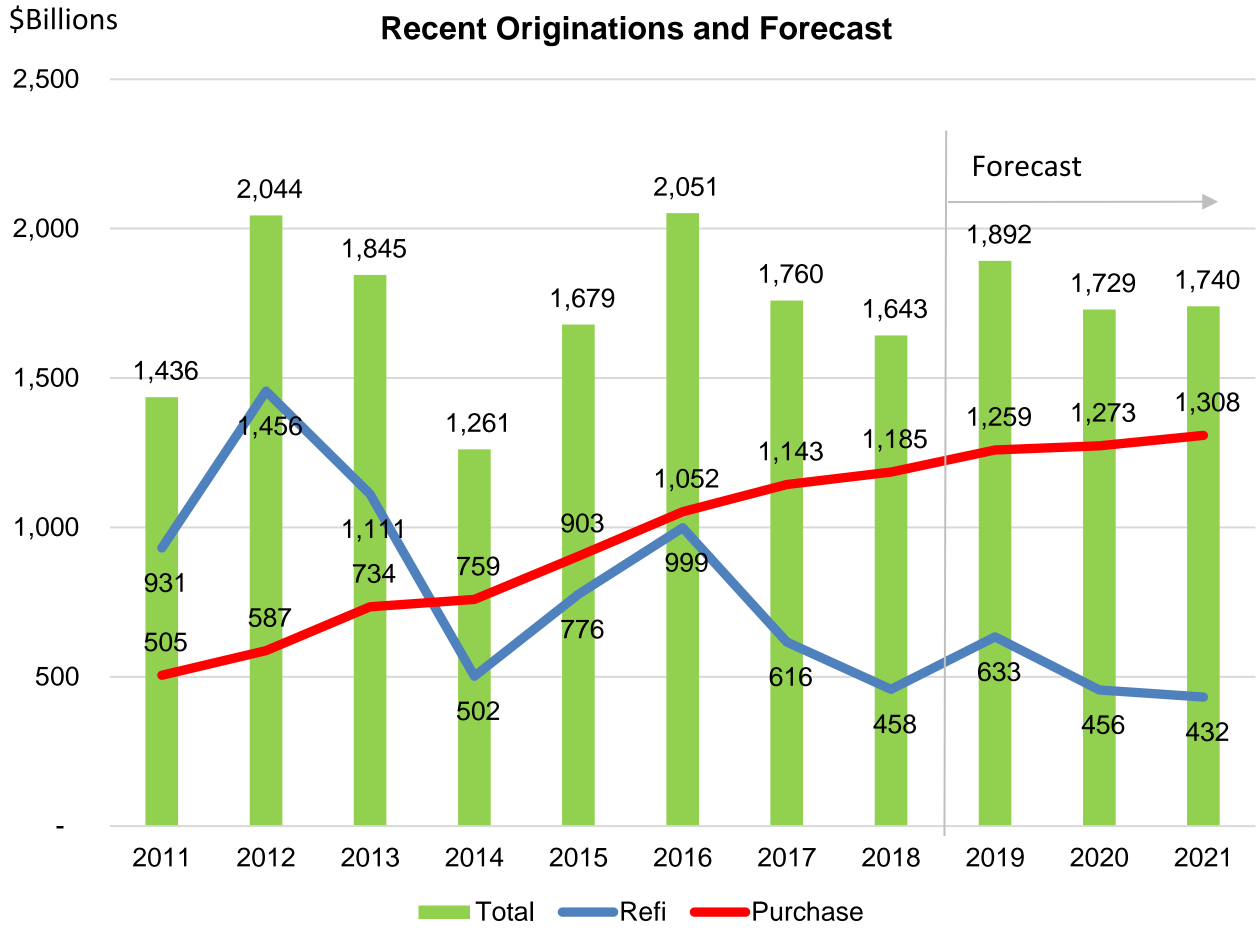
- After growing at a 3 percent rate in 2018, the strongest year for GDP growth since 2005, we forecast growth will slow to 2.0 percent in 2019, 1.1 percent in 2020 and 1.4 percent 2021. The U.S. economy averaged around 2.5 percent in the first half of 2019, on par with 2018's growth and stronger than anticipated, as consumer spending growth remained healthy and businesses had a strong first quarter. However, as mentioned earlier, we expect that this growth will slow as consumer spending and business investment is expected to cool off in the coming quarters and there is more of a drag to growth from the broader global slowdown.

