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Senate Fires Back at House Tax Bill--What it Means For Housing And Rates

Last week was dominated by the release and parsing of the GOP tax bill in the House. This week the Senate fired back with its own bill. Stocks and bonds both lost ground in response, but is the tax bill the only scapegoat? Is it even the most important scapegoat?

Spoiler alert: no! Especially with respect to rates, the tax headlines were **not** the first thing on the mind of bond traders as they pushed interest rates to 2-week highs. We'll address those less overt considerations, but first let's bring ourselves up to speed on the new tax bill.

The Senate bill shares several substantial similarities to the House bill, but two key differences concern the housing market:

Property Taxes

- **House:** homeowners can deduct up to $10k
- **Senate:** no property tax deduction

Mortgage Interest

- **House:** homeowners can deduct interest on up to $500k of mortgage debt
- **Senate:** Leaves current deduction limit of up to $1m of mortgage debt

At first glance, the Senate's version might **seem** better for housing because it retains the mortgage interest deduction (neither version retains HELOC deductions). But the more important issue is the elimination of other deductions that would normally tip the scales for some taxpayers in favor of itemizing.

Combine that with an increase in the standard deduction (similar to the House version) and the net effect on housing is similar for both versions of the bill for **one simple reason:** most taxpayers who were itemizing will instead take the standard deduction.

Among those who continue to itemize, the Senate bill would provide a **slight** edge for homeowners with mortgages closer to $1 million while the House version would be more meaningful for homeowners with loan balances closer to the $500k mark because it retains the $10k property tax deduction. The National Association of Realtors issued an official form letter decrying the perils of the House bill. Preliminary comments from NAR

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.07%	+0.02	0.00
15 Yr. Fixed	6.45%	0.00	0.00
30 Yr. FHA	6.51%	+0.02	0.00
30 Yr. Jumbo	7.26%	0.00	0.00
5/1 ARM	7.02%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.86%	-0.01	0.00
15 Yr. Fixed	6.16%	+0.03	0.00

Rates as of: 6/28

Market Data

	Price / Yield	Change
MBS UMBS 5.5	98.49	-0.45
MBS GNMA 5.5	99.10	-0.44
10 YR Treasury	4.4109	+0.0129
30 YR Treasury	4.5741	+0.0101

Pricing as of: 7/1 6:48AM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Jun 12	208.5	+15.58%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

President Elizabeth Mendenhall suggest a similar stance on the Senate version.

The NAR sees the House bill causing home values to **"plunge in excess of 10 percent."** That's a dramatic claim indeed considering the NAR previously suggested the bill would deter existing homeowners from abandoning mortgages with grandfathered tax deductions, thus further constricting supply--a frequently cited source of pressure toward higher prices.

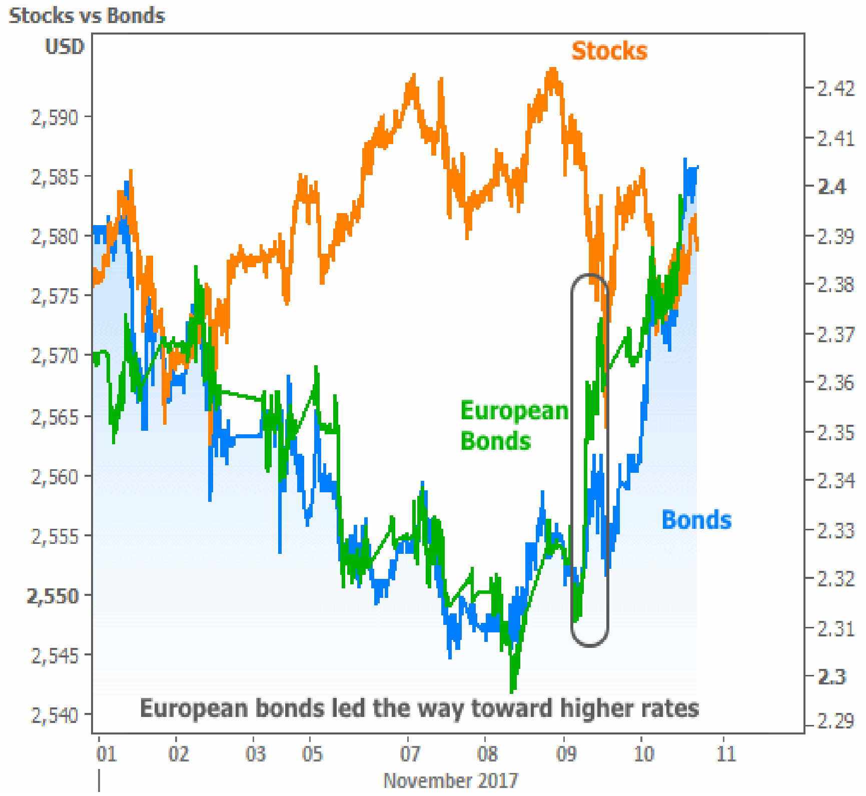
Brainteasers aside, this week's measurable drama centered on a **spike in interest rates**. Given the proximity to the tax plan announcement, it's fair to wonder if there was some connection. It even looked like the **House** tax bill pushed stocks higher and rates lower while the **Senate** tax bill had the opposite effect.

