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RESEARCH AND ECONOMICS

MBA Forecast Commentary

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Economy Back on Track, Positive Signs Return for Housing

MBA Economic and Mortgage Finance Commentary: August 2014

Key highlights from this month's forecast:

1) The BEA's advance estimate of GDP growth for the second quarter of 2014 showed an unexpectedly strong rebound from the first quarter's contraction. Second quarter growth was estimated to be 4.0 percent, the strongest single quarter since 2013. We expect that the economy will grow around 3 percent in the third and fourth quarters. However, international events such as tension in Russia and Ukraine, additional unrest in Iraq and the Gaza Strip provide potential downside risks to the forecast. These ongoing situations have also pushed rates much lower than anticipated as investors have sought safer assets.
2) The job market has been robust, providing well over 200,000 jobs per month, even though the unemployment rate ticked up to 6.2 percent in July. Concerns remain over still-low labor force participation and the ability of the long-term unemployed to find jobs. We still expect unemployment to fall below 6 percent by the end of 2014 and continue to decline slowly to around 5.5 percent by the end of 2015.
3) Housing had a slight reprieve from its recent run of poor performance, as home sales, housing starts, and credit availability picked up in July. We expect a 42 percent decrease in overall mortgage originations in 2014, with purchase originations decreasing 10 percent and refinance originations decreasing 60 percent.

The advance estimate of GDP growth for the second quarter of 2014 showed real GDP growth of 4.0 percent. This was a welcome bounce back from the first quarter, which was revised upward a little to show real GDP contraction of 2.1 percent (growth was previously reported to have contracted 2.9 percent in the first quarter). The second quarter growth in real GDP was driven mainly by personal consumption expenditures, business fixed investment, and residential fixed investment. Residential investment was a drag to real GDP growth for the previous two quarters and regained its footing, in line with the increase in housing starts and home sales in the second quarter.

Following the FOMC meeting at the end of July, the statement released by the Committee contained a very similar economic outlook to other recent statements, but noted that labor underutilization by various measures is a concern. There was however, sufficient strength in the economy to support labor market growth. The Committee announced that it would continue with its tapering of asset purchases, further reducing the pace to $10 billion per month in agency MBS and $15 billion per month in Treasury securities. The tapering is not on a preset course, but is expected to continue. The Committee expects that the fed funds rate will continue to be held at exceptionally low levels for an extended period, even after the completion of asset purchases.

In our forecast, we expect real GDP growth to continue around 3.0 percent for the rest of 2014. Real GDP growth for 2014 is expected to be 2.0 percent, increasing to 2.7 percent in 2015. Consumer spending is expected to drive growth significantly, increasing between 2.6 to 2.8 percent for the rest of 2014. Wage growth might still be slow, but consumers continue to be buoyed both by stock market 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. Given the recent international events such as political conflict and violence in Iraq, Israel, and Ukraine, investors have sought safer assets and have driven rates much lower than expect, but we expect that will be a temporary distortion and that the 10 Year Treasury rate will pick back again in the fourth quarter of 2014, before increasing to 3.3 percent by the end of 2015.

We maintain an optimistic view of business fixed investment as most indicators signaled some strength of late. Industrial production increased for the sixth straight month and capacity utilization increased for the second month in a row, with the manufacturing component showing healthy gains in terms of both industrial production and capacity utilization. The ISM's manufacturing index also increased in July, as the new orders, production, and employment all saw increases. Shipments of core capital goods (nondefense capital goods, excluding aircraft) decreased in June, but new orders increased following two months of declines. Shipments of core capital goods are used as an input to the BEA's estimates for business fixed investment for the current quarter, and 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.

