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MBA Research Commentary

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Stronger Economic Outlook, but Lower Mortgage Originations Expected

MBA Economic and Mortgage Finance Commentary: January 2013

With rising mortgage rates and the start of certain regulatory implementations, we have seen purchase application activity fall almost 20 percent compared to the same period last year and have also seen refinance applications decrease around 70 percent over the same time frame. As a result, we have lowered our forecast for mortgage originations in 2014. Purchase originations are now expected to be $677 billion for 2014 compared to $711 billion forecast previously. Compared to 2013, purchase originations are expected to increase by 3.8 percent.

Refinance originations were revised lower as well, and are now expected to be $440 billion in 2014, compared to $463 billion as estimated previously. The lower refinance total is around 60 percent lower than 2013 refinance originations.

Although we have lowered our forecast for originations, the forecast also reflects a stronger outlook for economic growth along with signs that the labor market has regained its footing. Real GDP growth in the fourth quarter of 2013 is expected to be around 2.5 percent, not nearly as fast as the 4.1 percent growth rate we saw in the previous quarter, but still a healthy number based on current indicators of business investment and retail sales.

The economy was stronger than expected in the third quarter of 2013, showing a 4.1 percent growth rate in real GDP, as businesses built up their inventories and invested in more capital goods. We expect that a spillover of some of that inventory along with a pickup in personal consumption expenditures and increased business investment in capital goods will offset a weak residential fixed investment number and provide growth of around 2.5 percent in the fourth quarter. We will likely start to see inventory investment correct itself in early 2014 as businesses work to clear what has been currently built up. And consumer spending is doing well, including strong holiday sales, as reported in the most recent retail sales data.

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Industrial production increased significantly in November, showing the largest single month change in a year, as all three industry groups (mining, utilities, and manufacturing) had increases over the month. Overall new orders for durable goods increased 3.5 percent in November, the third increase in four months. Excluding transportation, new orders were up 1.2 percent from October, the largest single month increase since May 2013. New orders for nondefense capital goods, excluding aircraft, increased 4.5 percent over the month, the largest increase since an 8.9 percent increase in January. New orders of core capital goods are an indicator of future business fixed investment. Shipments of core capital goods, which are used as an input to the BEA's estimates for business fixed investment, increased 2.8 percent in November. This was the largest increase since March 2012, and came after declines in four of the prior five months.

The ISM's manufacturing index for December dropped by 0.3 percent, but the employment and new order components increased and remained at highs since 2011 and 2010, respectively. The employment index increased 0.4 percent to 56.9, the highest since June 2011, while the index for new orders increased in December by 0.6 percentage point to 64.2 percent, which is its highest reading since April 2010. The inventories index dropped 3.5 percent to a reading of 47.0, the lowest in six months, and the first contraction after two months of growth. This is potentially a sign that some manufacturing firms are already starting to work through their inventories.

Manufacturing is still about 5 percent off its peak, but has come back steadily after falling about 20 percent during the worst of the recession. Industrial capacity utilization is back close to 2008 levels, and slightly below long-term average of 80 percent. This could be the year that businesses see the need to build capacity. Economists refer to this as the "accelerator effect"--businesses spend to build capacity to meet growing demand, but this spending itself leads to greater demand.

The job market had improved throughout 2013 but disappointed in December, with job growth over the month totaling 74,000 jobs. This was in sharp contrast to gains of 241,000 and 200,000 jobs in the prior two months. In fact, for the other 11 months of 2013, job growth averaged 192,000 jobs per month, with December's total of 74,000 the lowest single month's gain since January 2011.

