

MBA Forecast Commentary: December 2022

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MBA's Outlook for 2023

The December version of MBA's forecast economic and mortgage market forecasts are qualitatively similar to the past few months:

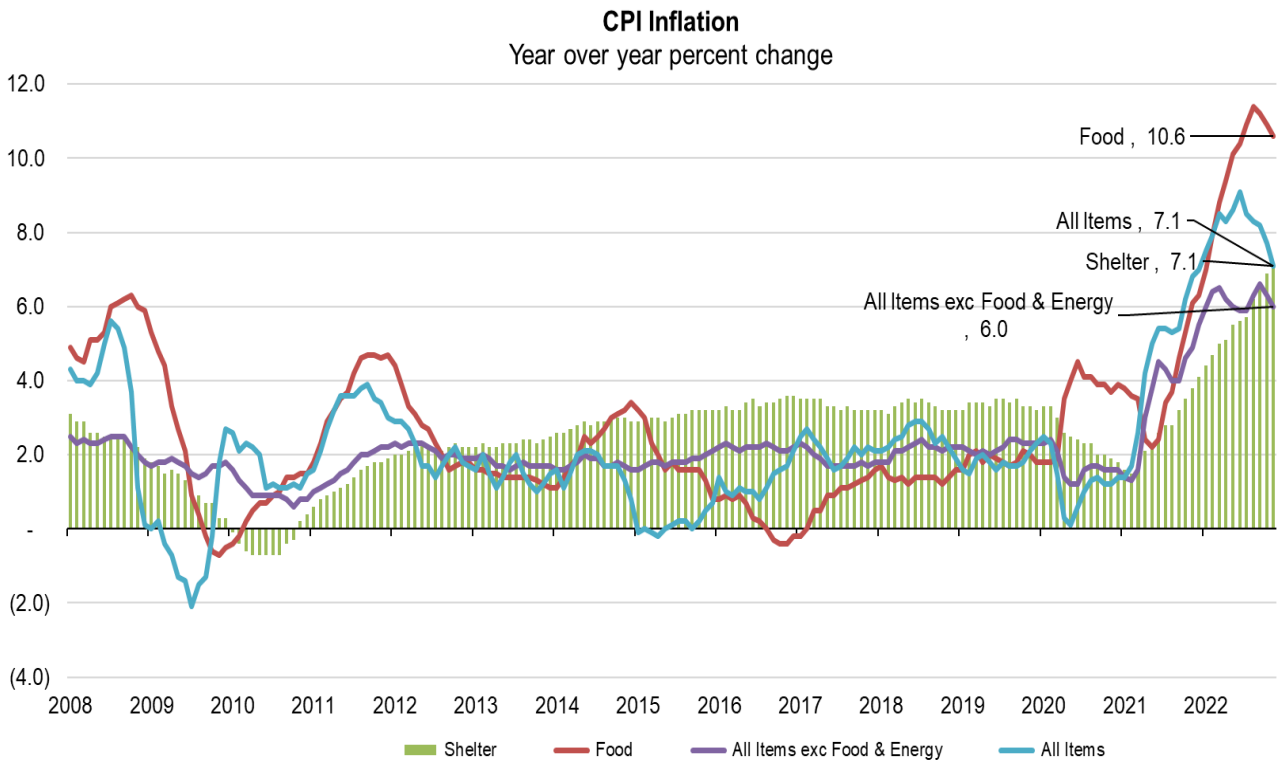
- We are expecting a recession in the first half of 2023, which will result in the unemployment rate increasing from 3.7% as of November 2022 to 5.5% by the end of 2023.
- The Federal Reserve will continue to increase short-term rates to fight inflation. They will ultimately be successful, but it will be early 2024 before inflation reaches their 2% target.
- Although short-term rates will continue to increase as the Fed pushes them up the next few meetings, long-term rates have already peaked. We expect that 30-year mortgage rates will end 2023 at 5.2%.

Here are some highlights from our December forecast, including notching down our forecasts for some key variables of interest to the industry:

- While we would still characterize the path for the national home price index as "flat", we are now forecasting several quarters of year-over-year declines in the level of national home prices. We had already been expecting some pretty significant declines in the West and Mountain regions of the country.
- Our new forecast has mortgage origination volume dropping about 15% in 2023 compared to 2022 to about \$1.9 trillion. Incoming application activity remains quite low even though mortgage rates have dropped almost a percentage point recently, so we scaled back our forecast for the first half of 2023. We are forecasting \$1.45 trillion in purchase originations, \$449 billion in refinances for 2023.
- We have also reduced our forecast for both new and existing home sales in line with the ongoing weakness in purchase application volume. The new home sales are expected to average a 616,000 unit annual pace in 2023, a 4% decrease from 2022, while we expect 4.5 million existing home sales, a decline of almost 13%.
- Delinquencies and foreclosures remain quite low, but we do expect them to increase next year as the unemployment rate rises.
- Industry employment has declined, but we expect it will decrease further in 2023.

