Jeffrey Chalmers
Senior Loan Officer, Movement Mortgage
NMLS #76803 - #39179 Licensed: CA, CT, FL, MA, ME, NH,
99 Rosewood Dr, Suite 270 Danvers, MA 01923

Office: (774) 291-6527
Mobile: (774) 291-6527
Fax: (855) 951-5626
jeffrey.chalmers@movement.com
View My Website

Why Are Mortgage Rates Skyrocketing Toward 5%?

While weeks in 2022 have been terrible for mortgage rates, we've always been able to say "at least it wasn't as bad as that one week in 2013." We can't really say that anymore.

Sharply higher rates out of the gate on Monday, a few hopeful days mid-week, then another terrible day on Friday.

Why is all this happening?

It's both simple and complicated. The simple part of the explanation has to do with the Federal Reserve (the Fed) making several unexpected adjustments to its policy outlook. Fed policy involves setting the key overnight lending rate in the US as well as deciding how to buy and sell large amounts of certain bonds.

In addition to US Treasuries, those "certain bonds" include mortgage-backed-securities (**MBS**), which directly dictate mortgage rates. As such, the Fed bond buying outlook has a very big impact on mortgage rates. If the Fed gives the market a reason to expect smaller MBS purchases, rates rise. The bigger the surprise, relative to previous expectations, the bigger the reaction in the mortgage market.

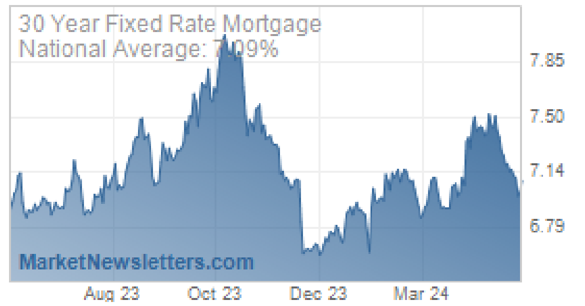
Starting in **November**, the Fed began reducing the size of the bond purchases that began at the start of the pandemic. This was bound to happen at some point, but November was a bit earlier than some of the market expected. As a result, MBS **suffered**.

Then in **December**, the Fed announced it would decrease MBS purchases at a faster pace. This wasn't really the end of the world at the time, because even after the Fed completely eliminated its scheduled bond purchases, they would still be reinvesting the proceeds from previous investments.

That **sounds** complex, but a simple example should clear things up. Imagine the Fed is your mortgage lender. As you make payments, or if you sell/refi and pay your loan off completely, the Fed will take that money and use it to lend to someone else. This is exactly what's happening with the Fed's "reinvestments," but on a grand scale.

In this way, the Fed is **not** buying any **NEW** MBS. They're simply **replacing** MBS that would otherwise fall off its balance sheet. These reinvestments account for a substantial amount of buying demand in the bond market, and **"bond buying demand" = lower rates**, all other things being equal.

National Average Mortgage Rates



	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.09%	+0.07	0.00
15 Yr. Fixed	6.56%	+0.03	0.00
30 Yr. FHA	6.62%	+0.07	0.00
30 Yr. Jumbo	7.35%	+0.04	0.00
5/1 ARM	7.30%	+0.06	0.00
Freddie Mac			
30 Yr. Fixed	7.02%	-0.42	0.00
15 Yr. Fixed	6.28%	-0.48	0.00

Rates as of: 5/17

Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.40	-0.15
MBS GNMA 6.0	100.78	+0.04
10 YR Treasury	4.4223	+0.0454
30 YR Treasury	4.5610	+0.0549

