Economic & Housing Research **Outlook**

SEPTEMBER 2016

Mortgage Originations Poised to Surge

Even as housing market activity begins its seasonal cooldown, our forecast for the best year in total home sales since 2006 looks increasingly on the mark.

Through the first seven months of the year, home sales—both new and existing homes—totaled 3.4 million, the highest total for this same time period since 2006. And indications from both mortgage applications and pending home sales imply this momentum will be sustained throughout the third quarter. As such, housing remains a bright spot for the economy as the rest of the economy sputters along.

The economy sputters along.

Outside of consumer spending, there's not a lot to get excited about for economic growth. It's slow and steady as the economy continues to sputter along, just managing not to stall. After a disappointing second quarter most analysts are expecting to see a modest bounce back in Real GDP growth in the third quarter of 2016. Real GDP growth in the second quarter was 1.1 percent, but Real Final Sales, excluding volatile inventory investment, grew at 2.3 percent. Real Final Sales have been running around 2 percent per year since 2012, and we expect GDP to follow. We forecast Real GDP growth to average 2.1 percent for the second half of 2016, bringing 2016 full-year growth to 1.5 percent and 2017 Real GDP growth to 1.9 percent.

Inflation rose more than expected in August reflecting advances in rents and medical care. The core consumer price index—excluding volatile food and energy prices—increased 2.3 percent on a year-over-year basis. Headline consumer prices have not risen at a pace above 2 percent since 2012. However, we anticipate that consumer prices will rise a bit faster for the balance of 2016, with full-year consumer price growth at 1.5 percent. In 2017, we forecast that rebounding gas prices will push headline inflation to 2.2 percent.

Forecast Snapshot (September 2016)

Summary (annualized)	2015	2016	2017
30-year PMMS (%)	3.9	3.6	3.7
Total home sales (M)	5.75	6.04	6.16
House price growth (%)	6.1	5.6	4.7
Total originations ($B)	1,750	2,000	1,650

The labor market, despite a disappointing August employment report, keeps chugging along. Though nonfarm payroll growth decelerated in August to 151,000, year-over-year job gains are over 2 million and the unemployment rate remains below 5 percent. Solid job gains finally seem to be translating into some modest real income gains with average hourly earnings up 2.4 percent year-over-year, up from 2.3 percent last year. Perhaps the best signal of labor market strength is the fact that total job openings in July were 5.9 million, the highest on record.

But there's limited upside potential for wage growth unless productivity growth turns around. Productivity, as measured by output per worker, has actually declined over the past three quarters to raise concerns about the viability of the economic expansion.[1] While productivity growth does tend to drop ahead of recessions there are many false positives, cases where productivity drops only to rebound without any subsequent recession. Still, it does no good to be sanguine about slowing productivity growth. As long as it remains slow, any gains in real income for America's households likely will be limited. We're cautiously optimistic that productivity growth will turn positive, with modest growth around 1 to 2 percent per year over the next couple of years, but we'll be watching trends in productivity closely.[2]

Solid job gains and low mortgage rates sustain housing's momentum.

Despite limited real wage gains and rising house prices, housing markets have sustained momentum into the third quarter of 2016. Following the Brexit vote, the average 30-year fixed-rate mortgage has ranged between 3.41 and 3.50 percent from June 23 through September 15, 2016.

We expect mortgage rates to gradually rise in the coming months, ending 2016 around 3.6 percent and averaging 3.6 percent for the year. This would be the lowest annual average in the past 40 years.[3] Next year, we expect rates to drift modestly higher, ending 2017 at about 3.9 percent and averaging 3.7 percent for the year.

The decline in rates from 4 percent at the end of 2015 to about 3.5 percent in the third quarter of 2016 is helping to support homebuyer affordability and offset higher home prices. For example, a prospective homebuyer looking to finance a $250,000 home loan with a 30-year fixed-rate mortgage would pay about $850 less per year in principal and interest payments with rates at 3.5 percent rather than 4.0 percent. The principal and interest payments on the same $250,000 mortgage at 4 percent is approximately equal to the payment on a $266,000 30-year fixed-rate mortgage at 3.5 percent—or 4 percent more home for the typical homebuyer.