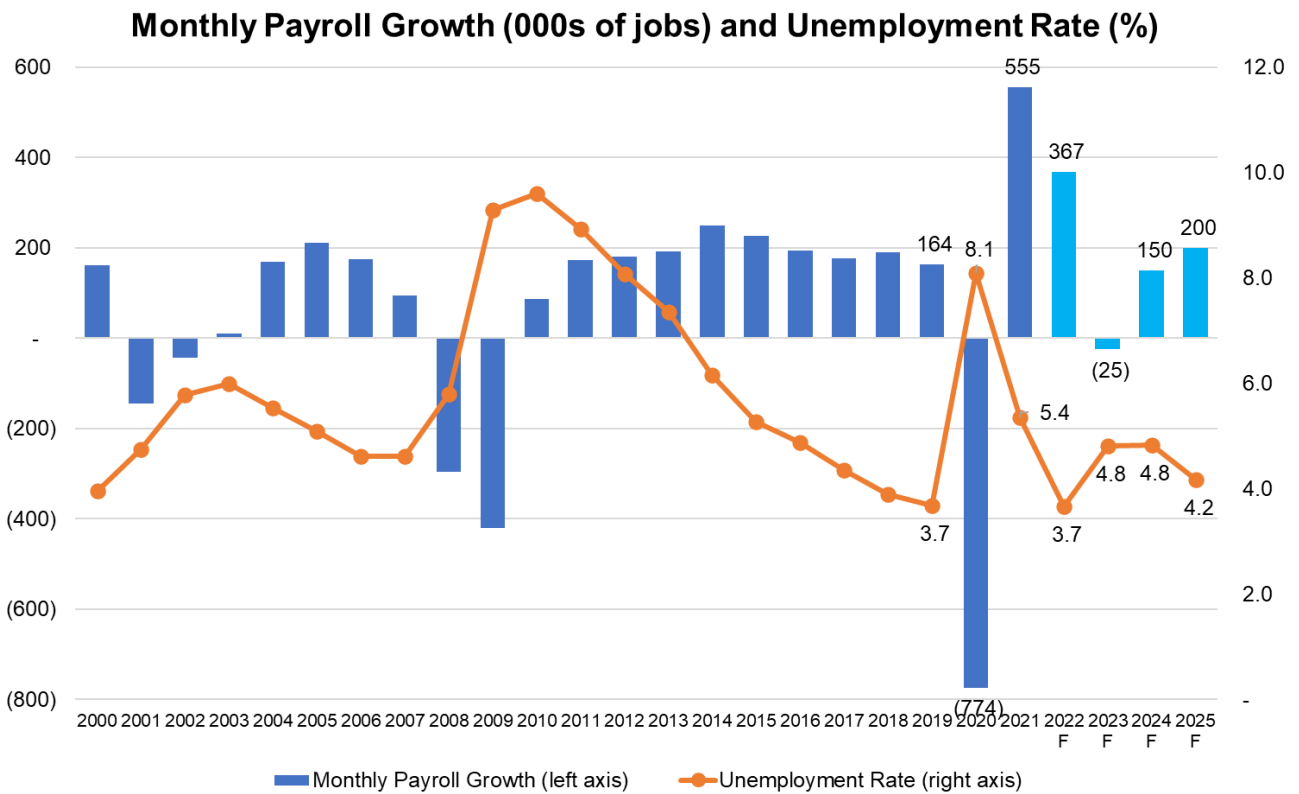
The details:

In terms of the macro picture, the most important number to watch over the next few months is the path for inflation. The November CPI number came in below market expectations, but at a 7% 12-month change, still way above the Fed's target. Within that headline number, the prices for many goods are now beginning to fall, shelter costs as measured by the BLS are decelerating on a monthly basis but shelter inflation still rose to 7.1% on a year-over-year basis. And, as highlighted by several Fed officials recently, inflation for non-shelter services is still too high, likely a consequence of wage pressures stemming from the still tight job market.



Source: Bureau of Labor Statistics

As highlighted in our summary, we do expect the job market to weaken significantly over the coming months. Job growth has slowed in four of the 11 months thus far in 2022, the number of job openings has decreased by over a million, and the number of layoffs has increased, particularly in the tech sector. However, the unemployment rate remains quite low, below the level that is likely to be sustainable over time, as evidenced by 5% annual wage growth – wage growth is running hotter than would be consistent with a 2% inflation rate. The next several months should produce negative trends in each of these labor market indicators. The peak unemployment rate of 5.5% that we are expecting at the end of 2023 is consistent with our characterizing this a relatively mild recession.

