

MBA Forecast Commentary: December 21, 2021

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Pandemic Uncertainty Arises Again, Faster Fed Tapering

As we approach the end of 2021, we face renewed uncertainty from the pandemic. The rapid spread of the Omicron variant has caused many to re-assess whether the robust economic recovery that began in mid-2020 and that has lasted through 2021 can continue at this pace. Odds are that this turn in the pandemic will likely be just a temporary setback. There will likely be more challenges to come, but an increasing vaccination rate, along with the experience and knowledge gained in dealing with the virus thus far, will hopefully reduce the severity of any adverse impacts on the economy.

We expect economic growth to average 5.5 percent in 2021 and to continue to grow at an elevated rate of 4.0 percent in 2022. Consumer demand for goods remains strong and the job market continues to improve, however the sustained high level of demand has added to pressure on supply chains, which were already under stress because of pandemic-induced disruptions. These supply chain bottlenecks have weighed on growth and have added to upward pressure on prices for both households and businesses. Overall consumer prices, as measured by the CPI, grew 6.8 percent year-over-year in November, the largest annual growth rate since the 1980s and the core CPI was up 4.9 percent, its largest since the 1990s. We expect higher levels of inflation to last through the end of 2022 as supply chain challenges gradually get worked out, but also as the boost to spending from fiscal stimulus wanes, reducing some demand for goods.

There is one major component of household spending that will likely see longer lasting inflationary impacts. The cost of shelter, which accounts for around 30 to 40 percent of household spending, has moved to its highest level since 2007 given increasing rental costs and accelerating home price appreciation as the US continues to see a shortage in housing. Due to the way shelter costs are measured in the CPI, we will likely see additional inflation from shelter over the next few years.

Given the inflation picture, it was no surprise that at the most recent FOMC meeting in December, the Federal Reserve moved to accelerate their taper of Treasury and MBS purchases, and signaled that the first rate hike will be coming sooner rather than later. The median FOMC voter now expects three rate hikes in 2022, although this is dependent upon a forecast of still strong growth and elevated inflation. The Fed's outlook for economic growth in 2022 has improved, while their forecast for inflation has worsened given the incoming data.

Mortgage rates have been kept lower than they otherwise would have been through the Fed's purchases of longer-term Treasuries and MBS. Given this faster rate of tapering and improving economy, we forecast that mortgage rates will rise to 4 percent by the end of 2022 and may be more volatile as the Fed backs away from the market, reducing its role as the largest buyer of MBS.

As rising mortgage rates lead to a drop in refinances, we expect that the strong economy will support an increase in home sales in 2022. Thus, we see 2022 as a transition year, moving from a refinance market to a purchase market, and we expect both 2022 and 2023 to be record years for purchase originations. While the market has struggled with a lack of inventory in 2021, and builders have reported ongoing supply chain challenges, there are growing numbers of homes under construction which will add to the inventory of new homes for sale. The inventory of existing homes (1.1 million units) remains extremely tight at less than half the long term average, but the addition of new homes to the mix should lead to more choices for potential buyers in 2022, including many who had hesitated to list their homes in 2021. This in turn should lead to an increase in the number of existing homes listed. Given the strong path of home sales, purchase originations are expected to finish 2021 at just over \$1.61T, the strongest year since 2005, and further increase to a record \$1.74T in 2022.

Additional housing inventory is sorely needed. Based on the most recent data, home prices nationally have been increasing at about an 18 percent rate compared to last year, with double-digit growth in almost every part of the country. The rate of house price appreciation is more than four times the pace of income growth and that is clearly not sustainable, particularly for potential first-time homebuyers. While existing homeowners can cash in their equity gains and use that gain toward a down payment for their next home, first-time buyers are seeing their chance to buy decrease, or at least are having to re-think the types and locations of properties that they might be able to afford. As a result, we have seen median sales prices and average mortgage sizes continue to grow, and the share of first-time home buyers has declined to 26 percent of existing home sales, down from 32 percent in November 2020.

