HaMMR Digest

Stay current with economic and mortgage market trends.

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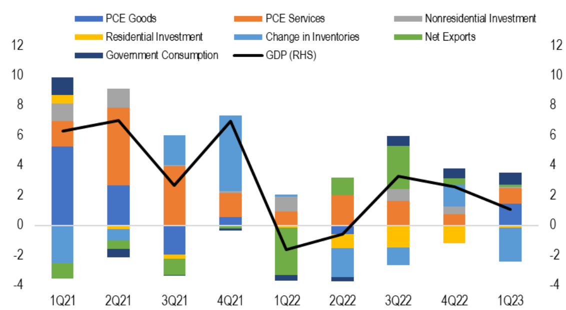
Weekly Wrap — Banking Squall Redux?

- U.S. growth downshifted in 1Q23, although strong inventory headwinds masked solid underlying activity.
- We expect growth to slow further with an outright recession narrowly avoided as the housing sector stabilizes.
- Wage and consumer inflation remain firm, solidifying another 25bps Fed rate hike this Wednesday.

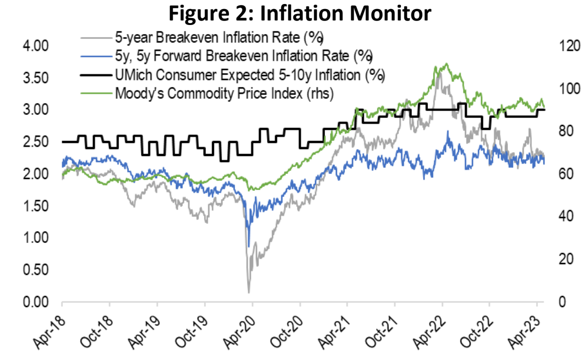
There is a reason we called the March bank failures a squall and not a crisis: the brief, localized gust of intense volatility passed and did not appear to be part of a larger storm cell. Additional squalls are possible, particularly for regional banks, but the risk of a systemic banking crisis remains remote. One of the banks capsized by the March squall, First Republic Bank (FRC), was finally rescued when it entered FDIC receivership over the weekend and was ultimately purchased by JPMorgan Chase & Co. FRC had been a known quantity from the beginning and markets have differentiated the idiosyncratic risk associated with the bank from broader financial stability concerns. As such, liquidity concerns remain in the rearview mirror with attention squarely on recession risk. The most anticipated recession in history was postponed again despite a disappointing first estimate for 1Q23 real GDP of 1.1% (consensus: 1.9%). A clearer reading of underlying demand was provided by sales to private domestic purchasers, which grew at a seven-quarter high of 2.9%. Weighing on this solid demand was a -2.3%-point drag on GDP growth from weaker inventory builds (Figure 1), which have been choppy as heightened recession concerns have kept firms cautious. Real capital equipment investment fell -7.3% in 1Q23 and for the third time in the last four quarters with real capital goods orders and shipments down -7.7% and -5.4%, respectively, in 1Q23 on an annualized basis — the steepest declines in more than two years as producers remained cautious.

Figure 1: Real GDP Growth (%-Point Contribution)



Sources Bureau of Economic Analysis, Arch MI

Figure 2: Inflation Monitor



Sources: Moody's, University of Michigan, Federal Reserve Board, Arch MI

The industrial cycle has yet to find its footing but there are green shoots. The advance trade balance for March narrowed to $85bn from $92bn in February amid a boost in exports, steady improvement in U.S. and global Purchasing Manager Indexes (PMIs) and the first meaningful increase in oil/mining structures investment since before COVID. Furthermore, private residential investment's drag on growth is likely behind us with the sector subtracting only -0.17%-points from GDP growth in 1Q23 compared to the prior two-quarter average of -1.3%-pts. Even with the existing home sales market struggling with tight inventory — likely the driver behind the -5.2% decline in the March Pending Home Sales Index (cons. 0.8%) — March new home sales climbed 9.6% m/m (cons. -1.3%), with the bulk of those sales coming from units not yet started. In conjunction with consumer demand that ran at a 3.7% annualized pace last quarter, it is difficult to see private investment not rebounding, albeit modestly, in the months ahead.

