

Jun 20, 2014

Improving Job Market, Weak Housing Market, Lower Mortgage Originations

MBA Economic and Mortgage Finance Commentary: June 2014

Key highlights from this month's forecast:

- 1) After negative growth in the first quarter of 2014, we expect the US economy will show healthy expansion over the rest of the year. Both households and businesses continue to spend, and this is likely to push growth over the 3 percent mark. Inflation has increased for a couple of months to the quickest pace since 2012, largely driven by shelter costs.
- 2) The employment picture continues to improve overall, with unemployment declining slowly and the economy adding more than 200,000 jobs per month, with a growing number of job openings indicating that employers are ready to hire. Concerns still remain over still-low labor force participation and the ability of the long-term unemployed to find jobs.
- 3) Despite stronger economic fundamentals and a better labor market, housing activity is running behind last year's pace, a trend observed across mortgage applications, home sales, and housing starts. A combination of higher rates, new regulations, and low housing inventory in many markets is keeping transaction volume low. Given these trends, we have lowered our purchase originations forecast for 2014 and 2015.

Despite an improving macroeconomic environment, mortgage application activity remains slow, with applications for home purchase mortgages roughly 15 percent below last year's pace, and refinance applications almost 60 percent slower than a year ago. Existing home sales have been essentially flat at a 4.6 million annualized pace for the past four months, which is around 6 to 7 percent weaker than the same period a year ago. Existing home sales have actually showed seven straight months of year over year contraction. New home sales have seen three months of year over year decreases and data from MBA's Builder Applications Survey point to yet another decrease in May. Thus, with such a weak pipeline, we have reduced our purchase originations estimates for the third and fourth quarters of 2014 by \$26 billion. As a result, purchase originations are expected to total \$595 billion in 2014 (compared to

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\$621 billion for the May forecast), a decrease of almost 9 percent from 2013. Refinance originations are expected to be \$426 billion in 2014, a 61 percent decrease from 2013. Overall mortgage originations for 2014 are estimated to be \$1.02 trillion, a 42 percent decrease from 2013. This would mark the lowest annual total for mortgage originations since 1997.

We also lowered our purchase originations forecast for 2015, as the weakness this year has caused us to lower expectations for single family housing starts and home sales for 2015. The weakness continues to be concentrate in the first-time homebuyer segment of the market, although the entire conforming portion of the market is contracting at this point. We expect the rental market to benefit as these young households continue to rent rather than purchase, and have increased our multifamily starts forecast to reflect that dynamic.

Economic growth in the first quarter of 2014 was negative, showing contraction of 1.0 percent, as business fixed investment, residential investment, and private inventories all showed significant slowdowns. Residential investment has now been a drag to real GDP growth for two straight quarters. The last time residential investment contracted was in 2010 and the last time we saw two quarters of negative growth was in 2009. Consumer spending remained strong in the first quarter, falling off only slight from the fourth quarter's pace, but remaining close to the highest since 2010.

The FOMC determined that the economy has shown sufficient strength that the tapering of asset purchases will carry on as planned, and announced an additional \$10 billion reduction in purchasing pace following the June meetings. The pace of purchases will now be \$15 billion per month in MBS and \$20 billion per month in Treasuries and we expect only severe changes in economic and market conditions could sway the Committee's current tapering plan and monetary policy in general. The Committee also lowered their projections for 2014 growth relative to the March meeting, along with expectations for a slightly more rapid decrease in the unemployment rate. The outlook for inflation was for slightly higher inflation in 2014.

In our forecast, we expect real GDP growth to rebound in the second quarter, and remain above 3.0 percent for the rest of 2014. Real GDP growth for 2014 is expected to be 2.2 percent, increasing to 2.6 percent in 2015. Consumer spending is expected to drive a significant part of this, staying at around 3.3 percent for the rest of 2014. Consumers continue to be buoyed both by stock market wealth and home equity 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.

