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MBA Forecast Commentary

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Strong Third Quarter, but Likely Slower Growth Going Forward

MBA Economic and Mortgage Finance Commentary: November 2014

Highlights from this month's outlook:

1. Following a strong third quarter of growth, we expect that real GDP growth will be slightly slower in the coming quarters
2. With their October meeting, the FOMC ended the Fed's quantitative easing program
3. Certain housing indicators showed signs of picking up, with home sales and housing starts increasing in recent weeks.
4. Mortgage performance improved in the third quarter, with the percent of loans delinquent and the percent of loans in foreclosure both reaching the lowest level since 2007.

A strong third quarter of 2014 in terms of economic growth, while welcome news, is also starting to show signs that some of the growth previously attributed to and expected to occur in the fourth quarter was pulled forward. This has resulted in a lower forecast for the fourth quarter and also for the first half of 2015.

Housing indicators in recent weeks showed some resurgence in home sales and housing starts, but home prices continue to moderate thought still showing positive year over year growth. Home prices are still around 5 percent below the peak in 2007. A three week rally in mortgage rates in October provided a small boost to refinance applications, and likely pulled some refinance activity into the fourth quarter of 2014 from the first quarter of 2015.

QE3 is officially over. In the FOMC statement following the October meeting, the Fed clearly recognized the stronger economy and job market, seeing past the recent financial market volatility to recognize the improved growth prospects in the US for the year ahead. The statement still suggests that there will be a "considerable time" before the Fed increases short-term rates, but we expect this is consistent with a

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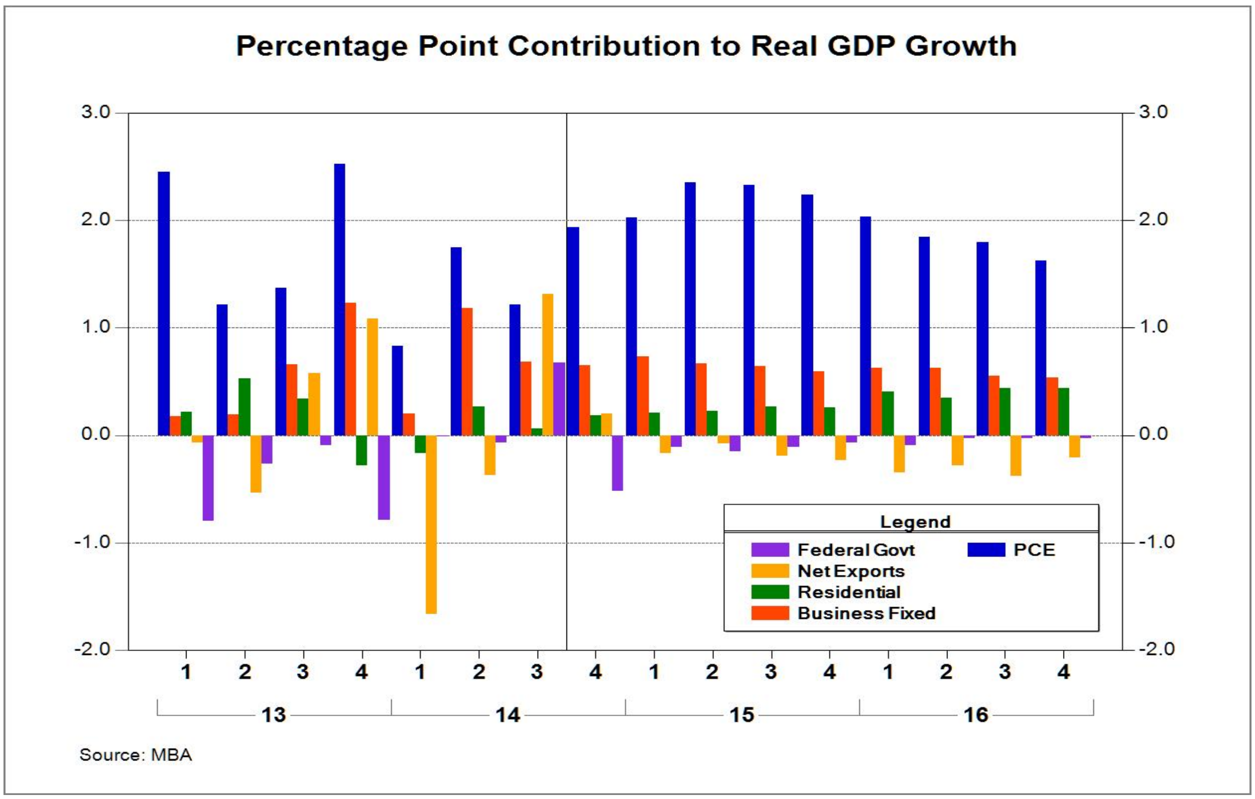
first rate increase in June or July of 2015. This announcement was also consistent with our forecast, so we still expect to see mortgage rates slowly rise to 5% by the end of 2015.

