



Mike Baker

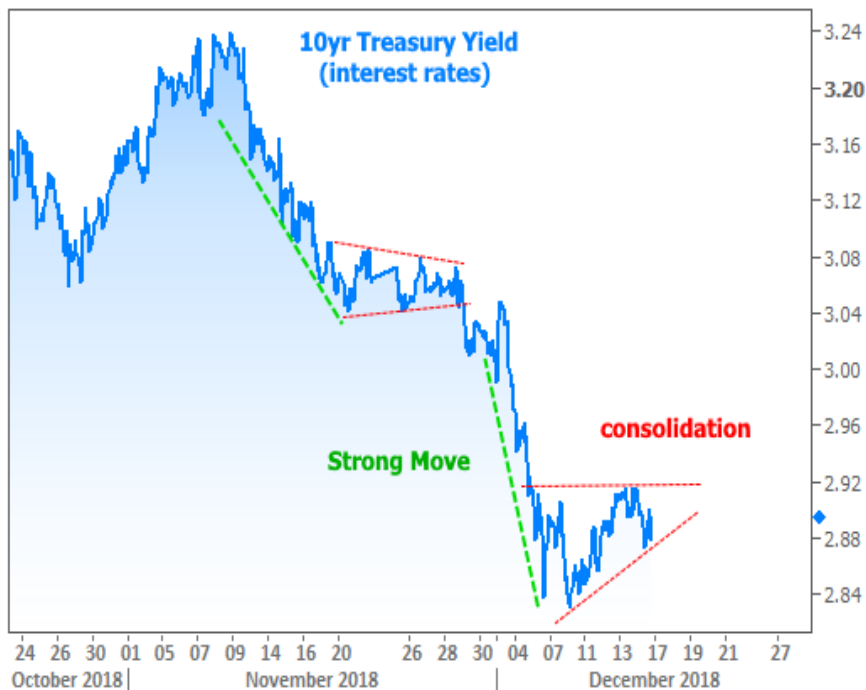
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The Fed Will Hike, But Rates Could Keep Falling

Last week, we discussed a surprising spike in market volatility. Fortunately, one of the volatile moves involved **interest rates dropping** to their lowest levels since September. This week has been quite different. The volatility is gone. Rates have bounced modestly and consolidated (i.e. moved in a narrower range).

Rates



Consolidation is often seen just ahead of some big flashpoint. While there are a few potential market movers in play right now, the **biggest** potential flashpoint would be next week's policy announcement from the Fed. Not only is it likely to inform the direction of the next "strong move," but it may well cast a vote on rates being able to break below this longer-term floor.

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	4.3951	-0.0029
30 YR Treasury	4.5659	+0.0019

Pricing as of: 7/1 2:44AM 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%



If we're talking about the Fed being the deciding factor in rate momentum, and if we know that the Fed is in charge of hiking or cutting interest rates, you'd be well within your rights to assume that a Fed rate hike is tantamount to a vote for another "floor bounce" as seen in the chart above. But that's **not exactly** how it works.

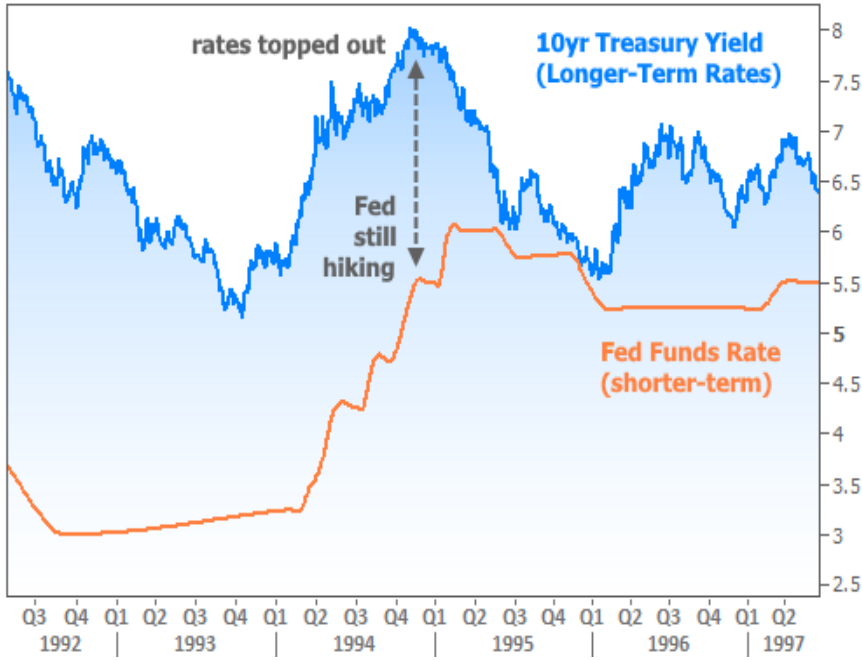
In fact, the Fed could **hike** next week and rates could keep on **falling**. That seems confusing at first glance, but consider that there are many different types of interest rates (fixed, variable, long-term, short-term, etc). The Fed Funds Rate (the thing the Fed hikes or cuts) is the **shortest-term** rate (it only applies to the money big banks need to borrow from each other to meet overnight obligations).