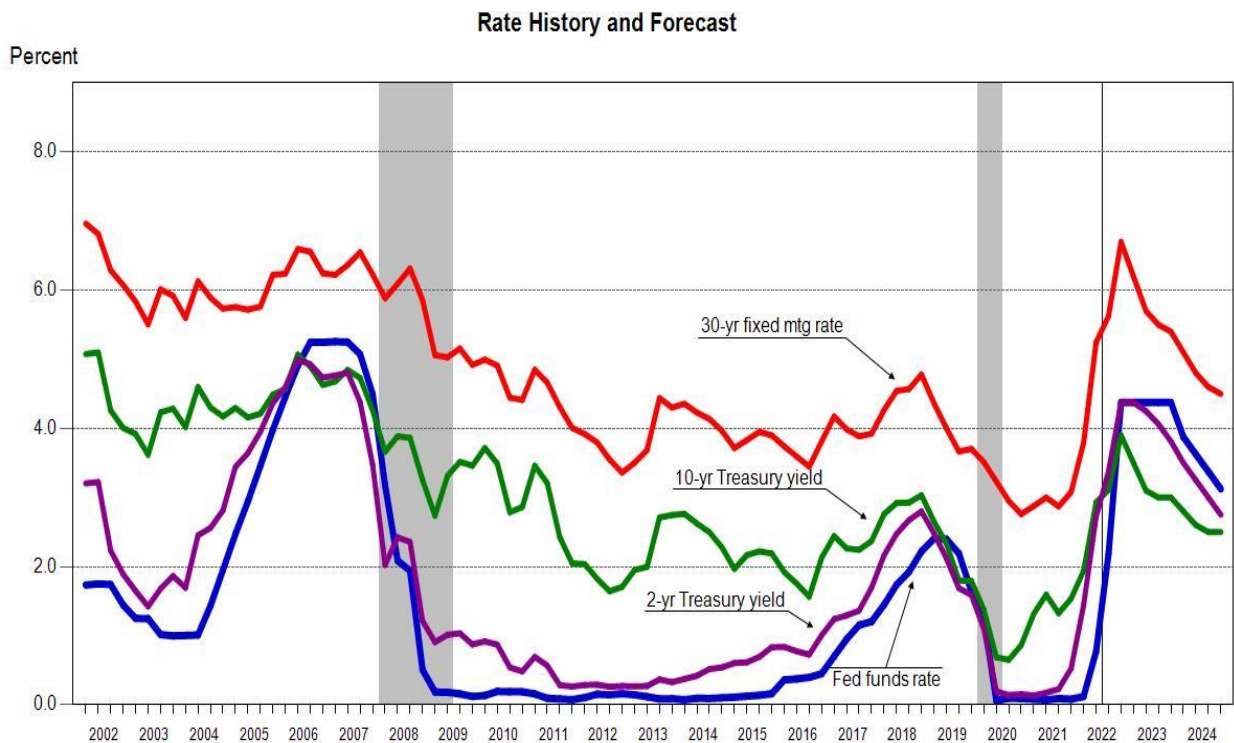


Source: Bureau of Labor Statistics

As expected, the FOMC raised the federal funds target by 50 basis points at their December meeting. Perhaps more importantly for the mortgage market, the committee’s projections also signaled that they anticipate slower growth, higher unemployment, and higher inflation in 2023 than they had indicated at the September meeting. If recent trends continue with respect to consistent declines in inflation amidst an increasing risk of recession, we may be near the peak rate for this cycle, now expected to be just over 5%.

The housing market has certainly welcomed the recent decline in mortgage rates. This decline is reflecting market expectations of being near the peak for short-term rates, as well as increased signs

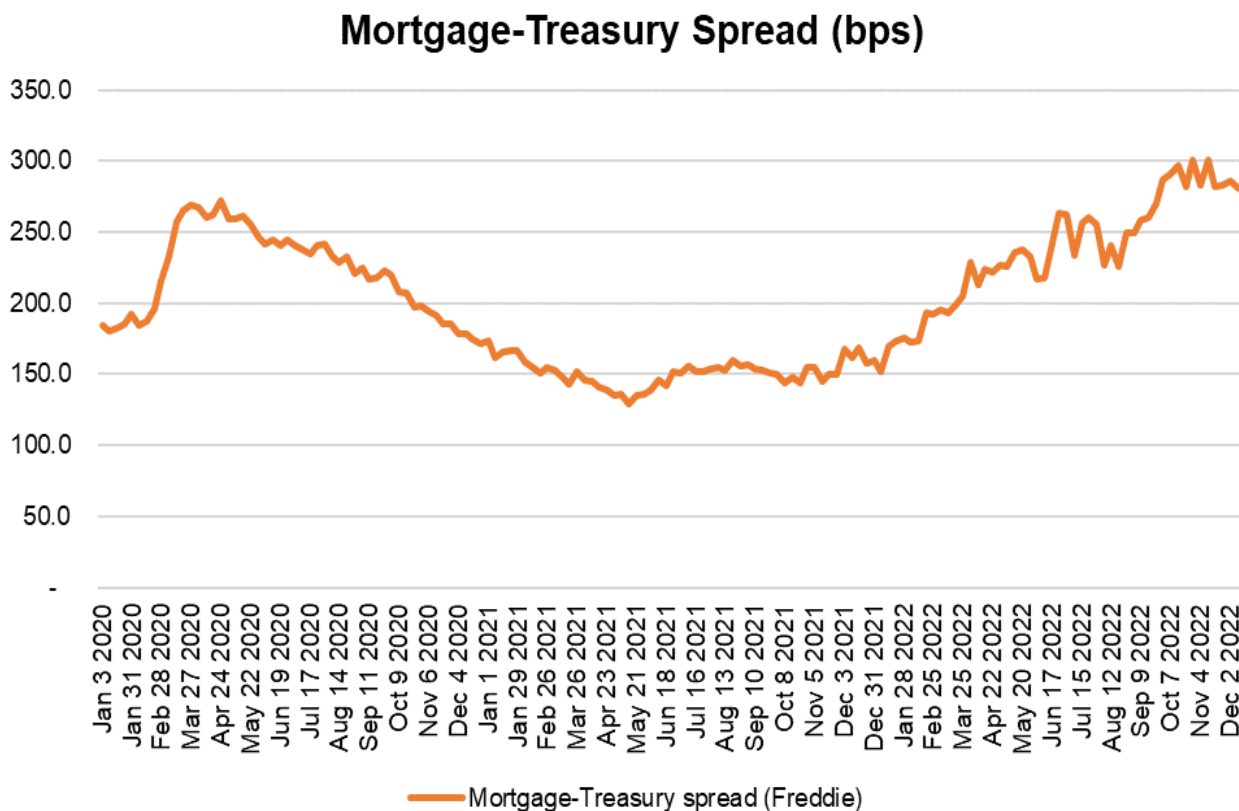
that the US is headed for a recession next year. Weaker growth typically leads to lower long-term interest rates, including mortgage rates. MBA is forecasting that mortgage rates for 30-year fixed-rate loans, which were at 6.3% in the most recent week, are expected to drift down and end 2023 around 5.2%. Housing and mortgage markets benefit from both a strong economy, which supports growing household incomes, and also lower inflation, which translates to lower mortgage rates.