But we'll have to dig deeper to get to the bottom of the volatility--at least for bonds and rates. Fortunately, there are **other explanations** that fit even better than the tax bill.

The first has to do with European bond markets. The European Central Bank (ECB), recently announced its own version of the sort of tapering (a gradual decrease in bond buying) that the Fed announced in late 2013. Both central banks opted for 9-10 month sunsets on bond purchases. Investors are wondering if the ECB will stick to its gameplan or if they'd be open to extending bond purchases if officials deemed it necessary.

We heard from two ECB officials this week who made a case for sticking to the gameplan. The less likely the ECB is to resume buying bonds in the future, the more upward pressure it puts on interest rates.

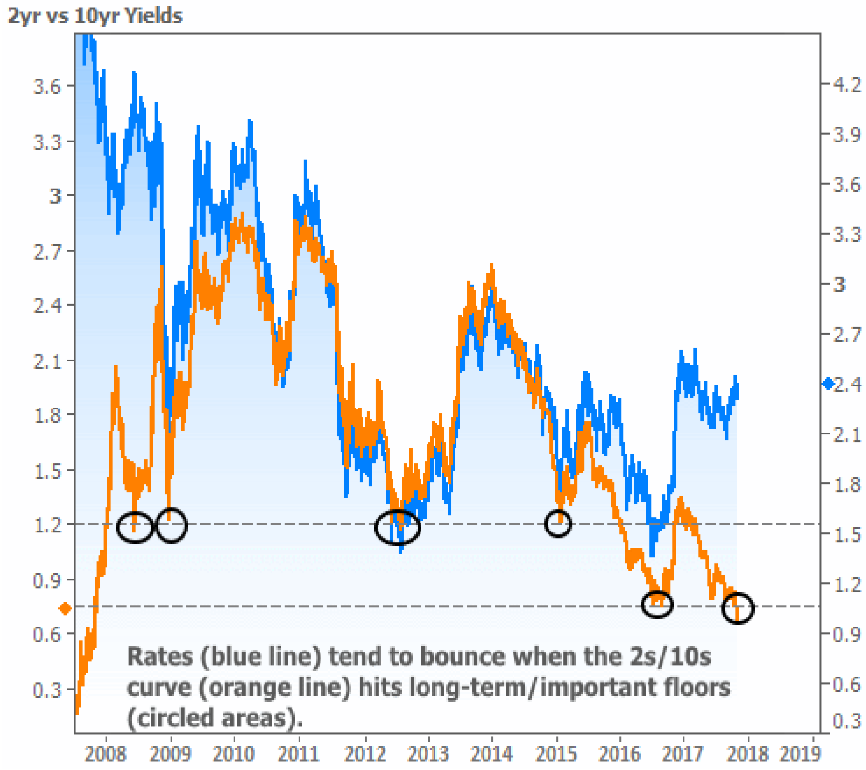
European interest rate movement definitely has an effect on rates in the US (and vice versa). With that in mind, a case could easily be made for European rates leading the way higher for US rates with the latter **pausing for half a day** (notice the blue line doesn't immediately follow the green line higher) to digest the Senate's tax plan news. Here's the same chart from above, but with European bonds added into the mix.



The final consideration is **almost** too esoteric to mention, but it is important to bond markets (which dictate rates) at the moment. It has to do with the **yield curve**--the spread between longer and shorter term Treasury yields.

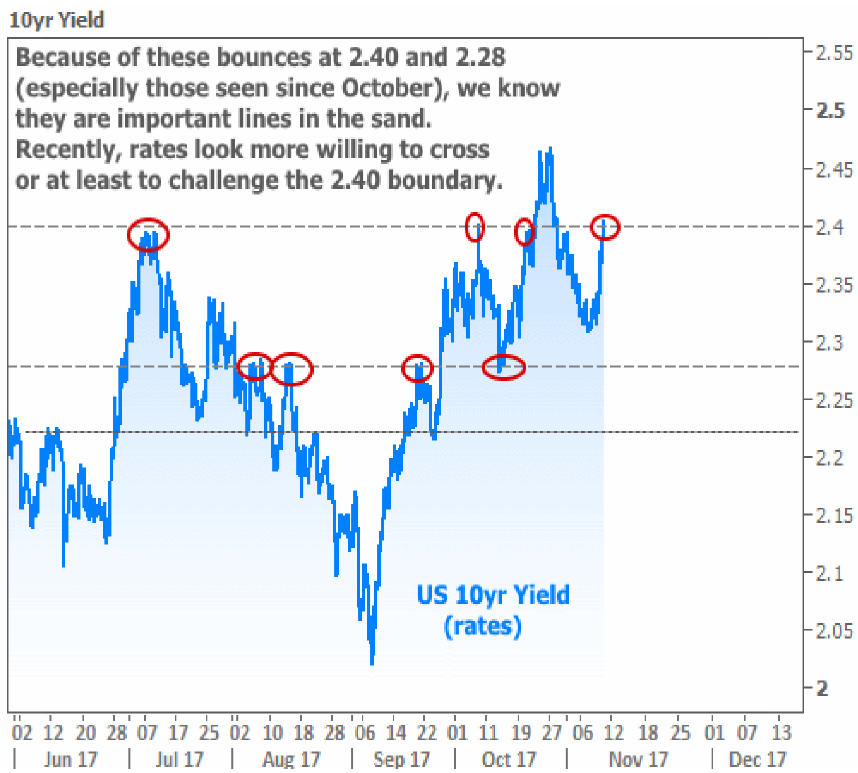
The quintessential poster child for the yield curve is the spread between 2yr and 10yr Treasury yields (aka 2s/10s curve). The following chart plots that spread against regular old 10yr Treasury yields (which tend to move in a similar manner to mortgage rates).