Our forecast for an increase in housing starts and home sales, coupled with our expectation of higher mortgage rates, should together lead to deceleration in home-price growth to around 5 percent in 2022.

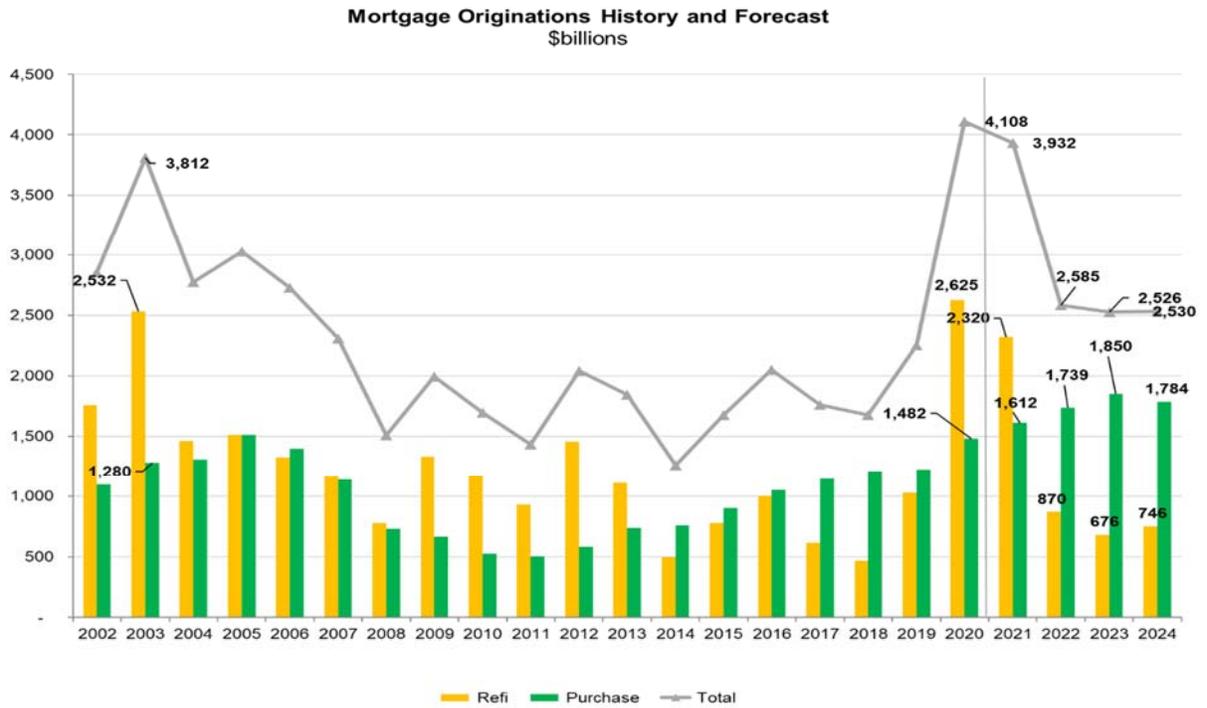
For 2021, refinance originations are expected to come in at \$2.32T, a decline from \$2.63T in 2020, but still the third largest refinance total ever. However, as rates increase and fewer borrowers have an incentive for a rate/term refinance, we expect 2022 refinance volume to be under \$900B. Data from our applications survey continue to show that even with mortgage rates still in the 3.2 to 3.3 percent range, refinance applications remained well below where they were a year ago, as most qualified borrowers have already refinanced into lower rates.

