Mike Baker
Head Interest Rate Shopper, The Rate Shop
Individual NMLS: 259076 Company NMLS: 2554765 State
23211 W 45th St Shawnee, KS 66226

Office: 913-213-3335
Mobile: 913-213-3335
mike@rateshopkc.com
View My Website

# Next Week's Fed Rate Hike Won't Affect Rates

The Federal Reserve meets 8 times a year to set its policy rate: **The Fed Funds Rate**. At next week's meeting, a "rate hike" is a foregone conclusion. And that's precisely why it **won't** matter.

The financial market is the quintessential "discounting mechanism." That means the price of any given asset will move based **not only** on what's happening today, but also on what's **likely** to happen in the future. The more certain a future outcome, the more it will be priced in today.

The Fed Funds Rate is actually a great example because it leaves very little to chance in terms of timing and size. Markets have a **very good idea** of when the next hike is coming and an even better idea of how big it will be. Contrast that to the commodities market, where a trader might have to connect complex dots between weather patterns, production methods, and shifting consumer preferences in order to even begin thinking about the future price of soybeans.

The Fed, on the other hand, has **all but promised** that it will hike by precisely 0.25% next week, and traders have no reason to believe otherwise. Does this mean mortgage rates are going up 0.25% next week too?

Not hardly!

First of all, mortgage rates are not directly based on the Fed Funds Rate. More importantly, as we just discussed, markets will adjust for whatever can be known about the future. Interest rates are quite good at this! Any impact on mortgage rates from next week's rate hike has **already come and gone**.

How can we be so sure?

First of all, I'm **not** saying that the Fed **announcement** won't have an impact on rates (more on that in a moment). I'm saying the Fed **RATE HIKE** itself has already had the impact it's going to have. There are other aspects of the Fed's announcement that can cause volatility for mortgage rates, but as for the hike itself, consider an interest rate market that is even more closely linked to the Fed than mortgage rates.

The following chart plots overnight indexed swaps or "OIS" against the actual Fed Funds Rate. OIS can be thought of as a free market version of the Fed Funds Rate, but one that can move every day as opposed to 8 times a year. Because of that nimbleness they provide clear confirmation for impending

## 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

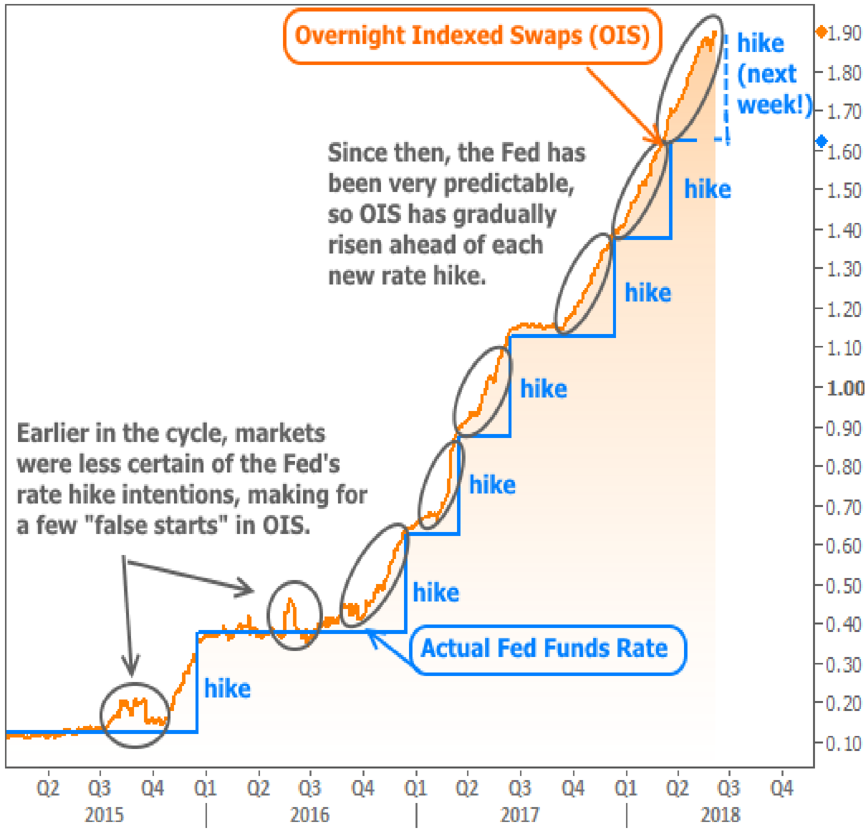
| | Price / Yield | Change |
|---|---|---|
| MBS UMBS 5.5 | 98.49 | -0.45 |
| MBS GNMA 5.5 | 99.10 | -0.44 |
| 10 YR Treasury | 4.4059 | +0.0079 |
| 30 YR Treasury | 4.5673 | +0.0033 |

