Broader Economy Doing Well, Housing Still Weak, Troubles Abroad

MBA Economic and Mortgage Finance Commentary: April 2014

There are three separate trends we are tracking right now:

1) The US economy appears to be on the verge of a pickup in the pace of growth. Businesses and households are spending more freely, job market indicators continue to improve, and there are even some signs that inflation is beginning to increase somewhat.

2) Housing markets are coming out of the cold winter with seasonal spring demand, but we are still running well behind where we were last year at this time in terms of purchase applications and existing home sales. A combination of higher rates, new regulations, and tight inventory in most markets is keeping transaction volume low, even with tales of multiple offers on listed properties prevalent.

3) The first two trends are consistent with our forecast of rising rates amid a Fed taper. However, troubles in Ukraine and concerns about the pace of growth in China have been enough to cause rates to come down somewhat in the first quarter. We still expect rates to increase as the taper continues, and anticipate increasing rate volatility as the Fed’s purchases absorb a smaller share of new MBS and Treasury issuances.

Slower, but positive, first quarter 2014 growth will be followed by more robust growth in the second half of the year. Even in a weaker first quarter, consumer spending is expected to be in the 2.5 percent growth range, and will likely increase to over 3.0 percent for the rest of 2014. Business fixed investment has the potential to surprise to the upside in our forecast, as industrial production and capacity utilization continues to creep up. Housing remains in the doldrums, as mortgage applications and home sales continue to disappoint, even as home prices continue to rise. In fact, the residential investment component of GDP was a drag to overall growth for only the first time since 2010. Residential fixed

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investment is largely comprised of brokers’ commissions, which in turn is connected to home sales. As a result, we have revised our purchase originations forecast to show a decrease for 2014 relative to 2013.

The FOMC, in its March statement, noted that economic growth in the January to March time frame was hampered by severe winter weather, but that household and business spending continued to improve, as did labor market conditions. The unemployment rate however, was still elevated, and housing sector growth was slow. The Committee continued with its tapering of QE3, with reductions in agency MBS purchases and Treasury securities purchases. The April pace of purchases is now $25B per month in MBS and $30B per month in Treasuries. With regards to forward guidance, the Committee reaffirmed that an accommodative monetary policy stance would continue, and that rates would remain low for a “considerable time” after unemployment and inflation levels reached the Committee’s threshold levels. Fed Chairwoman Yellen said in a press conference following the statement that this could mean around six months, which caused some volatility in the markets. We view Yellen to be similar to Bernanke in terms of monetary and regulatory policy stances, but with several governor spots still unfilled and more hawkish Presidents in the voting rotation, we expect only severe changes in economic and market conditions to sway the Committee’s current tapering plan and monetary policy.

The final estimate for real GDP growth in the fourth quarter of 2013 was 2.6 percent, driven largely by a 3.3 percent increase in personal consumption expenditures and a 5.7 percent increase in business fixed investment. The change in private inventory investment declined from the third quarter and was a slight drag to growth, after boosting third quarter growth by 1.67 percentage points.

We expect consumer spending to continue as households take advantage of recent stock market wealth, as household wealth driven by corporate equity holdings reached historical highs in the fourth quarter. Following last year’s refinance activity driven by low rates and continued home price improvement, we saw a broader increase in home equity wealth, as lower rate mortgages have allowed households to pay down more of their principal and free up more equity in their homes.
Potential has been gathering for a more significant increase in business fixed investment, an upside risk in our forecast. Shipments of nondefense capital goods, excluding aircraft, were up 0.6 percent in February after a 1.5 percent decrease in January. Shipments of core capital goods are used as an input to the BEA’s estimates for business fixed investment for the current quarter. New orders of core capital goods are an indicator of future business fixed investment, and this measure decreased 1.4 percent in February after a 0.8 percent increase in January.

The ISM’s manufacturing index increased in March to indicate 10 straight months of expansion in the manufacturing sector, although the first quarter 2014 average was still lower than the average for the fourth quarter of 2013. Growth in March was driven by a 7.7 percent increase in the production component, while the employment component decreased, inventories were unchanged, and the new orders component was only up by 0.6 percent. The production increase was a bounce back from a decrease of 6.6 percent the previous month, which dropped that index to its lowest level since 2009.
Industrial production strengthened 0.7 percent in March following a 1.2 percent increase in February. The increase was reflected across all major industry groups – manufacturing increased 0.5 percent, mining increased 1.5 percent, utilities increased 1.0 percent. Capacity utilization was at 79.2 percent in March, an increase from 78.8 percent in February, and the highest since June 2008. Similarly, all three major industry groups saw increases in capacity utilization as well. Manufacturing capacity utilization was the highest since April 2008.