Business fixed investment is also expected to bounce back following negative growth in the first quarter, and finish 2014 at almost 4 percent for the year, as industrial production and capacity utilization are

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likely to pick up after a slow fourth quarter. We still expect interest rates to increase as the taper continues, but at a much slower pace with international troubles in Iraq and Ukraine causing investors to pursue safer investments in US Treasuries. Our forecast is for rates to increase only slightly to 2.8 percent in the fourth quarter of 2014, before rising to 3.2 for 2015. We also still anticipate increasing rate volatility as the Fed's purchases absorb a smaller share of new MBS and Treasury issuances.

The ISM's manufacturing index increased in May to indicate 12 straight months of expansion in the manufacturing sector, with the production and new orders components showing strength over the month and reaching their highest respective levels since December 2013. One concerning data point was the employment component, which showed a decrease in May, but still remained at levels that indicate growth. Industrial production increased 0.7 percent in May following a 0.3 percent decrease in April. The increase came in manufacturing and mining, while utilities saw a decrease. Capacity utilization was at 79.1 percent in May, an increase from 78.9 percent in April, with manufacturing and mining capacity utilization the highest since 2008. Capacity utilization for utilities decreased and was the lowest since August 2013. Shipments and orders for core capital goods (nondefense capital goods, excluding aircraft) decreased in April following increases in March. 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. We expect that the coming months' data will improve on strength in manufacturing and industrial production.

Monthly payroll growth has now been over 200,000 for four months straight with a 217,000 job increase in May. Total private payrolls added 216,000 jobs in May, with government payrolls adding only 1,000 jobs, the lowest in four months. Service providing industries added 198,000 jobs in May while goods producing industries added 18,000 jobs. The four month total for overall payroll growth was the highest four month total since April 2012.