Consumer spending did cool into the latter half of 1Q with real expenditures coming in flat (cons. -0.1%) in March after averaging 0.6% in the prior two months. Nonetheless, weekly card spending indicates consumption has rebounded from the late-March lull. Measures of consumer confidence were mixed in April despite robust 7.8% annualized growth in 1Q real disposable income, which allowed households to increase the savings rate to a 16-month high of 5.1%. March Core Personal Consumption Expenditures (PCE) consumer inflation was in-line with expectations at 0.3%, but the three-month annualized rate remained hot at 4.9%. Alongside the Employment Cost Index for private wages and salaries accelerating to 4.9% annualized growth in 1Q from 4.7% in 4Q22 and a modest upside surprise to April medium-term consumer inflation expectations (Figure 2), another 25bps rate hike to 5.00-5.25% is all but guaranteed from the Fed on Wednesday.

Recent Data Releases

Key economic and housing data releases over the last week:

Date	Indicator	Period	Actual	Consensus	Previous	Note
4/25/23	FHFA House Price Index m/m	Feb	0.5%	-0.1%	0.1%	sa
4/25/23	S&P CoreLogic CS 20-City m/m SA	Feb	0.1%	-0.4%	-0.4%	sa
4/25/23	S&P CoreLogic CS 20-City y/y NSA	Feb	0.4%	-0.1%	2.6%	nsa
4/25/23	New Home Sales	Mar	683	632	623	k, saar
4/25/23	New Home Sales m/m	Mar	9.6%	-1.3%	-3.9%	sa
4/25/23	Conf. Board Consumer Confidence	Apr	101.3	104.0	104.0	index, sa
4/26/23	MBA Mortgage Applications	4/21/23	3.7%	--	-8.8%	w/w, sa
4/26/23	Wholesale Inventories m/m	Mar P	0.1%	0.1%	0.1%	sa
4/26/23	Durable Goods Orders	Mar P	3.2%	0.7%	-1.2%	m/m, sa
4/27/23	Initial Jobless Claims	4/22/23	230	248	246	k, sa
4/27/23	Continuing Claims	4/15/23	1,858	1,870	1,861	k, sa
4/27/23	GDP Annualized q/q	1Q A	1.1%	1.9%	2.6%	saar
4/27/23	Personal Consumption q/q	1Q A	3.7%	4.0%	1.0%	saar
4/27/23	Pending Home Sales m/m	Mar	-5.2%	0.8%	0.8%	sa
4/27/23	Pending Home Sales y/y	Mar	-23.3%	-20.7%	-21.1%	nsa
4/28/23	Employment Cost Index	1Q	1.2%	1.1%	1.1%	q/q, sa
4/28/23	Personal Income	Mar	0.3%	0.2%	0.3%	m/m, sa
4/28/23	Personal Spending	Mar	0.0%	-0.1%	0.1%	m/m, sa
4/28/23	Real Personal Spending	Mar	0.0%	-0.1%	-0.2%	m/m, sa
4/28/23	PCE Inflation m/m	Mar	0.1%	0.1%	0.3%	sa
4/28/23	PCE Inflation y/y	Mar	4.2%	4.1%	5.1%	nsa
4/28/23	PCE Core Inflation (ex Food and Energy) m/m	Mar	0.3%	0.3%	0.3%	sa
4/28/23	PCE Core Inflation (ex Food and Energy) y/y	Mar	4.6%	4.6%	4.7%	nsa
4/28/23	U. of Mich. Sentiment	Apr F	63.5	63.5	63.5	index, nsa
4/28/23	U. of Mich. 1 Yr Inflation	Apr F	4.6%	--	4.6%	nsa
4/28/23	U. of Mich. 5-10 Yr Inflation	Apr F	3.0%	--	2.9%	nsa

