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MBA Forecast Commentary

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2014 Ending with Broader Economic Strength

MBA Economic and Mortgage Finance Commentary: December 2014

Highlights from this month's outlook:

1. We expect both economic and employment growth to continue into 2015, and that housing is poised for stronger growth next year as well.
2. Following a strong third quarter of growth, we expect that real GDP growth will be slightly slower in the coming quarters, but growth will still be at a healthy pace.
3. The FOMC is going to be "patient" and continue to balance employment gains against still soft inflation. This leaves our forecast of interest rates largely unchanged.
4. We had a strong October for most housing measures, but November housing starts and new home sales were weaker.

Over the last month, the US economy continued to show strength in the midst of global uncertainty. Better than expected November retail sales and a strong jobs report accompanied plummeting oil prices and heightened concerns regarding global economic growth. While 2014 was a disappointing year for housing markets, other positive signs in the economy suggest that households may be gaining enough stability to re-enter the market for homeownership, or to enter it for the first time. While global uncertainty remains an important downside risk to the economy, we think that the US economy has built a solid foundation for continued gains in 2015.

Coming in stronger than expected, retail sales increased in November by a seasonally adjusted 0.7 percent. Relative to November a year ago, retail sales were 5.1 percent higher, driven by greater sales for motor vehicle dealers (up 9.5 percent) and nonstore retailers (up 8.7 percent).

Industrial production in the US increased 1.3 percent in November, the largest monthly increase since 2010, and the third straight increase. Utilities and manufacturing drove the increase, while mining had a slight decrease over the month. Overall capacity utilization increased to 80.1 percent, the highest level since 2008, driven also by utilities and manufacturing. The ISM manufacturing index decreased slightly in

November, as most component indexes showed declines. The new orders and suppliers deliveries component indexes increased in November. While October orders for durable goods were up (0.4%), they were mainly driven by transportation equipment. Excluding transportation, orders were down 0.9% in October, equal to the revised rate for September.

Falling oil prices have caused us to decrease our projected change in consumer prices to 1.6 percent for the fourth quarter of 2014. However, we have only slightly adjusted our forecast downward to 1.8 percent for 2015 on the assumption that the collapse in oil prices will only have a transitory effect on the pace of overall inflation.

The US labor market remains relatively strong, as job openings in both private and government sectors have increased steadily this year, and initial claims for unemployment insurance remain quite low. In the November employment report from the BLS, non-farm payrolls grew by 321,000 jobs over the month. The report also included upward revisions to the previous two months' totals. The labor force participation rate remained unchanged at 62.8 percent, as did the unemployment rate at 5.8 percent, still the lowest rate recorded since July 2008.

