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The Day Ahead: ECB Rain Check Raises Questions For Short-Term Rate Trend

Rates and yields have been trending steadily higher since hitting all-time lows in early July. Those lows were most immediately attributable to the Brexit reaction, and thus the initial bounce back toward higher rates wasn't too severe and the resulting uptrend was barely detectable. 10yr yields essentially leveled-off in a sideways range surrounding 1.55% and that seemed to be that.

Enter early September. Bond volatility increased significantly after European Central Bank (ECB) President Mario Draghi kept quiet on the topic of extending the ECB's asset purchases set to expire in March 2017. Granted, that was 6 months away at the time, but **if anyone likes to flash his bazooka** (i.e. verbally promise/threaten to use as much aggressive monetary policy as needed), it's Draghi. Markets took the change in tone as signalling a potential shift in the ECB's discourse--a shift that could be an early warning sign that the ECB was considering tapering asset purchases.

Market participants (and most mortgage professionals!) remember the taper tantrum all too well, and no one is very excited about a potential European version, even though it is destined to happen eventually. Several articles suggested European officials were already actively discussing the matter, but Draghi subsequently **denied** the "rumors." Just last week, Draghi **rephrased** those rumors as real conversations, but only at the "committee level" within the ECB. In other words, yeah, they're talking about it, but Draghi and the ECB governing council haven't made any decisions yet.

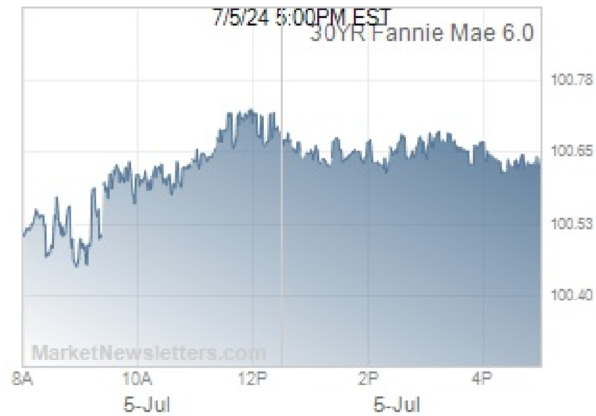
The removal of the most immediate threat (a firmer comment on tapering from Draghi at last week's ECB press conference) has been enough for bond markets to catch their breath and make up some recently lost ground. But The ECB's reference to the December meeting being the time where they'll share more details on March 2017's bond buying expiration **raises questions** about where bonds should go between now and then.

Short term momentum is actually quite good, but is **already** nearing "overbought" levels (the lower of the two horizontal blue lines in the following chart). Longer-term momentum still tells the **most accurate** story, which is that bonds are generally trending higher, but are in a position to consider at least a temporary correction (i.e. the green line may head lower, as it did in late September).

MBS & Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.61	+0.22
MBS GNMA 6.0	100.74	+0.21
10 YR Treasury	4.2808	-0.0010
30 YR Treasury	4.4721	-0.0136

Pricing as of: 7/7 7:37PM EST



Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.03%	-0.05	0.00
15 Yr. Fixed	6.44%	-0.01	0.00
30 Yr. FHA	6.50%	-0.05	0.00
30 Yr. Jumbo	7.24%	-0.01	0.00
5/1 ARM	7.05%	-0.02	0.00
Freddie Mac			
30 Yr. Fixed	6.95%	+0.09	0.00
15 Yr. Fixed	6.25%	+0.09	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.03%	+0.09	0.62
15 Yr. Fixed	6.56%	+0.09	0.54
30 Yr. FHA	6.90%	+0.11	0.95
30 Yr. Jumbo	7.11%	-0.01	0.50
5/1 ARM	6.38%	+0.11	0.54

Rates as of: 7/5

Before any short term corrections **even have a chance**, yields will have to get through this pesky 1.73% level, which has been the critical pivot point of the past 2 months. It served as a ceiling in September and has now acted as a firm floor on 4 of the past 7 trading days.

To be sure, things **could be much worse** at the moment, but until yields are clearly breaking below 1.73, it makes most sense to remain defensive against the prospect of an ongoing trend toward higher rates.

This week is light on data, but there are a few potential market movers on Thursday and Friday. Chief among these are Durable Goods and Advance GDP. Normally, GDP figures are too much of a lagging indicator to matter when it comes to near-term market movement, but the "advance" version is the first (and earliest) reading for any given quarter. It has a **symbolic and strategic** importance as it is often there that we see the biggest departures from forecasts.

Treasury auctions will also be happening from Tuesday through Thursday. This can sometimes result in a general, **negative** pressure on bond markets up until Thursday afternoon, with some **positive** relief (all things being equal) after that. The other background benefit for bonds will be the run up to "month-end." Monday is the official end of the month, but it's not uncommon for traders to get their month-end trading in on the previous Friday (or before). The fact that Monday is Halloween--thus potentially decreasing some market participation in the afternoon as traders punch out for family/friends--makes it even more likely this week.

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