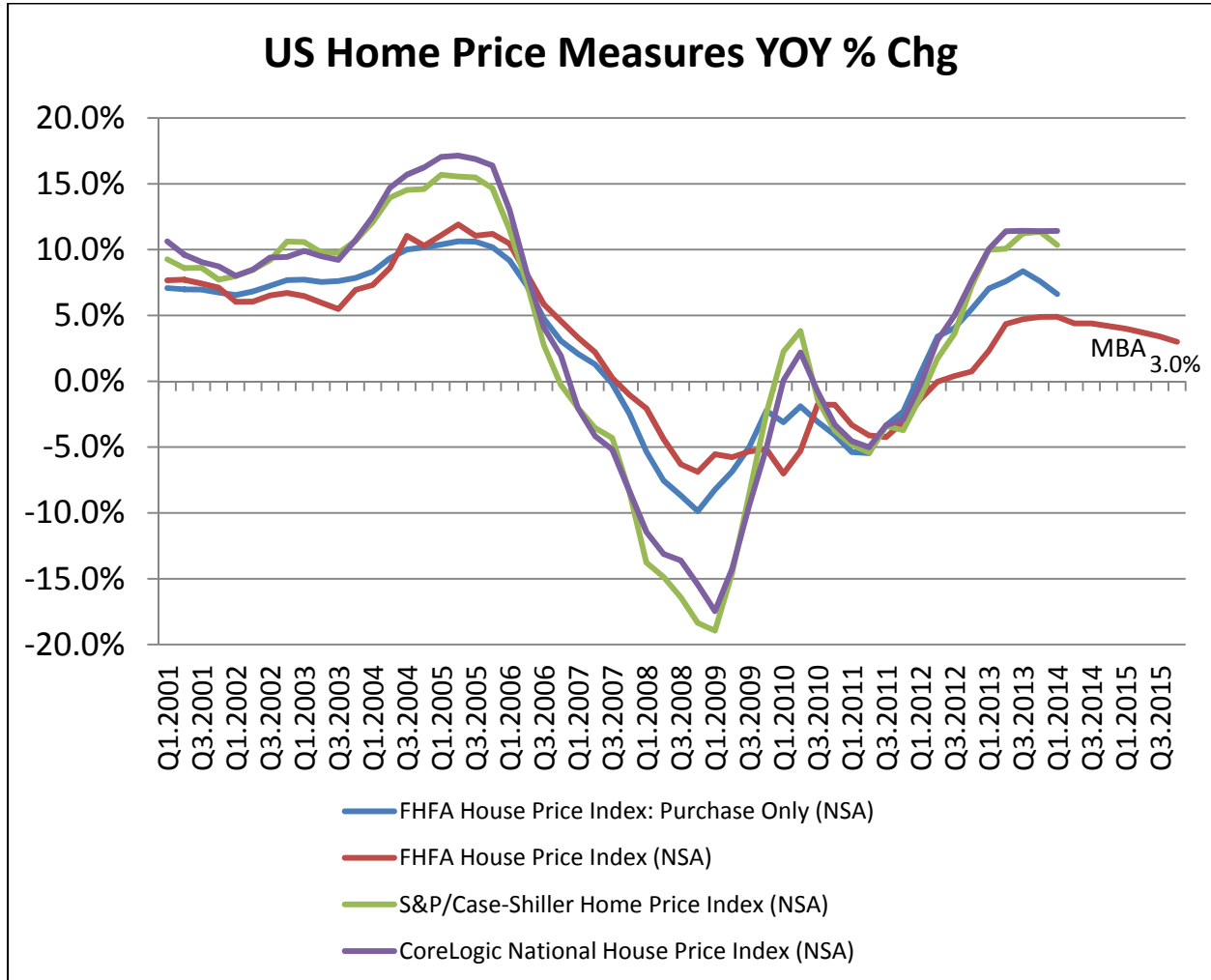
The unemployment rate was unchanged at 6.3 percent in May, as labor force participation also remained unchanged at 62.8 percent. The unemployment rate is the lowest since August 2008, but the participation rate is also the lowest since 1978. One piece of good news here is that the participation rate seems to have hit a floor, reaching the 62.8 percent level four times in the last eight months, only to inch back up a little. There still remains a concern over the mismatch of available workers to skills that employers are seeking, along with the difficulty for long-term unemployed workers to find jobs. The U6 measure of labor underutilization inched lower to 12.2 percent, which was the lowest level since 2008, but this is still above the long run average of 10.7 percent.

The labor market seems to be back on track, gaining over 200,000 jobs per month, and we expect this pace of monthly growth through 2015. We expect the unemployment rate to decline slowly though through 2014, dropping to 6.0 percent by the end of the year, and then averaging 5.7 percent in 2015.

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Turning to the housing market, US home price trends have been largely positive due to a low level of inventories of homes for sale, but we expect these gains to slow in 2015 as more homes make their way onto the market. We expect slower but still positive home price appreciation through 2015 of around 3 percent.