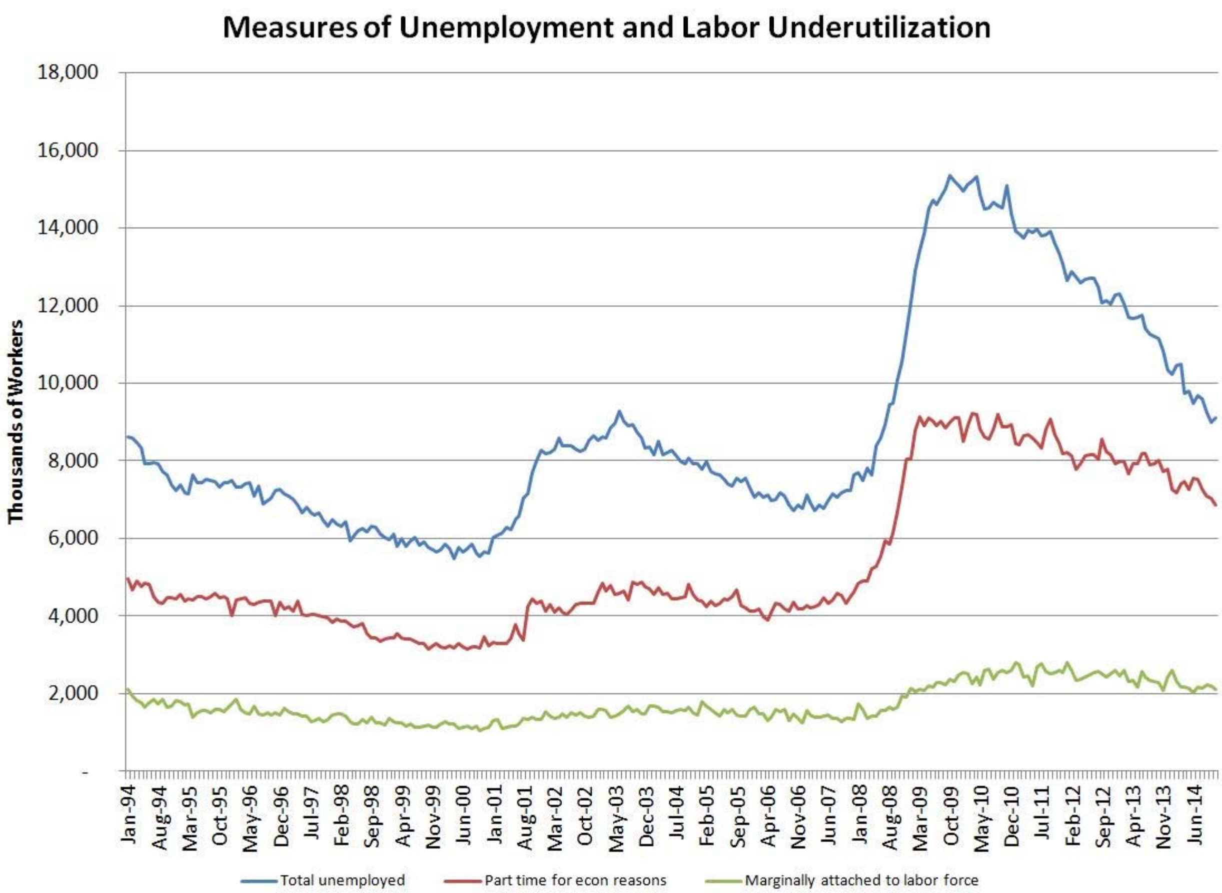
The number of workers who are employed below potential, accepting part time jobs for economic reasons and also working lower paying full time jobs than those they might have had previously have not been declining as fast as overall unemployment. Nonetheless, the number working part time for economic reasons has fallen in each of the last five months, as shown in the chart on the next page. Wages also increased in November, rising 0.6 percent in real terms (SA).

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 by yearend 2016.

With the current pace of economic growth, we expect that fourth quarter growth will be around 2.5 percent, and bring 2014's average growth to 2.2 percent. 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.

Following three months of steady increases, the Census Bureau reported that single family housing starts decreased 5.4 percent in November to a seasonally adjusted annual rate (SAAR) of 677,000 units. The Census revised October sales upward to 716,000 units (SAAR).

On the heels of strong new home sales in October, November sales volume also dropped significantly. The MBA's estimates of new single-family home sales from its Builder Application Survey were running at 401,000 units, a decrease of 13 percent from the October pace of 461,000. Average loan size increased to almost $307,000 in November from roughly $300,000 in October, indicating that builders are having greater success with higher priced homes and difficulty at the entry level, as first-time buyers continued to face tight credit conditions.



Source: Bureau of Labor Statistics

Despite November declines in housing indicators, the general trend during the second half of 2014 was positive for housing. Improvement in the housing sector 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.

Our outlook is for single family housing starts to increase by nearly 14 percent in 2015 and by more than 15 percent in 2016, accompanied by strong growth in new home sales. We are currently projecting existing home sales to rise by 5.4 percent and 4.1 percent respectively.