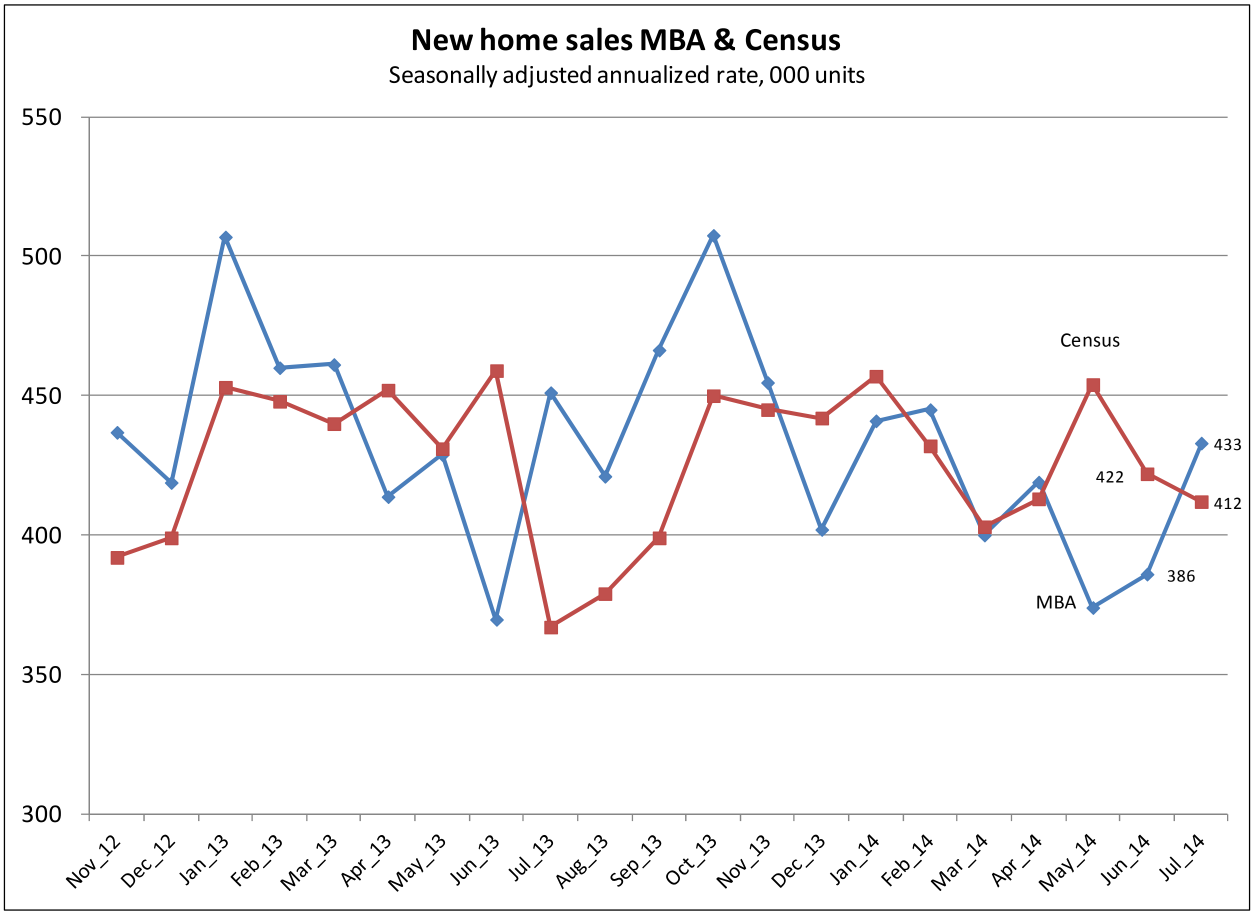
Monthly payroll growth has now been over 200,000 for six consecutive months, averaging over 240,000 jobs per month in that period. Of slight concern was that private payrolls only contributed 198,000 jobs in July, the lowest level since January, as most service providing industries grew at slower rates than in June. Government payrolls added 11,000 jobs. The unemployment rate increased to 6.2 percent in July from 6.1 percent in June, the first increase since February this year. This was also tied to the fact that the labor force participation rate increased for the first time in four months, going to 62.9 percent after being at 62.8 percent for three months. The U6 measure of labor underutilization inched higher to 12.2 percent, still above the long run average of 10.7 percent. Workers who could only obtain part time work for economic reasons was lower in July, but remained at elevated levels relative to historical averages.

The labor market seems to be back on track, gaining over 200,000 jobs per month, and we expect this pace of growth through 2015. We expect the unemployment rate to decline slowly though through 2014 and 2015, averaging 6.2 percent for 2014 and 5.6 percent in 2015.

In terms of the housing market, home sales and housing starts picked up again, even though mortgage applications have remained generally muted. Existing home sales in July increased to a 5.1 million unit annual pace, the second month above the 5 million unit mark, as reported by the NAR. The sales pace was the highest since the middle of 2013, although, on a year over year basis, existing home sales have shown declines for nine consecutive months.

