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The Paradox of Central Banks and The Mortgage Market

Ever since the Fed stepped in to save the mortgage market in 2008 by announcing that it would buy mortgage-backed-securities, the relationship between central banks and financial markets became more **intertwined** than it already was.

While it was the Fed's bond buying programs that had the most forceful impact on mortgage rates over the years, Fed policy continues to play an important role in shaping the movement of the **entire financial market**. In fact, financial markets (including the bond markets that drive mortgage rates) are arguably more sensitive to central bank policy now than ever before.

The **reason for this is simple**: the world's biggest central banks have never been doing so much to stimulate their respective economies. As the current business cycle matures (translation: stock markets might be topping out after 7 year rally—something they've done twice in a row now), investors worry about the economy's ability to sustain further growth without central banks keeping the accommodation flowing.

Accommodation can refer to asset purchases like the Fed's quantitative easing measures or simply to low rates. In general, when central banks offer more accommodation, it helps stocks move higher and rates move lower—which is the opposite of their typical relationship. We've seen several great examples in recent weeks and they highlight the market's sensitivity to central bank policy.

Earlier in the month, the simple statement from European Central Bank President Mario Draghi that further rate cuts were unlikely (they're already in negative territory, by the way!) was enough to push rates higher and stocks lower (which means they're both improving, because lower rates result from higher bond prices). Two weeks ago, the softer stance in the Fed Announcement pushed stocks and rates in opposite directions again. Now this week, Fed Chair Yellen gave a speech that reiterated the Fed's more cautious outlook and **yet again**, rates and stocks improved in unison.

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.28%	-0.09	0.00
15 Yr. Fixed	6.75%	-0.07	0.00
30 Yr. FHA	6.70%	-0.12	0.00
30 Yr. Jumbo	7.48%	-0.07	0.00
5/1 ARM	7.35%	-0.07	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00

Rates as of: 5/3

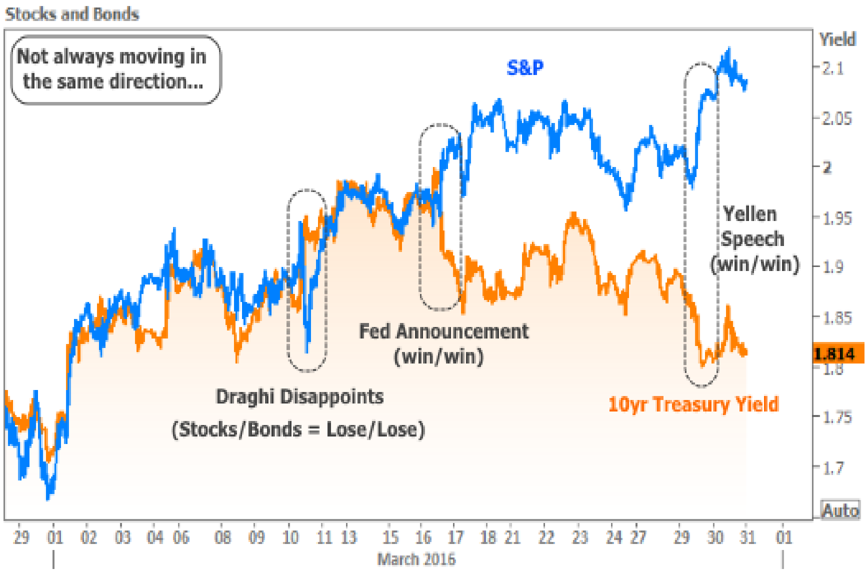
Market Data

	Price / Yield	Change
MBS UMBS 6.0	100.09	+0.31
MBS GNMA 6.0	101.03	+0.29
10 YR Treasury	4.5138	-0.0657
30 YR Treasury	4.6711	-0.0579

Pricing as of: 5/3 5:04PM EST

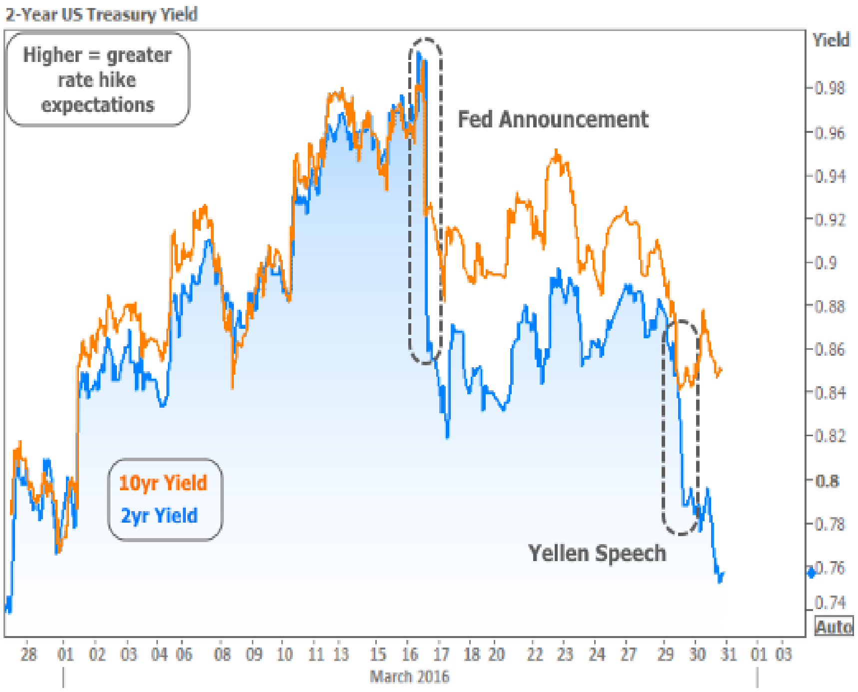
Recent Housing Data

		Value	Change
Mortgage Apps	Apr 24	196.7	-2.67%
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%



This phenomenon whereby stocks rise and rates fall is indicative of the paradox of Central Bank policy with respect to mortgage rates. **"Accommodation" is theoretically good** for the economy in the long term, and a stronger economy ultimately supports higher rates. Yet that same accommodation can take the form of lower policy rates. In other words: lower rates can mean higher rates. Wait, what?!

