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What The Fed's Emergency Rate Cut Means For Mortgage Rates

There are a lot of words here. If you have a mortgage you might ever refinance (and especially if you think Sunday's emergency Fed news means you can now get a lower rate), read every last one of them.

Background: Fed's Emergency Rate Cut and QE

It's **extremely important** for the sound functioning of the mortgage market that consumers read and understand the following: THE FED DID NOT JUST CUT YOUR MORTGAGE RATES!

I'm not a loan officer. I don't play one on TV. I don't benefit from the decision you make on locking a mortgage rate. I'm just a guy who watches and understands the day-to-day movement in average mortgage rates better than just about anyone. It's one of the few things in this life I will claim to be the best at. You can take what I'm saying to the bank, literally and figuratively.

I can't count the number of articles I've written or the variety of ways I've reported mortgage rates moving in the OPPOSITE direction as a Fed rate cut/hike, or simply staying put despite a Fed cut/hike. Here's a recent example from March 3rd.

The extent to which consumers and especially financial news media (who should REALLY know better by now) mistakenly believe the fallacy of the Fed dictating mortgage rates is truly unfortunate. Even now, you're reading this article and some of you will still be contacting your originators asking if you can get a lower rate. But it doesn't work like that. I urge you to avoid buying into misinformation. Make an effort to elevate your level of understanding. Start here:

Part 1: The Fed Funds Rate Itself

The Fed funds rate doesn't directly affect any mortgage rates apart from home equity credit lines. While it often moves in the same direction as the traditional 30yr fixed mortgage rate in the long run, there are months and even years of time when they seemingly have nothing to do with each other.

This makes sense for a few key reasons. The Fed Funds Rate is a **different animal** than the mortgage rate. It applies to loans with a term of up to 1 day. That's a far cry from the average mortgage, and investors approach those loans with completely different sets of priorities. That's why we sometimes see longer and shorter term rates move in OPPOSITE directions (which

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.08%	-0.05	0.00
15 Yr. Fixed	6.45%	-0.02	0.00
30 Yr. FHA	6.55%	-0.05	0.00
30 Yr. Jumbo	7.25%	-0.04	0.00
5/1 ARM	7.07%	-0.03	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: 7/3

MBS and Treasury Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.39	+0.19
MBS GNMA 6.0	100.53	+0.14
10 YR Treasury	4.3602	-0.0724
30 YR Treasury	4.5297	-0.0761

Pricing as of: 7/3 5:59PM EST

accounts for the "inverted yield curve" phenomenon that made news in 2019 when 10yr Treasury yields were lower than all of the short-term rates under 2 years, including Fed Funds).

But even if long and short term rates always moved in the same direction, there's a more important reason that mortgage rates might not follow the Fed. The bonds that dictate mortgage rates trade **thousands of times a day**. Mortgage lenders themselves update their rates at least once a day. In contrast, the Fed only meets to consider changing its rate 8 times a year, barring emergencies (like today). This means mortgage rates can and do move well in advance of Fed rate changes. Indeed, the behavior of longer-term rates like mortgages can often predict the market conditions that prompt the Fed to make a move.

Bottom line: the bond market (which includes mortgages rates) has been able to react to coronavirus implications for weeks, and the fed is just getting caught up to market realities. They're a battleship in a river, and that river has been swift. If you need more convincing on this particular point, here is a more detailed conversation.

Part 2: What About the New QE?

QE = Quantitative Easing (the term for the Fed's large-scale bond buying programs designed to lower interest rates and encourage free flow of lending/capital).

If you've been reading part 1 and thinking to yourself "ok smart guy, but what about the new mortgage bond buying the Fed just announced today?" Congratulations! You understand more than 99% of the population about what matters. The Fed did indeed announce new mortgage bond buying as a part of its QE package today. This will help restore the correlation between 10yr Treasury yields and mortgage rates, but it WON'T immediately restore the normal space between the them.