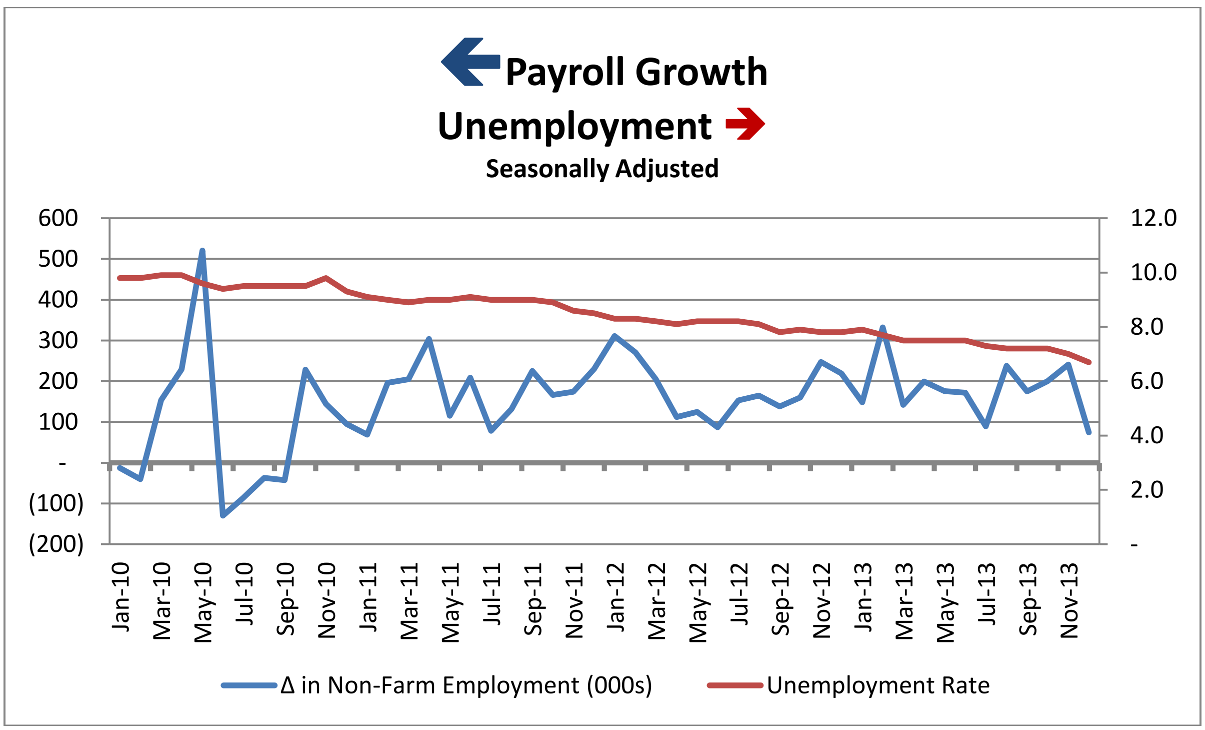
The unemployment rate dropped to 6.7 percent from 7.0 percent in November, reaching the lowest level since 2008. However, even as the number of unemployed workers decreased, so did the number of workers who are actually counted as part of the labor force. As a result, the labor force participation rate was down to 62.8 percent, where it was two months prior, and the lowest since 1978. This continues to be a significant concern as many workers have been unable to find work and are increasingly dropping out of the workforce. The decrease in the participation rate was driven by a significant decline in participation by workers who were either high school graduates or did not have a high school diploma. Workers who had some college education or at least a college degree saw an increase in participation in December. There remains a significant mismatch in the skills required to fill job openings and workers looking for jobs.

The overall number of reentrants to the labor force was the lowest since 2009, and decreased in 10 of the 12 months in 2013. The number of new entrants increased in December, but only increased in five of the 12 months in 2013.

The U6 measure of labor underutilization remained unchanged at 13.1 percent and is down from its peak of 17.2 percent, but remains well above the long term average of about 10 percent. Included in this measure are workers marginally attached to the workforce, and that category increased in December to the highest level in seven months.

The payroll growth total comprised of an increase of 87,000 private jobs and a decrease of 13,000 government jobs. Notable increases were in retail trade (+55,300 jobs), professional and business services (+19,000 jobs), and manufacturing (+9,000 jobs). The construction sector had a decrease of 16,000 jobs, reversing a 19,000 job increase in November. Education and health service jobs, typically a more resilient sector, were unchanged from the previous month, the first time since 2010 that there was no growth in this sector.

Within the government sector, federal, state, and local governments all saw contraction in their payrolls, with the largest decline coming from local government education which had a 14,900 job drop in jobs from November.

