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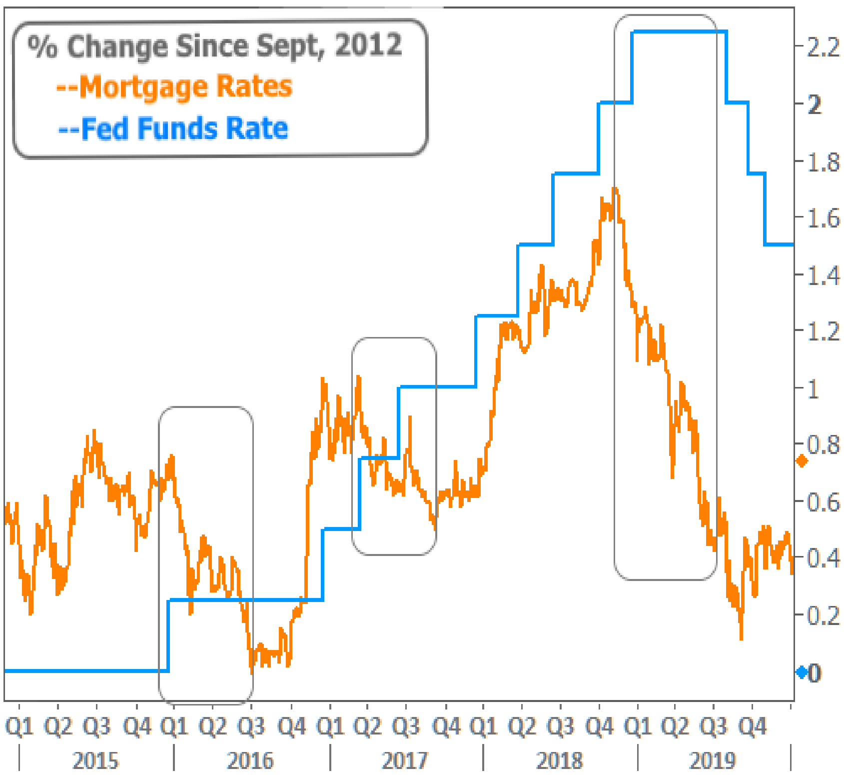
Highest Mortgage Rates in 3 Years After Fed Hikes, But Is There a Connection?

Mortgage rates are based on movement in the bond market, and as of the middle of this week, bonds had lost a good amount of ground every day for **8 straight days.** With that, the average 30yr fixed rate officially hit its highest level in 3 years. That happened on the same day that the Federal Reserve hiked rates for the first time since 2018, but is there a connection?

The Fed's relationship with mortgage rates is quite interesting. The most popular misconception is that a Fed rate hike means higher mortgage rates, but that's not exactly how it works. In fact, there are many examples of the Fed hiking rates only for mortgage rates to fall.



Despite the paradoxical reality highlighted above, the Fed nonetheless has an extraordinary amount of influence over mortgage rates. One reason we don't see a more immediate correlation is that mortgage rates move every day whereas the Fed only meets to make rate decisions 8 times per year. The Fed also does a fairly good job of telegraphing probable rate changes (e.g. this week's was a 100% foregone conclusion). That gives the mortgage market

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	4.4884	-0.0254
30 YR Treasury	4.6486	-0.0225