Pricing as of: 7/1 4:54AM EST

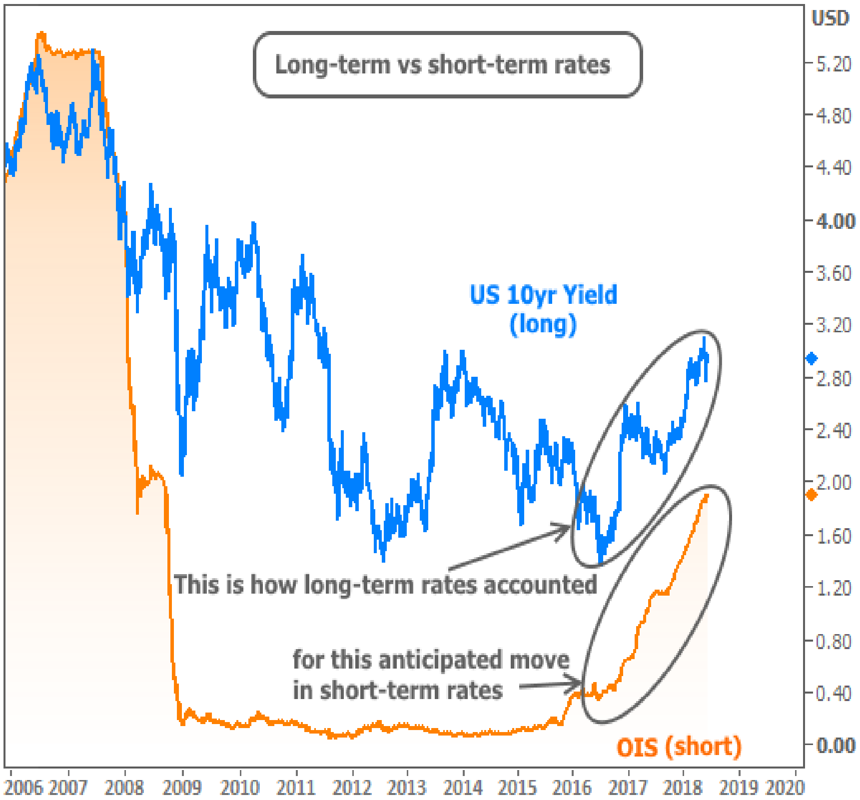
## Recent Housing Data

| | | 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% |

Fed hikes.  They are the **escalator** to the Fed's **staircase**.




Long-term rates, like 10yr Treasuries or mortgages, are even more willing to adjust for future probabilities.  They've taken two big leaps higher during this Fed rate hike cycle WELL before each phase of the cycle was complete. In other words, if we just established that short term rates have already positioned for next week's hike, it's **not even a consideration** for longer-term rates.




While the hike itself will not be news for rates, the announcement **could** still have an impact. That's because the announcement is more than just a 'yay' or 'nay' on the next rate hike. 4 out of the year's 8 Fed announcements, in particular, are more meaningful because they bring an update to the **Fed members' forecasts**. Next week's is one of those 4.

The forecasts are most closely-watched due to the component that tracks the Fed's **rate hike outlook** (sometimes referred to as "the dots" because it's presented on a dot plot). After all, if we just established that today's rates are ready and willing to move based on whatever they can know about the future, how about an updated look at where the Fed sees rates in the future?!

Although the dots are far from a guarantee for future hikes, they are still the best tool at investors' disposal when it comes to getting a general sense of how quickly the Fed is willing to hike and to what ultimate levels. With that in mind, any big change from the previous dot plot is **always** grounds for a **big** market reaction. If rates move higher or lower in a big way at 2pm on Wednesday afternoon, this is likely the reason.