Figure 1.

| | 2020 | 2021 | 2022 | 2023 | 2024 |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| GDP Growth | -2.3% | 5.5% | 4.0% | 2.2% | 1.9% |
| Inflation | 1.2% | 6.4% | 3.0% | 2.0% | 1.9% |
| Unemployment | 8.1% | 5.4% | 3.7% | 3.5% | 3.7% |
| Fed Funds | 0.125% | 0.125% | 0.875% | 1.625% | 2.125% |
| 10-year Treasury | 0.9% | 1.5% | 2.3% | 2.5% | 2.5% |
| 30-year Mortgage | 2.8% | 3.1% | 4.0% | 4.3% | 4.3% |
| New home sales (000s) | 828 | 788 | 924 | 1,031 | 1,025 |
| Existing home sales (000s) | 5,678 | 6,126 | 6,446 | 6,597 | 6,417 |
| Purchase originations (\$B) | 1,482 | 1,612 | 1,739 | 1,850 | 1,784 |
| Refi originations (\$ B) | 2,625 | 2,320 | 870 | 676 | 746 |
| Total originations (\$B) | 4,108 | 3,932 | 2,609 | 2,526 | 2,530 |

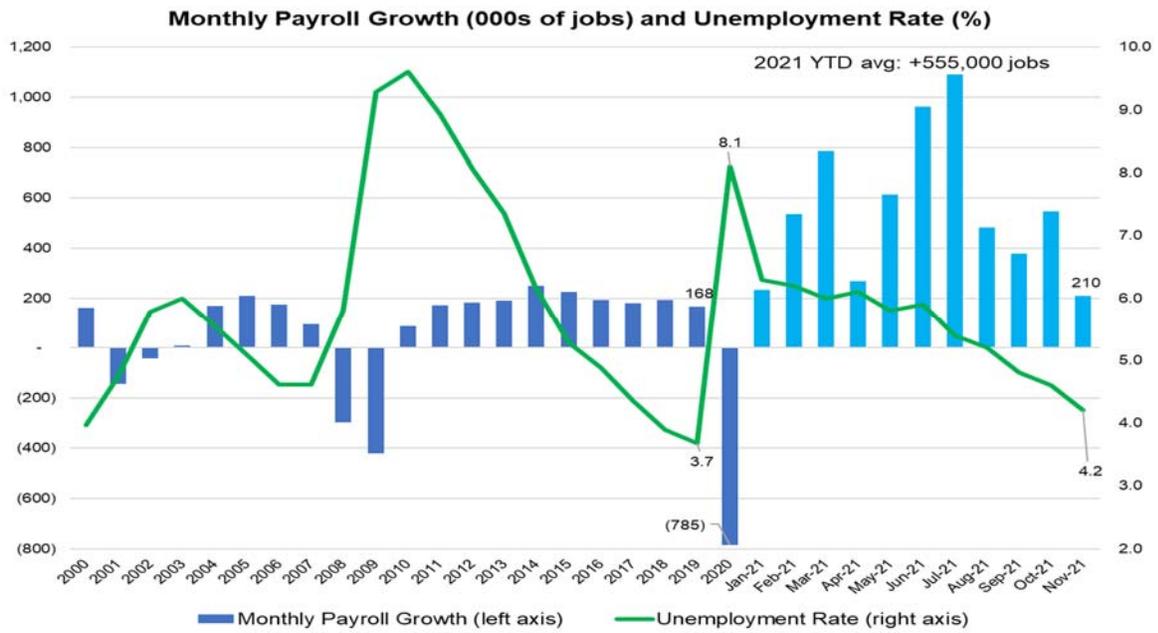
Source: MBA Forecast

Figure 2.