Pricing as of: 5/17 5:59PM EST

Recent Housing Data

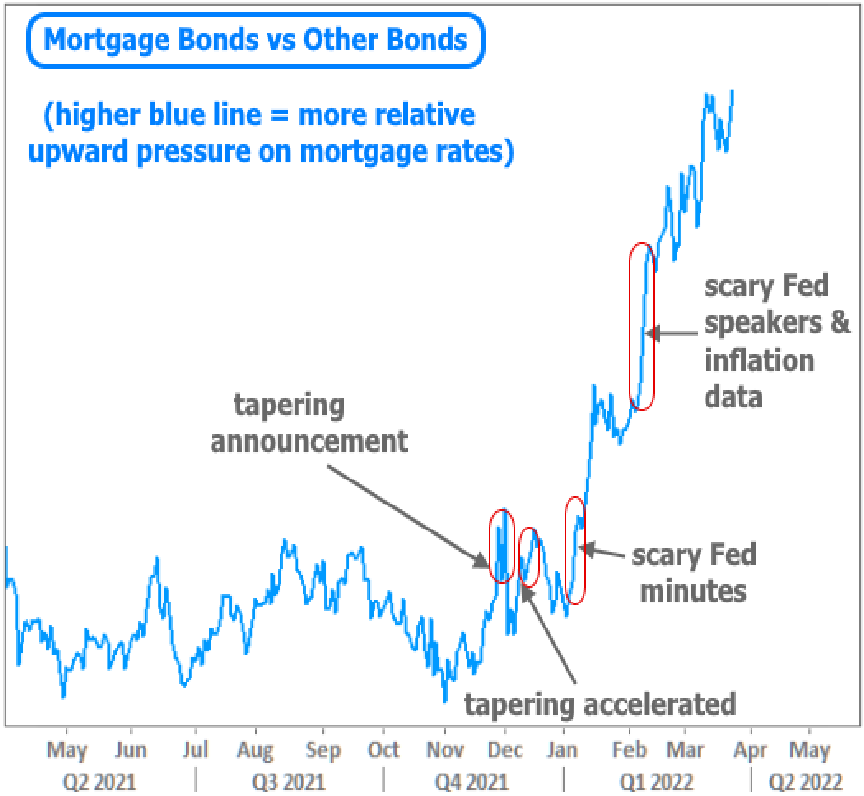
		Value	Change
Mortgage Apps	May 15	198.1	+0.51%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

Last time Fed bond buying fell to "reinvestment only" status, it took **YEARS** for them to finally put caps on reinvestments each month. In so doing, they began to gradually **shrink** their MBS holdings. The technical term for this is "balance sheet normalization" or simply "**normalization.**" Mortgage rates didn't love the idea, but it was gradual enough to be tolerable. Plus, the market had years to prepare.

On January 5th, 2022, the "minutes" were published from December's Fed meeting (this is the normal timeline for Fed announcements, with "minutes" following exactly 3 weeks later). The minutes can reveal additional details that didn't make it into the official policy statement, and that's exactly what happened in this case.

The market learned the Fed was discussing shifting gears into the balance sheet normalization phase **MUCH faster** than precedent suggested. To make matters worse, the committee had been discussing a faster pace of rate hikes than markets expected. Granted, the Fed Funds Rate doesn't directly dictate mortgage rates, but if the market suddenly expects more/faster hikes, interest rates tend to move higher across the board.

The following chart helps us visualize this in terms of the mortgage market. The higher the blue line, the higher mortgage rates are moving relative to other rates (for bond experts who want the technical explanation, this is MBS yield vs Treasury yields with comparable duration).



As mentioned in the chart, scary inflation data is a problem for the Fed's rate hike outlook because controlling inflation is one of the Fed's 2 key policy goals. Incidentally, the other part has to do with "full employment" but since there are more than 100 jobs out there for every 60 people without one, the Fed is understandably just focusing on inflation at the moment. And inflation is... well... you've heard.

When something happens that increases inflation expectations--whether it's a new economic report, or a war in Ukraine that indirectly affects the price of commodities (like gas/oil), or a pandemic that affects the price of so many other things--the market responds by adjusting its expectations for Fed rate hikes. Those expectations translate directly to how actual interest rates are moving. Fed speakers add fuel to this fire by confirming that the market is right to be afraid (both of rate hikes and balance sheet normalization). This paragraph, **more than anything else** in the newsletter, sums up the big problem for rates in 2022.