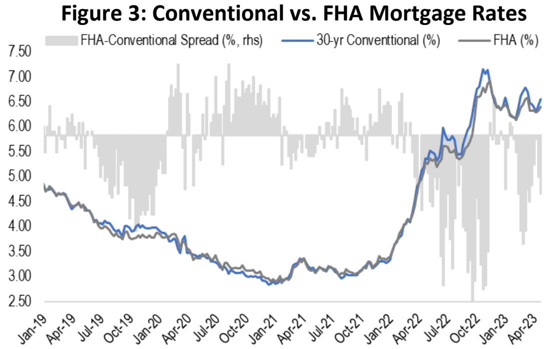
Sources: Bloomberg Consensus Survey of Economists, Arch MI

Green = beat expectations; **Red** = worse than expectations; (compared vs. prior if no consensus estimates available)

MORTGAGE APPLICATIONS BOUNCE BACK FROM PRIOR WEEK'S BIG DROP

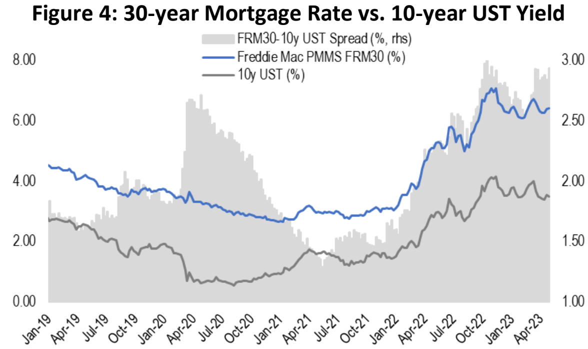
According to the MBA Weekly Applications Survey, the average contract conventional mortgage rate rose 12bps to 6.55% during the week ending April 21 while the FHA contract mortgage rate also rose 8bps to 6.41%, resulting in a -4bps contraction in the spread between the FHA and conventional mortgage rate to -0.14% (Figure 3). Freddie Mac's more recent Primary Mortgage Market Survey (PMMS) for the week ending April 26 indicated that the FRM30 climbed 4bps w/w to 6.43% (Figure 4) as 10-year UST yields declined -6bps to an average of 3.49% over the same period. Accordingly, the spread between the PMMS FRM30 and the 10-year UST widened 10bps to 2.94%, about 125bps wider than its typical non-stressed level prior to the pandemic and still close to the peak of 300bps reached last October. We expect rate volatility and mortgage spreads to remain wide until more clarity is gained around the path of inflation and monetary policy, which is not likely to occur before mid-year.

Figure 3: Conventional vs. FHA Mortgage Rates



Sources: Mortgage Bankers Association, Arch MI

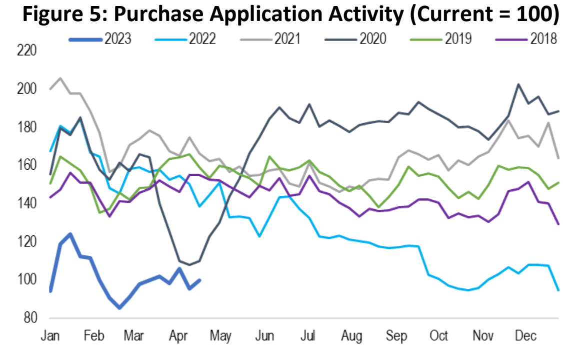
Figure 4: 30-year Mortgage Rate vs. 10-year UST Yield



Sources: Freddie Mac Primary Mortgage Market Survey, Federal Reserve Board, Arch MI