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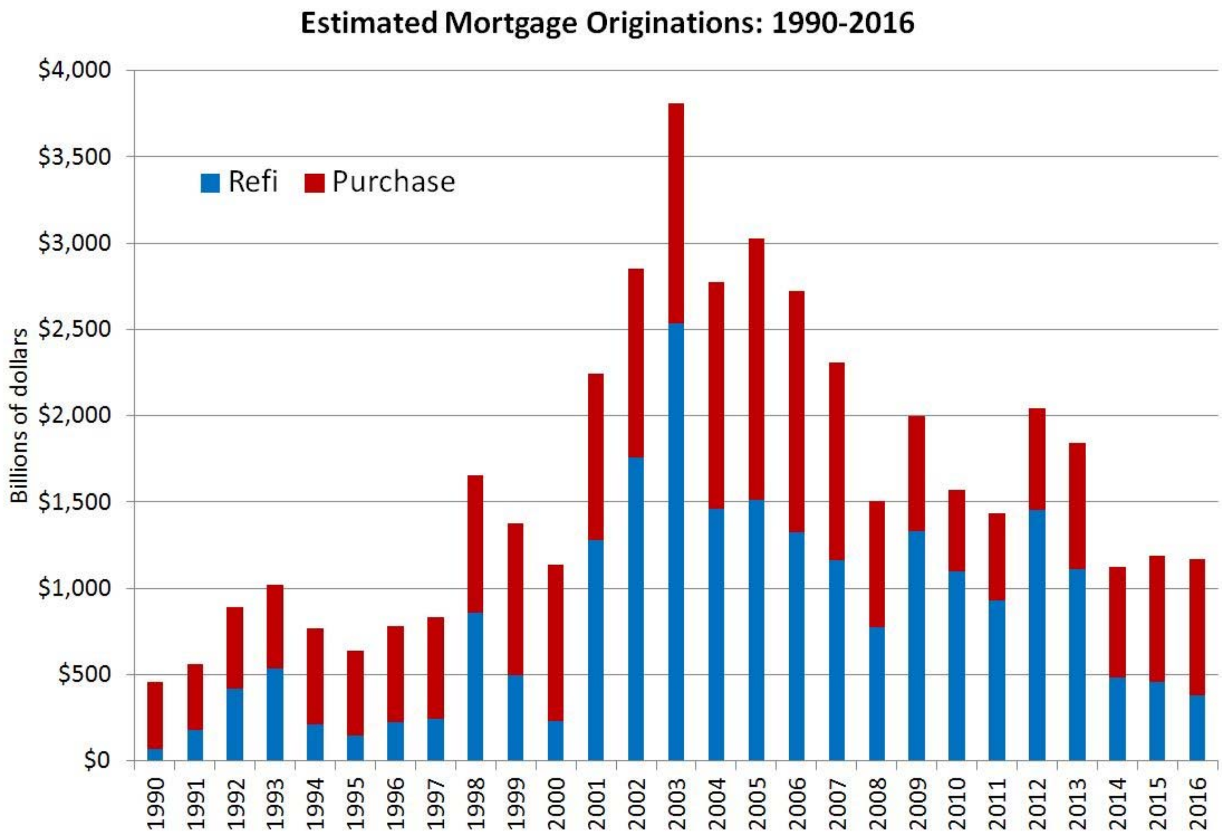
Despite the end of QE, interest rates have trended downward throughout 2014. Continuing their flight to quality, global investors have put downward pressure on longer-term Treasury yields. As of the week ending December 12, 2014, the average mortgage rate the 30-year conforming rate was at its lowest level since May 2013. Uncharacteristically, the 30-year jumbo rate has been consistently lower than the conventional 30-year rate since November of 2013. Recent gains in MBA's Mortgage Credit Availability Index have also been driven by gains in the jumbo market.

We now expect fourth quarter 10-year Treasury yields to be around 2.3 percent and for the 30-year fixed rate mortgage interest rate to settle at 4 percent for the quarter. Our forecasts of 4.8 and 5.4 percent for 30-year rates in 2015 and 2016 respectively remain unchanged.

Refinance applications continued to ebb in November following a brief spike in October. However, low rates midway through December may once again cause an uplift in refinance volume. Purchase applications trended slightly upwards in November but still remain near historic lows.

In terms of mortgage originations, we estimate a total of $1.19 trillion in mortgage originations for 2015, compared to $1.12 trillion in 2014 (chart is on the next page). Purchase originations will drive the increase, increasing to $733 billion in 2015 from $638 billion in 2014. Refinances are expected to drop to $456 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.



Source: MBA December 2014 Forecast

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