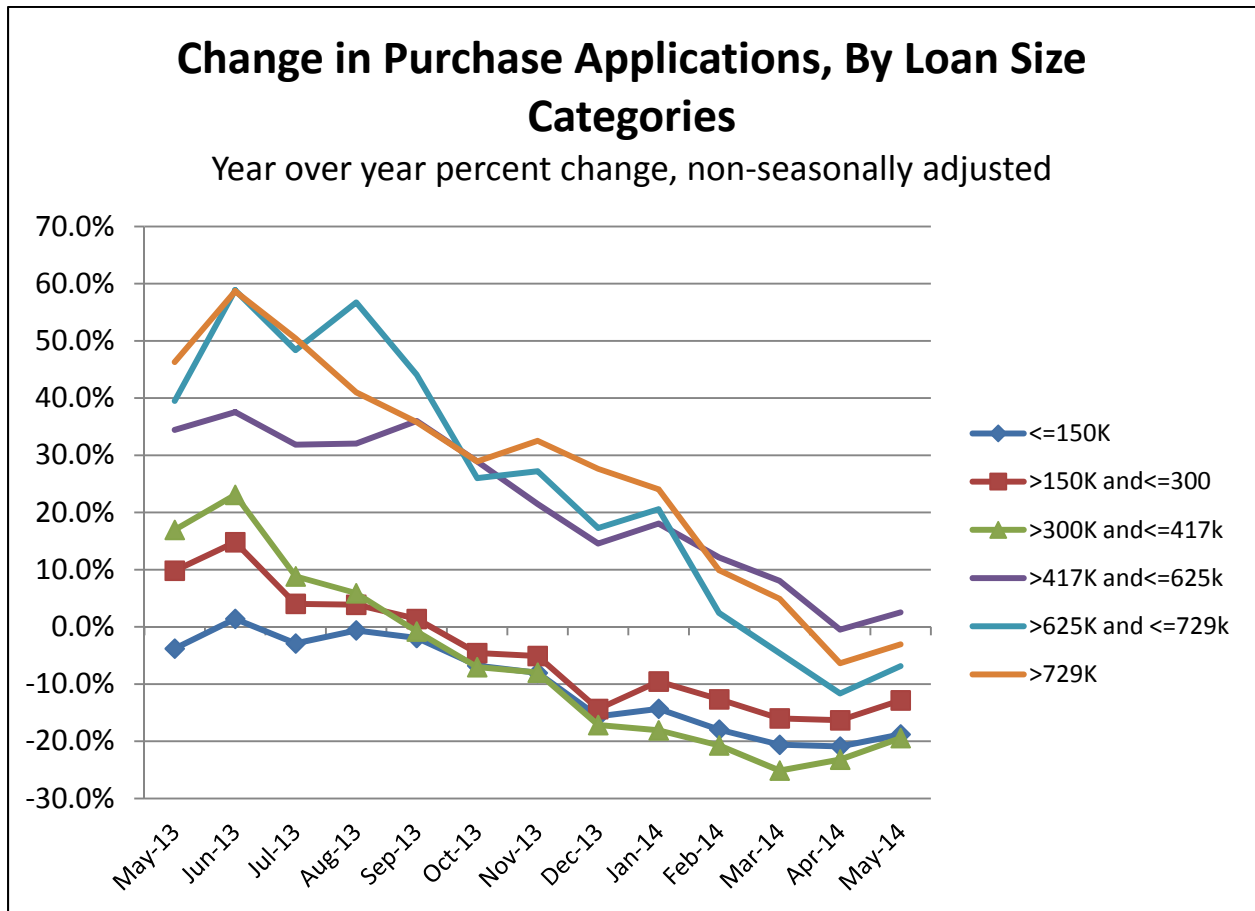


Source: FHFA, Case-Shiller, CoreLogic

However, there has been a significant divergence in terms of the mix of home sales and mortgage applications based on price and loan amounts. The chart below shows how that trend has evolved and even as purchases are declining overall, the higher end of the market is not decreasing as rapidly. This is also consistent with the greater availability of jumbo mortgage products and lower jumbo mortgage rates compared to conforming mortgage rates.