To be fair, it wouldn't have been as big of a problem if the Fed had been more aggressive in combatting inflation in 2021, but policymakers were afraid of short-changing the economic recovery when new covid variant risks weren't as well-understood. Even then, the Fed likes to move slowly and predictably. Unfortunately, that approach has proven to be extremely ill-advised given current market dynamics. That was already true before the Ukraine war, but doubly true after.

The result is a **RAPID** repricing of expectations as the market moves as quick as it possibly can to get in position for the Fed's probable rate hike path. The following chart shows exactly how traders have been adjusting their bets on the Fed Funds Rate at the end of 2022.

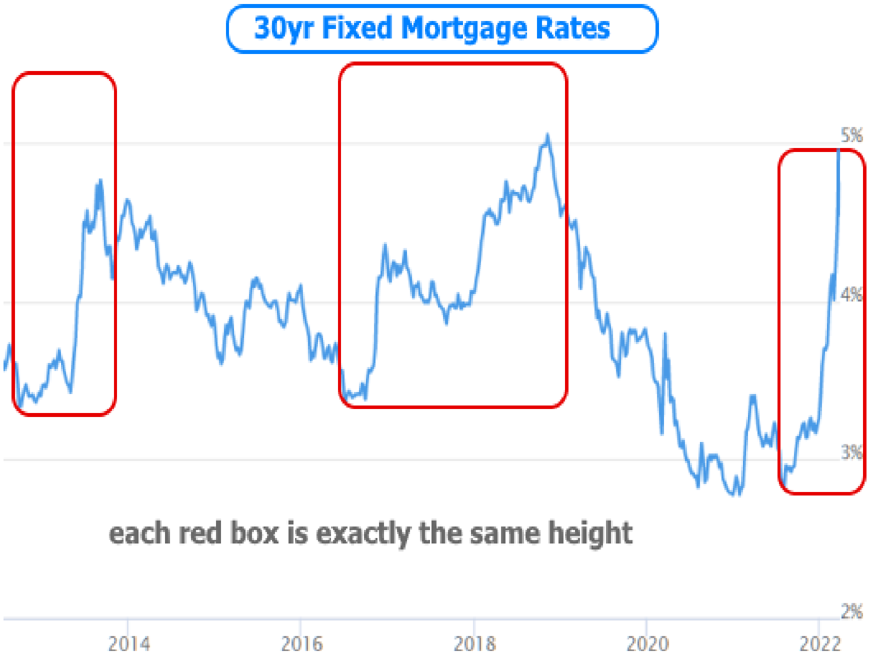
This is an **extraordinarily fast** shift in rate hike expectations. With the Fed Funds Rate currently in the 0.25-0.50 bracket, it would require **EIGHT** rate hikes in the standard 0.25% amount to hit the year-end target. There are only 6 Fed meetings remaining! So at least 2 of those meetings will require a 0.50% hike. It's been more than **20 years** since we've seen a 0.50% hike. Now markets are expecting 2 of them in relatively short order. There's even been talk of a 0.75% hike.

It's this rapid repricing of expectations that makes things so volatile right now. Again, the Fed funds rate doesn't directly dictate mortgage rates, but this unprecedented shift (complicated by the unexpected war in Ukraine) is sending shockwaves throughout the rate markets. Mortgages are taking some extra damage because they're more reliant on Fed bond buying than Treasuries (and the Fed stated a preference to hold only Treasuries in the future. Double whammy!).

The net effect for mortgage rates is the fastest spike since 1994, assuming a time frame of several months. In terms of single week time frames, we figured the record set on Friday, June 21st, 2013 would stand for a long time and that nothing else would ever really come too close. The good news is that the record +(0.52%) still stands.