- Monthly payroll growth rebounded to gains of 193,000 and 164,000 in June and July after a weak May, while the unemployment rate was unchanged at 3.7 percent. Job openings remain at high levels, and while the job market is currently very tight, we expect the unemployment rate will start to increase, reaching 4.1 percent in 2020 and 2021 as overall growth slows.

- The drop in housing starts in July was driven by a sharp 17 percent drop in multifamily starts, led by a drop in the Northeast. Nationally, single-family starts were up for the month and the year. Applications for the purchase of new homes increased in July, and we anticipate that builders are going to react to this pickup in sales, now supported by extremely low mortgage rates, by increasing the pace of construction. However, although builder confidence is high, the lack of skilled labor continues to be a constraint on the pace of building. Growth in job openings in the construction sector continues to outpace hiring (see chart 4).

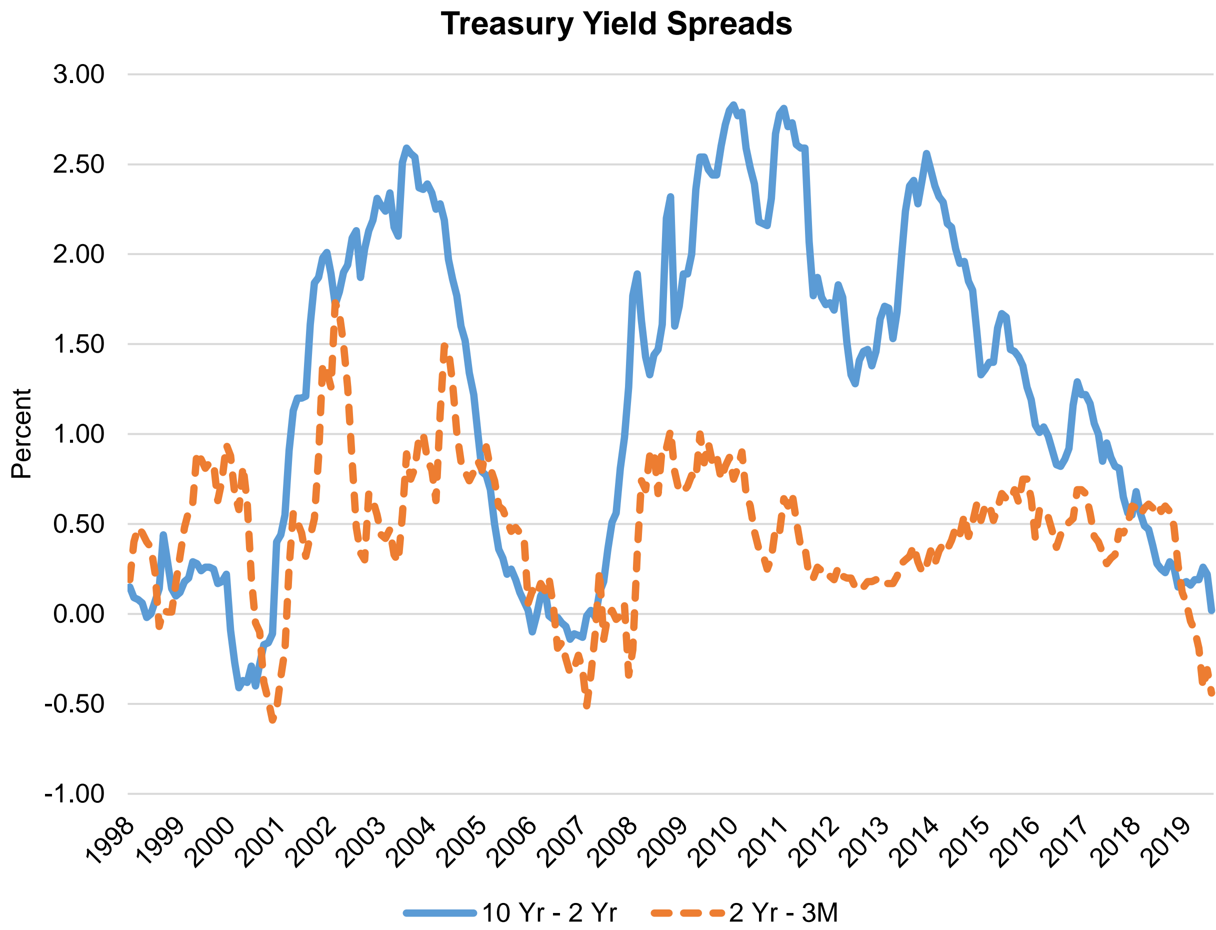
- As discussed earlier, the lower than expected mortgage rate levels have led us to revise the refinance originations forecast higher. We now expect $633 billion in refinance volume for 2019, a 38 percent increase from 2018. We also expect moderate growth in home purchase mortgage originations in the coming years, with dollar volume increasing about 5 percent to $1.26 trillion in 2019 from an estimated $1.19 trillion in 2018. Total originations are expected to increase to $1.89 trillion in 2019 from $1.64 trillion in 2018 as a result of the upward adjustment to refinance volume.