Beyond the Fed, there are **other landmines** on next week's calendar. In terms of economic data, Tuesday's Consumer Price Index (inflation data) is a heavy hitter. Thursday morning brings a policy announcement from the Fed's biggest counterpart, the European Central Bank (ECB).

Global financial markets are perhaps **even more interested** in hearing from the ECB because it will soon be forced to address the topic of ending its bond buying program--possibly as early as next week. These bond buying programs ("QE" for the Fed and the "APP" for the ECB) are big business for interest rates. The timing and details of the ECB's exit will almost certainly cause some volatility in rates, for better or worse.

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## Recent Economic Data

## Event Importance:

| Date | Event | Actual | Forecast | Prior |
|---|---|---|---|---|
| **Monday, Jun 04** | | | | |
| 9:45AM | May ISM-New York index | 782.5 | | 779.3 |
| 10:00AM | Apr Factory orders mm (%) | -0.8 | -0.5 | 1.6 |
| **Tuesday, Jun 05** | | | | |
| 10:00AM | May ISM N-Mfg PMI | 58.6 | 57.5 | 56.8 |
| 10:00AM | May ISM N-Mfg Bus Act | 61.3 | 59.3 | 59.1 |
| **Wednesday, Jun 06** | | | | |
| 7:00AM | w/e MBA Purchase Index | 252.8 | | 242.7 |
| 7:00AM | w/e Mortgage Refinance Index | 1007.3 | | 970.7 |
| 8:30AM | Q1 Productivity Revised (%) | 0.4 | 0.6 | 0.7 |
| 8:30AM | Q1 Labor Costs Revised (%) | 2.9 | 2.8 | 2.7 |
| 8:30AM | Apr International trade mm $ (bl) | -46.2 | -49.0 | -49.0 |
| **Thursday, Jun 07** | | | | |
| 8:30AM | w/e Jobless Claims (k) | 222 | 221 | 221 |
| **Friday, Jun 08** | | | | |
| 10:00AM | Apr Wholesale inventories mm (%) | 0.1 | 0.0 | 0.0 |
| **Monday, Jun 11** | | | | |
| 11:30AM | 3-Yr Note Auction (bl) | | 32 | |
| **Tuesday, Jun 12** | | | | |
| 8:30AM | May CPI mm, sa (%) | 0.2 | 0.2 | 0.2 |
| 8:30AM | May Core CPI Year/Year (%) | 2.2 | 2.2 | 2.1 |
| **Wednesday, Jun 13** | | | | |
| 7:00AM | w/e Mortgage Market Index | 365.3 | | 370.8 |
| 8:30AM | May Producer Prices (%) | 0.5 | 0.3 | 0.1 |
| 8:30AM | May Core Producer Prices YY (%) | 2.4 | 2.3 | 2.3 |
| 2:00PM | N/A FOMC rate decision (%) | 1.750 - 2.000 | 1.875 | 1.625 |
| **Thursday, Jun 14** | | | | |
| 8:30AM | May Retail Sales (%) | 0.8 | 0.4 | 0.3 |
| 8:30AM | May Import prices mm (%) | 0.6 | 0.5 | 0.3 |
| 8:30AM | May Export prices mm (%) | 0.6 | 0.3 | 0.6 |
| 8:30AM | w/e Jobless Claims (k) | 218 | 223 | 222 |
| 10:00AM | Apr Business Inventories (% ) | 0.3 | 0.3 | 0.0 |
| **Friday, Jun 15** | | | | |
| 8:30AM | Jun NY Fed Manufacturing | 25.00 | 19.00 | 20.10 |
| 9:15AM | May Industrial Production (%) | -0.1 | 0.2 | 0.7 |
| 9:15AM | May Capacity Utilization (%) | 77.9 | 78.1 | 78.0 |
| 10:00AM | Jun 1yr Inflation Outlook (%) | 2.9 | | 2.8 |
| 10:00AM | Jun 5yr Inflation Outlook (%) | 2.6 | | 2.5 |
| 10:00AM | Jun Consumer Sentiment | 99.3 | 98.5 | 98.0 |

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

| Date | Event | Actual | Forecast | Prior |
|---|---|---|---|---|
| **Wednesday, Jul 11** | | | | |
| 1:00PM | 10-yr Note Auction (bl) | 22 | | |
| **Thursday, Jul 12** | | | | |
| 1:00PM | 30-Yr Bond Auction (bl) | 14 | | |

## 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**