Apart from Home-Equity Lines of Credit (HELOCs), a Fed rate hike has no immediate implication for mortgages or other long-term rates. Mortgages are driven by mortgage-backed-securities (MBS) which have much more in common with longer-term rates like 10yr Treasury Yields. Longer-term rates do their best to move **in advance** of Fed rate hikes/cuts.

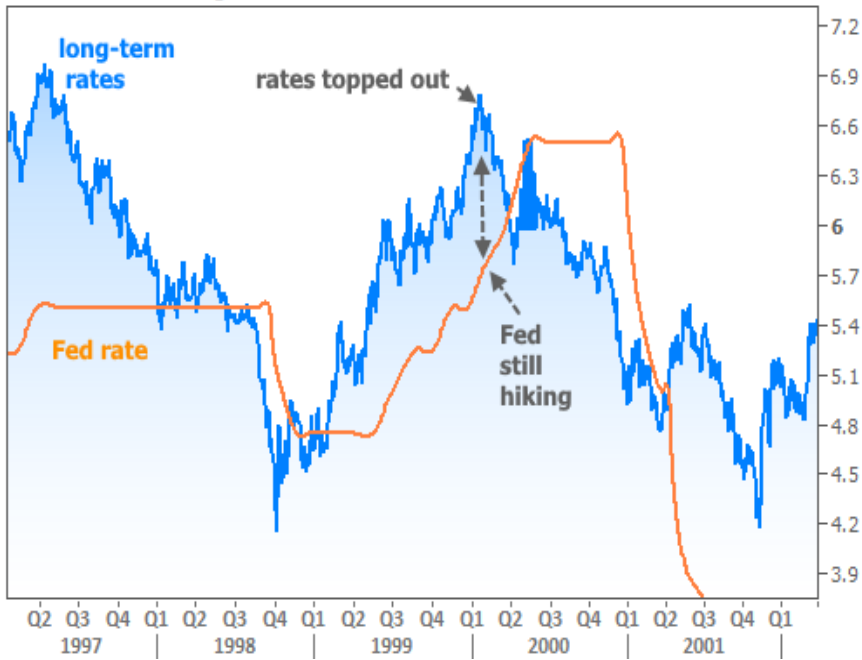
In other words, the Fed can **hike** "rates" (meaning their own Fed Funds Rate) and "other rates" (like mortgages and 10yr Treasury yields) could actually move **lower**. This is exactly what tends to happen near the end of an economic cycle, and many market watchers agree we're getting close.

The following series of charts shows how longer-term rates often behave as the Fed gets closer to pausing its rate hike cycle. In all cases, 10yr Treasury yields are used as a benchmark for longer-term rates (blue line). The orange line is the actual Fed Funds Rate.

