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RESEARCH AND ECONOMICS

MBA Forecast Commentary: March 24, 2021

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More Rapid Increase in Rates, Inflation, and Home Prices

Consistent with last month's outlook, we maintained our expectations for stronger economic growth in 2021 given the ongoing COVID-19 vaccine rollout, labor market improvement, and passage of the American Rescue Plan, a fiscal stimulus bill that is expected to provide relief to households and businesses. As households begin to raise their levels of spending, particularly on services, after months of increased savings and with additional stimulus income, this will be a significant boost to growth in the coming quarters. Recent data showing positive developments in the job market is another indication that businesses are gearing up for these increased levels of activity. However, supply chain bottlenecks have emerged more broadly across the economy, pushing prices higher and causing upward pressure on inflation. These factors have contributed to a steeper increase in Treasury rates than in our previous forecast, and higher mortgage rates along with that.

As the Fed continues to keep short term rates low and is still adding to its balance sheet, market participants have been monitoring their communication very closely for signs of potential tightening in monetary policy. The FOMC's latest projections showed that more members anticipate a first rate hike in 2023, even while the median member sees rates unchanged through that year. This reflects the current expectation of more rapid economic growth, faster movement towards full employment, and a higher rate of inflation as a result of the American Rescue Plan and the growing success of the vaccine rollout.

The most recent statement did not indicate any changes in the Fed's plans to continue to purchase $120 billion per month of longer-term Treasuries and MBS. However, we do expect that the economy will make 'substantial further progress' by the end of this year, which likely means the potential for the beginning, or at least the announcement, of a tapering of these QE purchases.

Our forecast is for real GDP growth to average 5.7 percent in 2021, a significant rebound from the 2.4 percent contraction in 2020. Households have amassed a significant amount of savings, with the saving rate hitting 20 percent in February, due to stimulus support but also the reduced opportunity for discretionary spending as dining, travel, entertainment, and other industries continue to operate below full capacity. This will likely result in more consumption spending later in the year as more of the country is vaccinated and we see more of a recovery in these sectors.

Job growth picked up sharply in February, with a 379,000 gain in payrolls that was led by a 465,000 increase in private sector jobs. However, the overall level of employment was still down 6.2 percent compared to February 2020 and despite the drop in the unemployment rate to 6.2 percent in February, 10 million people were still unemployed, with 4.1 million among the long-term unemployed (an increase of 125,000 from January).

The bulk of the job growth last month was in the hard-hit leisure and hospitality sector, which gained 355,000 jobs but was still down 20.4 percent compared to last year. An increase in temporary hiring, widespread gains in the retail trade sector, and upward revisions to January's job growth, were signs that the jobs picture is brighter than expected. Additionally, a potential positive sign for increased downtown activity and hiring in the coming months was the fact that the number of workers returning to the office increased in February – 22.7 percent teleworked due to the pandemic vs. 23.2percent in January.

The February jobs report was strongly positive for the broader economy's growth prospects over the next several months. We have been expecting a burst of activity from pent-up demand as the vaccine rollout continues, especially in the sectors hardest hit by the pandemic, most of which depend on in-person economic activity. The unemployment rate, which was at 6.2 percent in February, is expected to drop to 4.8 percent by the end of the year, with hiring accelerated by a surge of consumer spending as pandemic restrictions are lifted.

As growth picks up and inflationary pressures increase, rates have increased more sharply in recent weeks and we expect the 10-year yield to average 1.9 percent in the fourth quarter. Mortgage rates will also follow a similar path, with the 30-year fixed mortgage rate increasing to 3.6 percent by the end of 2021. The spread between the 30-year fixed mortgage and 10-year Treasury yield has narrowed in

recent months, down to around 150 basis points, as capacity constraints have eased and volumes slow with higher rates. Thus, mortgage rates should track more closely with Treasury rates as they increase.

