Starting 2015 on Firm Footing

MBA Economic and Mortgage Finance Commentary: January 2015

Highlights from this month’s outlook:

1. The new year is beginning on a firm footing in terms of US economic and job market growth, leading us to predict that housing is poised for stronger growth as well.
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, there has been a resurgence of refinance activity to start 2015.

Based on the incoming data over the past month, we have kept our overall outlook largely the same – expecting strong domestic growth driven by consumer spending aided by falling oil prices. There are now more concerns over global economic weakness, especially in light of the ECB’s announcement of its own quantitative easing program, pushing interest rates even lower in recent weeks. Both a strong economy and declining rates should provide a spark for housing in 2015, and we have already seen evidence of refinance activity picking back up as mortgage rates have declined. As a result, we have raised our refinance originations estimate for 2015 in this month’s forecast.

Third quarter real GDP growth has been revised to 5.0 percent, as reported by the BEA. This followed second quarter growth of 4.6 percent (also revised). Growth in PCE and nonresidential fixed investment were stronger than expected, as consumers continued to spend on durable goods and robust investment in business equipment continued. Investment in structures was still positive in the third quarter, but not quite as strong as the rate in the second quarter. Federal government spending increased substantially for the quarter, as defense spending had its strongest quarter since 2009.

Industrial production in the US decreased slightly in December, as a large decrease in the utilities sector offset increases in manufacturing and mining. Overall capacity utilization decreased as well, also driven by a sizeable drop in the utilities sector, which hit the lowest utilization rate in five months. The ISM...
manufacturing index decreased in December to its lowest level since June 2014, as the new orders, production, and inventory sub-indexes fell significantly. Some of the decline was attributed to delays caused by the ongoing issues at ports on the West Coast, notably Los Angeles and Long Beach. Shipments and new orders of core capital goods, which are nondefense capital goods, excluding aircraft, have both trended lower in recent months, with the most recent data being for November. 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 have caused us to reduce our forecast for consumer price inflation to 1.2 percent for the fourth quarter of 2014. Additionally, we adjusted our forecast downward to 1.5 percent for 2015 as we now think that oil prices will remain low for a longer period of time.

The US labor market continues to strengthen, as job openings in both private and government sectors have increased steadily, and initial claims for unemployment insurance remain quite low. In the December employment report from the BLS, non-farm payrolls grew by 252,000 jobs over the month. Government payrolls grew by 12,000 jobs, the most in three months. The report also included upward revisions to the previous two months’ totals. The labor force participation rate decreased to 62.7 percent, tying the September 2014 number, and the lowest since 1978. The unemployment rate decreased to 5.6 percent, the lowest since 2008.

The number of workers who are less than fully employed, accepting part time jobs for economic reasons and also working lower paying full time jobs than those they might have had previously have not been declining as fast as overall unemployment. Nonetheless, the number working part time for economic reasons has fallen in each of the last six months and is at its lowest level in six years.

While data on wage growth has been relatively disappointing until now, 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 increase recorded in the third quarter of 2014 was the biggest increase since 2008 and the recent trend has been in an upward direction.

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.

We expect that fourth quarter economic growth will be around 2.9 percent, bringing 2014’s average growth to 2.6 percent. Our projection for overall US economic growth is 2.8 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.

© 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.
Housing starts ended 2014 on a high note, as single family starts increased 7 percent to 728,000 units the fastest annualized pace in six years. Total single family starts for 2014 however, were still well below long run average, approximately 60 percent of the historical pace. Multifamily starts decreased to 361,000 units in December 2014. For 2015, MBA forecasts 380,000 multifamily starts and 730,000 single family starts.

The MBA’s estimates of new single-family home sales from its Builder Application Survey were running at 409,000 units in December. The seasonally adjusted annual rate is an increase of 2 percent from the November pace of 401,000 units. On an unadjusted basis, the MBA estimates that there were 28,000 new home sales in December 2014, unchanged from November.
Interest rates trended down throughout 2014 and continue to do the same in 2015. Continuing their flight to quality, global investors have put downward pressure on longer-term Treasury yields. As of the week ending January 16, 2015, the average mortgage rate the 30-year conforming rate was at 3.80 percent, its lowest level since May 2013. Since we have lowered our forecast for the 10 Year Treasury yield to 2.6 percent for 2015 and 3.3 for 2015, our forecast for the 30 Year Fixed mortgage rate has declined to 4.4 percent in 2015 and 5.2 percent in 2016. We now expect that mortgage rates will hit the five percent market in the middle of 2016, as opposed to the middle of 2015 as previously published.

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. 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.

Source: Preliminary data from MBA Mortgage Credit Availability Index
The trends that we have observed in credit availability were also reinforced by findings in the purchase applications data, where for much of the 2013 to 2014 period, purchase applications for mortgages of less than $417,000 showed year over year decreases. Only in December did we see some breaks in the trend, but despite the reprieve, the lower half of the market is generally still contracting. We expect to see some of these segments start to grow again this year, as economic and job market growth bring about positive household formation and higher demand for entry to middle level housing units, and the need for mortgages to finance these transactions.

Source: MBA Monthly Profile of Mortgage Activity

Overall purchase activity, as measured in terms of mortgage applications, remained relatively depressed in 2014, but has started to show some signs of life early in 2015. Over past two weeks, purchase applications have increased on a year over year basis, in consecutive weeks, for the first time since 2013. Refinance applications started 2015 with quite a bang, essentially doubling in two weeks, as rates...
dipped back below the 4 percent market for the first time since 2013. However, the current level of the refinance index is still about half of where it was in the first half of 2013. In the most recent week’s release, there was a 22 percent increase in refinance application volume. In addition to being fueled by lower rates, the recent reduction in FHA mortgage insurance premiums also played a role: FHA refinance applications increased 57 percent last week.

MBA Refinance Index & 30 Yr Fixed Rate

Source: MBA Weekly Applications Survey

In terms of mortgage originations, 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 $732 billion in 2015 from $638 billion in 2014. Refinances are expected to be to $471 billion in 2015, an upward adjustment from $456 billion previously reported, but still below $484 billion originated in 2014. 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 refines to decline to $379 billion for a total of $1.17 trillion in origination volume in 2016.

Source: MBA January 2015 Forecast