The BEA's report on third quarter 2014 GDP indicated that real GDP growth was 3.9 percent, which followed a strong second quarter in which growth was 4.6 percent. Personal consumption spending, business fixed investment, government spending, and net exports were the main drivers of growth in the third quarter. Businesses continued their investment in equipment and intellectual property products in the third quarter. Net exports, which were a drag to growth in the previous two quarters, contributed positively to overall growth in the third quarter, as imports shrank for the first time since 2012. This was likely due to global stresses and a stronger US dollar.

Our projection for overall US economic growth is 2.8 percent in 2015 and 2.5 in 2016, which will be driven mainly by strong consumer spending and business fixed investment, as households continue to spend on durable goods, such as cars and appliances, and as businesses invest in new plant and equipment. Moreover, after several years of contraction, the rate of government spending should no longer be a significant drag on the economy. International risks still remain as a significant downside risk to the forecast. The chart below shows the components that we expect will contribute to GDP growth in 2015 and 2016.



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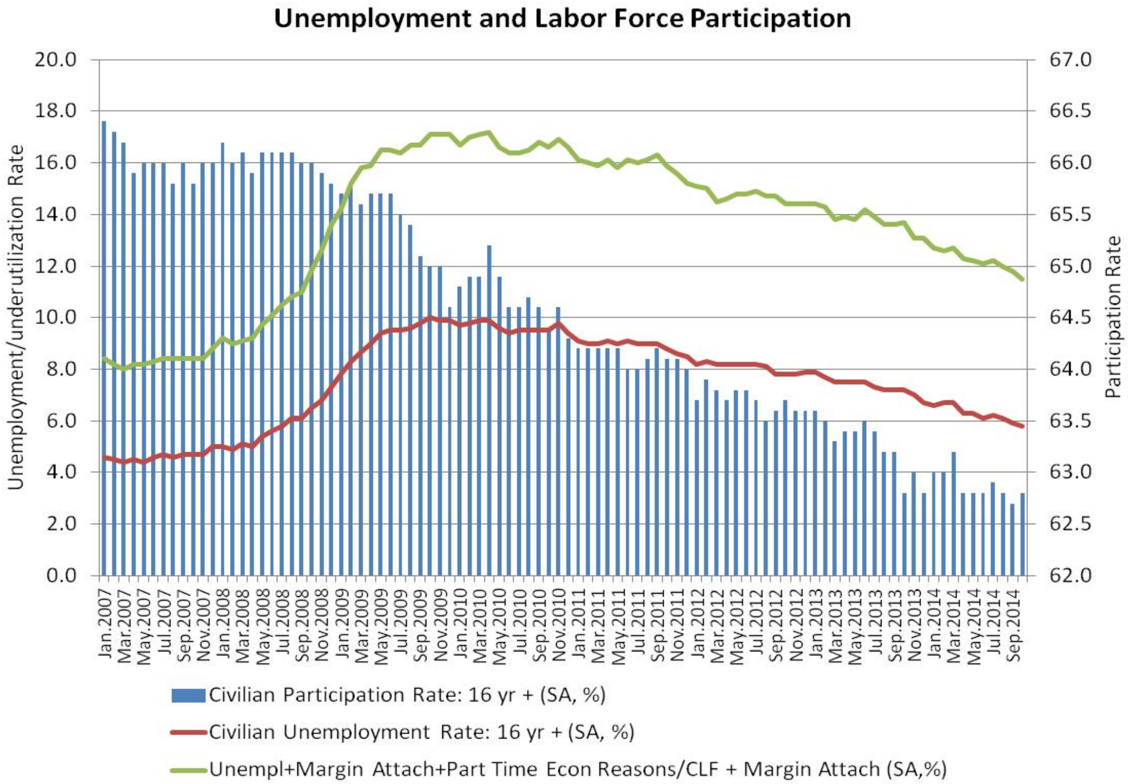
Source: Bureau of Economic Analysis, MBA November 2014 Forecast

