RESEARCH AND ECONOMICS

MBA Forecast Commentary

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Economic Growth Steady, but Housing No Longer Leads the Recovery

MBA Economic and Mortgage Finance Commentary: March 2014

Despite a pace of slow but steady economic growth and job growth gathering pace, most US housing measures have shown weakness in recent months. Fourth quarter 2013 GDP growth was revised lower, but we still expect almost 2 percent growth in the first quarter of 2014, as personal consumption expenditures continue to drive overall growth. Additionally, we saw the largest monthly growth in payrolls for three months in February. However, these developments have not really helped the housing market as housing starts have slowed, despite still-increasing permits, and existing home sales and applications for home purchase mortgages continue to decline.

Economic growth in the fourth quarter of 2013 was revised down to 2.4 percent from 3.2 percent. Personal consumption expenditures, business fixed investment, and inventory investment continues to drive growth. We expect growth in the first quarter to be 1.9 percent, as PCE growth continues, before increasing to 2.7 percent by the end of 2014. Residential fixed investment dropped 8.7 percent in the fourth quarter of 2013, subtracting 0.29 percentage points from GDP growth, the first time since 2010 that residential fixed investment was a drag to growth. The weakness is residential sector was caused by a slowdown in housing starts and reduction in the brokers' commissions component, as existing home sales weakened at the end of the year.

Industrial production strengthened in February, as increases manufacturing and mining offset a decrease in the utilities sector. Capacity utilization also increased, but this time only the manufacturing sector drove the increase, with the mining and utility sectors both showing small decreases. The ISM's manufacturing index recovered slightly in February after showing some weakness in January. Growth was driven by new orders and inventories mainly, while the employment component was unchanged from the previous month. The production component decreased 6.6 percent, dropping to the lowest level since 2009.

The advanced report for new orders of durable goods showed a decrease of 1.0 percent in January, although excluding transportation, orders for durable goods increased 1.1 percent. New orders for nondefense capital goods, excluding aircraft, increased 1.5 percent over the month, reversing a 1.6 percent drop in December. 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, decreased 1.0 percent in January, which was the largest decline since 2012. This reinforces our expectation that business fixed investment will likely decelerate in the first quarter, as measures of business investment and consumption activity ended 2013 slightly weaker and appear to have started 2014 on a similar note. 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, reaching around a 5 percent pace.

Following a weak two-month stretch in payroll growth in December and January, firms added 175,000 jobs in February. Private payrolls added 162,000 jobs while government jobs contributed another 13,000. Private job growth has accelerated in each of the last two months and this was the first increase in government payrolls in three months, signs that the job market is on its way back after a disappointing December and January stretch. For the two months prior, the increase in payroll employment revised upward a total of 25,000 jobs. The unemployment rate ticked up a little to 6.7 percent from 6.6 percent in January and labor force participation in February was unchanged at 63.0 percent. The U6 measure of labor underutilization decreased to 12.6 percent, bringing it to its lowest level since 2008.

The labor market seems to be heading in a better direction now, and we are maintaining our expectation for monthly job growth to be around 180,000 jobs per month over the next year, but expect that to rise to around a 200,000 job pace in 2015. We expect the unemployment rate to decline slowly though through 2014, averaging 6.4 percent, and decrease a little more to 6.1 percent in 2015. As the economy strengthens, there may be a slight increase in labor force participation, which will hold the unemployment rate higher temporarily, as workers return to look for jobs.

Similar to our outlook for last month, the housing market has weakened despite steady growth in the broader economy. Mortgage application activity remains slow, with applications for home purchase mortgages still 15 to 20 percent below last year's pace, and refinance applications over 60 percent slower than a year ago. The purchase index has not seen the typical late winter/early spring pickup in activity that has been typical of previous years. Existing home sales are running at the slowest pace since late 2012, and have also started to see year over year decreases. We expect existing home sales to remain lukewarm through the second quarter of 2014, staying below the five million unit annualized pace, before recovering later in the year to reach around a 5.4 million unit SAAR. New home sales have been more robust of late, based on data from Census and from MBA's Builder Applications Survey, and we expect new home sales to increase slowly through the year to total 505,000 units.

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Housing starts have decreased to around a 900,000 unit pace over the last two months after exceeding the one million unit mark in November and December. Single family starts have dipped below the 600,000 unit mark and multifamily starts were around 320,000 units in January and February. There was however, a 24 percent increase in multifamily permits in February, potentially a sign that builders expect more activity in coming months. The February level of multifamily permits was the highest monthly total since 2007. We expect that housing starts will begin to increase more meaningfully as the economy grows, finishing 2014 at over the one million mark, before increasing to around 1.2 million starts in 2015.