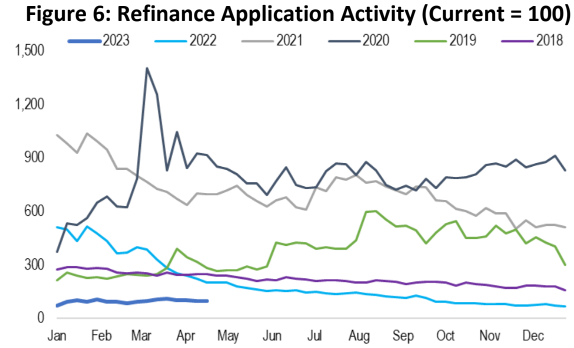
Despite rates inching higher, the MBA Weekly Applications Survey increased 3.7% w/w for the week ending April 21, leaving the index down -37% year-over-year and down -47% compared with pre-pandemic levels (i.e., the average of the same week in 2018 and 2019). The weekly increase was driven primarily by a 4.6% increase in purchase applications, which remained down -28% y/y despite the weekly increase, and -36% below the pre-pandemic level (Figure 5). Refinancing applications increased 1.7% w/w but remained down -51% y/y and -62% relative to pre-pandemic levels (Figure 6).

Figure 5: Purchase Application Activity (Current = 100)



Sources: Mortgage Bankers Association, Arch MI

Figure 6: Refinance Application Activity (Current = 100)

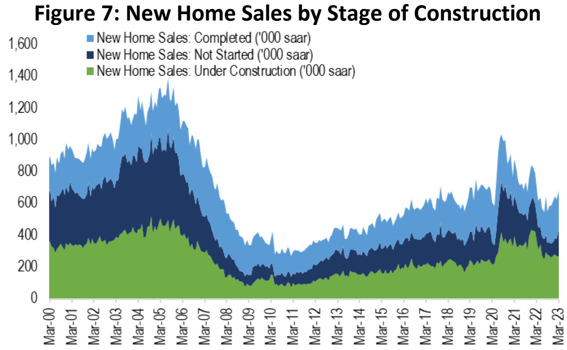


Sources: Mortgage Bankers Association, Arch MI

NEW HOME SALES LEADING THE WAY

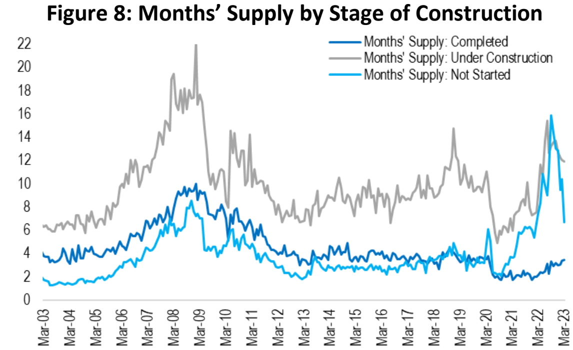
Data from the Census Bureau showed new home sales climbed for the third time in the last four months through March, rising 9.6% m/m (cons. -1.3%) to a seasonally adjusted annual rate of 683k (cons. 632k) from 623k in February (revised down from 640k). Despite the outsized monthly gain, new home sales were down -3.4% y/y and remain -3% below the pre-pandemic pace of sales (Figure 7). Notably, new home sales have been in an uptrend since September, albeit choppy, while existing home sales have remained more depressed. Recent commentary from public home builders indicate that demand has steadily improved this year, which confirms the recent improvement in the National Association of Home Builders (NAHB) sentiment index. Additionally, the use of incentives by builders to move product has likely played a factor in bolstering new home sales, which leaves existing home sellers at a relative disadvantage. Accordingly, new home sales comprised 13% of the total home sales market over the past three months, up from 11% at the onset of the pandemic.