1 For an interesting discussion, see Brookings conference on productivity.
2 Recent data from the Census Bureau shows median household income rose 5.2 percent in 2015, but real median household income is still below 2007 levels.
3 The lowest annual average for the 30-year fixed-rate mortgage in our Primary Mortgage Market Survey was in 2012, when the 30-year fixed-rate mortgage averaged 3.66 percent.

Nationally, house prices have increased about 3 percent over the six months from December 2015 to June 2016. The combination of rising house prices and falling rates have resulted in *increased* homebuyer affordability nationwide. In other words, the impact of lower mortgage rates has more than offset the rise in house prices, at least nationally. Of course, some markets have seen 6-month house price appreciation of over 6 percent, but, on balance, lower rates have maintained or slightly improved homebuyer affordability.

Looking ahead, we have revised up our forecast of home price appreciation to 5.6 percent and 4.7 percent in 2016 and 2017, respectively. This is up from last month's forecast of 5.3 percent for 2016 and 4.0 percent for 2017. We still expect house price growth to moderate over the next year as new supply comes to market and higher mortgage rates dampen homebuyers' demand, but at a more moderate pace than before.

Expect a surge in third quarter 2016 mortgage originations.

The latest public data on mortgage origination activity are reports for the second quarter of 2016, which have not yet captured the Brexit impact. Immediately following the Brexit vote, from June 23 to June 24, 10-year U.S. Treasury yields fell 19 basis points. Additionally, mortgage rates fell 8 basis points from the week of June 23 to June 30 and an additional 7 basis points the following week, from June 30 to July 7.

If a homeowner decided to refinance on June 24 when would the origination occur and show up in the data? According to Ellie Mae, average time to close a conventional refinance mortgage is about 46 days. That would mean the loan would have been originated around August 9, too early to be recorded in recent mortgage origination data.

Even prior to Brexit, mortgage origination activity was strong. According to Inside Mortgage Finance there were $510 billion in first lien mortgage originations in the second quarter of 2016 (our slightly higher estimate of $535 billion includes second liens). The surge in second quarter originations was primarily due to stronger home sales and higher house prices. Total home sales for the second quarter were up 5 percent in 2016, compared to 2015. Home prices were up about 6 percent year-over-year in the second quarter. Assuming that the cash share of home sales was roughly constant and average loan-to-value ratios also remained roughly constant from the second quarter of 2015 to the second quarter of 2016, purchase mortgage originations should have been up about 11 percent over that time period.

All indications are that mortgage originations will surge in the third quarter of 2016. Home sales in July 2016 were off the 2015 pace, but pending home sales and home purchase mortgage applications are up. In fact, according to the National Association of Realtors, pending home sales are at their second highest level in over a decade and purchase mortgage applications are up 11 percent from last year.

Even if home purchase originations are flat year-over-year, total originations will rise due to strong refinance activity. Application data from the Mortgage Bankers Association indicates that refinance applications are up about 24 percent from the second quarter 2016 and nearly 60 percent year-over-year in the third quarter.

Our forecast calls for a $60 billion, or 11 percent, increase in third quarter originations relative to the second quarter, and for total originations to reach $2 trillion in 2016. With rates rising modestly over the next few quarters refinance, activity will likely decline. Purchase originations will rise, but not enough to offset the decline in refinance activity. In our latest forecast, total originations will fall by $350 billion to $1.65 trillion in 2017.

Second quarter refinance activity was strong.

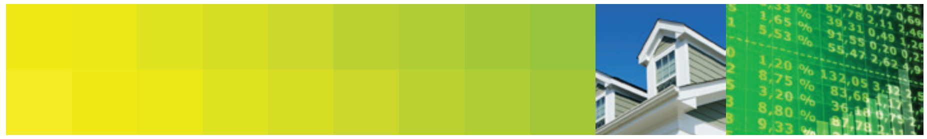
Refinance statistics for the second quarter of 2016 are now available. Freddie Mac's quarterly refinance statistics are based on loans Freddie Mac funded. More information about the report's methodology and the refinance statistics included in the report are available on our website.

A few key trends are worth mentioning:

Following the financial crisis, for most quarters between 2010 and 2013, the "cash-out" refinance share fell, ranging between just 15 and 20 percent. In recent quarters the share of mortgages with loan amounts that were at least 5 percent higher than the original mortgage balance has been rising—41 percent in the second quarter, up from a revised 38 percent in the first quarter of 2016.