Source: Federal Reserve Board, Freddie Mac, MBA Forecast

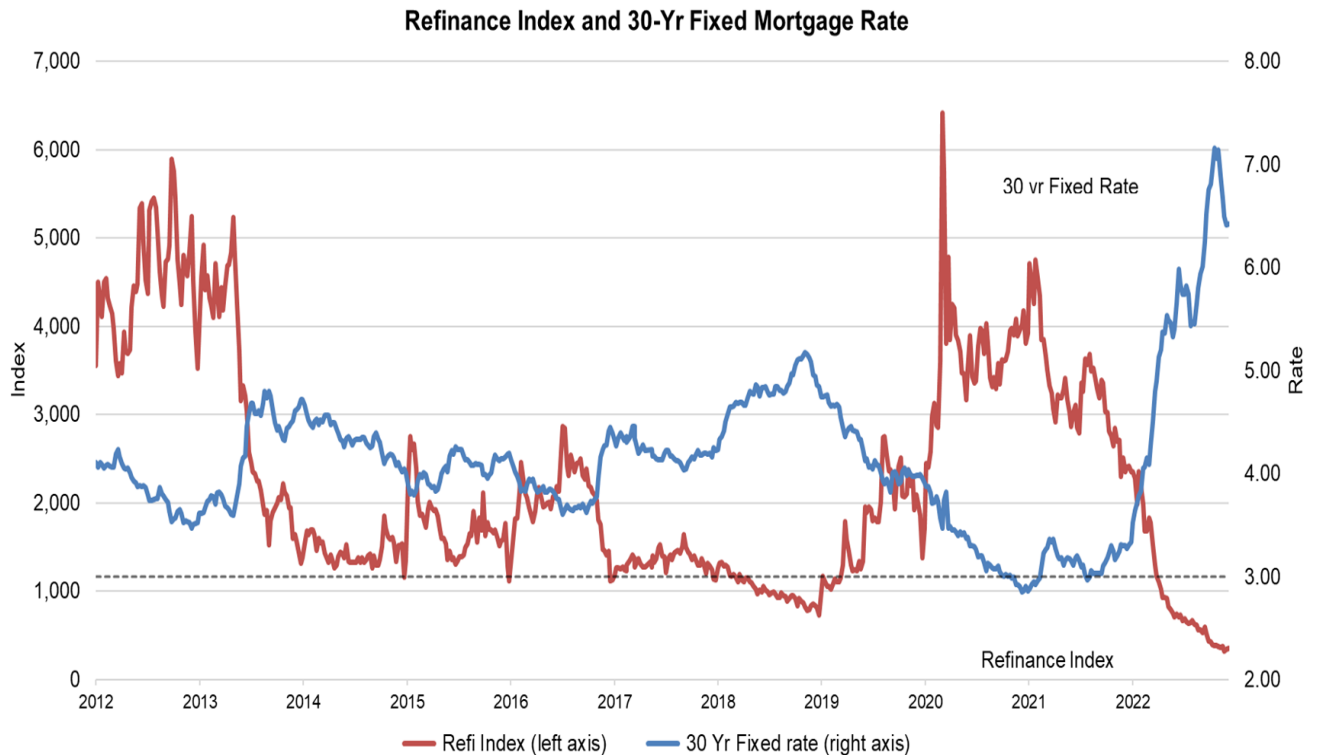
One of the more puzzling aspects of the current environment has been the extremely wide spread of mortgage rates relative to Treasury rates. This spread has historically averaged around 180 basis points, but since the spring of 2022 has averaged over 250 basis points. The exceedingly high level of interest rate volatility, likely a consequence of the Fed’s balance sheet reduction/quantitative tightening (QT), directly feeds into these wider spreads, as higher rate volatility leads to increased prepayment risk, which is priced in by investors. Beyond this effect, investors are also wary of the Fed’s eventual plans to move from passive roll-off of their large MBS portfolio to a period of active MBS sales. We do not expect the Fed to begin selling MBS any time soon, but do believe they will at some point over the next few years.

In the meantime, just in the past few weeks there have been signs that at least some investors have decided to take advantage of these historically wide spreads to lock in nominal yields on agency MBS, which may not stick around long. We are forecasting that this spread will compress through the course of 2023 as investors realize this relative value, but are estimating that this spread does not return to its more typical level below 200 basis points until later in the forecast horizon.



