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

Time To Think About Mortgage Rate Complacency (Before It's Too Late)

After **months** of waiting and multiple successive reports of all-time lows from other sources, the average lender is now finally back in line with the **actual all-time lows** seen on August 4th, 2020.

With different sources making this claim at different times, how **do you know who's right?** Actually, everyone's right, as long as you understand how they arrive at their numbers.

For instance, surveys that ask lenders for their best possible rates are logically going to suggest lower than average rates because refinances cost a lot more than purchases at the moment, despite comprising a majority of the market. That's why Freddie Mac's survey has seen successive all-time lows even though refi-weighted rates are just now getting back to that promised land.

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	4.3931	-0.0049
30 YR Treasury	4.5597	-0.0043

Pricing as of: 6/30 10:43PM EST

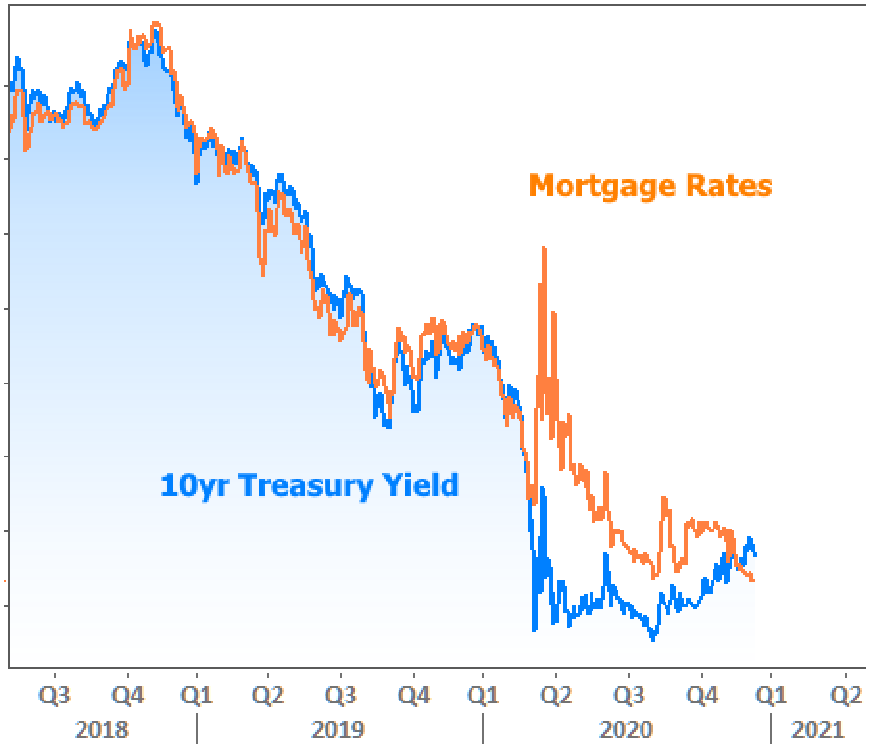
Recent Housing Data

		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%

So rates are back! But **now what?** Will they go lower? Are they at risk of a bounce? For questions like this, rate watchers have long been turning to 10yr Treasury yields as the "secret" source of guidance.

Actually, it's no secret. Mortgage rates tend to behave a lot like other longer-term bonds because mortgages actually **ARE** longer-term bonds. After all, a bond is just an agreement for a borrower to pay lender back over time. In the case of US Treasuries, investors are lending money to the US government. In the case of mortgages, banks lend to people who pay back over time.

10yr yields and mortgage rates are **so similar** in their movement that one typically need only know what 10yr yields are up to. Case in point, check out the left side of the following chart.