We expect that rising mortgage rates will result in slowing refinance activity in 2021. The 30-year fixed rate was below 3.5 percent for most of 2020, and below three percent for the second half of the year. As mortgage rates increase, there will not be many borrowers left who can refinance. The first half of 2021 will still see significant volume with the spillover of refinancing activity in late 2020, but so we still expect refinance originations to total $1.5T in 2021. This is still a significant decrease from an estimated $2.4T in refinance originations in 2020.

Demographic drivers will drive purchase growth in 2021, as there is a large swathe of the population entering prime homeownership age. Most millennials are rapidly approaching peak first-time homebuyer age. The largest cohort of millennials are now 29, and historically, peak first-time homebuyer age is 32 or 33. This wave of young homebuyers will support the purchase market for at least the next few years. Additionally, there are still households looking to move into homes with potentially larger and more functional space to facilitate remote work and learning. Our forecast is for home sales to increase this year, and we are anticipating a strong spring housing market. However, this is dependent on both home builders' ability to ramp up production, and current owners listing their homes for sale. The lack of inventory on the market is preventing home sales from being much higher. Despite this constraint, purchase originations are expected to increase to $1.67T in 2021 from $1.43T in 2020.

February turned out to be a less positive month for many major housing market gauges – we saw declines in starts and sales. Part of the February weakness was severe winter weather, but another reason why housing starts and new home sales slowed was that home builders continue to be confronted with rising input costs, labor shortages, and a lack of available lots, causing them to slow production. Existing-home sales fell in February as well, likely due to both the impact of the severe winter storms in the South, and the continuing lack of inventory that is frustrating the home searches of prospective buyers. The supply of homes on the market is still at a 2-months supply, with around 1 million homes available for sale. The supply-demand imbalance has led to a sharp run-up in home prices, with the median sales price up almost 16 percent nationally, and as much as 21 percent in the West. We will be watching to see if some of these patterns reverse as weather improves, but there will be some downside risk to growth if these inventory shortages do not improve. Home price growth is

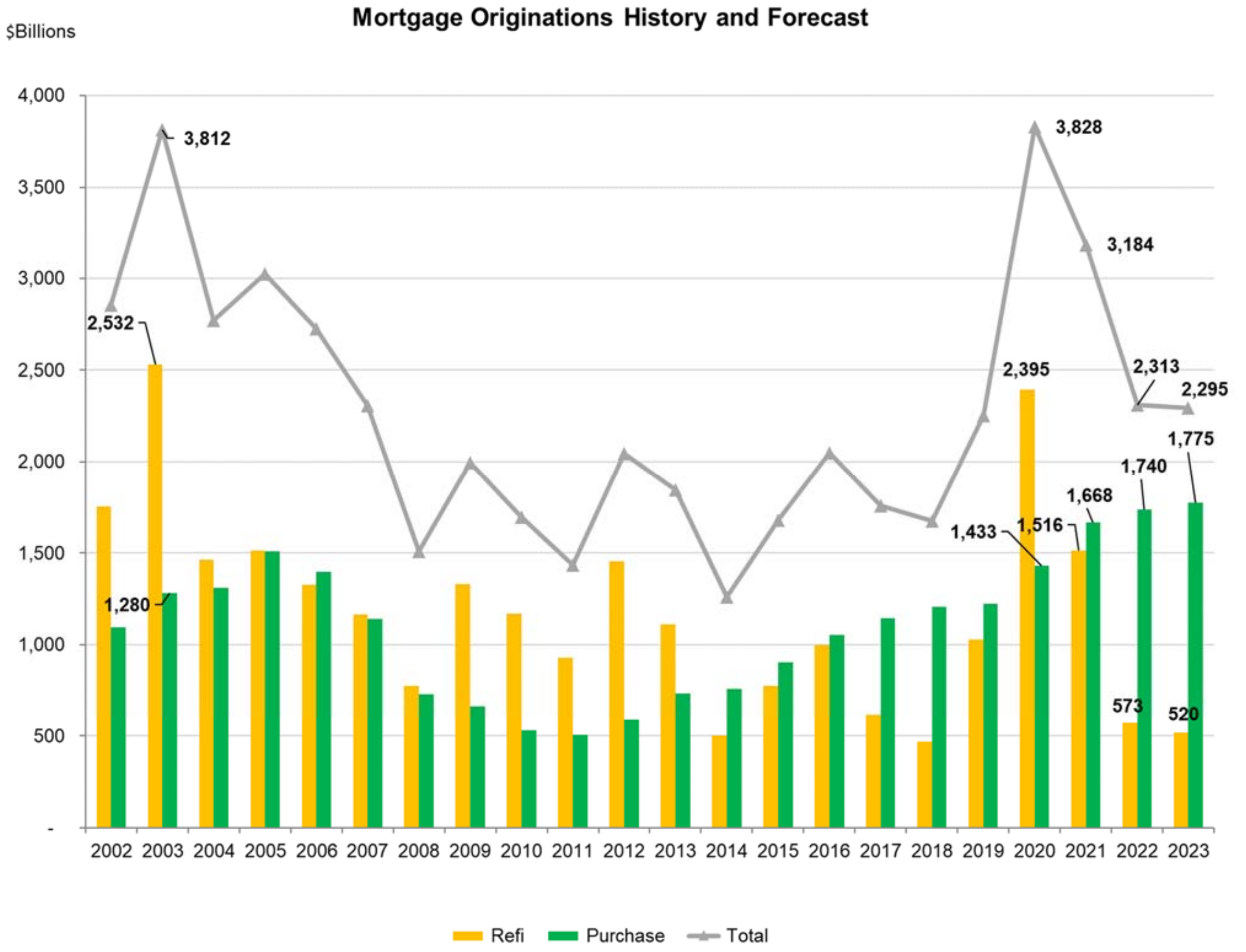
around triple income growth, reaching in excess of 10 percent annually in the fourth quarter of 2020, and mortgage rates are increasing, and these will pose significant affordability challenges for many households if the current trends continue.

