More Rapid Increase in Rates, Inflation, and Home Prices

We expect rapid economic growth in 2021 given the COVID-19 vaccine rollout, continuing labor market improvement, and higher likelihood of a substantial fiscal stimulus bill being passed in coming months. Additionally, the BEA estimated that the fourth quarter of 2020 grew at a four percent pace, stronger than expected. The growth was led by business investment in new equipment and residential investment, both of which are a strong sign that companies and households are confident of a return to a more robust rate of activity in the year ahead. The spending on home construction is sorely needed given the record low level of inventory in the housing market.

In February, we raised our estimate of annual real GDP growth in 2021 to 5.9 percent from 3.7 percent in the previous month’s forecast, with most of the increased growth coming in the second half of 2021. With a widely distributed vaccine reaching more of the country, we anticipate that many consumers will unleash pent-up demand fueled by the cash they have been saving over the past year. This is especially so in the service sector of the economy, which has been most severely impacted by the limited or even absence of in-person transactions. As a result, growth in consumer spending is expected to exceed 5 percent in 2021, after contracting by 2.6 percent in 2020. We noted previously that jobs related to leisure and hospitality were still lagging the overall recovery and when this wave of spending returns, we also expect that many of these jobs will be recovered as well, adding to this picture of improvement.

The jump in rates and rate volatility reflect the ongoing debate among market participants regarding how quickly the economy may return to “normal”. However, the weight of the evidence now points to further increases in rates. We need additional government spending to fund the relief package, and there will be upward pressure in rates due to the increase in economic growth and inflation. There have already been various data points such as the Producer Price Index and metrics on shipping costs pointing
to higher input costs to businesses as they prepare to meet this increase in demand, but also continue
to manage various supply chain complications because of the pandemic. These increased costs in many
cases will be passed on to the consumer in the form of higher prices. The 10-year Treasury yield started
2021 just under one percent, and briefly reached 1.6 percent this week before falling back to 1.4
percent. We now expect the 10-year yield to average 1.6 percent by the end of the year, but could move
higher given the recent jump. The 30-year fixed mortgage rate likely to follow a similar path, increasing
to 3.4 percent by the end of 2021. The spread between the 30-year fixed mortgage and 10-year Treasury
yield has narrowed in recent months, to a point where we might see profitability challenges for some
lenders, and thus keeping them from holding rates low as Treasuries move higher. Thus, mortgage rates
should track more closely with Treasury rates as they increase.

This increase in mortgage rates is expected to cause a significant slowing in refinance activity in 2021.
The 30-year fixed rate was below 3.5 percent for most of 2020, and below three percent for the second
half of the year. As mortgage rates increase, there will not be many borrowers left who can refinance, so
we expect refinance originations to total $1.39T in 2021, a 39 percent decrease from an estimated
$2.27T in refinance originations in 2020. Our estimate for 2021 refinance originations was revised
higher, as incoming data on the first quarter continues to show a robust pace of refinancing, but we still
expect a sharp falloff in the second half of 2021 as rates increase.

We expect to see a continuation of strong housing demand 2021, both from millennial first time
homebuyers and households looking to move into larger, newer homes, some in less dense markets.
Purchase originations are poised for a 10.5 percent increase in 2021 to a record high of $1.57T in 2021,
an upward revision of $10B from last month’s forecast, after $1.42T in 2020.

The FOMC left rates unchanged at their January 27th meeting, continuing to indicate that short-term
rates will stay low for years to come. With respect to asset purchases, the statement also made clear
that the Committee is waiting for “substantial further progress” until they begin to taper their purchases
of Treasuries and MBS. However, market participants remain uncertain regarding how to interpret the
Fed’s asset purchase intentions, and are wary of another quick move in rates, should the economy
rebound strongly in the second half of this year. MBA does indeed forecast for faster economic growth,
given the positive news in recent weeks regarding improved vaccine deployment. As we see inflationary
pressures build and the unemployment rate continue to decline, we will continue to be vigilant for signs
or communication that the Fed is at least thinking about slowing their asset purchases. As we saw in
2013’s “taper tantrum” episode, the announcement of such a change in plans would impact market rates well in advance of the actual change.

Total employment rebounded in January following a decline in December, but the small increase leaves the economy with almost 10 million, or 6.5 percent, fewer jobs than in February 2020. The job losses in December were once again concentrated in leisure and hospitality, and that continued last month, with gains overall hard to find outside of temporary help services. Leisure and hospitality employment was 3.8 million, or 23 percent, lower than in February 2020. The increase in average weekly hours, coupled with the boost in hiring of temps, suggests that employers are poised to hire more over the next several months if the economy rebounds as we expect.

Although the headline unemployment rate declined to 6.3 percent in January, there are still 4 million people who have been actively looking for work for 27 weeks or longer. These are the workers that need additional support from the proposed stimulus bill, including enhanced unemployment benefits and direct payments. We expect that job growth will pick up significantly in the second half of the year, a strong rebound, as pent-up demand for a range of goods and services will require rapid hiring as the pace of vaccine deployment accelerates. The unemployment rate is expected to decline from its current level of 6.3 percent to 4.7 percent by the fourth quarter of 2021.