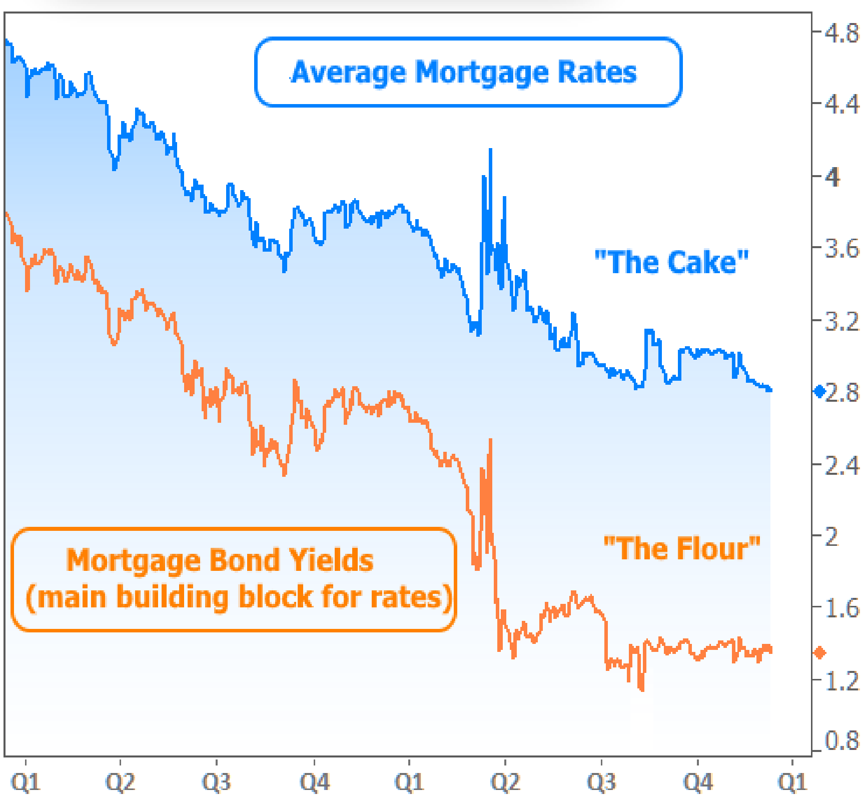


But what in the world is going on with the right side of the chart? Yes, there's the handy, generic 2020 answer "well, the pandemic probably did something to screw things up and now there's a new normal," but let's dig deeper. Those interested in the simplest explanation can **just read the next paragraph** and go about their business.

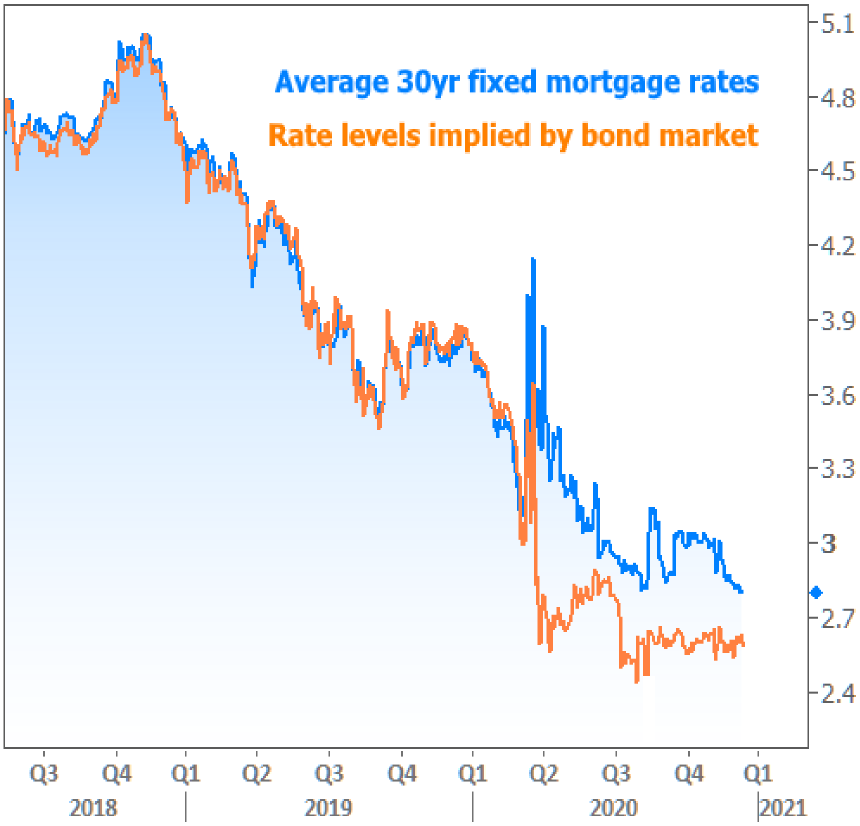
The **simplest explanation** is that certain forces prevented mortgage rates from falling as quickly as Treasury yields. Thus, mortgage rates **have a cushion** that has allowed them to hold steady even as Treasury yields have moved back up. That's actually a fantastically short and sweet way to explain and understand it if not for that pesky issue of the blue line moving up and above the orange line in the chart above.

In other words, mortgage rates not only closed the gap, but now they're **lower** than Treasuries say they should be. That's OK, because Treasuries **don't get the final say.** That honor goes to mortgage bonds (officially mortgage-backed-securities or MBS). These bonds are what groups of similar loans "turn into" through the process of securitization. They can then be traded by investors just like Treasuries. As they trade, their value changes by the minute. The changes in that value can be tracked and charted just like the 10yr Treasury yield.