Industrial production in the US showed a decrease in October, the second decrease in three months. The decrease was driven by mining and utilities; the mining sector had the largest single month decrease in a year. Shipments of core capital goods (nondefense, excluding aircraft) decreased in October after seeing increases since May 2014. New orders for core capital goods decreased as well, falling for the second straight month. This was a weak start to the quarter, and it may be a sign of the third quarter's strength pulling some growth forward from the fourth. This was in contrast to the ISM manufacturing index's solid increase in October, as its new orders, production, and employment indexes all saw healthy gains over the month. The production index is at its highest level since 2004.

The US labor market remains relatively strong, as job openings in both private and government sectors have increased steadily this year. However, weekly unemployment claims, which were trending down through most of the year, increased in recent weeks. In the October employment report from the BLS, non-farm payrolls grew by 214,000 jobs over the month, which included upward revisions to the previous two months' totals as well. Accompanied by a slightly tick up in the labor force participation rate, the unemployment rate decreased to 5.8 percent, the lowest rate recorded since July 2008. Despite the October increase in the labor force participation rate, it remains below the 63 percent mark, essentially in the lowest range of values since 1978. There still remain a significant number of workers who are employed below potential, accepting part time jobs for economic reasons and also working lower paying full time jobs than those they might have had previously. Overall labor underutilization remains high, as evidenced by the slightly elevated level of the U6 measure shown in the chart below.



Source: Bureau of Labor Statistics

We anticipate that as the economy grows, more workers may return to the work force to seek employment, and this will temper the decline of the unemployment rate. We forecast monthly job growth will average 220,000 per month in 2015, and that the unemployment rate will decrease to 5.4 percent by the end of 2015 and 5.2 percent in 2016.

As the economy and labor markets strengthen, mortgage performance continues to improve on aggregate. In the most recent National Delinquency Survey, the overall delinquency rate and the percent of loans in foreclosure both decreased to their lowest levels since the end of 2007. Most measures have returned to pre-crisis levels. Foreclosure starts were unchanged on a seasonally adjusted basis, but increased slightly in the unadjusted data. Given that this measure reached the lowest level in eight years last quarter, and given the continued decline in delinquency and foreclosure inventory rates, we expect that the increase in the unadjusted starts rate is just regular seasonal fluctuation.

