RESEARCH AND ECONOMICS

MBA Forecast Commentary

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Low Purchase Originations Expected Despite Steady Economic Growth

MBA Economic and Mortgage Finance Commentary: February 2014

Our forecast reflects economic growth for the next two years at a pace of around 2.5 percent, as households continue to spend and business fixed investment ramps up. The labor market seems to have slowed momentarily in terms of payroll growth, but the unemployment rate continues to decrease. Despite slower monthly job growth and growing concerns about the financial situation in emerging market, we expect the US economy to remain on its current course of growth, and the Federal Reserve to continue its tapering of asset purchases.

We noted previously that rising mortgage rates and the start of certain regulatory implementations has adversely impacted mortgages originations, but we are also seeing effects of declining home sales and a tight inventory of homes on the market. Purchase application activity is still running at a pace that is around 17 percent lower compared to the same period last year and refinance application activity has been around 60 percent lower over the same time frame. Purchase originations are expected to be $663 billion for 2014, a 1.7 percent increase from 2013, and refinance originations are estimated to be $440 billion in 2014, a 60 percent decrease from 2013.

The economy was initially reported to have grown at a 3.2 percent pace in the fourth quarter of 2013, but recent reports on housing, retail sales and international trade indicate that the growth rate was possibly slightly lower. Personal consumption expenditures, business fixed investment, and inventory investment continues to drive growth, and this pattern is likely to continue into the first quarter of 2014, but at a slower pace than in the fourth quarter. We expect growth in the first quarter to be 1.9 percent before increasing to 2.6 percent by the end of 2014.

Industrial production decreased unexpectedly in January, as an increase in the utilities sector was not enough to outweigh contraction in the mining and manufacturing sectors. The overall decrease in industrial production was the first monthly drop after five straight months of increases. Capacity utilization also saw a similar trend, dropping to the lowest level in three months after a run of five monthly increases. The ISM's manufacturing index also showed significant weakness in January, dropping to the lowest index level since May 2013, with the largest monthly drop since 2008. The decrease was driven largely by the new orders index, which plummeted 20 percent over the month, but the production index and the employment index also saw significant declines.

Total new orders for durable goods decreased 1.5 percent in December, reversing a 1.5 percent increase in November. Excluding transportation, new orders were up 0.2 percent from November, the third straight monthly increase. New orders for nondefense capital goods, excluding aircraft, decreased 0.6 percent over the month, following a 3 percent increase in November. 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 for the current quarter, increased 0.6 percent in December.

Overall, measures of business investment and consumption activity ended 2013 slightly weaker and appear to have started 2014 along the same lines. With capacity utilization and industrial production still below long run averages, we expect that the pace of business fixed investment will gather more speed in 2014 and keep pace with consumer spending.

December and January saw the weakest two-month stretch in payroll growth since 2011. In January, nonfarm payroll employment increased by 113,000 jobs, while the unemployment rate decreased to 6.6 percent, as reported by BLS. Private sector payrolls increased by 142,000 jobs over the month, but government jobs declined by 29,000 jobs. The release included annual benchmark revisions for 2013, which increased overall change in payroll employment for the year by 136,000 jobs, an average of around 11,000 per month.

For the two months prior, the increase in payroll employment for November was revised to a gain of 274,000 jobs from a gain of 241,000 jobs, while the change for December essentially unchanged, revised to a gain of 75,000 jobs from a gain of 74,000 jobs as previously reported.

Private payrolls were driven by an increase of 76,000 jobs in the goods sector and an increase of 66,000 jobs in the services sector. However, the increase in payrolls for service industries was weak when compared to historical periods, with the January number the lowest monthly gain since June 2012.

Retail trade had the first contraction since March 2013 following a decline of almost 13,000 jobs. Health and education services, typically a strong category in terms of monthly job growth, were also weak – December was the first monthly decrease since 2010 and with the January drop, it was the first two month decrease (-10,000 jobs total) since 1989. Over the last 10 years the health and education sector has grown an average of 35,000 jobs per month.

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Government payroll employment contracted by 29,000 jobs in January, driven by local education job decreases (-8,700 jobs), postal service job decreases (-8,500 jobs), and state education job decreases (5,400 jobs). Federal payrolls excluding the postal service were down 4,000 jobs.

The unemployment rate decreased to 6.6 percent from 6.7 percent in December, the lowest rate since 2008, and the labor force participation rate increased slightly to 63.0 percent from 62.8 percent. The current participation rate is still 0.6 percent lower than a year ago and close to the lowest since 1978. The U6 measure of underemployment decreased to 12.7 percent from 13.1 percent, the lowest level since 2008, but still above the long run average of 10.6 percent.

Despite the upward revisions to the 2013 data and the decreasing unemployment rate, depressed labor force participation remains very much an issue, as both an aging workforce and a mismatch in the job skills sought by employers and what workers currently have continue to grow. Additionally, there was contraction in typically strong sectors for employment growth like retail trade and health and education services. Much of the decline in government payrolls was also driven by a reduction in education related jobs at the state and local levels. The decline in government jobs continues to make overall job growth look worse than it really is, but it is likely that the decline in government payrolls was the result of attrition, not layoffs.