The point is that the yield curve has plunged to its **lowest** levels (narrowest gap between 2 and 10yr yields) since **before** the Financial Crisis, and when the curve hits historically low levels, it can prompt a bounce in longer-term rates.



While there are underlying reasons the curve is doing what it's doing, the short-term trading reaction is **purely technical**. In other words, traders seize opportunities to push the curve back up when it enters the black circle areas in the chart simply because it's entering those black circle areas (and not for some fundamental reason like economic data or tax bill headlines). That push often involves rising longer-term rates like 10yr Treasuries and mortgages.

Next week is critical because this week's rate spike brought 10yr yields to an important ceiling at 2.40%. In general, rates have been more willing to challenge ceilings as opposed to floors recently. That behavior tends to foreshadow rising rates in the coming months, but a strong bounce at a 2.40% ceiling (especially if it's followed by a break below 2.28%) would be a major coup.



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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Nov 07				
1:00PM	3-Yr Note Auction (bl)	24		
Thursday, Nov 09				
10:00AM	Sep Wholesale sales mm (%)			1.7
10:00AM	Sep Wholesale inventories mm (%)	0.3	0.3	0.3
Friday, Nov 10				
12:00AM	Roll Date - Fannie Mae 30YR, Freddie Mac 30YR			
10:00AM	Nov 5yr Inflation Outlook (%)	2.5		2.5
10:00AM	Nov 1yr Inflation Outlook (%)	2.6		2.4
10:00AM	Nov Consumer Sentiment	97.8	100.7	100.7
Tuesday, Nov 14				
8:30AM	Oct Producer Prices (%)	0.4	0.1	0.4
8:30AM	Oct Core Producer Prices YY (%)	2.4	2.3	2.2
Wednesday, Nov 15				
7:00AM	w/e Mortgage Market Index	401.7		389.7
8:30AM	Oct CPI mm, sa (%)	0.1	0.1	0.5
8:30AM	Oct Core CPI Year/Year (%)	1.8	1.7	1.7

Event Importance:

No Stars = Insignificant
☆ Low
★ Moderate
★★ Important
★★ Very Important

Date	Event	Actual	Forecast	Prior
Thursday, Nov 16				
8:30AM	Oct Import prices mm (%)	0.2	0.4	0.7
8:30AM	Oct Export prices mm (%)	0.0	0.4	0.8
8:30AM	Nov Philly Fed Business Index	22.7	25.0	27.9
8:30AM	w/e Jobless Claims (k)	249	235	239
9:15AM	Oct Industrial Production (%)	0.9	0.5	0.3
9:15AM	Oct Capacity Utilization (%)	77.0	76.3	76.0
10:00AM	Nov NAHB housing market indx	70	68	68
Friday, Nov 17				
8:30AM	Oct House starts mm: change (%)	13.7		-4.7
8:30AM	Oct Build permits: change mm (%)	5.9		-3.7
Wednesday, Jan 10				
1:00PM	10-yr Note Auction (bl)	20		
Thursday, Jan 11				
1:00PM	30-Yr Bond Auction (bl)	12		

Real Talk

At The Rate Shop, we're not your average mortgage banker. We specialize in bringing you ridiculously low interest rates that will make you wonder what the other guys are doing. In fact the ONLY objection we ever hear is “your rates sound too good to be true”. Well they’re not, and here is why…

After 15 years in the retail banking world I was frustrated with the high interest rates that came from that business model. As I looked around at all the bloated layers of management and their expensive salaries and the overhead of running a larger company (think rent costs, employee health and benefit costs, payroll taxes, and on and on) it dawned on me that I was a part of the problem, and the solution, for me at least, was so easy to see.

Start my own mortgage brokerage shop. No expensive executive salaries, no expensive building to pay rent at, no unnecessary employees and all the costs that are associated with that. What happens when you cut out all the fat? You can provide lower rates and lower closing costs. It’s simple. Now here is the best part, you still get great service from a local Kansas City Lender. My mission is to let everyone know that low rates and great customer service are NOT mutually exclusive.

Thanks for coming along on this journey where Low Rates meet Great Service. The two do NOT have to be mutually exclusive. It’s just a lie that the big box mortgage companies have been telling you for years. Don’t believe me? Give me a call or shoot me a text on my personal cell phone today and compare my rates and costs up against any other lender in the country, and be prepared to be blown away.

Mike Baker