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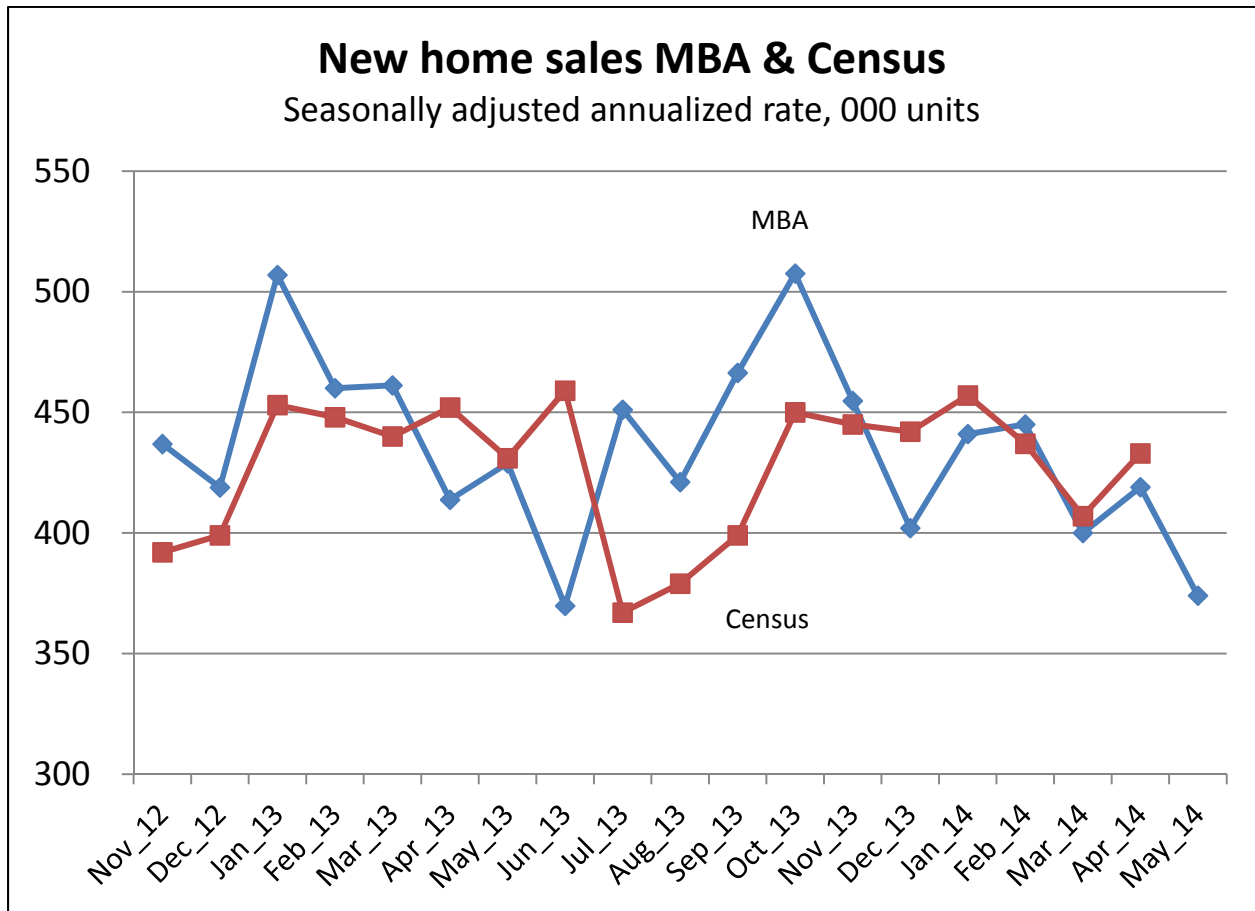
Source: MBA Weekly Applications Survey

Housing starts in May were down 6.5 percent after a 12.7 percent increase in April. Single family starts decreased 5.9 percent after two months of healthy increases, while multifamily starts were down 7.6 percent following a 29.2 percent increase in April. We expect that housing starts will continue to grow slowly through 2014, ending the year at over a million starts. For 2015, growth is expected to continue, but we have lowered our outlook for single family starts and raised the forecast for multi-family starts with higher expectations for rental households.

The new home sales market saw an uptick in April, but data from our Builder Applications Survey indicate that May new home sales were lower, showing a 10.7 percent decrease over the month. This 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, as showed in the chart below.

