

Financial FAQs

MBA RELEASES LONG-TERM ECONOMIC FORECAST

The Mortgage Bankers Association (MBA) today released its three-year economic forecast update. MBA is projecting robust economic growth of around 3.5 percent through 2007. Total residential mortgage production in 2005 will be \$2.78 trillion, the third-biggest year behind 2003 and 2002. But next year will see a slowdown in residential mortgage production as higher interest rates begin to affect real estate sales and refinances.

"At about 3.5 percent, economic growth will be solid this year despite a drag from sharply higher energy prices, hurricane-related impacts, and a widening trade deficit," said Doug Duncan, MBA chief economist and senior vice president for research and business development. "Housing will continue to be a major contributor to economic growth, and we expect the string of record-high home sales to continue for the fifth consecutive year in 2005."

A caveat is the impact of Hurricanes Katrina and Rita. The Congressional Budget Office has updated its estimate of the macroeconomic impact on the Gulf Coast. The two hurricanes are expected to reduce the annualized growth rate of GDP in the second half of the year by about 1/2 percentage point, with essentially all of the impact occurring in the third quarter.

By the fourth quarter, the negative effects of the hurricanes and the positive effects of the reconstruction should be largely offsetting. By early next year, economic growth is expected to be accelerated, on balance, as the reconstruction effort hits full stride. Ironically, by the middle of 2006, the level of real GDP could well be higher than it would have been in the absence of these two horrific natural disasters.

Duncan said that the labor market will remain strong nationally, even with the devastating impacts on labor markets in the Gulf areas. Core inflation should edge higher this year and next year as rising and elevated energy prices are expected to pass through to underlying inflation. The Fed is expected to continue its tightening through next year to ensure that inflation remains under control.

"Long-term rates, albeit rising, will remain relatively low, supporting residential and commercial real estate finance activity," continued Duncan. "Long-term rates have risen by about 40-50 basis points from their lows immediately after Hurricane Katrina."

The markets perceive that the Fed is now more concerned about inflation and will be more aggressive in raising rates than previously expected. We expect further increases in long-term yields of 20 to 30 basis points by the end of 2005, and another 40 to 50 basis points during 2006.

“The 30-year fixed-rate mortgage yield should reach 6.8 percent by the end of 2007. Even with this moderate increase from the current level, interest rates will still be quite low by historical standards,” said Duncan.

Following are the key points of the latest MBA forecast:

- Real GDP growth will average about 3.5 percent in 2005 through mid 2008.
- The unemployment rate will decline from the current level of 5.1 percent to 5.0 percent by the end of 2006 and to 4.9 percent by the end of 2007. Despite significant job losses due to Hurricane Katrina, the economy outside of the Gulf area remains healthy. Some job creation should also offset some of the job losses, as rebuilding activity is underway. We expect the labor market to add an average of about 190,000 jobs monthly over the next 12 months.
- Fixed mortgage rates will rise from today’s 6.10 percent to average about 6.65 percent in the fourth quarter of 2006 and 6.75 percent during the fourth quarter of 2007.
- The yield curve has flattened significantly since the beginning of the year, with the spread between fixed and adjustable rate mortgages declining by nearly 50 basis points to about 120 basis points by mid-October. The share of adjustable rate mortgages has declined this year as well and we project the decline in the share will continue through the middle of next year. The share is projected to rise again in late 2006 and 2008 as a significant number of hybrid adjustable rate mortgages reach their reset and are refinanced.
- Total existing-home sales for 2005 will increase by 3.7 percent relative to 2004 to a new record level in 2005, but will pull back by about 3.5 percent in 2006 and decline by another 5 percent in 2007. New-home sales will rise by nearly 5 percent to a record high in 2005, and will slip by 3 percent in 2006 and about another 4 percent in 2007.
- Existing home price appreciation is expected to be very strong this year, with median existing home prices accelerating to 10.8 percent during 2005. Increases in new home prices are projected to be significantly slower, with median new home price gains significantly moderating to 3.8 percent. Price gains in 2006 and 2007 are expected to continue to be healthy but at a more sustainable pace of about 5 percent for all homes.
- Residential mortgage originations for purchase loans will reach to \$1.49 trillion in 2005 and will edge down to \$1.47 trillion in 2006 and \$1.46 trillion in 2007. Residential refinance loans will total \$1.28 trillion in 2005 and then decline to \$785 billion in 2006 and \$689 billion in 2007.
- Total residential mortgage production in 2005 will be \$2.78 trillion, the third-highest level ever.
- There are both upside and downside risks to this forecast. On the upside, rebuilding could boost growth next year by more than projected. On the downside, higher oil prices, higher core inflation or more aggressive tightening by the Fed could result in a slower economic growth than projected.