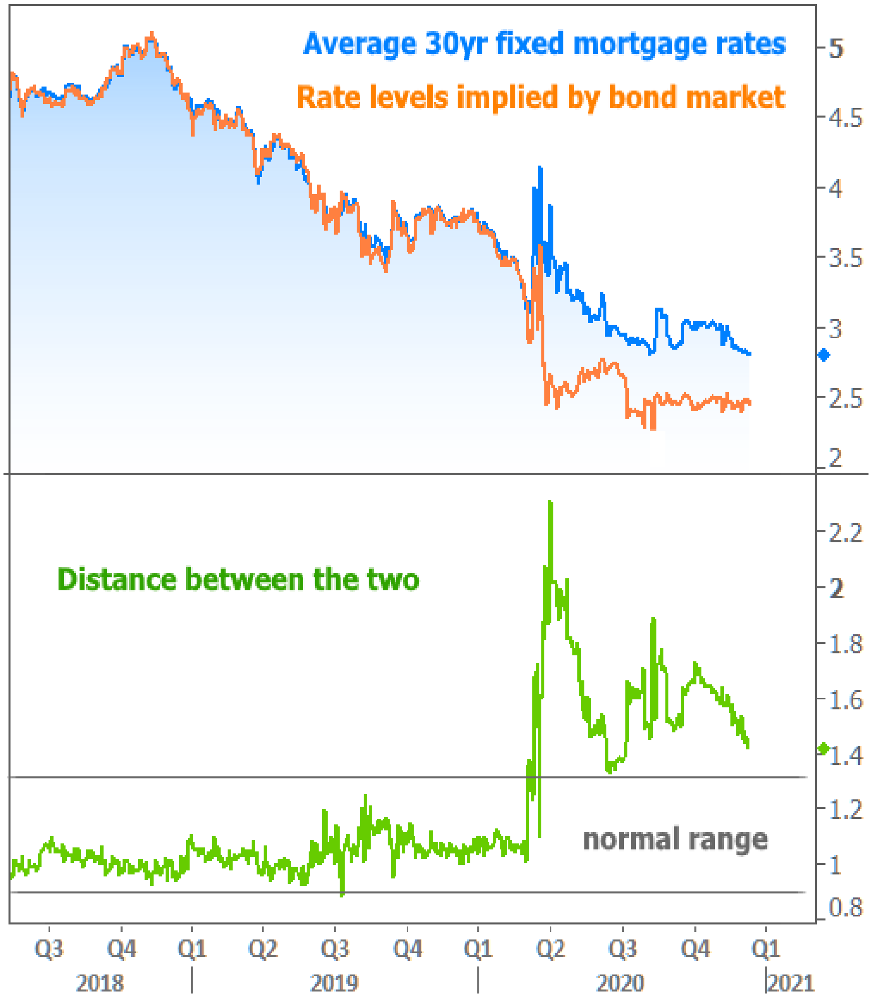
As you'd expect, that value has **almost everything** to do with how mortgage rates move over time (after all, this is a real-time reflection of what mortgage debt is worth to investors). As such, they are the primary raw ingredient in the mortgage rate recipe. With apologies to the gluten-free folks, mortgage bond yields are like the flour to mortgage rates' cake.



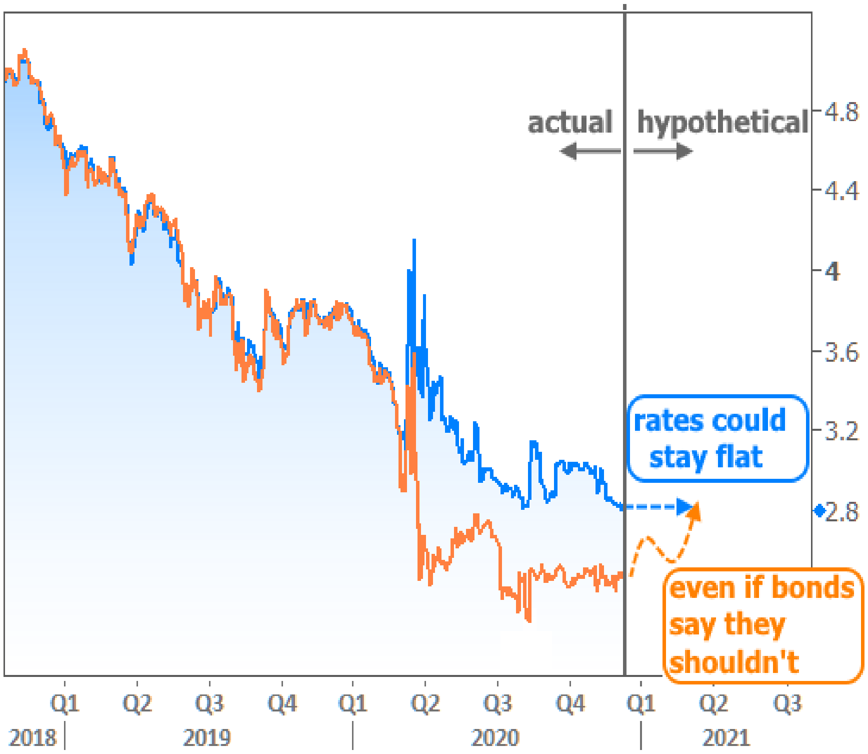
There's a lot of correlation there, obviously, but nuances are easier to see if we **slide the orange line up** to rest on the blue line--mostly.