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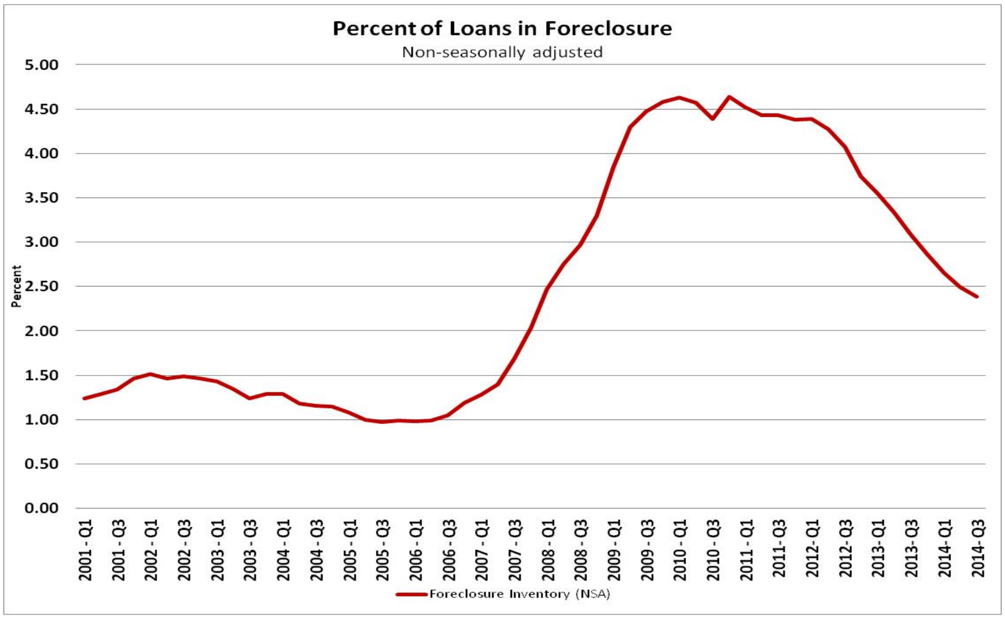
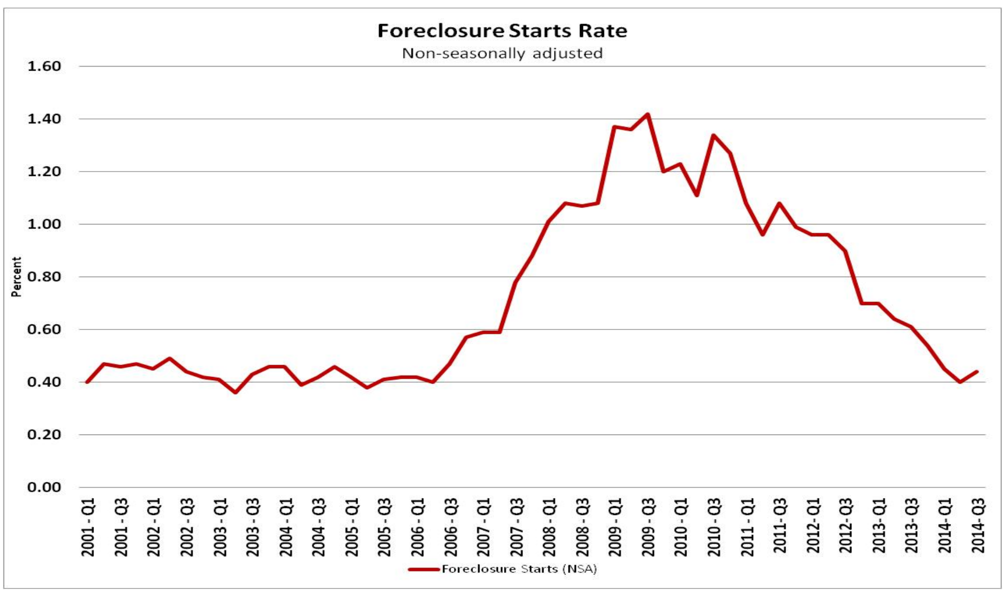