We have lowered our expectations for monthly job growth to around 180,000 jobs per month over the next year compared to a 200,000 job pace expected previously. We expect the unemployment rate to average 6.4 percent in 2014 and 6.1 percent in 2015. As the economy strengthens, there may be a slight recovery in labor force participation, which will hold the unemployment rate higher temporarily, as workers return to look for jobs.

The housing market has weakened a little in recent months. Mortgage application activity remains slow, existing home sales are running at the slowest pace since late 2012, and the most recent report on housing starts saw some significant slowdowns across the country.

Purchase applications have been decreasing on a year over year basis since early November 2013 and the most recent week's level is almost 17 percent lower than the same week in 2013. The current level of the purchase index is the lowest since September 2011. Refinance applications have seen decreases since mid 2013, which coincides with when mortgage rates have generally been rising as well.

Total housing starts fell 16 percent in January, with drops in both single family and multifamily starts. This was the lowest level of single family starts since 2012, dropping to 573,000 units from 681,000 units in December, on a seasonally adjusted basis. Multifamily starts were the lowest in four months, and suffered a 60,000 unit drop to 307,000 starts from 367,000 starts in December. It was about a 16 percent decrease for both in January from the previous month. On a non-adjusted basis, single family starts were down 3 percent and multifamily starts were up 8 percent compared to the same month one year ago.

Single family permits had a recent peak of 641,000 in November 2013 and have decreased in the each of the following two months. The January level was 602,000 permits, down from 610,000 in December. Multifamily permits peaked at 418,000 in October 2013 recently (that was the highest since June 2008), and were around 380,000 for each of the following two months, before falling to 335,000 permits in January 2014.

By region, total starts were up 62 percent in the Northeast, driven by a surge in multifamily starts, but down in the other three regions. The South and West had drops of 12.5 percent and 17.4 percent, respectively. For the South, single family starts were down 13.8 percent and there was a decrease of 9.2 percent in multifamily starts. The West had an increase of 10.7 percent in single family starts but a 44.2 percent drop in multifamily starts. The Midwest had a 68 percent decrease in total starts, going from 155,000 starts to 50,000 starts. Around 48,000 of those starts were single family, with just 2,000 multifamily starts in the Midwest for January, compared to 34,000 starts in February.

Mortgage credit availability remains a bright spot, as despite the reduction in loan offerings that fall outside the QM rule requirements, there has been an increase in jumbo and streamline refinance programs for borrowers, as captured by MBA's credit index. Similarly, the Federal Reserve's Senior Loan Officer Survey showed that mortgage credit standards loosened somewhat among larger institutions, but tightened for smaller lenders.

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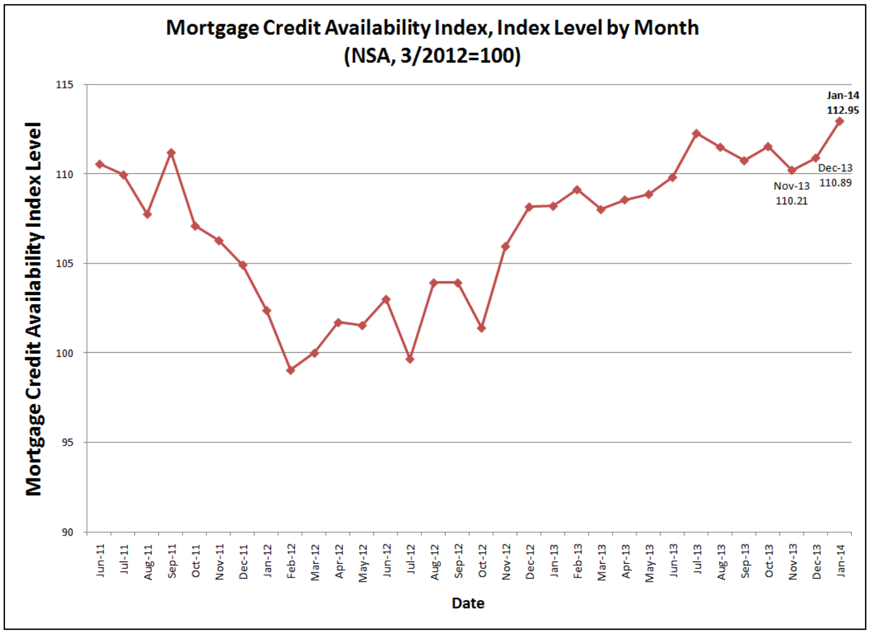

Additionally, there was a spike in new home related transactions in January, with an estimated 35 percent increase in new home sales and a 27 percent increase in mortgage applications for new homes, as captured by our survey of mortgage lenders affiliated with home builders. While this seems to conflict with indications from the purchase applications and existing home sales data, this is consistent with the home builders' view of the market, and also comes after weak sales in November and December.

Given the general slowdown in the housing and mortgage markets, we revised our purchase originations estimates lower to $663 billion in 2014. The lower purchase level results in an increase of 1.7 percent over 2013's purchase total of $652 billion. Refinance originations are still expected to be $440 billion for 2014, 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 37 percent lower. Mortgage rates will hit the 5 percent level in 2014, averaging 4.8 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.

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