With capacity utilization and industrial production still below long run averages but showing signs of stronger growth, we expect that the pace of business fixed investment will gather more speed in 2014, reaching around a 5 percent pace in the second half of the year.

The employment picture continues to improve after a brief weak spell in December and January. Total private payrolls added 192,000 jobs in March, with government payrolls unchanged over the month. The February and March increases were each over 190,000 jobs, and the January increase was revised up to 144,000 jobs. Service providing industries added 167,000 jobs in March while goods producing industries added 25,000 jobs, including a 19,000 job increase in construction.

The unemployment rate was unchanged at 6.7 percent in March, as labor force participation increased to 63.2 percent from 63.0 percent. With broader economic growth picking up pace, monthly payroll growth is starting to inch closer to the 200,000 job mark and workers are returning to the work force, causing the increase in labor force participation and holding the unemployment rate higher temporarily. The U6 measure of labor underutilization ticked up to 12.7 percent from 12.6 percent.

The labor market is back on track, gaining closer to 200,000 jobs per month, and we expect at least this pace of monthly growth through 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.

On housing, mortgage application activity remains slow, with applications for home purchase mortgages around 16 percent below last year’s pace, and refinance applications about 70 percent slower than a year ago. While we have seen a strong of small increases in the last few weeks, the purchase index has not seen the typical late winter/early spring pickup in activity that has been typical of previous years. As seen in the chart below, the current purchase index levels for each month have been the lowest since the mid to late 1990s.
Existing home sales are running at the slowest pace since late 2012, and have also started to see year over year decreases in each of the last four months. We expect existing home sales to remain lukewarm through 2014, finishing the year just over the five million unit annualized pace, and essentially flat from 2013. This is despite tight inventories of homes for sale and sustained home price appreciation. The inventory of homes for sale in February was 2.1 million units, close to the lowest levels since the early 2000s and below the series average of almost 2.7 million units.

US home prices trends have been largely positive but are starting to flatten out. We expect slower but still positive home price appreciation through 2015, and that is likely to apply some upward pressure home sales and purchase originations in the medium term.
However, there has been a significant divide in terms of the mix of home sales and mortgage applications based on price and loan amounts. There was significant year over year growth in the higher end of the market compared to the lower half both in terms of sales price and average purchase loan amount. The chart below shows how that trend is evident in both existing home sales and mortgage applications for purchasing a home. This is also consistent with the greater availability of jumbo mortgage products and lower jumbo mortgage rates compared to conforming mortgage rates.

Source: FHFA, Case-Shiller, CoreLogic
Housing starts in March provided some positive news, with total housing starts up 2.8 percent, reaching a 946,000 unit seasonally adjusted annualized pace. The overall increase was driven by a 6 percent increase in single family starts to a 635,000 unit annualized pace. Multifamily starts were down 3 percent to 311,000 units. On a non-adjusted, year over year basis, single family starts were up 2.9 percent, following two months of year over year decreases. Multifamily starts were down 18.5 percent over the year, the first annual decrease since June 2013. For the first quarter, single family starts were at 605,000 vs. our forecast of 590,000 starts, while multifamily starts were at 318,000 units compared to 330,000 starts in the forecast.

Single family permits increased slightly by 0.5 percent after three straight monthly drops, reaching 592,000 units and still below the starts pace. Single family permits have been below starts for four of the last five months. Multifamily permits decreased 6.4 percent after a 22.8 percent increase in February, but are still at a 398,000 permit pace. Total housing starts increased in the Northeast and Midwest, but were down in the South and the West, the two larger regions.
We expect that housing starts will continue to increase slowly through 2014, reaching the one million unit pace in the third quarter of 2014 and ending the year at a shade over a million starts. For 2015, single family starts are expected to accelerate as the economy continues to grow and the housing sector recovers more evenly, pushing overall starts to about 1.2 million units.

The new home sales market saw a drop in March following two months of growth. There was a 10 percent decrease in new home sales in March, 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.

![New home sales MBA & Census](chart.png)

Source: MBA Builder Applications Survey
Mortgage credit availability continued to increase in March 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. It is likely that lenders expanded options available to jumbo borrowers in light of the price trends noted earlier in existing home sales and purchase applications, with the higher end of the market seeing more growth on a year over year basis.

Originations for 2014 are expected to be $1.1 trillion, increasing slightly to $1.2 trillion in 2015. We expect purchase originations will be $646 billion in 2014, increasing to $808 billion in 2015. The estimate for purchase originations was revised lower this month since the current pace of purchase applications will essentially cover the second quarter’s originations flow and that pace is currently insufficient for purchase originations to end the year higher than in 2013. However, if home prices continue to increase and home sales ride economic and job growth in the second half of the year, we might see more purchase originations. 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.
Estimated Mortgage Originations: 1990-2015

Billions of dollars in originations

Source: MBA Forecast