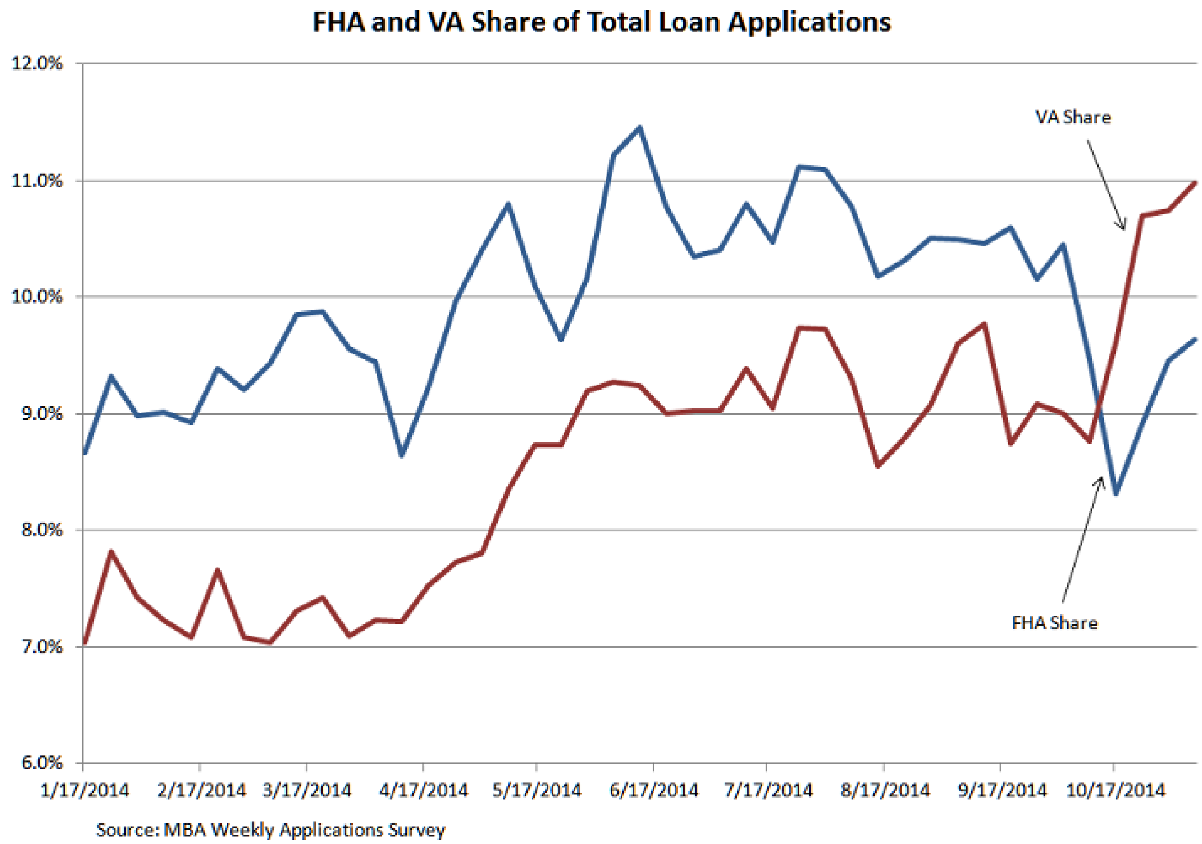
Source: MBA National Delinquency Survey

The largest increases in foreclosure starts rates were for subprime loans. Even though few to no subprime loans have been made post crisis, they still accounted for 33 percent of the new foreclosures started in the third quarter.

The seriously delinquent rate fell by 15 basis points last quarter and has dropped 100 basis points over the past year. Most of these loans were made prior to the downturn, with 74 percent of them originated in 2007 or earlier. Loans made in recent years continue to perform extremely well due to the improving market and tight credit conditions; loans originated in 2012 and later accounted for only four percent of all seriously delinquent loans.

The foreclosure starts rate for FHA loans increased by 12 basis points in the quarter. FHA loans were 17 percent of all loans serviced and accounted for 27 percent of new foreclosures. Of all FHA loans, those originated in 2010 and prior accounted for 87 percent of serious delinquencies. More recent vintages accounted for the remaining 13 percent.

Refinance applications received a boost in October as rates plunged for a brief spell, causing an increase in higher balance refinances. Purchase applications however, continued to hover close to 20 year lows. We also saw a shift in the government mortgage market, as the share of applications attributable to VA loans surpassed the FHA for the first time in many years, possibly the first time ever.



Recent housing indicators have pointed to growth in the housing market. These developments are likely a result of broader economic growth in the US that is gaining momentum, along with employment conditions secure enough that households are starting to reenter the housing market.