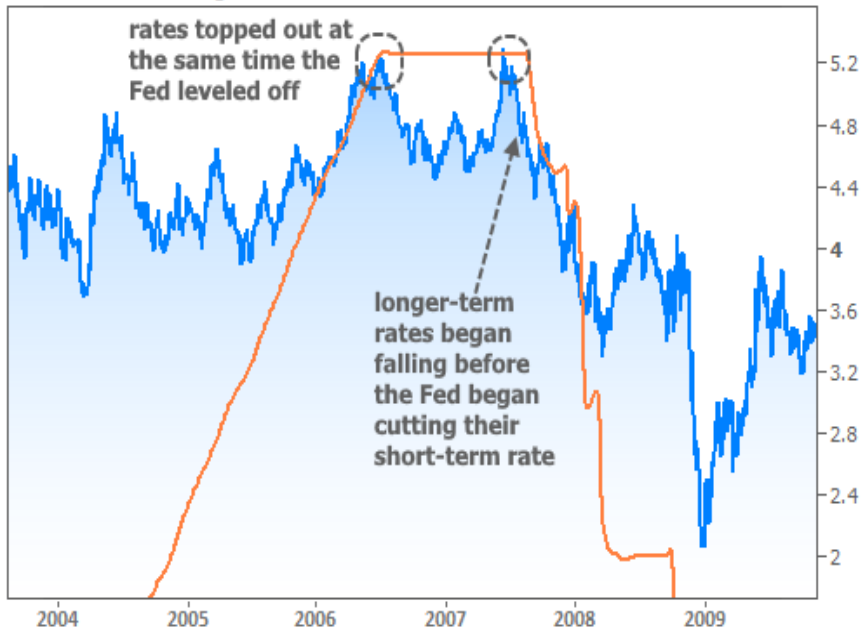
Fed Hikes Versus Long-Term Rates



Fed Hikes Versus Long-Term Rates



Fed Hikes Versus Long-Term Rates



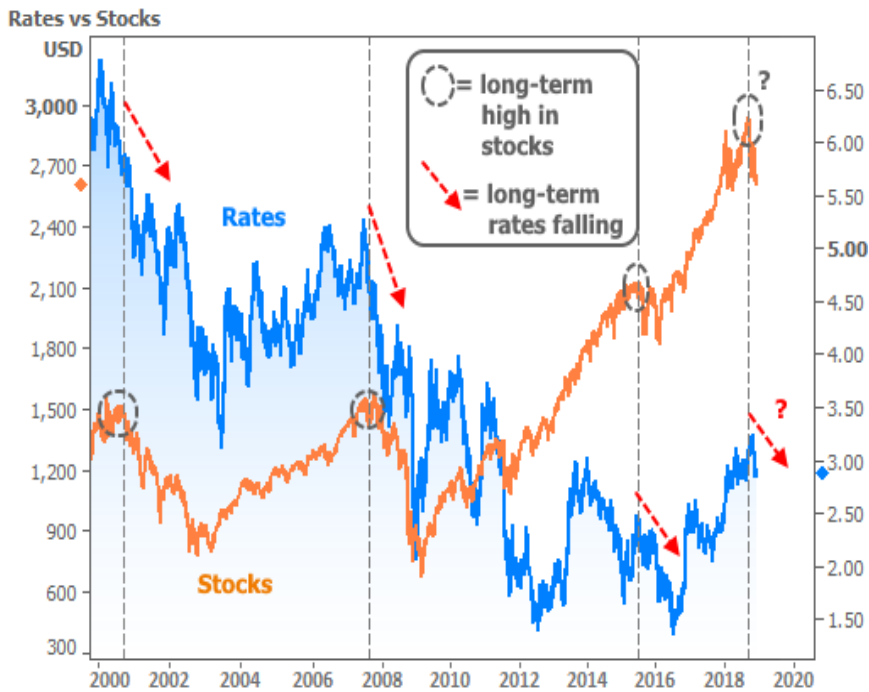
As you can see in the 3rd case, the Fed had already leveled off BEFORE longer-term rates officially began to fall. Even then, we could still say that longer-term rates began to **fall** before the Fed began to **CUT** rates. This is virtually always the case, and will almost certainly be the case in the current cycle.

All of the above **begs the question**: if we know the Fed is going to hike, and if we know that doesn't necessarily mean longer-term rates have to move higher, **why is next week's Fed announcement a big flash point?**

This is an excellent question. Indeed, a garden variety Fed announcement--even one that results in a rate hike--**hasn't** been much to write home about recently. This one is different for the same reason that rate volatility has increased recently. Specifically, the tone from Fed speakers changed markedly in late November and early Dec. This was most apparent in a late Nov speech from Fed Chair Powell in which he said rates were getting close to Neutral (in other words, the end of the Fed's rate hike cycle is in sight).

Keep in mind that the Fed's rate hike cycle isn't based on random decision making among a bunch of stuffy old bankers. They actually have to pay attention to underlying economic realities when it comes to setting policies that promote or dissuade growth.