US housing markets continued on strong footing. New home sales activity, as measured by the MBA Builders Applications Survey started 2021 at a strong pace, with purchase mortgage applications for newly constructed homes jumping nearly 19 percent compared to last January. These results are consistent with the still-increasing pace of single-family housing starts and permitting activity reported over the last several months. The low supply of existing homes on the market, and changing household preferences toward newer, larger homes, continue to spur buyer demand.

Our estimate of new home sales has proven to be a reliable leading indicator of the U.S. Census Bureau’s monthly new home sales number. We estimated that new home sales increased over 3 percent in January to a 905,000 seasonally adjusted annual pace, which is the second-highest since our tracking began in 2013, and slightly below October 2020’s record pace of 927,000 units. The Census Bureau’s new home sales released showed a 923,000 unit sale pace, up from a revised 885,000 units in December.
January’s existing-home sales increase pushed the annual sales pace to almost 6.7 million units, close to levels last seen since 2006. Despite scarce inventory levels in the entry-level portion of the market, first-time buyers represented a third of sales last month. We expect a significant portion of purchase demand in the coming years to be driven by millennials and the younger-age cohorts. As shown in the chart below, the 25- to 35-year-old age cohorts account for over 50 million people. However, tight housing supply and rising prices continue to be a constraint on an even higher sales pace. The number of homes for sale declined yet again, falling to a record low of 1.04 million units – a 1.9-months’ worth of supply. The median sales price has come down from a record high in October, but at $303,900, it was still 14 percent higher than a year ago. Tight inventory levels continue to create a competitive market for buyers and are pushing prices higher.

New single-family housing starts decreased in January after eight months of increases, dropping to a seasonally adjusted annualized pace of 1.16M units from a 1.32M pace in December. This was still an extremely robust level, as builders responded to demand for new homes. Single-family permit activity increased for the ninth consecutive month to 1.27M permits, a sign that new residential construction activity remains poised to remain at a strong clip, which hopefully bodes well for more choices for buyers and slower price growth in the spring. However, home-price appreciation continues to be driven higher by this low inventory of homes for sale, even as home building continues remains at a healthy pace. The FHFA’s monthly release on home price indexes showed that December’s purchase-only index was 11.4 percent higher than the year before, following an 11.0 percent increase in November. Those annual increases were both higher than the previous record high of 10.7 percent in April 2005. This has also showed up in higher median home sales prices and higher purchase mortgage loan balances. With credit availability still tight and prices still increasing more than three times personal income, we could see a severe affordability problem if these trends persist, which would damper the housing market recovery.
Figure 1.

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth</td>
<td>2.3%</td>
<td>-2.5%</td>
<td>5.9%</td>
<td>2.8%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Inflation</td>
<td>1.8%</td>
<td>1.2%</td>
<td>2.4%</td>
<td>2.1%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Unemployment</td>
<td>3.7%</td>
<td>8.1%</td>
<td>5.3%</td>
<td>4.5%</td>
<td>4.3%</td>
</tr>
<tr>
<td>Fed Funds</td>
<td>1.625%</td>
<td>0.125%</td>
<td>0.125%</td>
<td>0.125%</td>
<td>0.625%</td>
</tr>
<tr>
<td>10-year Treasury</td>
<td>1.8%</td>
<td>0.9%</td>
<td>1.6%</td>
<td>2.2%</td>
<td>2.6%</td>
</tr>
<tr>
<td>30-year Mortgage</td>
<td>3.7%</td>
<td>2.8%</td>
<td>3.4%</td>
<td>3.9%</td>
<td>4.4%</td>
</tr>
<tr>
<td>New home sales (000s)</td>
<td>685</td>
<td>813</td>
<td>949</td>
<td>1,023</td>
<td>1,046</td>
</tr>
<tr>
<td>Existing home sales (000s)</td>
<td>5,331</td>
<td>5,678</td>
<td>6,344</td>
<td>6,406</td>
<td>6,475</td>
</tr>
<tr>
<td>Purchase originations ($B)</td>
<td>1,225</td>
<td>1,424</td>
<td>1,574</td>
<td>1,628</td>
<td>1,653</td>
</tr>
<tr>
<td>Refi originations ($ B)</td>
<td>1,028</td>
<td>2,268</td>
<td>1,385</td>
<td>573</td>
<td>520</td>
</tr>
<tr>
<td>Total originations ($B)</td>
<td>2,253</td>
<td>3,692</td>
<td>2,959</td>
<td>2,201</td>
<td>2,173</td>
</tr>
</tbody>
</table>

Source: MBA Forecast
Figure 2.

Mortgage Originations History and Forecast

Source: MBA Forecast
Figure 3.

Home Sales and Inventory

Source: Census, National Association of Realtors
Figure 4.

Population by Age: Census Bureau 2020 "Middle" Estimates

Source: Census Bureau