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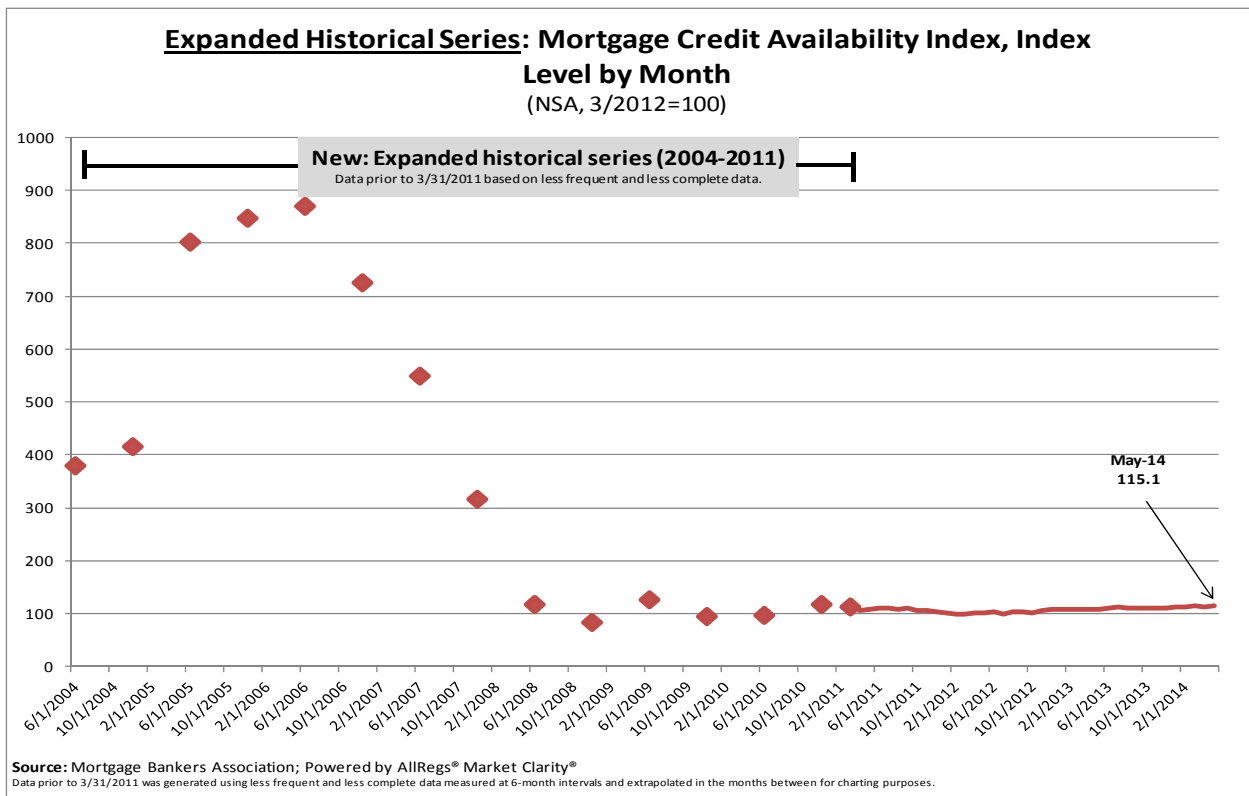
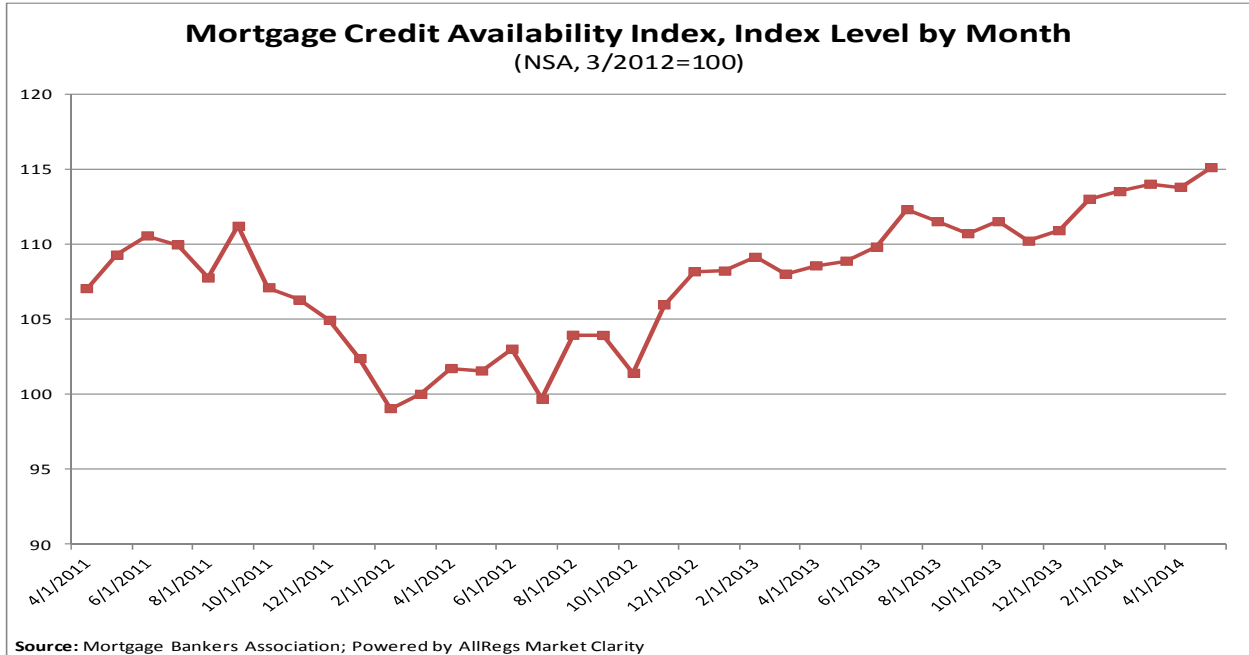