Figure 7: New Home Sales by Stage of Construction



Sources: Census Bureau, Arch MI

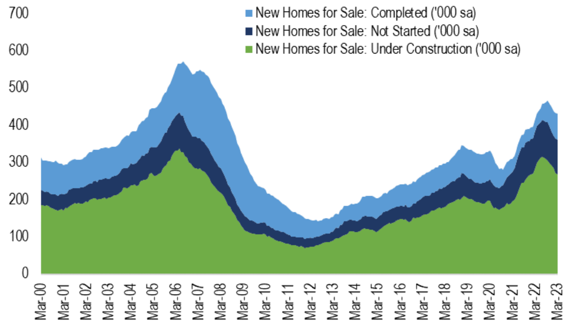
Figure 8: Months' Supply by Stage of Construction



Sources: Census Bureau, Arch MI

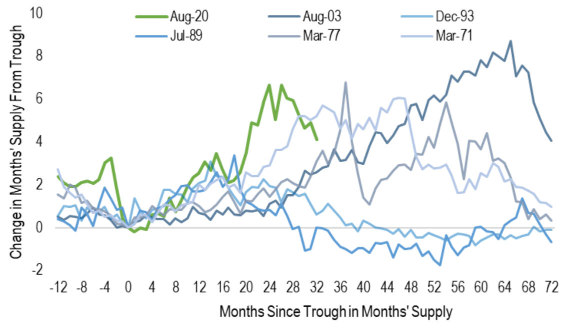
While new home sales continued to trend up, the supply of new homes has not experienced a rebound, contracting for the fifth month in a row and by -0.5% m/m in March. The inventory of new homes for sale in March represented a 7.6 months' supply, down from the cycle peak of 10.1 months back in July and not too far above the historical average of 6 months. Completed home sales continued to fall, declining -0.4% m/m and are down -13% from four years ago. Accordingly, the supply of completed, ready-to-occupy inventory continued its multi-month-march higher, rising 1.4% m/m. The rise of completed home inventory reflects a normalization as supply chain constraints have eased rather than a sign of stress. Additionally, builders continued to prioritize completing units already under construction instead of breaking new ground, which has lifted the months' supply of completed homes to 3.5 months, just slightly above where it stood at the onset of the pandemic (Figure 8). The bulk of new home inventory remains skewed toward units not started and under construction, which comprise 84% of the total inventory when combined (Figure 9).

Figure 9: Inventory of New Homes for Sale



Sources: Census Bureau, Arch MI

Figure 10: New Home Months' Supply Cycles



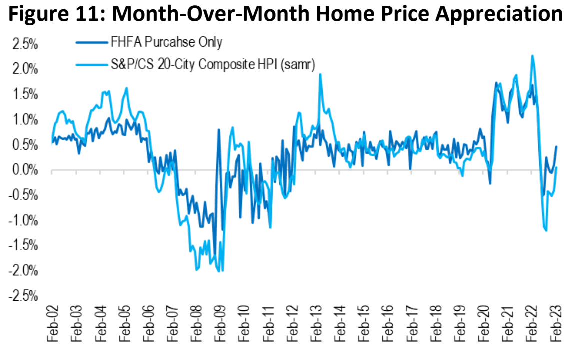
Sources: Census Bureau, Arch MI

Homebuilders have managed through this whiplash-inducing housing cycle much better than during the Global Financial Crisis (GFC). The current cycle for the new home market has been defined by extremes: the pace, magnitude and duration of the slump has been quite unique. The months' supply of new homes surged from a record-low of 3.3 months in August 2020 (defined as the peak of the cycle) to a peak of 10.1 months in July 2022 (defined as the trough of the cycle), or an increase of 6.8 months — a deterioration surpassed only by the GFC when months' supply climbed by 8.7 months to a peak of 12.2 months (Figure 10). However, it took over half a decade for the new home sales market to go from its cycle peak in August 2003 to its trough in January 2009, compared with just under two years for the current cycle. Even more impressively, the months' supply of new homes has returned to within shouting distance of its historic average a mere few months after enduring a historic downturn.