Pricing as of: 5/6 7:56AM EST

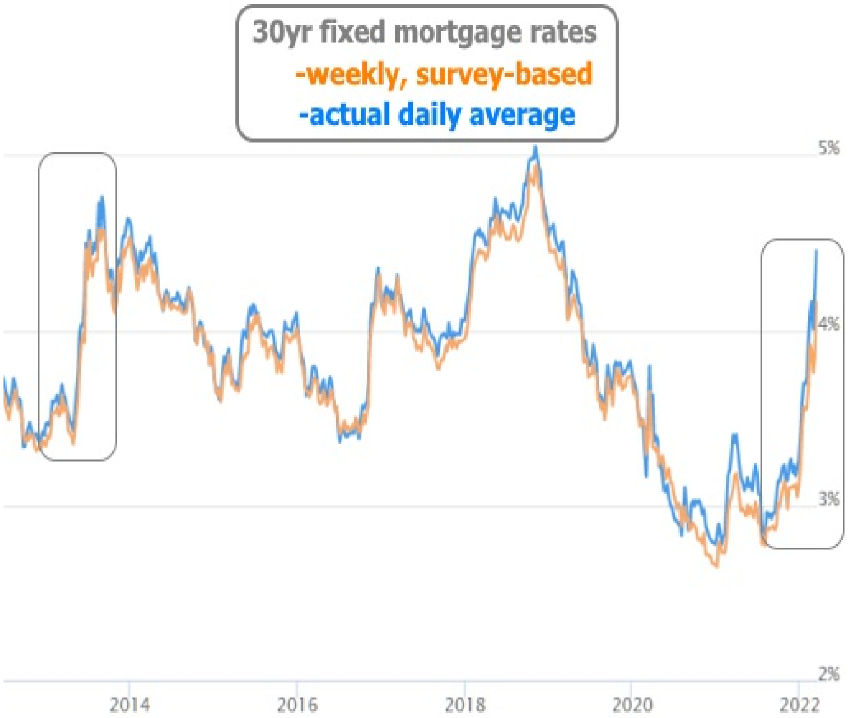
Recent Housing Data

		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%

ample time to adjust to changes in Fed policy before they happen.

The Fed also has other tools that affect mortgage rates, most notably, it buys Treasuries and mortgage-backed bonds (the financial instruments that most directly affect mortgage rates). When it merely **signals** an end to those buying programs, rates tend to spike rapidly. By the time changes are actually made, the market has already taken a majority of its lumps.

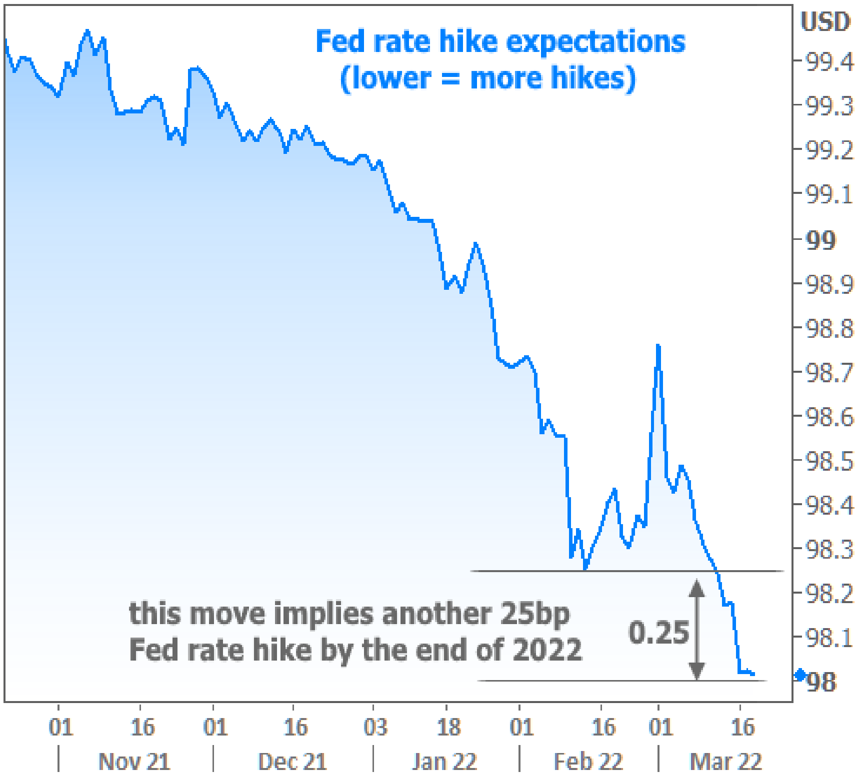
With mortgage rates having risen at the historically rapid pace of 1.25% in 2.5 months, we've certainly taken quite a few of the lumps destined for this particular bout of Fed policy tightening. Whether it's a true "majority" remains to be seen, but that's certainly possible. If it feels too early to start thinking about a supportive ceiling in mortgage rates despite the numerous additional Fed rate hikes expected over the course of 2022, consider what the mortgage market has already done to adjust for a less friendly Fed. In the following chart, both rectangles are the same size. In other words, the current rate spike is already bigger than that seen during 2013's infamous "taper tantrum."