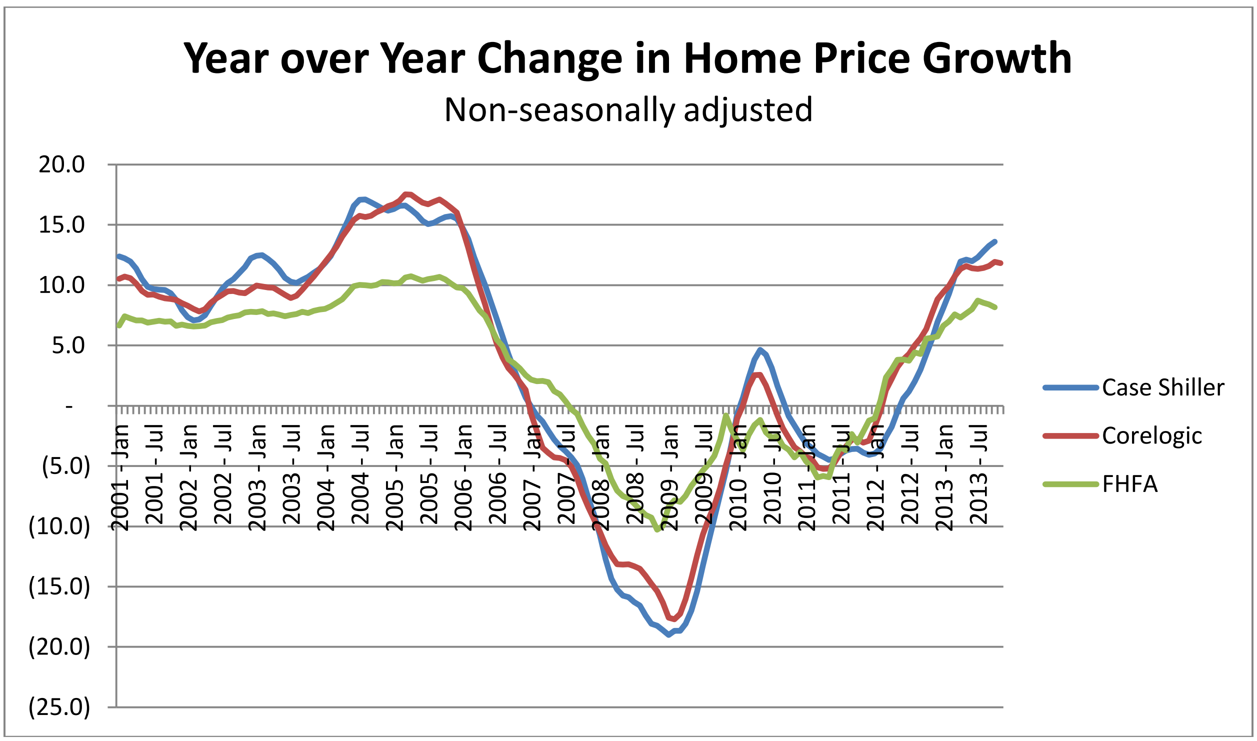


We project overall economic growth to be 2.5 percent in 2014 and 2.7 in 2015, driven by consumer spending and business fixed investment. The 10 Year Treasury rate will increase as a result, averaging

3.2 percent in 2014 and 3.4 percent in 2015. We expect the unemployment rate will decrease to 6.7 percent in 2014 and 6.2 in 2015 as monthly job growth stays in the 200,000 job range. As noted above, the virtuous cycle of businesses building capacity, leading to increased demand, which in turn returns to more capacity building will help sustain job and spending growth.

As we noted last month, the most recent data on housing starts (for November 2013) showed a surge in single family starts of almost 20.8 percent over the month and multifamily housing starts increased 26.8 percent. While multifamily starts are typically volatile and prone to large monthly swings, the single-family side of the market is generally tempered and the increase was the largest single month increase in starts since 1991. We believe that part of the monthly increase was due to the seasonal adjustment process, but even then on a year over year, non-adjusted basis, single family starts were up 29.4 percent and multifamily starts were up 38.8 percent. However, this trend is likely to be unsustainable, as we have not seen permits increase enough over the past few months to account for starts of this pace.

Home price growth continues, with the Corelogic price index up 11.8 percent in November on a year over year basis, the ninth straight double digit increase. The Case Shiller and FHFA monthly home price measures have also indicated continuing home price growth. The October data point for the Case Shiller series showed the strongest year over year growth since February 2006.



Given current home price trends, coupled with housing inventory levels still at low levels for both new and existing homes, we had expected a stronger performance from home purchase applications but that has not been realized thus far. With mortgage rates at two year highs and as lenders prepared for the implementation of the Qualified Mortgage Rule, applications for purchase mortgages have been on a declining trend since September 2013 when compared to levels a year ago. The four week moving average of the seasonally adjusted purchase index is at its lowest since March 2012.

Refinance activity started to decline around May 2013 as rates increased and refinance applications have showed year over year declines close to 70 percent in recent weeks. The four week moving average for the refinance index is the lowest since September 2008.

Since our forecast takes into account mortgage applications data, among other indicators, to determine originations in the near term, we revised our purchase originations estimates lower for the first half of 2014. We lowered our forecast for purchase originations to $677 billion in 2014, compared to $711 billion as previously estimated. The lower purchase level results in an increase of 3.8 percent over 2013's purchase total of $652 billion, compared to the 9 percent increase published previously. Refinance originations were also revised lower to $440 billion for 2014, compared to the previous estimate of $463 billion. With the downward revision, the drop in refinance originations in 2014 is still around 60 percent lower than 2013's refinance total of $1.1 trillion.

In total, originations for 2014 are expected to be $1.1 trillion, increasing slightly to $1.2 trillion in 2015. Compared to 2013, total originations in 2014 are expected to be down 36.4 percent. Mortgage rates will hit the 5 percent level in 2014, averaging 4.9 percent for the year, and increase further to 5.2 percent for all of 2015. As a result, refinance activity will decline, as will the refinance share of the market, and we will see the first purchase dominated originations market since 2006.