More simply put, the Fed is **beholden to the writing on the wall**. If economic indicators begin to shift, Fed policy will have to follow. While the Fed doesn't set policy according to the stock market, stocks nonetheless act as one of those indicators. The following chart shows that rates reliably fall when stocks undergo a large-scale shift (2015's example was much less pronounced due to the distortions caused by the Fed's unprecedented asset purchase program, which helped both stocks and bonds).



Bottom line, markets suspect the Fed--either through the text of their policy announcement, the press conference with Powell, or the quarterly update of their rate hike forecasts--may confirm **just how serious they are** about slowing the pace of rate hikes or doing something else to acknowledge potential shifts in economic realities.

In addition to the Fed, we'll also get updated reports on **several housing market benchmarks** (new construction, builder sentiment, and existing home sales). Much of that data collection happened BEFORE the nice drop in rates, so any resilience in the housing data would be doubly reassuring (because the lower rates that followed would only help).

Subscribe to my newsletter online at: <http://housingnewsletters.com/rateshopkc>

Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Dec 11				
8:30AM	Nov Producer Prices (%)	+0.1	0.0	0.6
8:30AM	Nov Core Producer Prices YY (%)	+2.7	2.5	2.6
Wednesday, Dec 12				
7:00AM	w/e Mortgage Refinance Index	851.6		836.4
7:00AM	w/e MBA Purchase Index	256.1		249.9
8:30AM	Nov CPI mm, sa (%)	0.0	0.0	0.3
8:30AM	Nov Core CPI Year/Year (%)	+2.2	2.2	2.1
Thursday, Dec 13				
8:30AM	Nov Import prices mm (%)	-1.6	-0.9	0.5
8:30AM	w/e Jobless Claims (k)	206	222	231
Friday, Dec 14				
8:30AM	Nov Retail Sales (%)	+0.2	0.2	0.8

Event Importance:

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

Date	Event	Actual	Forecast	Prior
9:15AM	Nov Industrial Production (%)	+0.6	0.3	0.1
9:15AM	Nov Capacity Utilization (%)	78.5	78.6	78.4
10:00AM	Oct Business Inventories (%)	+0.6	0.6	0.3
Monday, Dec 17				
8:30AM	Dec NY Fed Manufacturing	10.9	20.00	23.30
10:00AM	Dec NAHB housing market indx	56	61	60
Tuesday, Dec 18				
8:30AM	Nov House starts mm: change (%)	+3.2		1.5
8:30AM	Nov Housing starts number mm (ml)	1.256	1.225	1.228
8:30AM	Nov Build permits: change mm (%)	5.0		-0.4
8:30AM	Nov Building permits: number (ml)	1.328	1.259	1.265
Wednesday, Dec 19				
7:00AM	w/e MBA Purchase Index	238.6		256.1
7:00AM	w/e Mortgage Refinance Index	832.2		851.6
10:00AM	Nov Existing home sales (ml)	5.32	5.20	5.22
10:00AM	Nov Exist. home sales % chg (%)	+1.9	-0.6	1.4
2:00PM	N/A FOMC rate decision (%)	2.250 - 2.500	2.375	2.125
Thursday, Dec 20				
8:30AM	Dec Philly Fed Business Index	9.4	15.0	12.9
8:30AM	w/e Jobless Claims (k)	214	216	206
10:00AM	Nov Leading index chg mm (%)	0.2	0.0	0.1
Friday, Dec 21				
8:30AM	Q3 GDP Final (%)	3.4	3.5	3.5
8:30AM	Nov Durable goods (%)	0.8	1.6	-4.3
8:30AM	Nov Nondefense ex-air (%)	-0.6	0.2	0.0
10:00AM	Nov Personal Income (%)	+0.2	0.3	0.5
10:00AM	Nov Core PCE Inflation (y/y) (%)	+1.9	1.9	1.8
10:00AM	Dec Consumer Sentiment (ip)	98.3	97.5	97.5
10:00AM	Dec Consumer Inflation Expectations (1yr) (%)	2.7		2.7
10:00AM	Dec Consumer Inflation Expectations (5yr) (%)	2.5		2.4
Wednesday, Jan 09				
1:00PM	10-yr Note Auction (bl)	24		
Thursday, Jan 10				
1:00PM	30-Yr Bond Auction (bl)	16		

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