Source: MBA Builder Applications Survey

Mortgage credit availability continued to increase in May. The MCAI increased 1.14 percent from 113.8 in April to 115.1 in May. A decline in the MCAI indicates that lending standards are tightening, while increases in the index are indicative of a loosening of credit. The index was benchmarked to 100 in March 2012. The increase in May was partially as a result of a slight increase in the availability of jumbo loans. Another component was the action by some investors to lower credit score requirements on FHA loans. However, despite recent increases, credit availability is still very tight by historical standards. Credit availability was eight times as high in 2006 and about four times as high in 2004, and given the current regulatory environment and changing preferences of borrowers, it is unlikely that we will reach those levels in the near term. The following two charts illustrate the most recent data from our credit index.

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Source: MBA Mortgage Credit Availability Index, Powered by AllRegs Market Clarity

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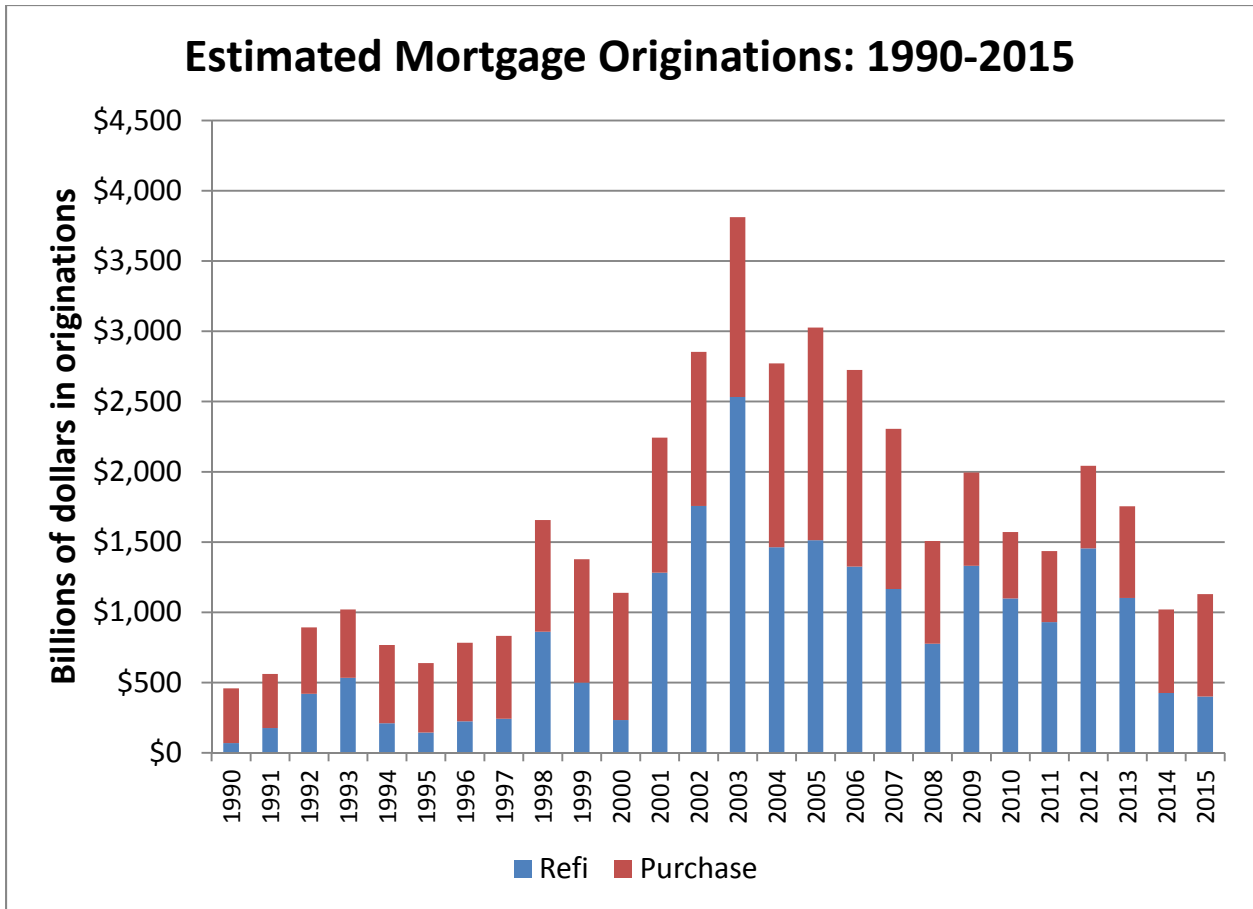
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As outlined at the beginning of this commentary, even as the macroeconomic environment improves, mortgage application activity mortgage applications for home purchase remains depressed and home sales have underperformed as well. Therefore, we have reduced our purchase originations estimates for the third and fourth quarters of 2014 by \$26 