Figure 1.

	2019	2020	2021	2022	2023
GDP Growth	2.3%	-2.4%	5.7%	2.7%	1.7%
Inflation	1.8%	1.2%	2.2%	2.5%	2.2%
Unemployment	3.7%	8.1%	5.5%	4.3%	4.2%
Fed Funds	1.625%	0.125%	0.125%	0.125%	0.625%
10-year Treasury	1.8%	0.9%	1.9%	2.7%	3.2%
30-year Mortgage	3.7%	2.8%	3.6%	4.5%	5.0%
New home sales (000s)	685	813	946	1,021	1,048
Existing home sales (000s)	5,331	5,678	6,404	6,429	6,504
Purchase originations ($B)	1,225	1,433	1,668	1,740	1,775
Refi originations ($ B)	1,028	2,395	1,516	573	520
Total originations ($B)	2,253	3,828	3,184	2,313	2,295

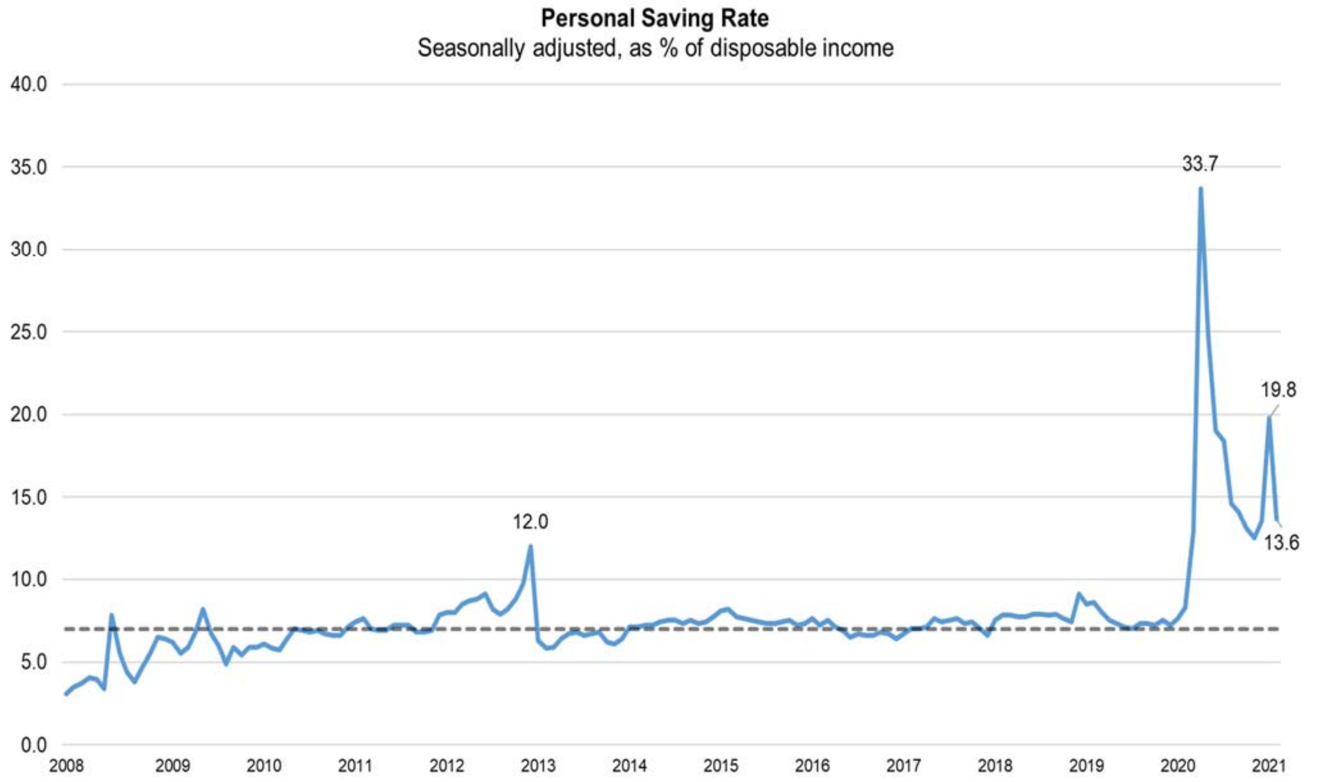
Source: MBA Forecast

Figure 2.