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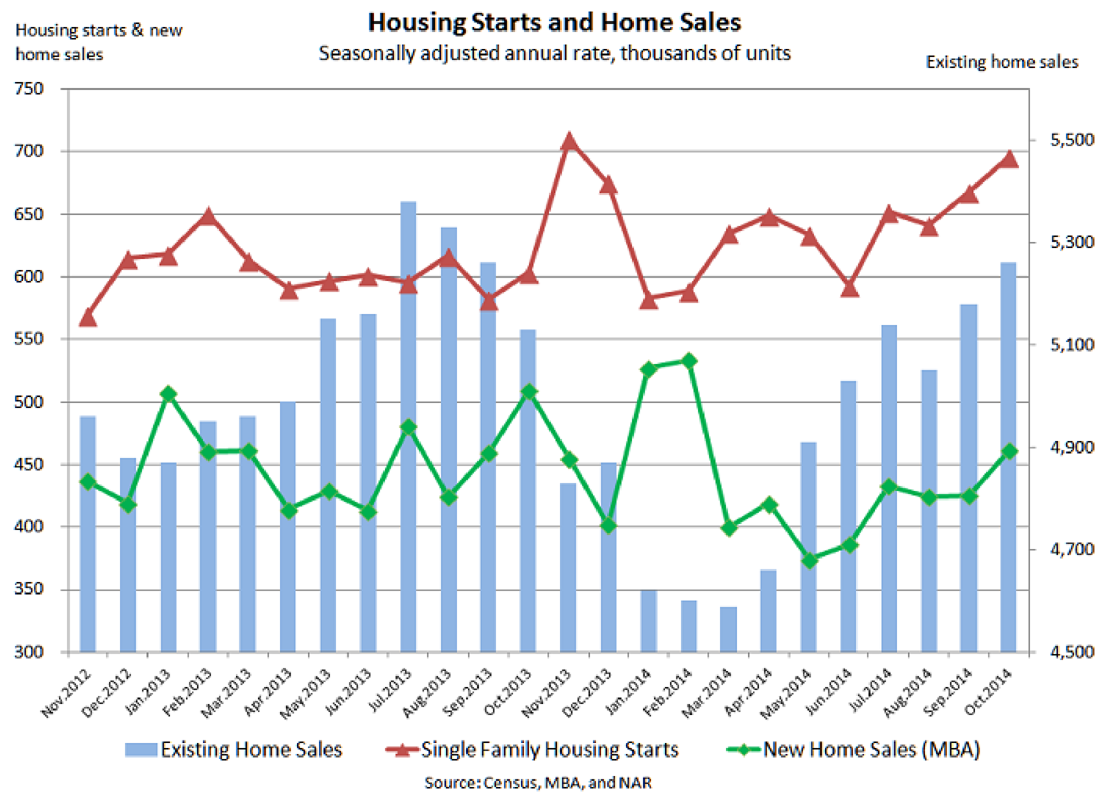
The Census Bureau reported that single family housing starts increased 4.2 percent in October to a seasonally adjusted annual rate (SAAR) of 696,000 units. This was the fourth straight year over year increase and the annualized pace of starts was the highest in almost a year.

