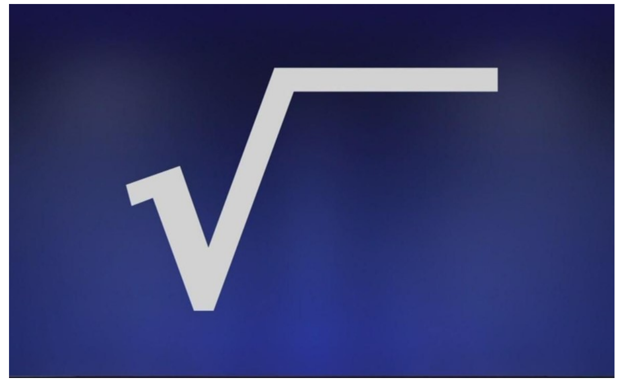
CenterState
CORRESPONDENT DIVISION

Market Update

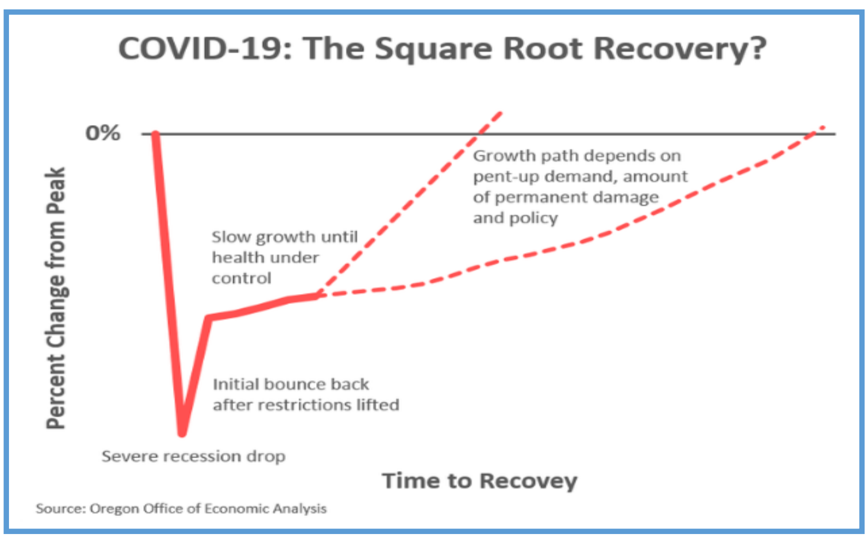
Economic News

April 8, 2020



The risk-on rally this week ran out of steam yesterday afternoon as investors ran too far ahead of the good news on slowing case level growth. It's not hard to see that New York-based traders reacted with enthusiasm as case counts tapered for a third straight day in the Big Apple, but New York does not a country make, and there are still many areas that are seeing increasing case counts and that fact may have tempered some of the enthusiasm as well. The 10-year Treasury yield ranged from a low of 0.68% to 0.78% before settling at 0.71%, and that was with new supply being auctioned which no doubt contributed to the heaviness in bids. One bit of good news is that the new SBA Paycheck Protection Program is likely to get additional funding as President Trump mentioned that another $250 billion on top of the initial $349 billion will be requested. With the Fed stepping in to provide a term lending facility secured by said SBA loans, it looks like the full weight of the government is pitching in to make this program successful. The additional funding will be good news to bankers and borrowers who have been racing to get applications completed and submitted. For all those involved, the additional funding provides a measure of relief and time to move the loan application process through at a more measured and thoughtful pace.

Economists are busy trying to concoct various recovery scenarios from V-shaped to U-shaped to L-shaped to W-shaped and now you can add to that list the Square Root-shaped recovery. Josh Lehner at the Oregon Office of Economic Analysis is credited with developing the latest in recovery scenarios and we kind of like it. The thinking is as follows: The sudden stop of the economy sends us into a severe recession literally overnight. Once the health situation improves some, the so-called flattening of the curve, and case numbers peak, the social and business restrictions begin to slowly lift. This results in an initial bounce in economic activity, although far from a return to pre-virus levels. We may be able to get out and enjoy a restaurant meal again, perhaps get a haircut but our options will likely by limited. While we don't know the extent of that initial rebound it seems reasonable that the economy will come back in fits and starts and not in one fell swoop.