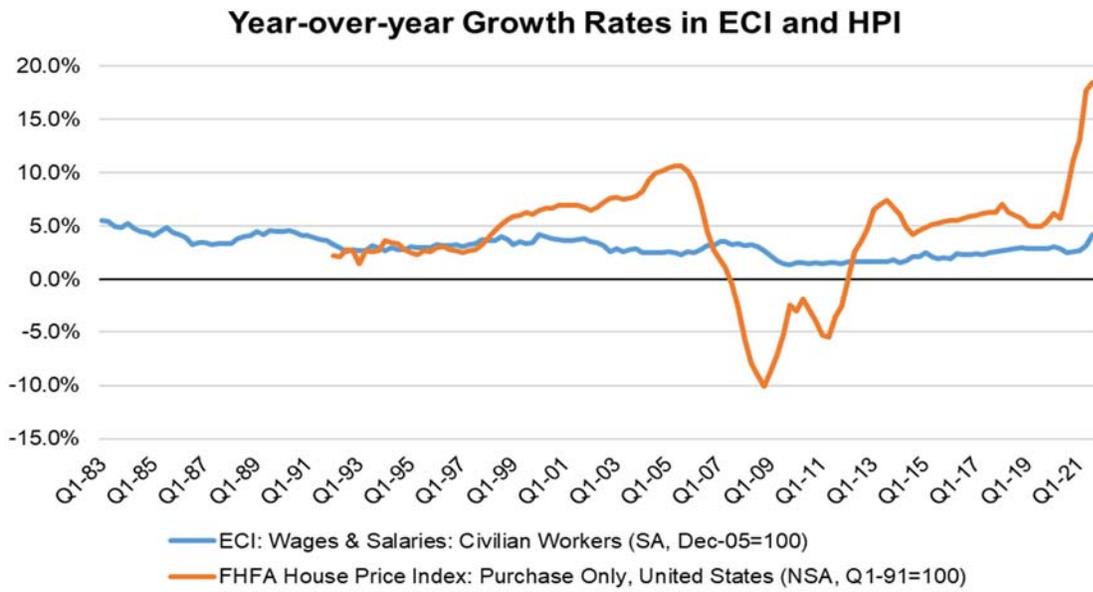
Source: MBA Forecast

Figure 3.



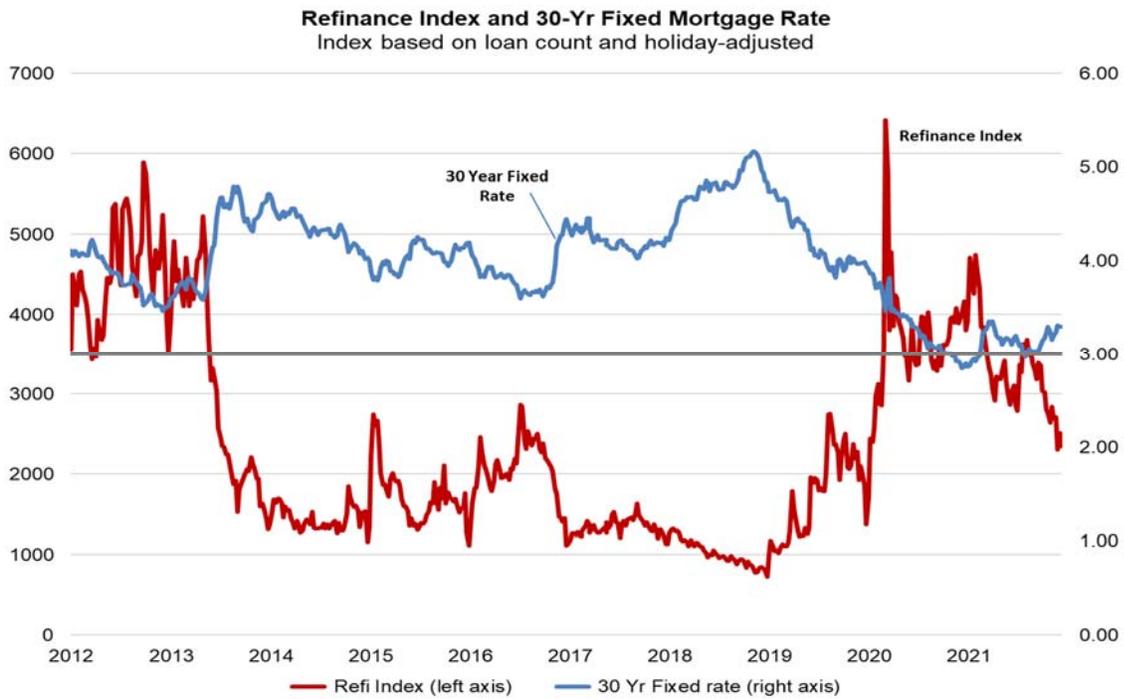
Source: Bureau of Labor Statistics

Figure 4.



Source: Bureau of Labor Statistics

Figure 5.



Source: Mortgage Bankers Association