Housing starts in February varied significantly across regions, as the West had a 5.5 percent decline in total starts and the Northeast had a 37.5 percent decrease, while the Midwest saw a 34.5 percent increase and the South saw a 7.3 percent increase.

Mortgage credit availability continued to increase in February according to MBA's credit availability index, despite the reduction in loan offerings that fall outside the QM rule requirements such as interest only products, loans with terms greater than 30 years, and most recently, 3/1 ARM loans. The recently implemented QM/ATR sections of the new CFPB regulations stipulate that ARM loans must qualify at the highest allowable rate for the first five years of the loan. As a result, many investors have discontinued loans whose interest rate adjusts after only 3 years. The increase in credit availability was driven by a broader offering of jumbo loans, streamline refinance products, and additional 5/1 ARM offerings.

Additionally, there was another increase in new home related transactions in February, with a one percent increase in new home sales and a 12 percent increase in mortgage applications for new homes, as captured by MBA's Builder Applications Survey, which is a survey of mortgage lenders affiliated with home builders. This measure has thus far proven to be an accurate leading indicator of the Census new home sales series, both on a seasonally adjusted and non-seasonally adjusted basis.

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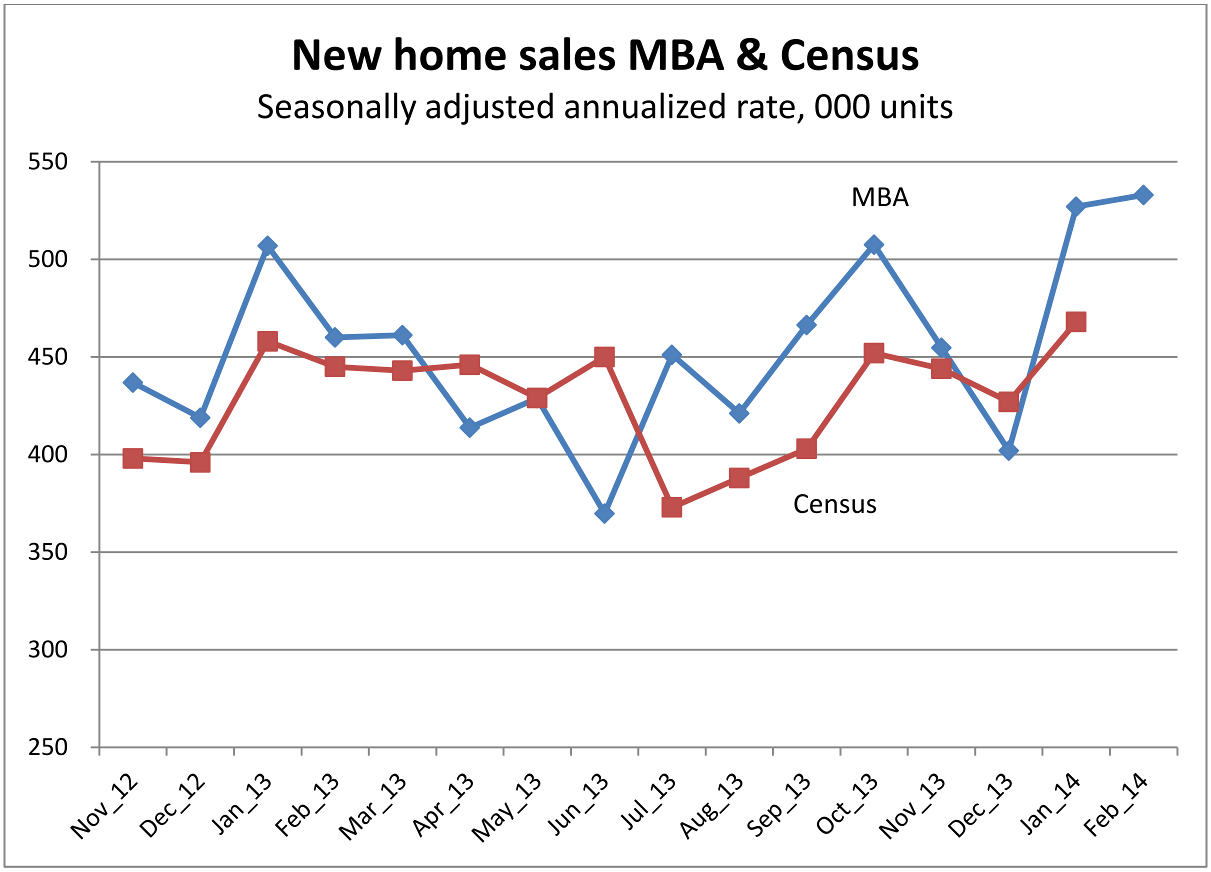