Figure 1.



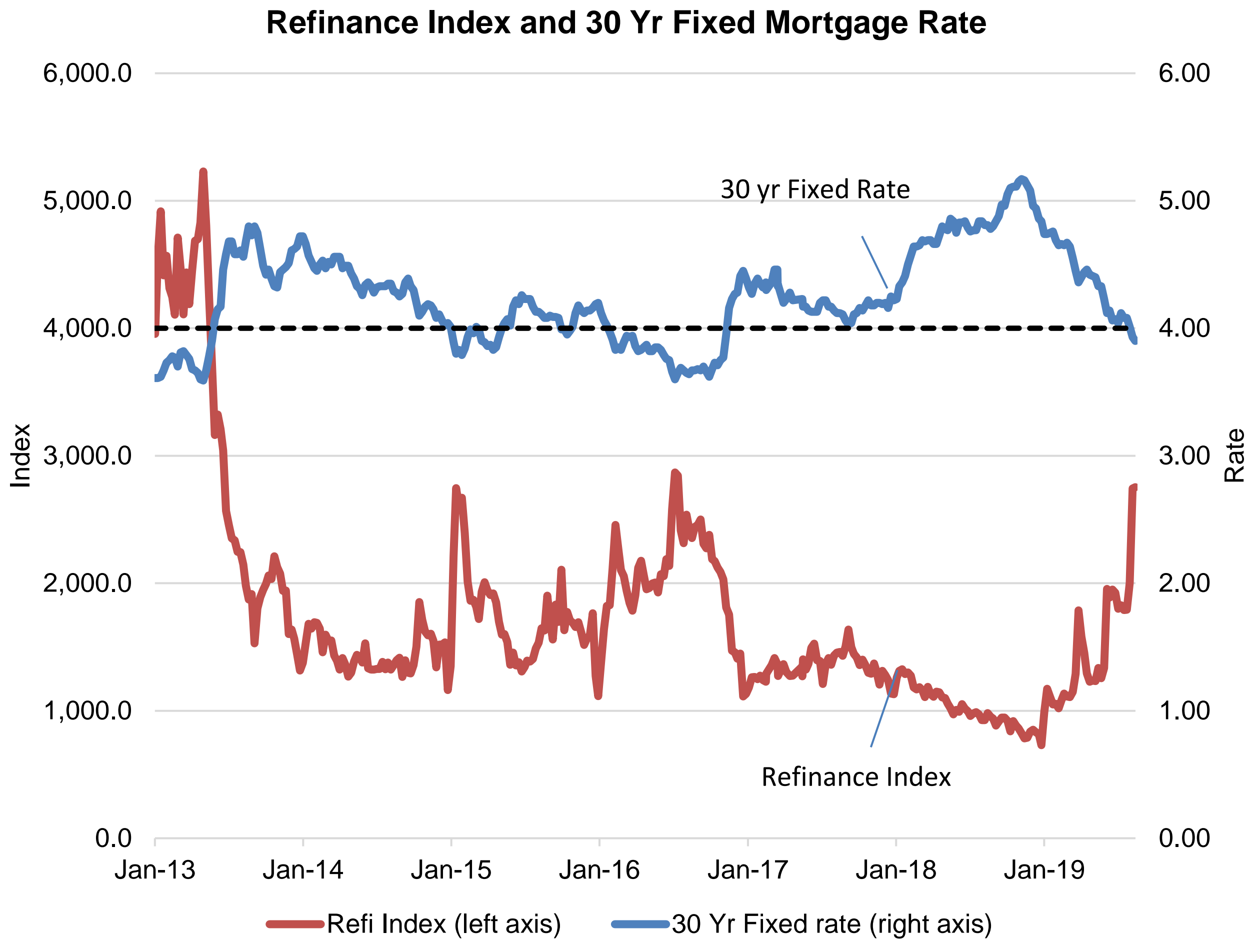
Source: MBA Forecast

Figure 2.