HOME PRICE GROWTH REBOUND CONTINUED IN FEBRUARY

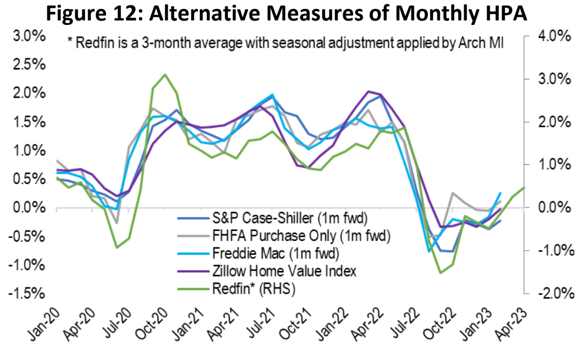
Repeat-sales home price index (HPI) growth improved in February. The FHFA Purchase Only (PO) HPI rose a robust 0.5% m/m (cons. -0.1%) on a seasonally adjusted basis, the second consecutive increase and an acceleration from the 0.1% gain in January (Figure 11). In similar fashion, but to less of a degree, the S&P/Case-Shiller 20-City Composite HPI rose 0.1% (cons. -0.1%) in February, the first monthly increase since June. Nine metropolitan areas within the 20-city composite recorded monthly gains, an improvement from five in January and none in December. Price declines were most severe in Seattle (-1.5%), Las Vegas (-0.9%) and Portland (-0.4%). Other more real-time measures of home price appreciation (HPA) had already shown a similar improvement in the monthly trend (Figure 12). Based on data from Redfin, monthly HPA continued to trend higher in March and April. These improvements should be reflected in subsequent releases of the repeat-sales HPIs.

Figure 11: Month-Over-Month Home Price Appreciation



Sources: S&P, FHFA, Arch MI

Figure 12: Alternative Measures of Monthly HPA



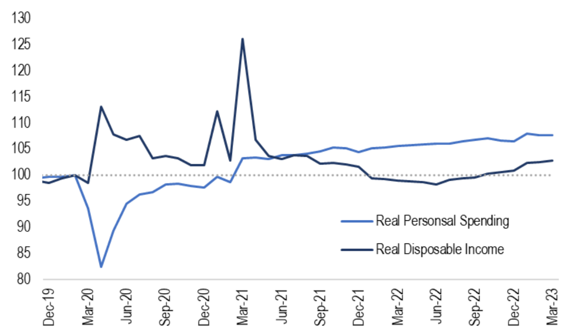
Sources: S&P, FHFA, Freddie Mac, Optimal Blue, Redfin, Zillow, Arch MI

It is important to note that during times of market volatility, there can be divergences between the FHFA and S&P/Case-Shiller HPIs. Index compositional differences do play a factor where the FHFA index is compiled based on conforming, conventional loans purchased and securitized by the GSEs (data included in the index are based on loan origination data) while the S&P/Case-Shiller index captures more transactions and uses a different weighting that places greater emphasis on regions with higher home values. The S&P/Case-Shiller index is a three-month average of closed sales, implying that closed sales for the most recent December–February period could include contracts signed as far back as October.

MARCH CAPPED OFF THE PROGRESSIVE SLOWDOWN IN 1Q CONSUMPTION

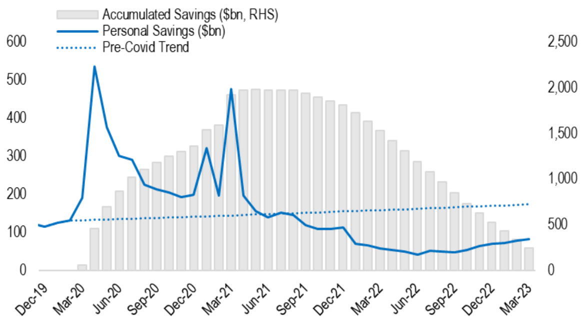
The March personal income and outlay report capped the end of the quarter that showed a progressive slowdown in consumer spending since January, but the underlying trend of solid income gains remained. Nominal personal income rose 0.3% m/m (cons. 0.2%) with steady gains for private wages as the labor market remained tight. Indeed, private wages rose 6.4% on a three-month annualized basis in March, an acceleration from 6.2% last month. Meanwhile, nominal disposable income increased 0.4% m/m after a solid 0.5% gain in February and the outsized 2.1% gain in January, which was largely due to one-off factors. Nominal spending beat consensus expectations, coming in flat (cons. -0.1%) with real spending also flat on the month (cons. -0.1%) after a -0.2% decline in February. Real disposable income continued to rise on a three-month annualized basis, up 7.8% in March after a 7.6% gain last month and a 8.6% surge in January, pushing the absolute level further above where it started before the pandemic (Figure 13).