We **can come to terms with the paradox** by remembering that there are different kinds of rates. The biggest difference between otherwise similar rates is their duration (i.e. 10yr Treasury notes vs 2yr Treasury notes). Investors' appetites for various durations are greatly informed by Fed policy. It's the shorter durations that are most receptive to the Fed's rate stance, as we can see in the following chart (we're using 10yr Treasuries as a proxy for minute-to-minute mortgage rate momentum because mortgage rates usually only change once or twice per day. Thus 10yr Treasuries show more variation, while remaining almost perfectly analogous to 30yr fixed mortgage rates over time).



What does it all mean to you? It may mean different things to different people, but my goal is to convey that what happens to the Fed Funds Rate won't necessarily happen to mortgage rates. It's a longshot, but if the Fed is able to able to keep rates at a level that ultimately generates inflation without crippling growth, folks on the news will be talking about the Fed's low rates while mortgage rates will be moving up.

As for now, there **doesn't seem to be too much belief** in that scenario, and thus we're seeing rates return to recent multi-week lows. Even so, some investors took Yellen's speech as a vote of confidence in the Fed doing what it takes to create inflation/growth. The alternative is that Yellen's speech suggests the Fed is more concerned about the global economy than previously thought. One of these camps will win, and rates will move accordingly.

Housing-Specific Data

This week's housing-related data was mostly limited to home price reports. Case-Shiller and Black Knight were both fairly close to each other in reporting 5.4 and 5.3 percent year-over-year growth respectively. There are **notable differences** in geography though, with Case-Shiller pointing out double digit annual growth in the West and Black Knight focusing on more recent growth in Eastern states.

If housing prices aren't likely to go lower any time soon, can we at least hope for **easing credit standards** to help the affordability picture? A recent Fannie Mae survey of lender sentiment suggests that underwriting may be leveling off and unlikely to get much looser.

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Monday, Mar 28				
8:30AM	Feb PCE price index mm (%)	-0.1		0.1
8:30AM	Feb Core PCE price index mm (%)	+0.1	0.2	0.3
8:30AM	Feb Personal consump real mm (%)	+0.2		0.4
10:00AM	Feb Pending homes index	109.1		106.0
Tuesday, Mar 29				
9:00AM	Jan CaseShiller 20 mm SA (%)	+0.8	0.7	0.8
10:00AM	Mar Consumer confidence	96.2	94.0	92.2
Wednesday, Mar 30				
7:00AM	w/e Mortgage Refinance Index	1784.7		1845.4
7:00AM	w/e MBA Purchase Index	228.6		224.0
8:15AM	Mar ADP National Employment (k)	200.0	194	214
Thursday, Mar 31				
8:30AM	w/e Initial Jobless Claims (k)	276	270	265
8:30AM	w/e Continued jobless claims (ml)	2.173	2.175	2.179
9:45AM	Mar Chicago PMI	53.6	50.0	47.6
Friday, Apr 01				
8:30AM	Mar Manufacturing payrolls (k)	-29	2	-16
8:30AM	Mar Unemployment rate mm (%)	5.0	4.9	4.9

Event Importance:

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

Date	Event	Actual	Forecast	Prior
8:30AM	Mar Private Payrolls (k)	+195	197	230
8:30AM	Mar Non-farm payrolls (k)	+215	205	242
10:00AM	Feb Construction spending (%)	-0.5	0.1	1.5
10:00AM	Mar ISM Manufacturing PMI	51.8	50.7	49.5
Monday, Apr 04				
9:45AM	Mar ISM-New York index	721.0		720.8
10:00AM	Feb Factory ex-transp mm (%)	-0.8		-0.2
Tuesday, Apr 05				
8:30AM	Feb International trade mm $ (bl)	-47.06	-46.2	-45.7
10:00AM	Mar ISM N-Mfg PMI	54.5	54.0	53.4
10:00AM	Mar ISM N-Mfg Bus Act	59.8	57.4	57.8
Thursday, Apr 07				
3:00PM	Feb Consumer credit (bl)	+17.22	14.74	10.54

All Your Mortgage Needs, Professionally Delivered with a Personal Touch

Whether you're a first-time homebuyer hoping to navigate the process of buying a home so that it is a fun and anxiety-free process or a homeowner looking for refinance options that deliver more freedom and flexibility, I can help you analyze your current situation and find money saving options. With expertise in all areas of mortgage and financing, my hope is that once I become your mortgage partner, I'll stay your mortgage partner. With clients from A to Z, files never leave my hands or my desk. From start to finish, every step of the way, my goal is to keep the lines of communication open, provide complete and attentive service, and ensure the most seamless and satisfactory process possible.

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