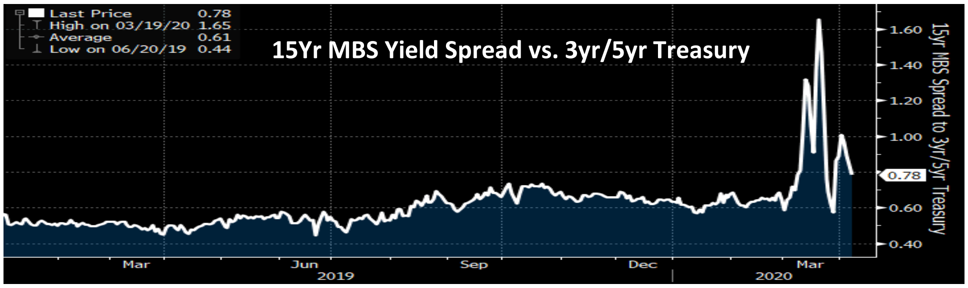


This initial bounce back likely takes the economy from near-depression level readings back to something resembling a severe or bad recession. From there the economy sees slow or moderate rates of growth until the health situation is firmly under control. That likely only happens once a vaccine with wide access is available. The health care experts still see that as a year away. Also, given the level of uninsured in this country and the uneven access to quality care some regions will see faster and more complete health recovery than other areas. The economic consequence of that will be seen as well. Those regions with higher levels of insured persons and wider access to quality care will see a quicker rebound. Thus, that square-root recovery may look vastly different in different parts of the country.

Prepare for a Rollercoaster Ride in Prepayments

March prepayments had a little bit for everyone but mostly it was faster prepay speeds that printed before the economy ran off the rails owing to the coronavirus shutdown. The March report saw aggregate conventional Fannie Mae 30-year speeds rise 42%, double the consensus call for a 20% increase. Ginnie Mae II 30-year aggregate speeds were 14% higher. The speed reports going forward may be severely muted by social distancing and planned programs for payment deferals.

- Fannie Mae 2.5%, 3% and 3.5% 30-year coupons saw their 2019 vintage speeds change by +8%, +11% and +14%, respectively. For Ginnie Mae 2.5%, 3% and 3.5% of 2019 vintage, the changes were +1%, +8% and +8%, respectively.
- Among the fastest-paying 30-year Fannie Mae majors that were issued during the first six months of 2019, the 4% MA3592 saw CPR rise 18% to 57.2 from 48.6, the 3.5% MA3597 increased 16% to 48.6 CPR and the 3% MA3644 was higher by 26% to 48.9 CPR.
- The recently passed CARES Act has added a new forbearance program for mortgage debtors struggling financially from the fallout of the virus. Forbearance is a temporary suspension of scheduled mortgage payments that borrowers are required to eventually make up.
- During forbearance, servicers advance principal & interest payments on behalf of the borrower. The law provides for up to a 6 month deferral period followed by another 6 month period, if deemed necessary. Loans in forbearance jumped from 0.25% on March 2 to 2.66% on April 1. Expect that number to continue higher.
- A delinquency buyout resulting in an involuntary prepayment will occur if the borrower cannot repay the missed payments in a timely manner & the servicer determines that the loan needs to be modified.
- Obviously, the size of a potential buyout surge will depend on the length of the economic shutdown and the amount of missed payments that have to be made up. At the same time, payment deferrals will slow prepayments from that cohort that eventually returns to work and resumes payments.
- Thus, it looks like we're in for a rollercoaster ride on prepayments. Extreme slowing in speeds in the next several months as payment deferrals are granted and then at some point later this year, perhaps November and into next year, increasing speeds as buyouts remove loans that borrowers can't repay. In the meantime, MBS spreads remain above 2019 averages.



Agency Indications— FNMA/FHLMC Callable

Maturity (yrs)	2 Year	3 Year	4 Year	5 Year	10 Year	15 Year
0.25	NA	NA	NA	NA	NA	NA
0.50	0.80	0.90	1.08	1.24	1.75	2.12
1.00	0.60	0.76	0.95	1.10	1.64	1.99
2.00	-	0.60	0.80	0.88	1.38	1.61
3.00	-	-	-	-	1.28	1.48
4.00	-	-	-	-	1.20	1.41
5.00	-	-	-	-	1.12	1.35
10.00	-	-	-	-	-	NA