Source: Freddie Mac, US Treasury

Refinance application volume is a shadow of its former self, down almost 90% compared to last year at this time. We do not expect any pickup in refinances next year. In fact, on an annual basis, we are looking for another 33% decline. Most of the refinance volume being done now is for cash-outs, and given the almost \$30 trillion in homeowner equity now, that will continue into 2023. We also expect that home equity lending could be a real source of growth for many lenders, as the millions of homeowners, with rates on their first mortgage below 4%, are not going to be interested in giving up those low rates, but still need to finance home improvements and other major expenditures.

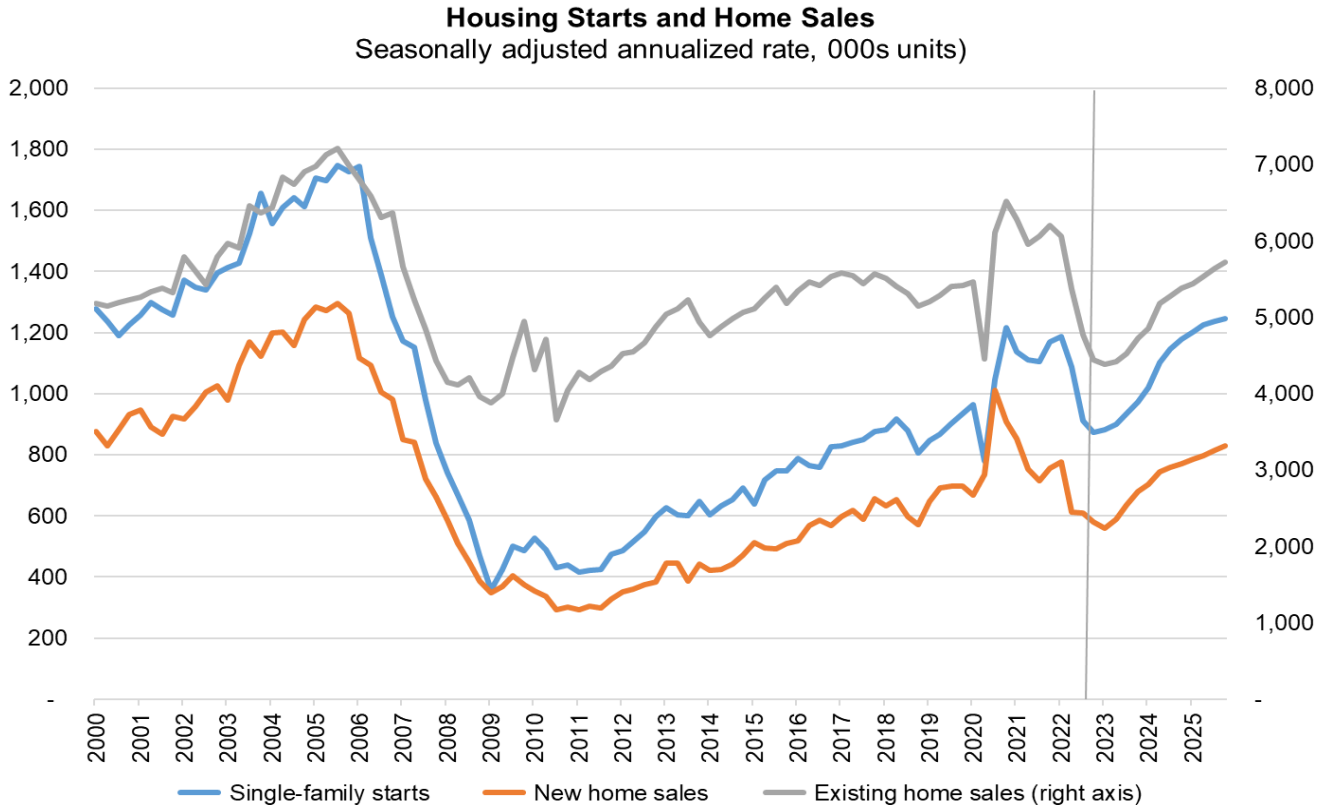


Source: MBA Weekly Applications Survey

While refinance application volume quickly nosedived in 2022 as mortgage rates increased, purchase application activity tried to keep up the pace in the early spring, but collapsed soon after as mortgage rates topped first 6% before peaking above 7% in the fall.

Even with mortgage rates returning to about 6.3% as of this writing, purchase activity remains light, even accounting for typical seasonal patterns. Purchase applications have been running almost 40% behind last year's pace for the past few months. As a result, we have brought down our forecast for purchase origination volume for next year. Importantly, this is a decrease both in the expected dollars of purchase origination and in the number of units, as we are now expecting a steeper drop in the pace of existing home sales, 12% versus 10% in last month's forecast, and are now forecasting a small, 4% decline in the number of new home sales. However, we retain our medium run bullish call on housing demand: there are 50 million 28-38 year olds in the US population right now. Household formation should remain robust for years, and many of these young people are at or approaching peak first-time homebuyer age. Demand should tilt towards first time home buyers (FTHB) as many move-up buyers will be somewhat reluctant to leave low rates behind. As we reach the other side of this recession and mortgage rates continue to drift down, shortages of housing inventory will once again pose a challenge for potential buyers.