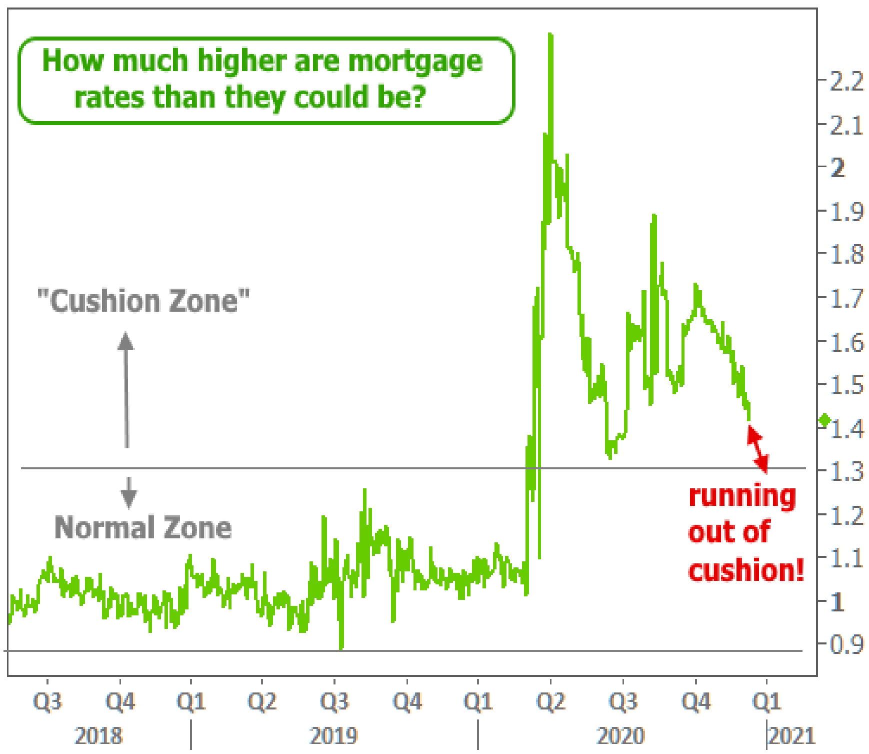
As you can see, there's a gap between the two since the pandemic. We can measure the size of that gap and give it its own line on the chart. Since mortgage rates are higher than mortgage bonds say they should be, this line is like **the cushion** for mortgage lender profitability.



The cushion means that the bond market could move in a way that suggests **higher** rates while mortgage lenders continue to hold rates **steady**.



But as you may have noticed, the cushion is getting smaller...



Once it gets back to its normal levels, mortgage rates will feel more compelled to follow mortgage bonds and the broader bond market. **Why would that be an issue?** For starters, mortgage bonds have been doing such an amazing job compared to Treasuries that investor sentiment finally shifted in the other direction.

In other words, mortgage rates can outperform Treasuries either because mortgage bonds themselves are outperforming **or** because lenders have a cushion, and we're down to the cushion being our last line of defense. **Bottom line**, if Treasury yields **continue** to rise, mortgage bond yields will be forced to follow. Without much of a cushion left, that means it wouldn't take long for mortgage rates to be pulled higher as well.

Is there a **reason to be concerned** that Treasury yields will rise?

Yes! Several of them. Vaccines offer brighter economic hopes. Stimulus spending incurs Treasury debt (which pushes yields/rates higher). The economy is learning how to operate with high covid case counts much better than it did in early 2020. And the Fed is on a fence about its next move. Taken together, it seems that Treasuries are trying to tell us something.

Of course if traders **knew** where rates would be in the future, they'd already be there. **A lot** can happen in the coming weeks and months to derail the rising rate trend in Treasuries. The biggest near term risks involve fiscal stimulus and the Fed. While a longshot at this point, if lawmakers manage to approve stimulus before the Fed meeting next Wednesday, it would likely put significant upward pressure on rates because it would lower the odds of the Fed making a rate-friendly move.

What kind of move are we talking about? The Fed is considering making an adjustment to the balance of bonds that it currently buys. The adjustment would help longer-term rates like mortgages. This is about a 50/50 chance right now, which means the bond market is likely to react either way. Fiscal stimulus from congress increases the odds that the Fed would sit tight on additional monetary stimulus.

The Fed's policy decision will be announced at 2pm ET on Wednesday.

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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