Housing starts in July were up 15.7 percent as both single family and multi-family starts showed healthy increases. Single family starts increased 8.3 percent to a pace of 656,000 units, which was the highest level since December 2013, although the June number was revised lower slightly. Multifamily starts surged almost 29 percent to a pace of 437,000 units, the highest pace since January 2006, however it should be noted that multi-family starts are often volatile and subject to large swings and revisions. We expect single family starts to end 2014 at around 640,000 units, with multi-family adding another 360,000 starts. For 2015, we expect around 780,000 single family starts and 380,000 multi-family starts, similar to previous forecasts.

The Census Bureau reported that in July, new home sales decreased 2.4 percent, while MBA's Builder Application Survey, which also has a measure of new home sales, reported a 12.2 percent increase in new home sales in July. Despite the sample and methodology differences, the MBA's new home sales series has tracked closely with Census' data for most of the survey's history but due to these sample differences, there may be months where the data points are different. At a similar point last year, the two series also saw a divergence in trends, as shown in the chart below.

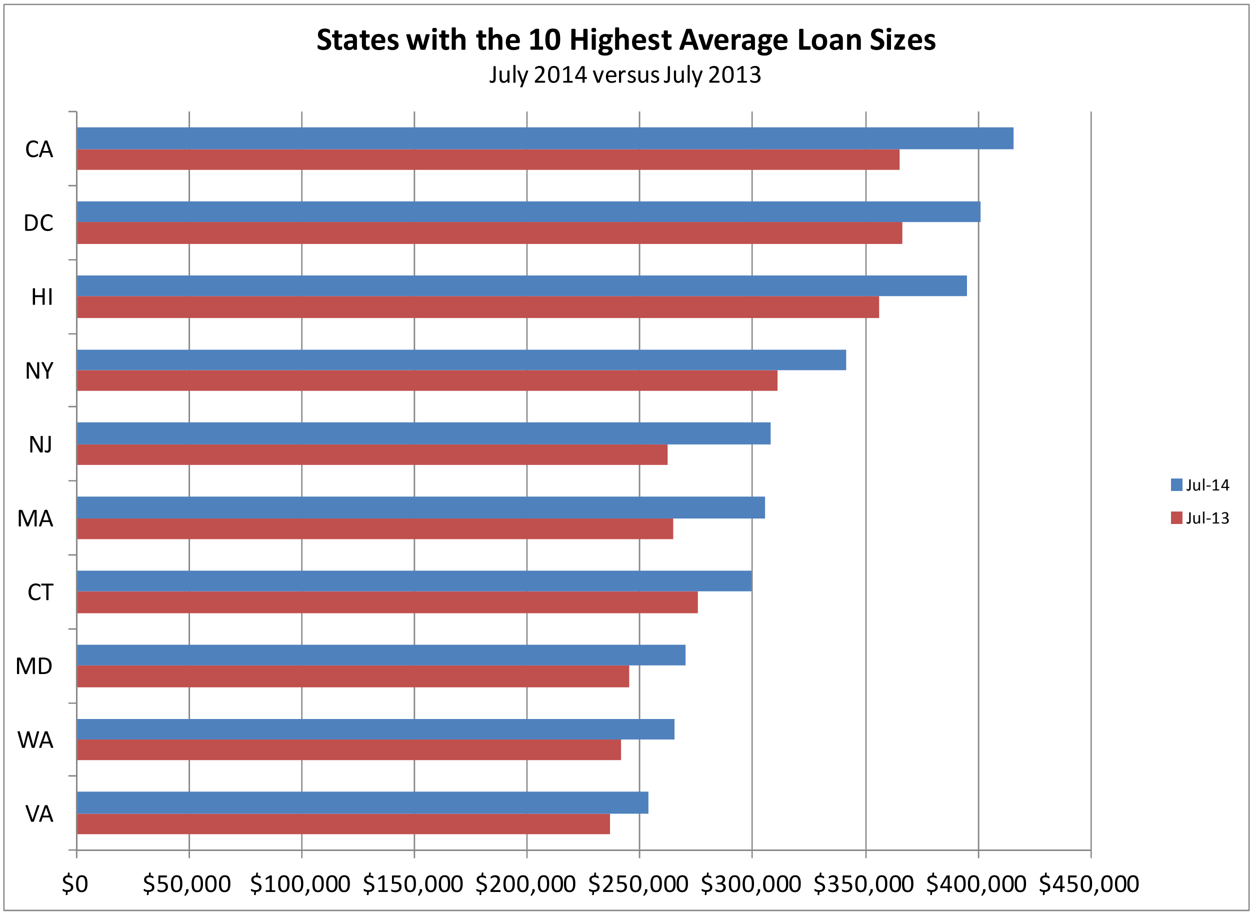


Source: MBA, Census

Mortgage application activity was slow yet again in July, with home purchase applications down 4.4 percent for the month. On a year over year basis, purchase applications were down 13.6 percent in July, and have YOY decreases for 10 consecutive months. Refinance activity was also lower, showing a 2.6 percent decrease from June. Refinance applications declined 42.9 percent from a year ago, and have shown 14 months of YOY decreases.

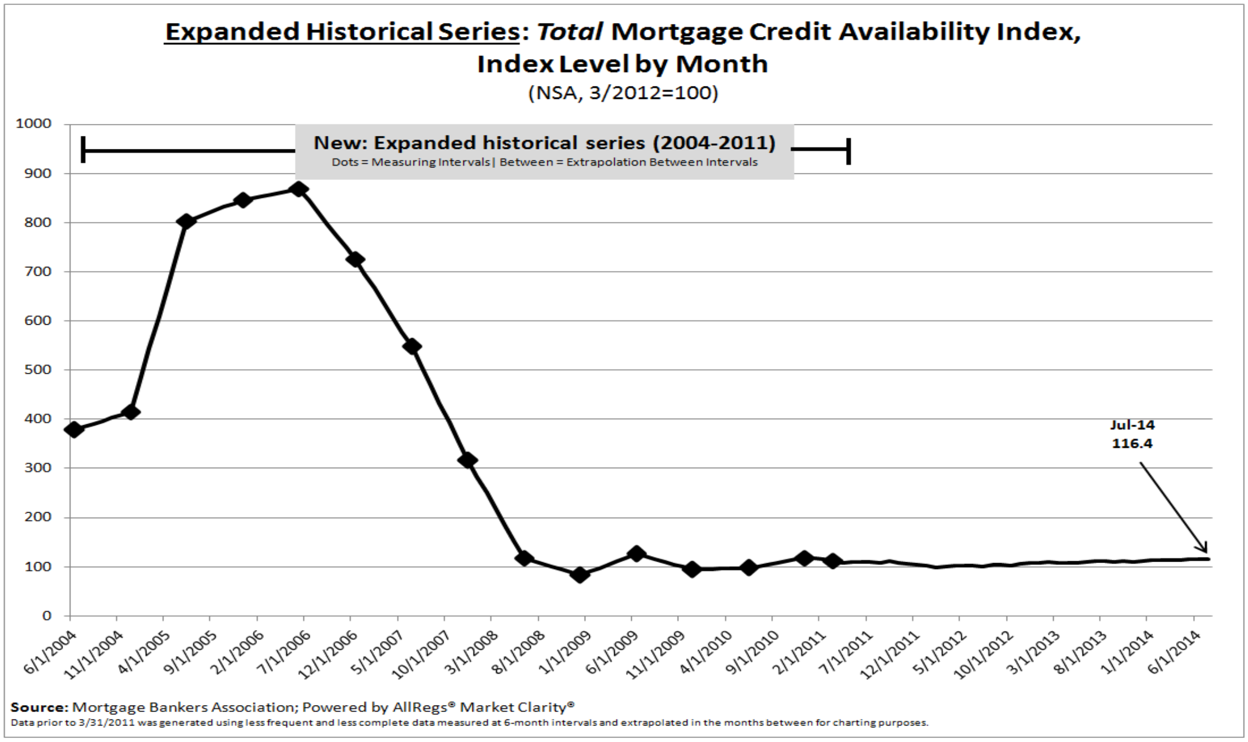
Despite the decreasing trend in application volume, the average loan size of mortgage applications continued to trend higher on a year over year basis, with the national mortgage average increasing to $244,000 in July 2014 from $213,700 in July 2013. Over the same time period, the average loan size for home purchase applications has increased to $271,500 from $259,900, while the average loan size for refinance loans has increased to $220,300 in July 2014 from $186,900 a year ago.