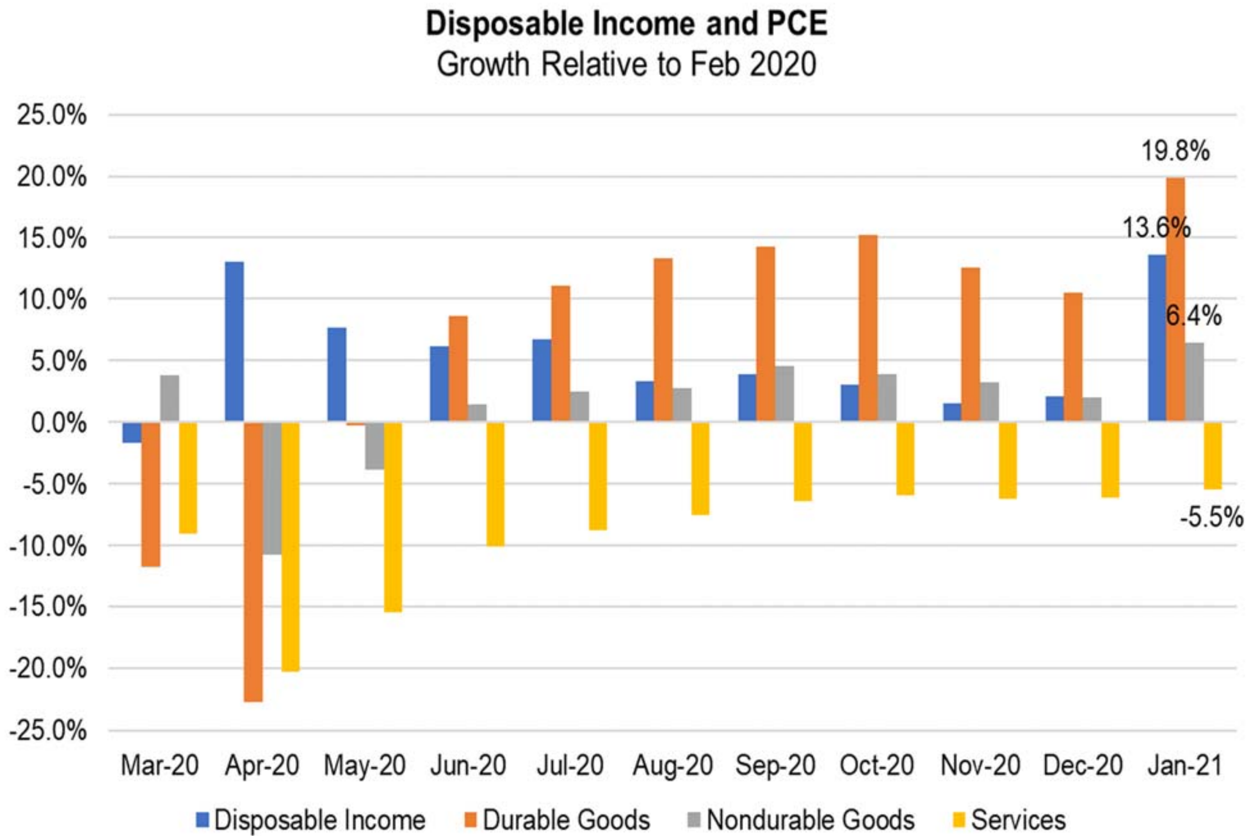
Source: MBA Forecast

Figure 3.



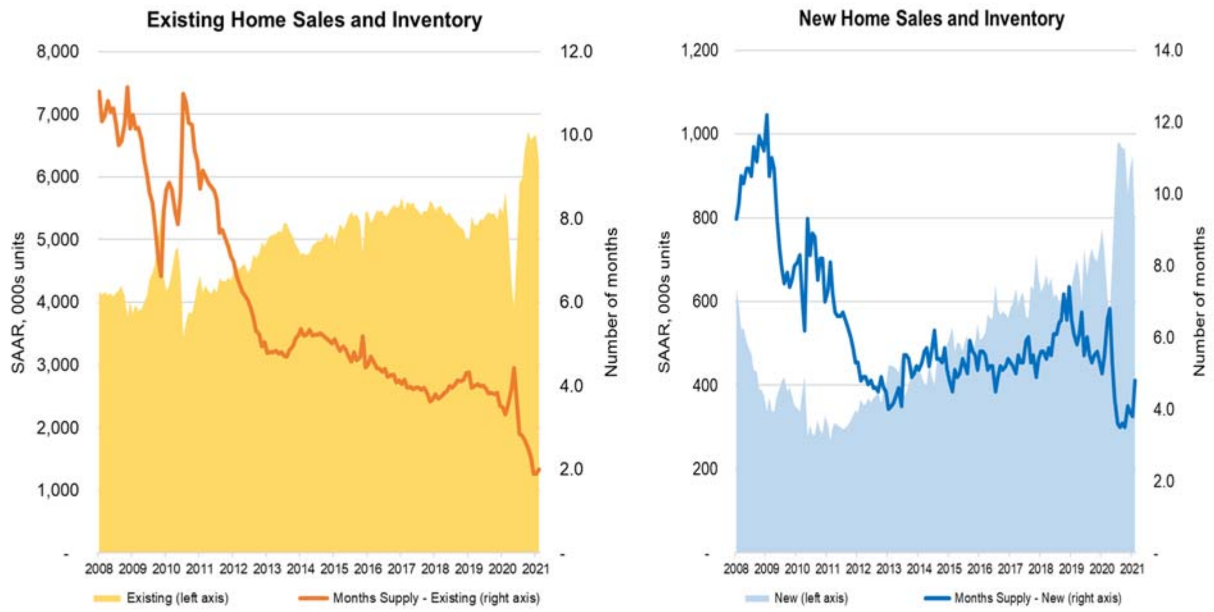
Source: Bureau of Economic Analysis

Figure 4.



Source: Bureau of Economic Analysis

Figure 5.



Source: Census Bureau, National Association of Realtors