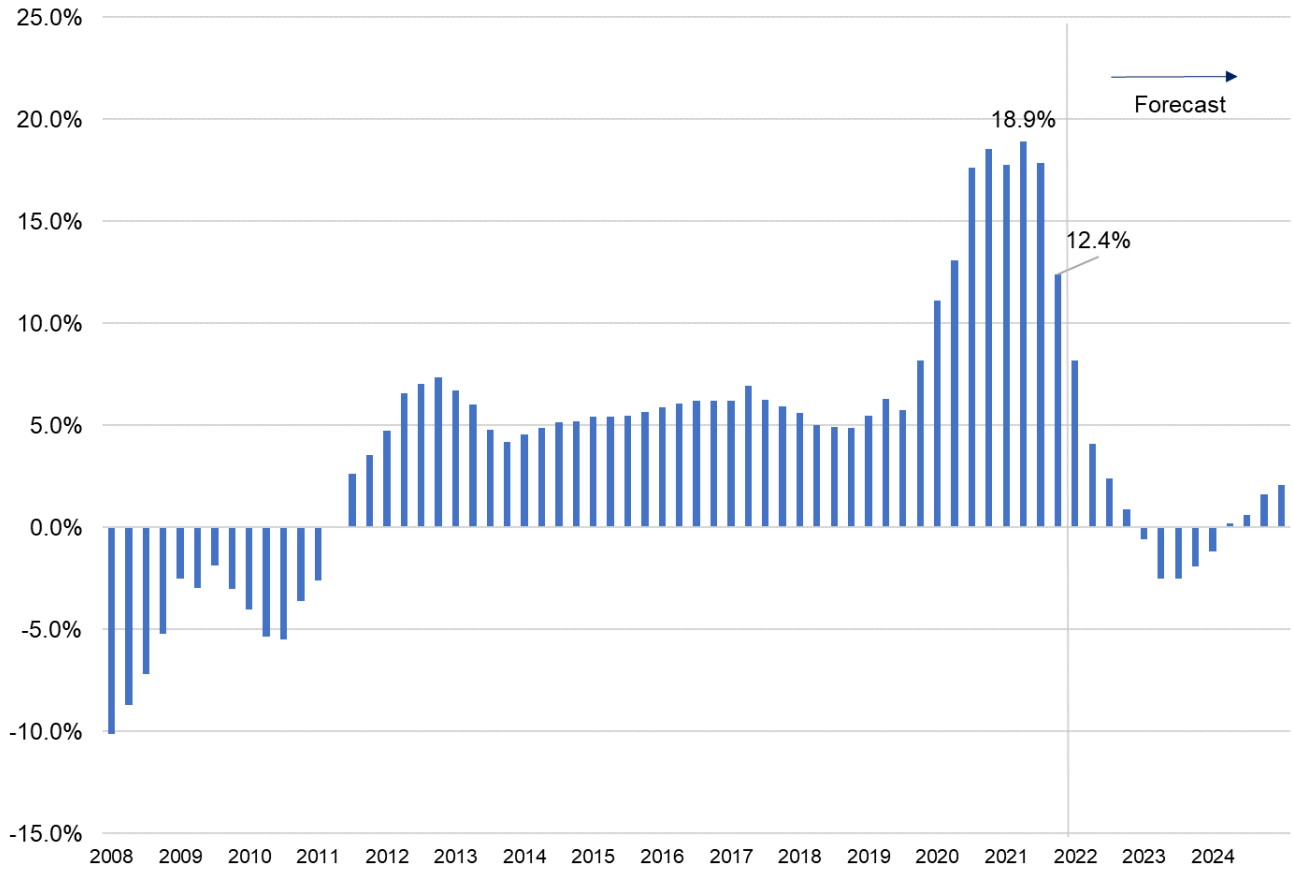
We do expect that the housing market will lead the US out of this recession, just as it has led the way into one.



Source: Census Bureau, National Association of Realtors, MBA Forecast

As a result of the expected weakness in the outlook for home sales, we have marked down our forecast for home prices at the national level. Inventories of new homes are increasing at the same time that demand has remained quite weak, and more builders appear to be offering price cuts as well as other concessions to move properties. While the third quarter data still showed a 12% year-over-year increase in home prices, monthly changes recently have been negative, and the declines in some parts of the country have been quite large, particularly on the West Coast and for the Mountain states. We still expect that the low inventory of existing homes and lack of distressed properties on the market will prevent a deeper decline in national home prices, but we do now expect more quarters of negative year-over-year price changes.