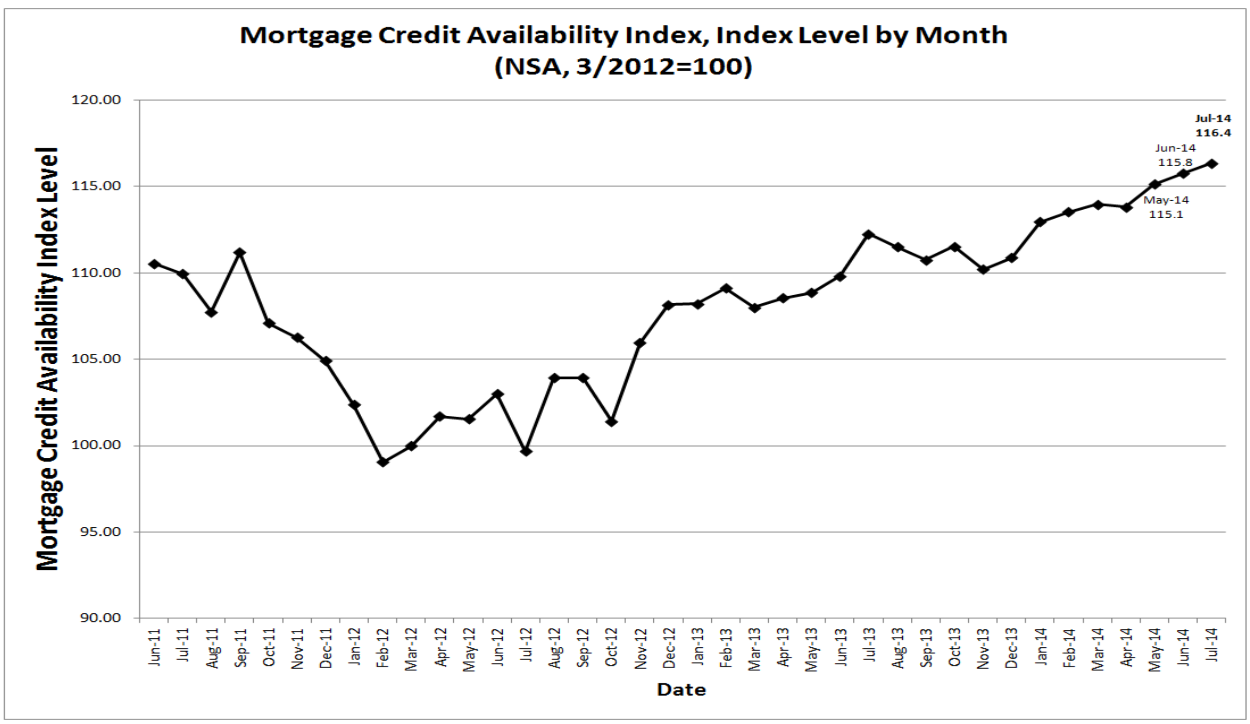
The chart below shows how the average loan size has changed for the ten states with the highest loan sizes, with California, DC, and Hawaii leading the way.



Source: MBA Monthly Profile of Mortgage Activity

Mortgage credit availability increased in July according to MBA's MCAI. The main driver in the July increase was an increase in the number of jumbo Adjustable Rate Mortgage (ARM) programs ranging from 3/1 ARM loans to loans with longer fixed terms like 10/1 ARM loans. Increased availability of higher balance Federal Housing Administration (FHA) and Department of Veterans Affairs (VA) loan programs also contributed to the net loosening to the index. Additionally, there was a slight loosening in lender criteria for several programs with respect to minimum credit scores and maximum loan-to-value (LTV) ratios, more so for FHA and VA loans. However, the overall index level remains well below prerecession averages and we do not expect any significant increases in the near future due to the current regulatory environment.