The bad news is that after this most recent Friday, the record **JUST BARELY stands!** The average lender moved higher by 0.49% this week. Considering mortgage lenders offer rates in set increments (.125, .25, .375, .5, etc) this is basically a tie. The average borrower would see a rate quote that is 0.50% higher this Friday vs last Friday in both occasions.

Moving beyond a 1 week time frame and nothing else in more than 25 years even comes close (you'd have to go back to 1994, and even then it's a close call).



There is **hope on the horizon**, however. It may sound trite, but the higher rates go and the faster they get there, the sooner the next period of relative stability can begin. This can happen even as the Fed continues to hike rates because the mortgage and Treasury markets are making immediate changes based on **future** expectations. When the future plays out as expected, it doesn't imply any change to the rates we're currently seeing (indeed, it's been the CHANGE in future expectations that's hurt rates so badly).

This **doesn't** mean rates won't go any higher. But it **does** mean that they've clearly already put in a lot of work toward reaching their next peak. Any additional surprises will depend on incoming data and events--especially inflation related data and geopolitical events that greatly affect the outlook for growth or inflation.

Subscribe to my newsletter online at: http://housingnewsletters.com/clicknfinance

Recent Economic Data

Date	Event	Actual	Forecast	Prior
Wednesday, Mar 23				
7:00AM	w/e MBA Purchase Index	265.4		269.5
7:00AM	w/e MBA Refi Index	1522.7		1778.3
10:00AM	Feb New Home Sales (%) (%)	-2.0		-4.5

Event Importance:

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

Date	Event	Actual	Forecast	Prior
10:00AM	Feb New Home Sales (ml)	0.772	0.810	0.801
10:30AM	w/e Crude Oil Inventory (ml)	-2.508	0.114	4.345
Thursday, Mar 24				
8:30AM	Feb Durable goods (%)	-2.2	-0.5	1.6
8:30AM	w/e Jobless Claims (k)	187	212	214
9:45AM	Mar Markit Composite PMI	58.5		55.9
Friday, Mar 25				
10:00AM	Feb Pending Sales Index	104.9		109.5
10:00AM	Mar Consumer Sentiment (ip)	59.4	59.7	59.7
Monday, Mar 28				
11:30AM	2-Yr Note Auction (bl)	50		
1:00PM	5-Yr Note Auction (bl)	51		
Tuesday, Mar 29				
9:00AM	Jan Case Shiller Home Prices-20 y/y (%)	19.1	18.4	18.6
9:00AM	Jan FHFA Home Prices y/y (%)	18.2		17.6
10:00AM	Mar Consumer confidence	107.2	107.0	110.5
1:00PM	7-Yr Note Auction (bl)	47		
Wednesday, Mar 30				
7:00AM	w/e MBA Purchase Index	267.1		265.4
7:00AM	w/e MBA Refi Index	1295.1		1522.7
8:15AM	Mar ADP National Employment (k)	455	450	475
8:30AM	Q4 GDP Final (%)	6.9	7.1	7.0
Thursday, Mar 31				
8:30AM	Feb Core PCE Inflation (y/y) (%)	5.4	5.5	5.2
9:45AM	Mar Chicago PMI	62.9	57.0	56.3
Friday, Apr 01				
8:30AM	Mar Non-farm payrolls (k)	431	490	678
8:30AM	Mar Unemployment rate mm (%)	3.6	3.7	3.8
10:00AM	Feb Construction spending (%)	0.5	1.0	1.3
10:00AM	Mar ISM Manufacturing PMI	57.1	59.0	58.6

Because Integrity Matters™

Jeffrey has spent the last three decades perfecting an Honest, Open and Transparent (HOT™) loan and closing process that is laser-focused on enhancing the consumer mortgage experience. By combining old-school, trustworthy customer service with real-time, mobile-friendly technology, he has successfully built thousands of loyal, raving fans.

Jeffrey Chalmers