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What's Behind This Week's Big Drop In Rates?

I've gone out of my way on several occasions to explain why mortgage rates are **not** directly affected by Fed rate cuts. Now this week, the Fed cut its rate and mortgage rates dropped abruptly the very next day. Is it time to revisit this logic?

Not even a little bit. It is true that the Fed cut its policy rate this week. And you've no doubt heard newscasters refer to that as "a rate that affects a wide variety of consumer loans." But apart from certain Home Equity Lines of Credit (HELOCs), the Fed Funds Rate has no direct bearing on longer-term mortgage rates.

Why did rates drop right after Fed day then?

First off, if the Fed rate cut were a big deal for the bond market (which underlies mortgage rates), we would have seen a big, immediate reaction in bonds. We didn't...

Instead, bonds **weakened** slightly in the 30 minutes following the Fed's rate cut. It wasn't until markets got clarity on the Fed's policy path that things began to improve. And **EVEN THEN**, the improvement related to Powell's press conference was dwarfed by that seen the following morning.

The stock market can actually help us make more sense of the movement in bonds (aka "rates"). Both stocks and bonds like a friendly Fed. With Powell being perceived as friendlier than expected, both stocks and bonds improved (orange line moved higher and blue line moved lower in the following chart on "Fed day").

Then notice how the orange line (stocks) reverses course and heads **lower** the next morning in the "weak data" box. This had to do with a report that Chinese officials cast doubt on the viability of the US/China phase 1 trade deal. The move was exacerbated by an exceptionally weak economic report from the Institute for Supply Management-Chicago (Chicago PMI).

The big drops in the orange and blue lines inside the "weak data" box coincide exactly with the trade deal headline and the Chicago PMI data (which is seen as an advance indicator for other key economic reports). Because stocks were falling at the same time, it confirms the source of the movement was the downbeat data and not some after-effect from Fed day.

National Average Mortgage Rates



	Rate	Change	Points
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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	4.3902	-0.0078
30 YR Treasury	4.5568	-0.0072

Pricing as of: 7/1 12:47AM 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%

Rates vs Stocks



Stocks and bond yields ended the week by moving **higher** on Friday. This was partly due to a stronger-than-expected jobs report, but that was actually more of a benefit to stocks. Bonds were fairly undecided until the ISM Manufacturing data was released (one of those important reports for which Chicago PMI is an advance indicator). While the ISM number was indeed weaker than expected, it didn't miss the mark by nearly as much as the Chicago number. The result was a modest increase in yields.

Despite the weakness on Friday, **rates did very well overall** this week, and that couldn't have come at a better time. Just last week we were forced to discuss a fairly gloomy outlook when we asked if it was [time to start worrying about rising rates](#).

In fact on Thursday alone, rates dropped at their fastest single day pace since March 22nd. To be fair, many lenders adjusted rate sheets on Wednesday afternoon, but even if we consider a 48 hour time frame for mortgage rate movement, changes of that magnitude (about an eighth of a percentage point or 0.125%) are rare. In fact, more often than not, **entire weeks** go by without a 0.125% change in average 30yr fixed rates.

The size and speed of the move is interesting in and of itself, but it's made **more interesting** by the fact that this week's most prevalent mortgage rate headlines claimed that rates were actually HIGHER. Rest assured, that's **not** the case. So what's with the misleading headlines?

This is actually a fairly common occurrence. It stems from the fact that the industry's longest-standing and most widely-cited mortgage rate barometer--Freddie Mac's weekly rate survey--is only updated once per week. Moreover, Freddie's weekly rate is announced on Thursday morning whereas the data is primarily collected on Monday and Tuesday. The last 2 days of the week aren't even counted.

All of the above means that any significant movement in rates in the 2nd half of any given week can create a big discrepancy between Freddie's numbers and reality. The differences are only more pronounced if rates were moving in the opposite direction heading into the first part of the week, which is exactly what happened this time around.