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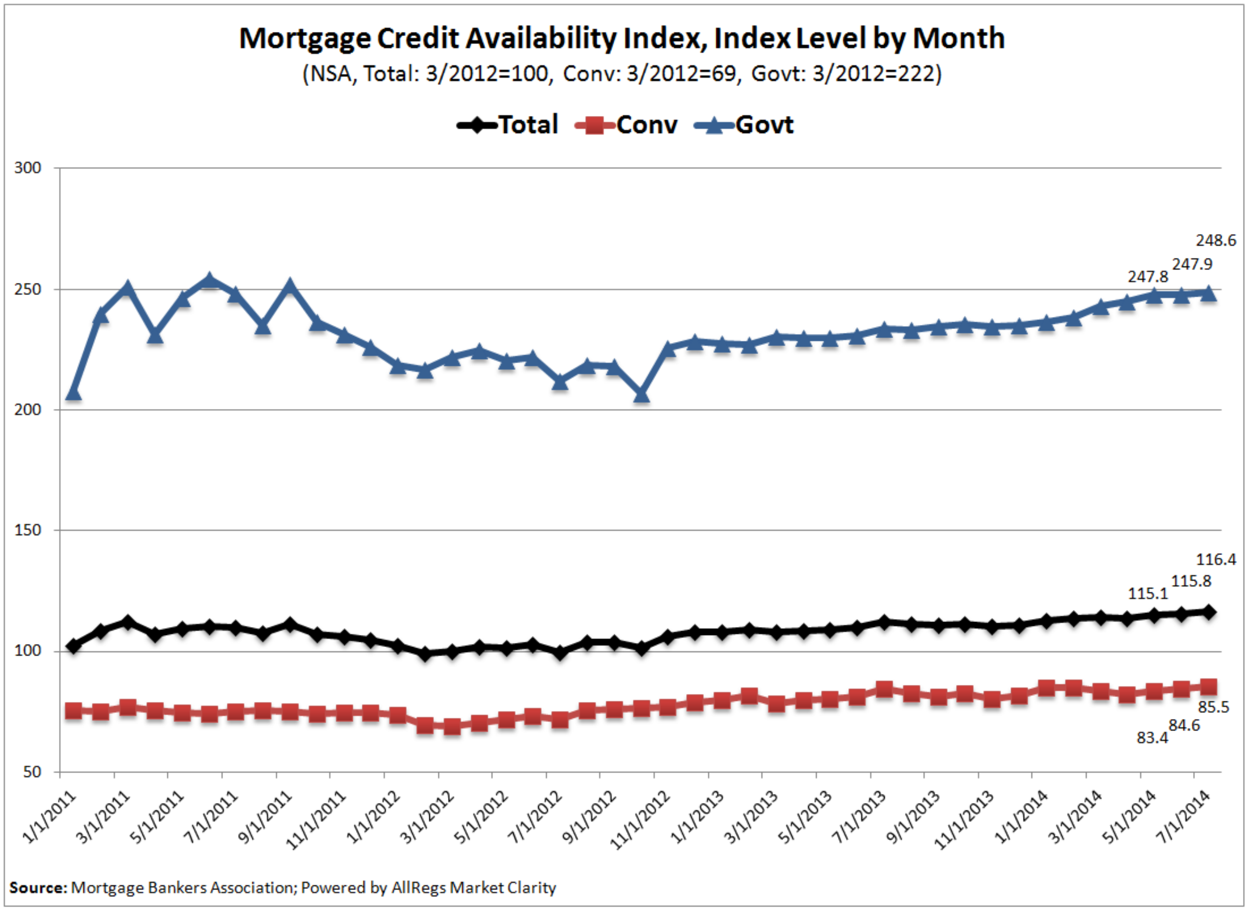
In our July release of the credit index data, we created two new indexes by disaggregating the main index into conventional and government components, with the government index covering the FHA, VA, and RHS backed loans, and the conventional index representing the remainder of the market that are non-FHA, VA, and RHS backed loans.

Both component indexes saw slight increases in July, as noted above with regards to the overall index, credit availability is still low by historical standards.



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

Similar to previous months, even as the broader economy and job market continue their improvement, mortgage application activity for home purchase remains in decline. Home sales however, have started to improve. We expect purchase originations to decrease 11.7 percent in 2014 relative to 2013, totaling $576 billion in purchase volume. Refinance originations are still expected to fall 60.9 percent to $431 billion in 2014 relative to 2013's level of $1.1 trillion. For 2015, purchase originations are expected to increase to $729 billion, an increase of 25.2 percent. Refinance originations will decrease slightly in

2015, dropping to $401 billion, as rates continue to increase. Even with lower than expected mortgage rates thus far in 2014, we have not seen any meaningful increase refinance activity. We expect that mortgage rates will remain below the 5 percent mark for 2014, averaging 4.5 percent for the year, before increasing to 5.0 percent for 2015.

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