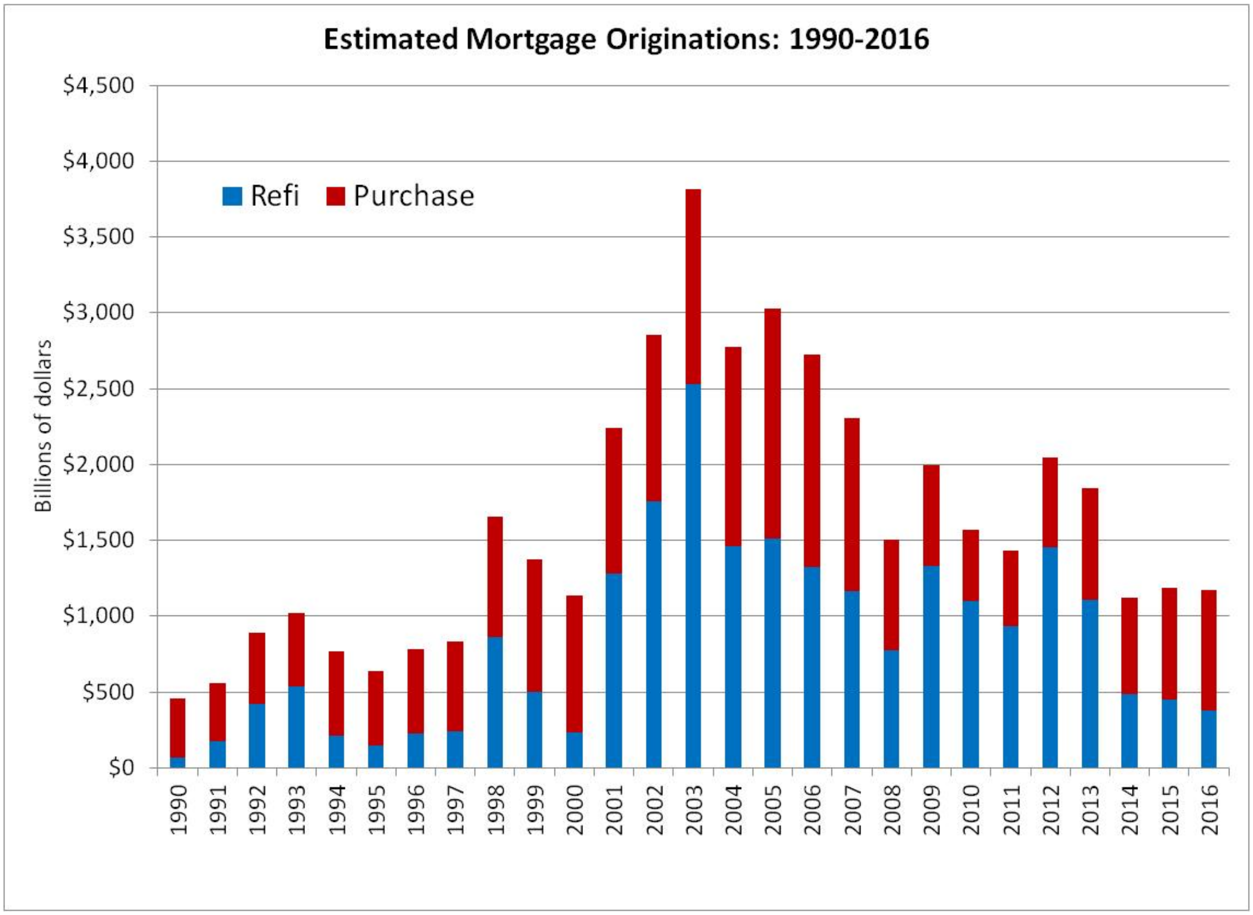
The MBA's estimate of new home sales from its Builder Application Survey increased to a SAAR of 461,000 units in October, an increase of 8.5 percent, reaching the highest level since February 2014. The Census measure of new home sales increased to a SAAR of 458,000 units from a downwardly revised pace of 455,000 units.

Existing home sales, as reported by the NAR, increased by 1.5 percent in October to a SAAR of 5.26 million units, reaching the highest level since September 2013. This was a 2.5 percent increase from October 2013 and the first YOY increase in 12 months. Our outlook is for housing starts and home sales to pick up in 2015 and 2016, as much of the restrained household formation growth starts to be reversed, credit availability loosens a little, and the economy and job markets strengthen.



In terms of mortgage originations, we estimate a total of $1.18 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014. Purchase originations will drive the increase, increasing to $733 billion in 2015 from $638 billion in 2014. Refinances are expected to drop to $451 billion in 2015 from

$484 billion in 2014. For 2016, where above-trend economic growth is still expected, the improvement in the housing and mortgage markets should continue, leading to $791 billion in purchase originations. However, rates will likely continue to rise and cause refinances to decline to $379 billion for a total of $1.17 trillion in 2016.



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