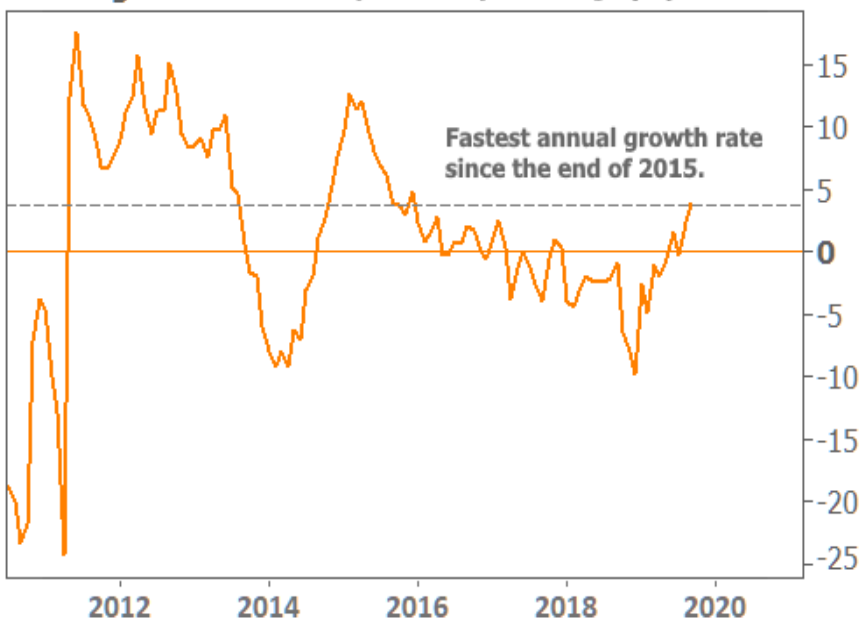
In other words, Monday--the day that gets the most weight in Freddie's survey--saw the **highest** rates of the current week. They didn't fall much on Tuesday or Wednesday, which is the last possible opportunity for rate quotes to make it into Freddie's survey. As such, the survey logically conveyed "higher mortgage rates this week" **just in time** for lenders' actual rate sheets to show the huge improvement.

In addition to the welcome developments in rates, a key housing report out this week showed the highest levels of Pending Home Sales since the end of 2017 and the fastest annual growth since 2015.

Pending Home Sales



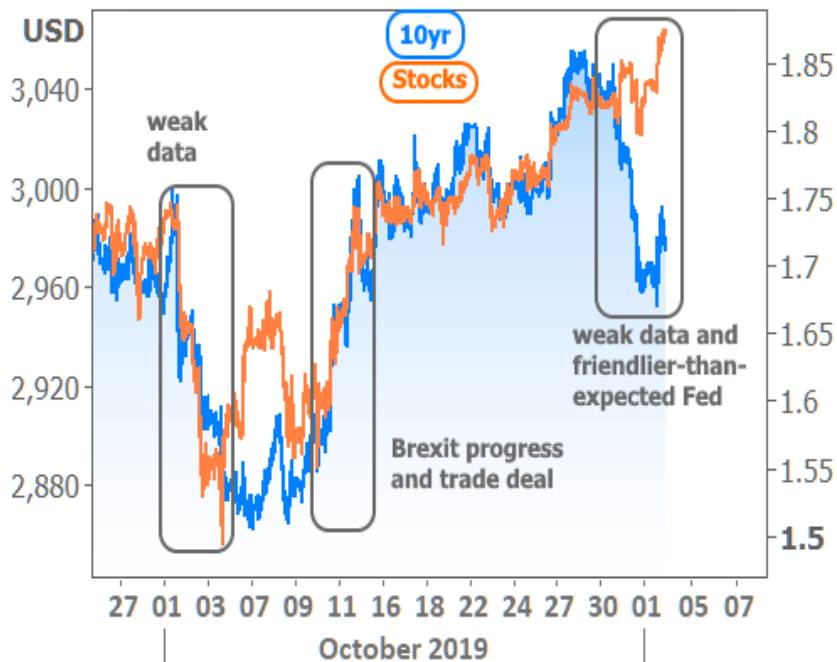
Pending Home Sales year-over-year change (%)



Surging sales, and big drops in mortgage rates! **Are we out of the woods with respect to last week's doom and gloom?** Ah... it would be great if anyone could accurately predict that future, but the market remains beholden to data and events that have yet to occur. Sure, analysts can guess at how things might happen, but the market simply adjusts itself to account for those guesses anyway. The best we can do is understand the future in "ifs" and "thens" based on what markets say is important to them.

If we zoom out the stock/bond chart to a slightly wider time frame, we only get more evidence that economic data and the trade war are hot topics. Events like Brexit and other geopolitical considerations will also flare up and offer some input from time to time, but these are generally supporting actors next to the state of the global economy.