Source: MBA Builder Applications Survey

Originations for 2014 are expected to be $1.1 trillion, increasing slightly to $1.2 trillion in 2015. We expect purchase originations will be $661 billion in 2014, increasing to $808 billion in 2015. Refinance originations are expected to be $419 billion in 2014 and drop further to $411 billion in 2015 as rates continue to increase. 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. The 2014 level of originations will be the lowest overall annual total since 2000.

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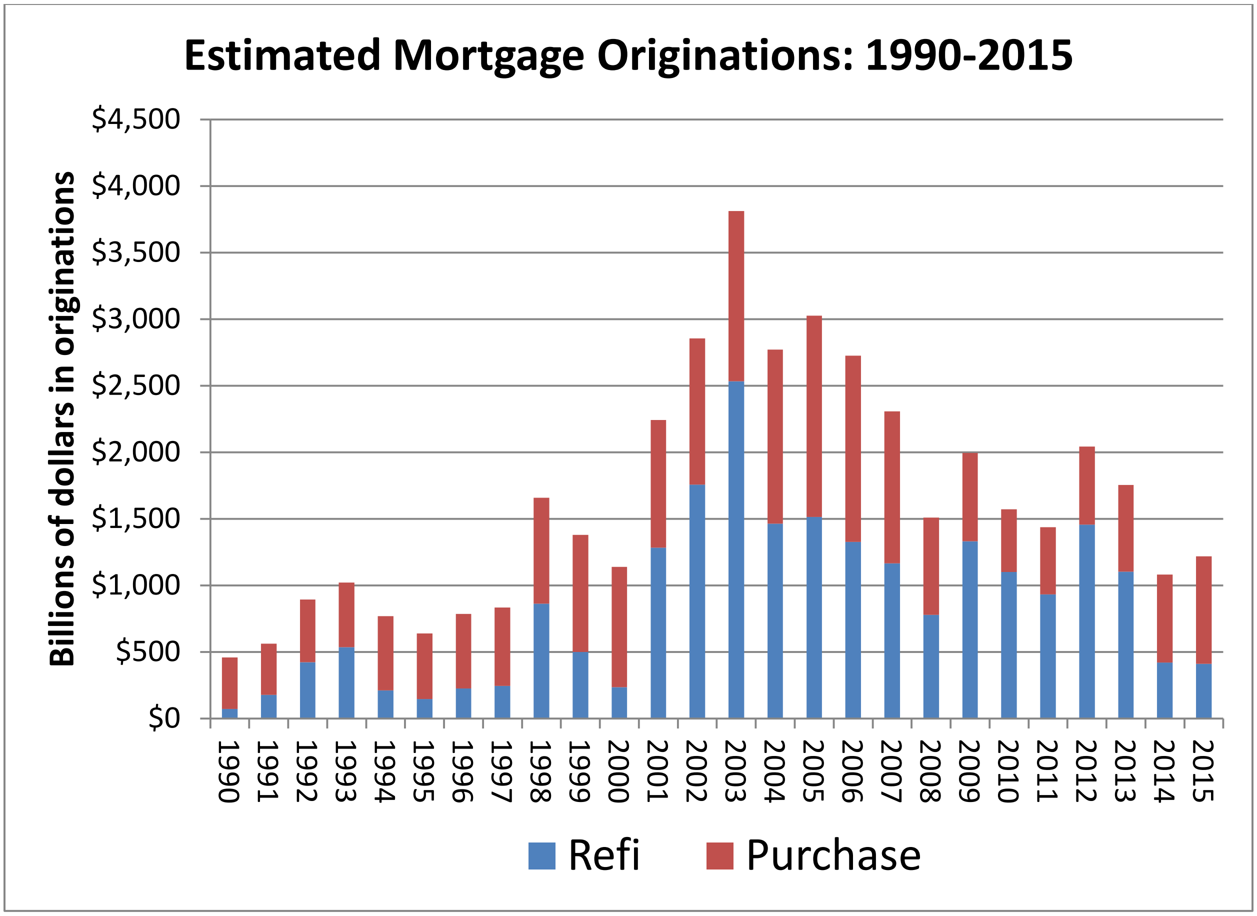

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