While mortgage rates definitely take cues from the broader bond market (especially when markets are relatively calmer), they move for several other reasons. That caused a lot of head scratching this week as mortgage rates jumped at the fastest pace EVER while many savvy consumers were still waiting for them to drop as much as Treasury yields had dropped.

One of the biggest reasons for the mortgage vs Treasury disconnect was a massive supply glut of new mortgage debt caused by rampant refinance demand recently. After all, even if people felt like rates SHOULD BE lower, they nonetheless hit new all-time lows last Monday and successively broke 3-year lows in few weeks prior. This flood of mortgages needed to be sold to investors in order for mortgage lenders to keep lending. But investors were no match for the unprecedented spike in supply. Like any marketplaces with way too many sellers and not enough buyers, prices rapidly fell, and falling prices on mortgages equate to higher rates for consumers.

Supply must also be considered from the lender's standpoint. Even in cases where lenders still had money to lend, the record surge in refinance demand forced them to raise rates simply to slow the flow of new business.

Supply may have been the biggest issue for the mortgage market this week, but it wasn't the only issue. Mortgage investors were also spooked by the speed of the decline in rates heading into March. When consumers pay off their old mortgages faster than expected (because they're refinancing), mortgage investors earn less interest. That gives them another compelling reason to pay less for mortgage debt. And again, mortgage investors paying less for mortgages = higher rates.

To add insult to injury, 10yr Treasury yields moved significantly HIGHER throughout the week. So even if mortgage rates could have overcome all of their own specific issues, their typical guidance giver was still telling them to move higher.

Bottom line: mortgage rates have had no reason to move lower this past week and every reason to move higher. The Fed's QE (just announced) sounds like a lot at $200 bln, but in this market, it won't even cover 2 months' worth of new mortgage supply. It's a token handout meant simply to ensure the mortgage market continues to function smoothly, and not nearly enough to drop us instantly back to all-time lows. It's a tourniquet, not a panacea.

Where rates go from here will depend on where the bond market goes. To be sure, there's a very good chance that yields will stay extremely low and move lower due to what many see as a fairly large and inevitable recession. If that increasingly looks to be the case, mortgage rates will gradually return lower, BUT--and this is the important "but"--MORTGAGE RATES AREN'T DROPPING 0.50% TODAY AND THEY'RE NOT ANYWHERE CLOSE TO 0%. They were a lot closer to 4% on Friday afternoon (many scenarios were pricing-out higher than that).

By getting back into buying mortgage debt, the Fed is giving rates a fighting chance to head back toward all-time lows. It definitely won't happen overnight and it isn't a guarantee.

So what should you do?

I get asked for advice on rates more and more as the years go by, but clairvoyance remains elusive. I've never felt it wise or responsible to offer blanket advice to people with different scenarios and different levels of risk tolerance--especially when I can't predict the future. Tonight is as close to an exception as we'll get. Reason being: rates rose so much last week that it took the pressure off consumers who wanted to lock a lower rate. All you could do was to wait for things to come back in a friendlier direction.

As such, **I would give anyone the same guidance right now:**

> If you haven't done so already, make sure your originator has what they need in order to lock your loan when the time is right. Make a game plan. Talk about where rates are now and what rate you're looking to lock. They HAVE to have what they need from you in order to lock, and they may not have a very big window in which to pull the trigger (that window was less than a few hours wide at the all-time low rates last Monday morning).

Above all else, please don't call them and ask if you can get a lower rate now. Don't ask them if the Fed just cut mortgage rates to 0% or if your rate is now going to be 0.50% lower (that could happen, but it didn't happen today). I can give you the answer right here:

- You can't get a lower rate right now just because the Fed cut rates again
- If you didn't check on Friday afternoon, rates got a lot higher than you may have realized.
- You CAN, however, probably get a lower rate at some point in the coming weeks thanks to the Fed's reinvigorated mortgage bond buying efforts
- Lower rates aren't immediate or guaranteed, so make sure your originator has what they need from you in order to lock it when and if your desired rate becomes available

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With 27+ years of expertise in mortgage banking you can be confident in my knowledge and abilities to deliver a seamless loan transaction while providing personalized service.

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