Rates vs Stocks



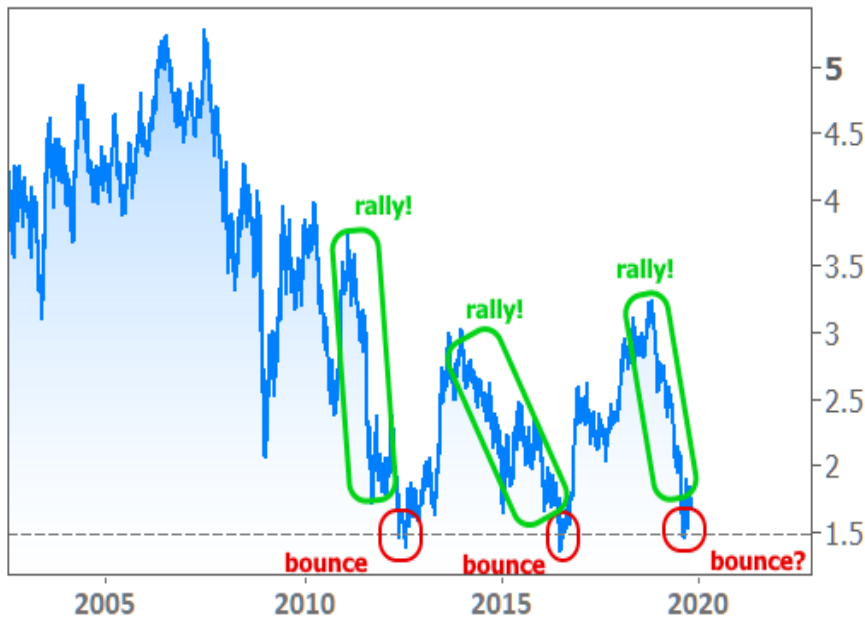
If we look at the super long term chart of 10yr yields (a proxy for momentum in longer-term rates like 30yr fixed mortgages), we see a refreshing trend is not only intact, but that rates may be on the move to the most exciting side of the 'railroad tracks.'

10yr Yield



Lest we get too excited about such things, it will serve us well to keep last week's cautionary message in mind. We do indeed **need to remain vigilant** about the risk of a rising rate trend taking root. We certainly managed to avoid confirming such things this week, but if we apply a few other lines to the chart above and zoom in on the last 10 years, we find cause for concern in 2019 being potentially one of only a few big turning points where rates surged to long-term lows and then began a relatively unpleasant move higher.

10yr Yield



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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Oct 29				
9:00AM	Aug CaseShiller 20 yy (%)	+2.0	2.1	2.0
9:00AM	Aug CaseShiller 20 mm SA (%)	-0.2	0.0	0.0
10:00AM	Sep Pending Sales Index	108.7		107.3
10:00AM	Oct Consumer confidence	125.9	128.0	125.1
10:00AM	Sep Pending Home Sales (%)	+1.5	0.9	1.6
Wednesday, Oct 30				
7:00AM	w/e MBA Purchase Index	247.2		241.7
7:00AM	w/e Mortgage Refinance Index	2066.0		2076.9
8:15AM	Oct ADP National Employment (k)	125	120	135
8:30AM	Q3 GDP Advance (%)	1.9	1.6	2.0
2:00PM	N/A FOMC rate decision (%)	1.500 - 1.750	1.625	1.875
2:31PM	Powell Press Conference			
Thursday, Oct 31				
8:30AM	Sep Core PCE Inflation (y/y) (%)	+1.7	1.7	1.8
8:30AM	w/e Jobless Claims (k)	218	215	212
9:45AM	Oct Chicago PMI	43.2	48.0	47.1
Friday, Nov 01				
8:30AM	Oct Non-farm payrolls (k)	128	89	136
8:30AM	Oct Unemployment rate mm (%)	3.6	3.6	3.5

Event Importance:

No Stars = Insignificant

☆ Low

★ Moderate

★★ Important

★★★ Very Important

Date	Event	Actual	Forecast	Prior
10:00AM	Oct ISM Manufacturing PMI	48.3	48.9	47.8
Monday, Nov 04				
10:00AM	Sep Factory orders mm (%)	-0.6	-0.5	-0.1
Tuesday, Nov 05				
10:00AM	Oct ISM N-Mfg PMI	54.7	53.5	52.6
1:00PM	3-Yr Note Auction (bl)		38	
Wednesday, Nov 06				
7:00AM	w/e Mortgage Refinance Index	2102.7		2066.0
7:00AM	w/e MBA Purchase Index	241.0		247.2
Thursday, Nov 07				
8:30AM	w/e Jobless Claims (k)	211	215	218
3:00PM	Sep Consumer credit (bl)	9.51	15.00	17.90
Friday, Nov 08				
10:00AM	Sep Wholesale inventories mm (%)	-0.4	-0.3	-0.3
10:00AM	Nov 5yr Inflation Outlook (%)	2.4		2.3
10:00AM	Nov 1yr Inflation Outlook (%)	2.5		2.5
Wednesday, Jan 08				
1:00PM	10-yr Note Auction (bl)	24		
Thursday, Jan 09				
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

