

Michelle Meyer +1 646 855 6261

## Housing watch

### Like whoa

Mortgage applications surged 49% wow in the first week of January, following an 11% pop the week prior. This is the strongest two-week gain since December 2008. Given the volatility in the data, particularly around the holidays, we suspect part of this gain is simply noise. We therefore would not be surprised if there was a partial reversal in coming weeks. That said, we think a good part of this move is fundamental and reflects the fact that lower mortgage rates are starting to make a difference for the housing market.

### Refi reaction

The sharp increase in mortgage applications is driven by refinancing activity. The refinancing index is up 93% over the past two weeks, the first notable gain after the collapse in mid-2013 following the surge in interest rates. We think this is a direct response to the drop in mortgage rates which have declined 50bp from the recent peak of 4.23% in the middle of September (Chart 3). Borrowers who purchased a home between 3Q13 and 3Q14 will have at least a 50bp reduction in rates from refinancing, which is typically the minimum interest rate drop needed to cover the closing costs associated with refinancing.

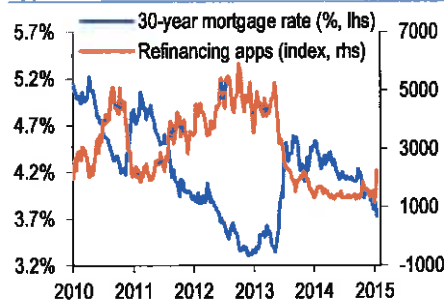
According to estimates from Chris Flanagan, the head of the securitized products research team, there could be 1.5 to 1.7 million borrowers who refinance in the first quarter. Assuming a 50bp reduction in interest rates on a \$200,000 home, the household will save \$50/month. This would imply aggregate savings of \$1.0 – 1.2bn, which is yet another form of stimulus for the consumer. While this is small relative to the estimated savings of \$93bn from the drop in gasoline prices, it helps on the margin.

### Purchase power

There was also a notable gain in purchase applications, rising 29% over the last two weeks. Even after smoothing through some of the noise, the four-week moving average is up 4.8% (Chart 4). The decline in rates has improved affordability which may be helping to spur housing demand. There is also an important psychological element: mortgage rates with a 3-handle can entice prospective borrowers. Realtors may give a sense of urgency by warning that the drop in mortgage rates could prove temporary.

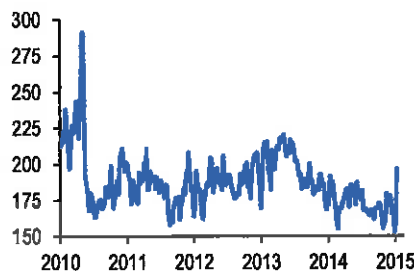
Mortgage applications are a useful real-time indicator of housing demand. But given the weekly volatility and potential sample issues, we will need confirmation from the home sales data. New home sales track signed contracts, while existing sales track closed contracts, making new home sales a leading indicator. However, the new home sales data are noisier and are subject to small-sample bias in the winter. Therefore, to get a true indication, we might have to wait a few months for existing home sales to be influenced.

Chart 3: As mortgage rates decline, refinancing applications rise



Note: 16 March 1990 = 100 for refinancing index  
Source: BofA Merrill Lynch Global Research, Mortgage Bankers Association, Freddie Mac

Chart 4: Purchase mortgage applications (index)



Note: 16 March 1990 = 100 for index  
Source: BofA Merrill Lynch Global Research, Mortgage Bankers Association

Table 1: Summary of housing forecasts

	Quarterly								Annual average			
	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	2013	2014	2015	2016
Existing home sales (000s, saar)	4603	4867	5123	5086	5036	5029	5065	5099	5073	4920	5057	5219
New home sales (000s, saar)	431	427	434	447	467	482	497	512	430	435	490	555
Housing starts (000s, saar)	925	985	1030	1047	1097	1147	1200	1265	930	997	1175	1400
S&P Case-Shiller home prices (% yoy)	9.9	7.1	5.1	4.0	2.9	3.9	4.5	3.7	9.6	6.5	3.7	2.1

Source: BofA Merrill Lynch Global Research, Census Bureau, National Association of Realtors, S&P Case-Shiller; Note: S&P Case-Shiller prices are annual average, 4Q/4Q change are in the quarterly table