Figure 13: Real Income and Spending (Feb. 2020 = 100)



Sources: BEA, Arch MI

Figure 14: Personal Savings



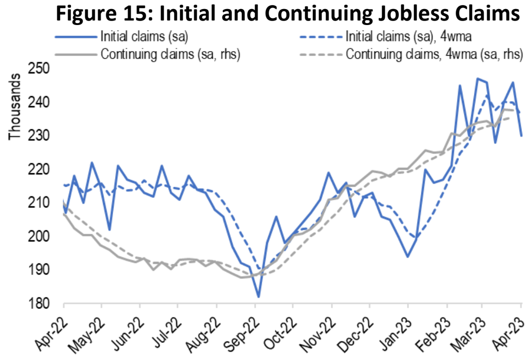
Sources: BEA, Arch MI

With disposable income outpacing spending in March, the savings rate rose 30bps m/m to 5.1% (Figure 14). Households are seemingly dipping into their savings less to fund spending, given the ongoing strength in the labor market and cooling inflation which has allowed real incomes to recover. That said, we do see the COVID-era savings buffer being depleted by 3Q23 and sooner for lower-income households given that the bulk of savings are sitting with higher-income households. With the stock of excess savings being depleted, the outlook for the consumer rests on how long the labor market will remain resilient and how willing consumers will be to tap into credit. We expect the labor market to cool over 2023 and accordingly envision consumer spending downshifting as the year progresses. Higher borrowing costs and tighter credit present downside risks to that already benign outlook. There is some upside risk to our outlook if consumers somehow find the confidence in the face of an economic slowdown to increase borrowing activity, for which they have capacity given low levels of aggregate outstanding debt relative to incomes.

JOBLESS CLAIMS APPEAR TO HAVE SETTLED IN TO A NEW HIGHER LEVEL

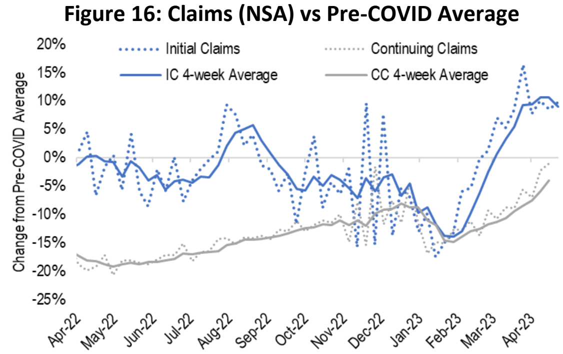
Initial jobless claims declined by -16k to a seasonally adjusted 230k (cons. 248k) during the week ending April 22, moving the four-week average down to 236k from 240k (Figure 15). The non-seasonally adjusted level of initial claims moved up to 10% above its pre-COVID average (i.e., 2018 to 2019) from 9% the week before and up from -17% below in mid-January (Figure 16).

Figure 15: Initial and Continuing Jobless Claims



Source: U.S. Department of Labor, Arch MI

Figure 16: Claims (NSA) vs Pre-COVID Average



Source: U.S. Department of Labor, Arch MI

Continuing claims for regular state programs (i.e., repeat filers for unemployment insurance) declined by 3k during the week ending April 15 to a seasonally adjusted 1,858k (cons. 1,870k), but the four-week average moved up to 1,837k from 1,826k. Meanwhile, the non-seasonally adjusted level of continuing claims moved up to -1% below its pre-COVID average from -2% the week before and up from -17% below in mid-January. Initial claims have effectively moved sideways since the beginning of March while continuing claims climbed higher. A steadying of new filers for jobless claims would reduce some upward pressure on the overall stock of unemployed individuals and reduce near-term recession risk as well. We continue to expect the economy to weaken over the second half of the year, which will cause claims filings and the unemployment rate to move up a bit higher, but not at an alarming rate.