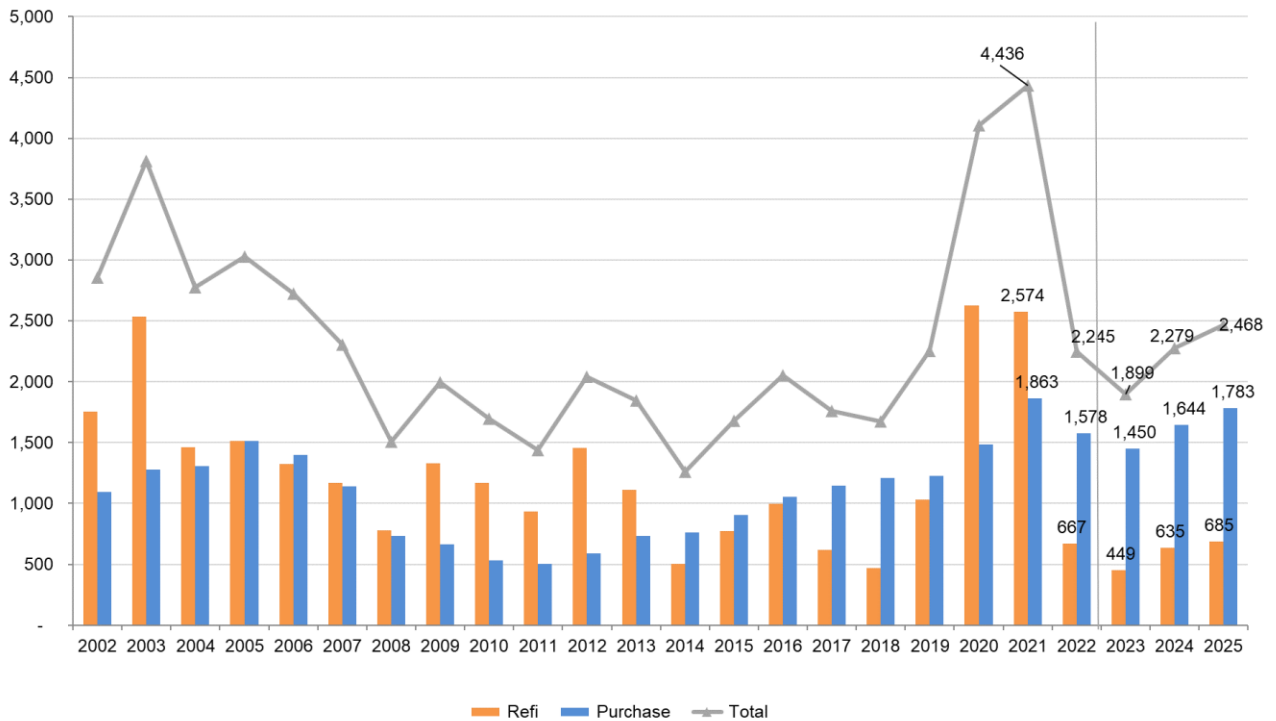
FHFA Purchase Only House Price Index, MBA Forecast
 Non-seasonally adjusted, year over year change



Source: Federal Housing Finance Agency, MBA Forecast

All in, we are now forecasting a 15% decline in origination volume in 2023 compared to 2022, following an almost 50% decline in 2022 compared to the prior year. This has been a very rough time for many lenders as not only have they been challenged by this decline in dollar volume, but with bigger average loan sizes over the past two years, the drop in unit volume has been even larger. After originating about 13.5 million loans in 2021, we estimate the industry originated about 6 million in 2022 and are forecasting a decline to about 4.6 million loans in 2023. While much of the industry may be compensated based on the dollars, the practical impact of this decline in units is impacting employment and the structure of the industry to an even greater degree.

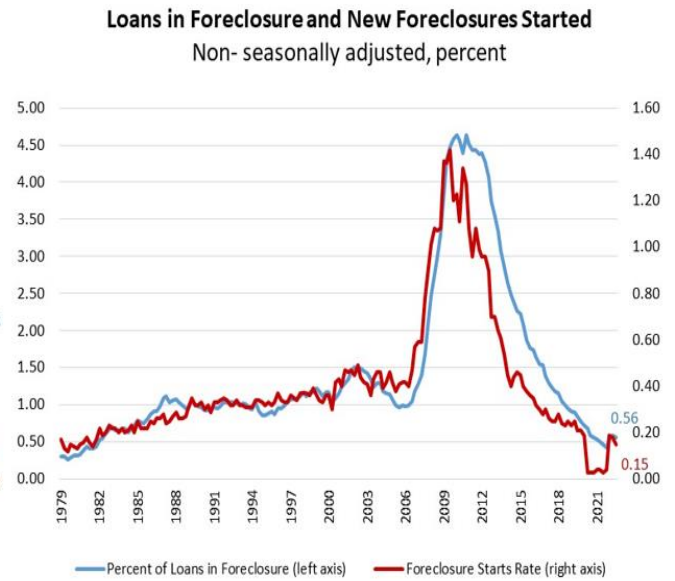
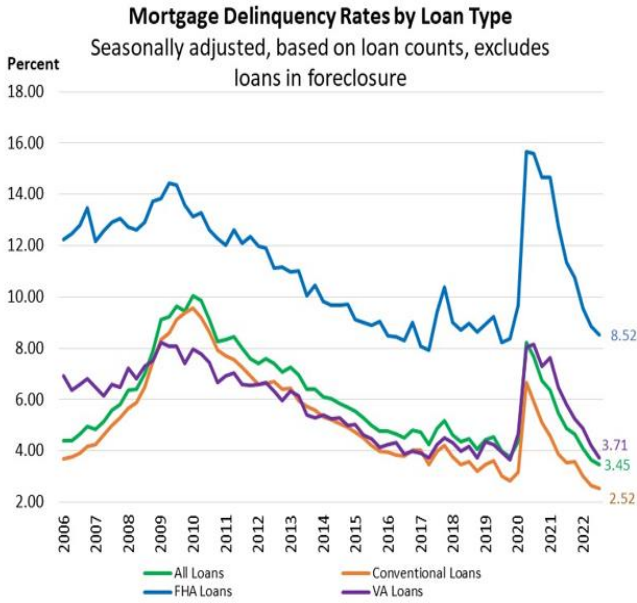
Mortgage Originations History and Forecast
\$billions