During the second quarter of this year, an estimated $13.3 billion net dollars of home equity were converted to cash during the refinancing of conventional prime-credit home mortgages. This is up from $11.4 billion in the first quarter of 2016 but substantially less than the peak cash-out refinance volume of $84.0 billion during the second quarter of 2006.

It is also worth noting that with interest rates at near historic lows, more recent loans are being refinanced. The median age of a refinanced loan was 5.5 years in the second quarter, the lowest since the first quarter of 2015. The average interest rate reduction in the second quarter was about 1.1 percentage points, translating into mortgage payment savings on average of about $2,500 per year.



September 2016 Economic & Housing Market Forecast

Forecasted Figures

Historical Data

As of 9/8/2016

INDICATOR	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2017 Q1	2017 Q2	2017 Q3	2017 Q4	Annual Totals 2015	Annual Totals 2016	Annual Totals 2017
Real GDP (%)	0.8	1.1	2.0	2.1	1.9	1.9	1.9	1.9	1.9	1.5	1.9
Consumer Prices (%) a.	-0.3	2.5	1.9	2.0	1.9	2.1	2.3	2.5	0.4	1.5	2.2
Unemployment Rate (%) b.	4.9	4.9	4.9	4.8	4.8	4.8	4.7	4.7	5.3	4.9	4.8
30-Year Fixed Mtg. Rate (%) b.	3.7	3.6	3.5	3.6	3.6	3.6	3.7	3.9	3.9	3.6	3.7
5/1 Hybrid Treas. Indexed ARM Rate (%) b.	2.9	2.8	2.9	3.2	3.2	3.3	3.4	3.6	2.9	3.0	3.4
10-Year Const. Mat. Treas. Rate (%) b.	1.9	1.8	1.6	1.8	1.8	2.0	2.1	2.3	2.2	1.8	2.1
1-Year Const. Mat. Treas. Rate (%) b.	0.6	0.6	0.6	0.6	0.7	0.9	1.1	1.3	0.3	0.6	1.0
Housing Starts c.	1.15	1.16	1.23	1.27	1.32	1.38	1.43	1.48	1.11	1.20	1.40
Total Home Sales d.	5.83	6.08	6.15	6.10	6.11	6.16	6.16	6.21	5.75	6.04	6.16
FMHPI House Price Appreciation (%) e.	1.6	1.4	1.3	1.2	1.2	1.2	1.1	1.0	6.1	5.6	4.7
1-4 Family Mortgage Originations f.											
- Conventional	$290	$410	$492	$391	$245	$359	$381	$296	$1,344	$1,583	$1,281
- FHA & VA	$95	$125	$103	$94	$95	$101	$89	$84	$406	$417	$369
- Total	$385	$535	$595	$485	$340	$460	$470	$380	$1,750	$2,000	$1,650
Refinancing Share - Originations (%) g.	55	49	50	47	43	39	33	30	48	50	36
Residential Mortgage Debt (%) h.	0.0	3.5	3.7	4.0	4.0	4.0	4.0	4.0	1.6	3.5	4.0

Note: Quarterly and annual forecasts are shown in shaded areas; totals may not add due to rounding; quarterly data expressed as annual rates.
Annual forecast data are averages of quarterly values; annual historical data are reported as Q4 over Q4.

a. Calculations based on quarterly average of monthly index levels; index levels based on the seasonally-adjusted, all-urban consumer price index.

b. Quarterly average of monthly unemployment rates (seasonally-adjusted); Quarterly average of monthly interest rates (not seasonally-adjusted).

c. Millions of housing units; quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).

d. Millions of housing units; total sales are the sum of new and existing single-family homes; quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).

e. Quarterly growth rate of Freddie Mac's House Price Index; seasonally-adjusted; annual rates for yearly data.

f. Billions of dollars (not seasonally-adjusted); conventional for 2014 are Freddie Mac estimates.

g. Home Mortgage Disclosure Act for all single-family mortgages (not seasonally-adjusted); annual share is dollar-weighted average of quarterly shares (2014 estimated).

h. Federal Reserve Board; growth rate of residential mortgage debt, the sum of single-family and multifamily mortgages (not seasonally-adjusted, annual rate).

PREPARED BY THE ECONOMIC & HOUSING RESEARCH GROUP

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