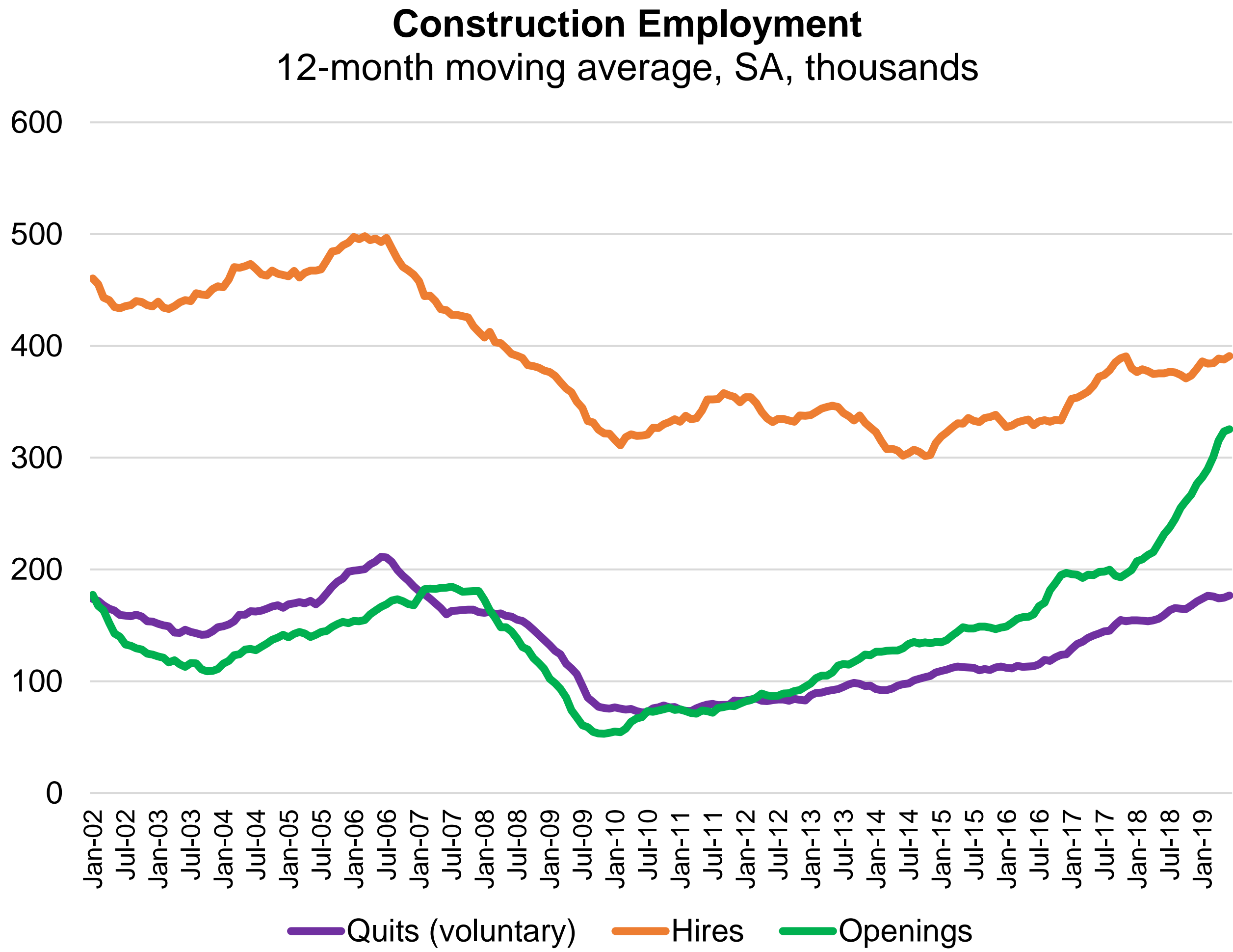
Source: BLS

Figure 3.



Source: MBA Weekly Applications Survey

Figure 4.



Source: Bureau of Labor Statistics