Source: MBA Forecast

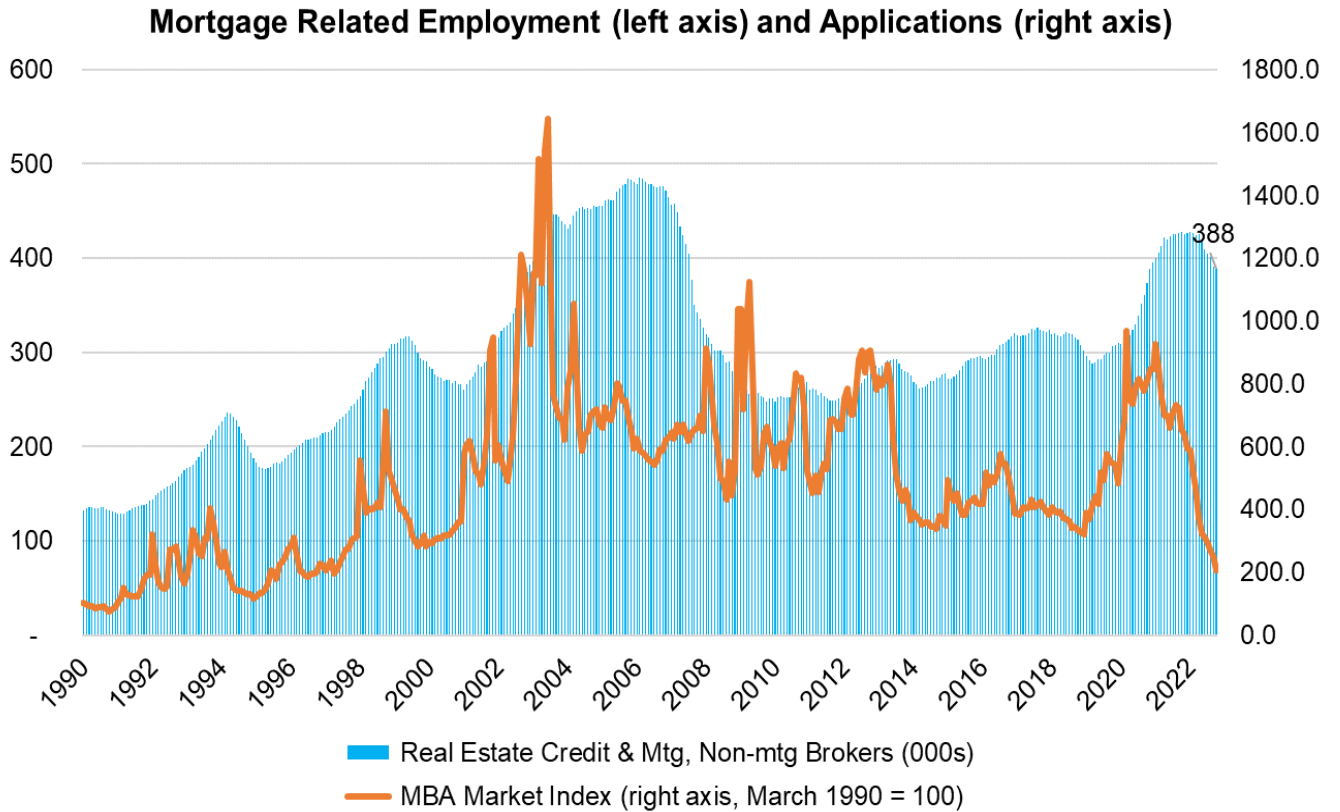
The good news in the mortgage industry this year has been on the servicing side. With slower prepayments, the value of mortgage servicing rights (MSR) jumped higher earlier this year, providing an important financial offset to the decline in production revenues, as well a source of cash for many lenders who sold MSRs. Beyond that, mortgage delinquencies reached a record low in MBA’s National Delinquency Survey in the third quarter at 3.45%, literally the lowest rate we have seen since 1979. Foreclosure starts and inventory rates also remain very low, even after the recent foreclosure moratoria have been lifted.

That said, both the delinquency and foreclosure numbers are likely to increase in 2023 and 2024 as the unemployment rate rises and the housing market continues to cool. This will add to servicing costs, which will be a negative for MSR values on top of any increases in prepayment rates that are likely to come with somewhat lower mortgage rates.



Source: MBA National Delinquency Survey

Servicing operations may require more headcount in 2023, but we do expect that originations businesses will continue to look to cut costs in the face of lower volumes and still tight margins. We had produced an estimate earlier in 2022 that the industry would likely reduce total employment by as much as 30% on a peak-trough basis through this cycle. At this point, employment has declined by about 10% from the peak in late 2021.



Source: Bureau of Labor Statistics, Mortgage Bankers Association

While we expect that 2023 will be a tough year for the broader economy as well as the housing and mortgage markets, it should ultimately bring lower mortgage rates and a return of housing demand as millennial first-time buyers enter the market in earnest.

Best of luck to you in the New Year!

- Mike Fratantoni and Joel Kan