The Week Ahead

This week brings another substantial amount of data releases and the highly anticipated May meeting of the Federal Open Market Committee (FOMC). We continue to expect the Fed to announce another 25bps rate hike on Wednesday to 5.25%, consistent with the Bloomberg Consensus Survey of Economists and market expectations. Prior to the meeting, the Fed will get updates on the economy from the April S&P Global Purchasing Manager Indexes (PMIs), the April Institute for Supply Management (ISM) sentiment indexes, the March Job Openings and Labor Turnover Survey (JOLTS), April auto sales and March durable goods orders. Altogether, these data releases are expected to show relatively steady activity relative to the most recent prior months for each. The week will end with the April employment situation report from the Bureau of Labor Statistics, which is expected to show a slight cooldown in job growth to 180k in April from 236k in March, an increase in the unemployment rate to 3.6% from 3.5%, and steady wage growth at 0.3% m/m.

UPCOMING DATA RELEASES

Key economic and housing data releases for the coming week:

Date	Indicator	Period	Actual	Consensus	Previous	Note
5/1/23	S&P Global US Manufacturing PMI	Apr F	--	50.4	50.4	index, sa
5/1/23	ISM Manufacturing	Apr	--	46.8	46.3	index, sa
5/1/23	ISM Prices Paid	Apr	--	49.0	49.2	index, nsa
5/2/23	JOLTS Job Openings	Mar	--	9.7	9.9	m, sa
5/2/23	Factory Orders	Mar	--	1.3%	-0.7%	m/m, sa
5/2/23	Durable Goods Orders	Mar F	--	--	3.2%	m/m, sa
5/2/23	Wards Total Vehicle Sales	Apr	--	15.0	14.8	m, saar
5/3/23	MBA Mortgage Applications	4/28/23	--	--	3.7%	w/w, sa
5/3/23	ADP Employment	Apr	--	150	145	k, m/m, sa
5/3/23	S&P Global US Services PMI	Apr F	--	53.7	53.7	index, sa
5/3/23	S&P Global US Composite PMI	Apr F	--	53.5	53.5	index, sa
5/3/23	ISM Services Index	Apr	--	51.8	51.2	index, nsa
5/3/23	FOMC Rate Decision (Upper Bound)	5/3/23	--	5.25%	5.00%	
5/4/23	Nonfarm Productivity	1Q P	--	-1.8%	1.7%	q/q, saar
5/4/23	Initial Jobless Claims	4/29/23	--	240	230	k, sa
5/4/23	Continuing Claims	4/22/23	--	1,873	1,858	k, sa
5/4/23	Unit Labor Costs	1Q P	--	5.4%	3.2%	q/q, saar
5/5/23	Nonfarm Payrolls	Apr	--	180	236	k, m/m, sa
5/5/23	Private Payrolls	Apr	--	157	189	k, m/m, sa
5/5/23	Unemployment Rate	Apr	--	3.6%	3.5%	sa
5/5/23	Average Hourly Earnings m/m	Apr	--	0.3%	0.3%	sa
5/5/23	Average Hourly Earnings y/y	Apr	--	4.2%	4.2%	nsa
5/5/23	Average Weekly Hours All Employees	Apr	--	34.4	34.4	sa
5/5/23	Labor Force Participation Rate	Apr	--	62.6%	62.6%	sa
5/5/23	Consumer Credit	Mar	--	17.5	15.3	$B, m/m, sa

Sources: Bloomberg Consensus Survey of Economists, Arch MI