billion. As a result, purchase originations are expected to total \$595 billion in 2014 (compared to \$621 billion for the May forecast), a decrease of almost 9 percent from 2013. Refinance originations are expected to be \$426 billion in 2014, a 61 percent decrease from 2013. Overall mortgage originations for 2014 are estimated to be \$1.02 trillion, a 42 percent decrease from 2013. This would mark the lowest annual total for mortgage originations since 1997 (see chart below).

We also lowered our purchase originations forecast for 2015 to \$1.13 trillion from \$1.22 trillion as published in the May forecast. This is due to 2014's weakness carrying over and thus lower expectations for single family housing starts and home sales for 2015. We do however, expect a 22.5 percent increase in purchase originations in 2015 relative to 2014 as home sales and starts show an increase as well. Refinance originations are expected to fall in 2015, decreasing another 5.9 percent as rates increase. We expect mortgage rates to be around 4.5 percent for 2014 and 5.1 percent for 2015. Even with rates still at historically low levels, we have seen significant burnout in refinance activity as many borrowers refinanced into even lower rates in 2012 and 2013. Over the past year, the 30 year fixed mortgage rate has increased 50 basis points and borrowers have proved very sensitive to rate increases, with even slight weekly increases causing large drops in refinance activity.

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Source: MBA 2014 June Forecast

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