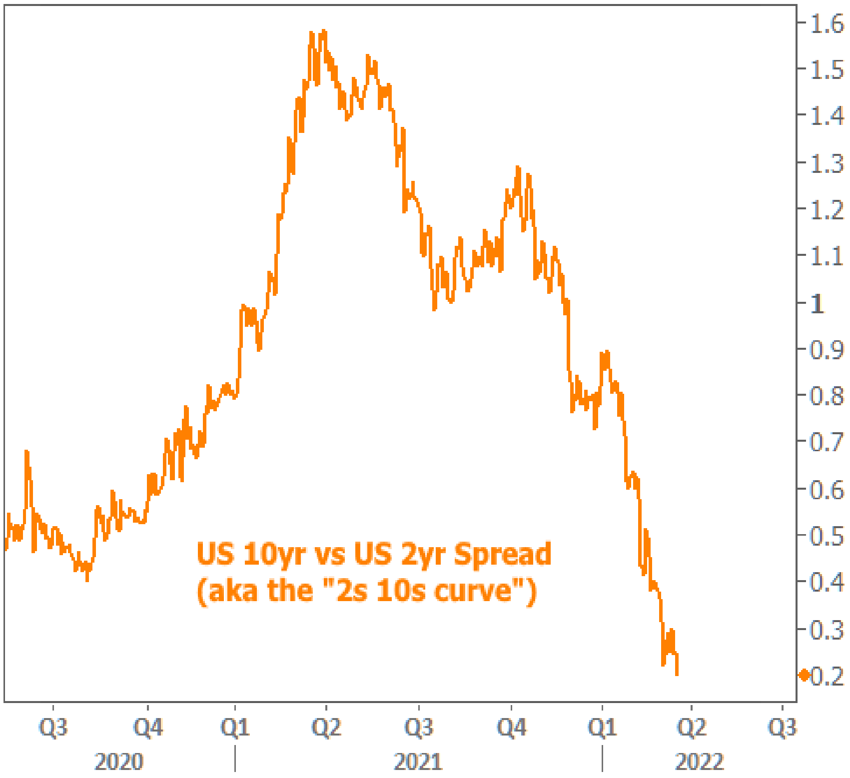
To be clear, this by no means guarantees a bounce. The only point is to convey that the bond market does what it can to move in advance of shifts in Fed policy. We won't really know the extent of that achievement until we see where things actually bounce.

Beyond that, there are big picture bounces and smaller scale corrections. It's too soon to discuss a big picture bounce, but this week's market movement suggests we're currently in the middle of one of those small scale corrections. This can be seen in the following chart of 10yr Treasury yields where momentum has shifted from "skyrocketing" at the beginning of last week to "consolidating" (higher lows and lower highs) by the end of the current week.

That's the 10yr though, and it hasn't been tracking with mortgage rates as well as it usually does. Shorter-term Treasuries (like the 2yr) have been doing much worse because they're much closer in duration to the Fed Funds Rate (the thing everyone is talking about when they say "the Fed hiked rates"). The Fed Funds Rate applies to money that's borrowed for less than 1 day, and there's much less of a gap between 1 day and 2 years than between 2 years and 10 years. With that in mind, here's what the market thinks about where the Fed Funds Rate is going:

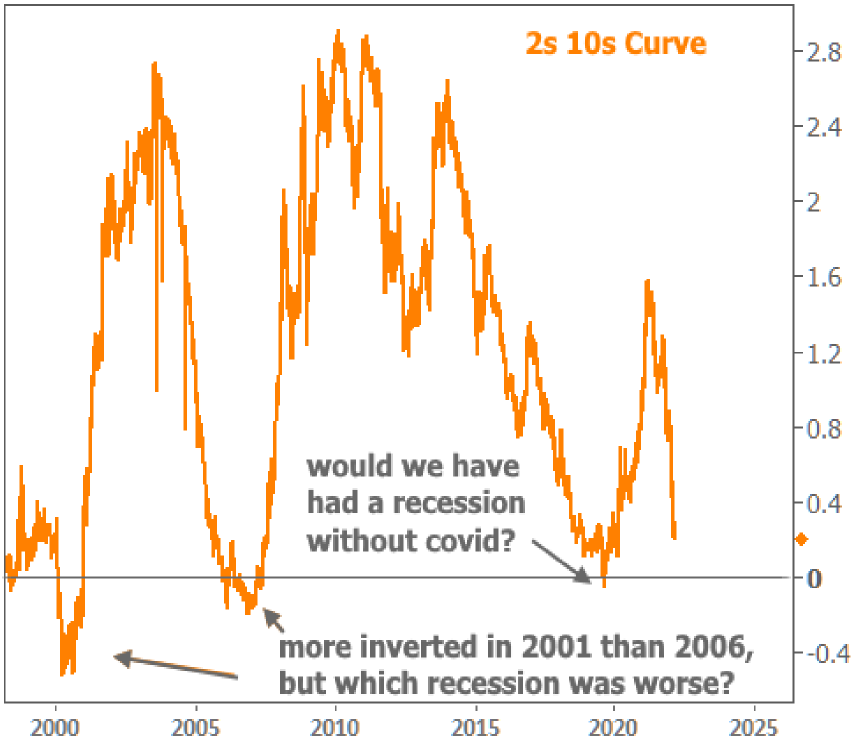


In other words, this week's Fed announcement helped the market understand that the fallout from the Ukraine war does nothing to slow down the rate hike outlook. If anything, the Fed is concerned it will only add to inflation, thus forcing even faster rate hikes (markets now see another 25bp hike compared to last week). To reiterate, the Fed Funds Rate has a bigger impact on shorter-term bonds. 10yr Treasuries, on the other hand, are more protected. The following chart shows the gap between 2yr and 10yr Treasury yields. The lower the line, the lower 10s are compared to 2s.



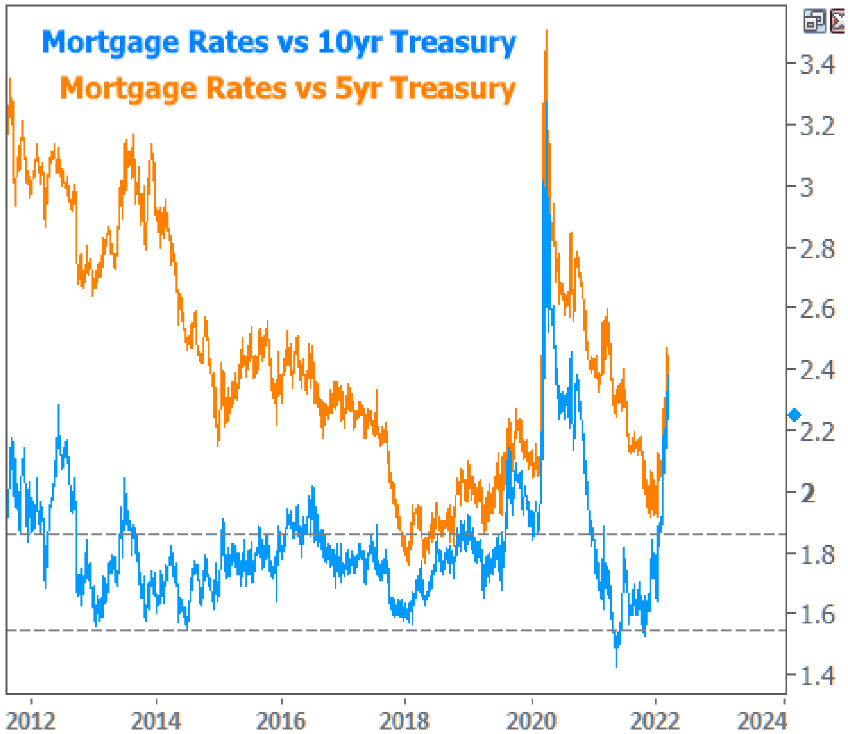
The 2s 10s curve (or "yield curve") is often discussed as a surefire recession indicator when the orange line goes below zero (aka "inverted yield curve"). If the current trend continues, it won't be long before the curve inverts again. But is it a surefire sign of recession?

All we can know is that it has generally been this way in the past. We don't really have any great examples of curve inversion in the age of quantitative easing (the Fed's big bond buying campaigns). As seen below, 2019 is the only candidate, and we'll never know if that microscopic curve inversion would have brought about a recession because covid happened a few months later. One thing we **CAN** observe about the yield curve is that the size of the inversion does **NOT** correlate with the size of the recession. So at the very least, this may be an imperfect predictive tool, but only time will tell.



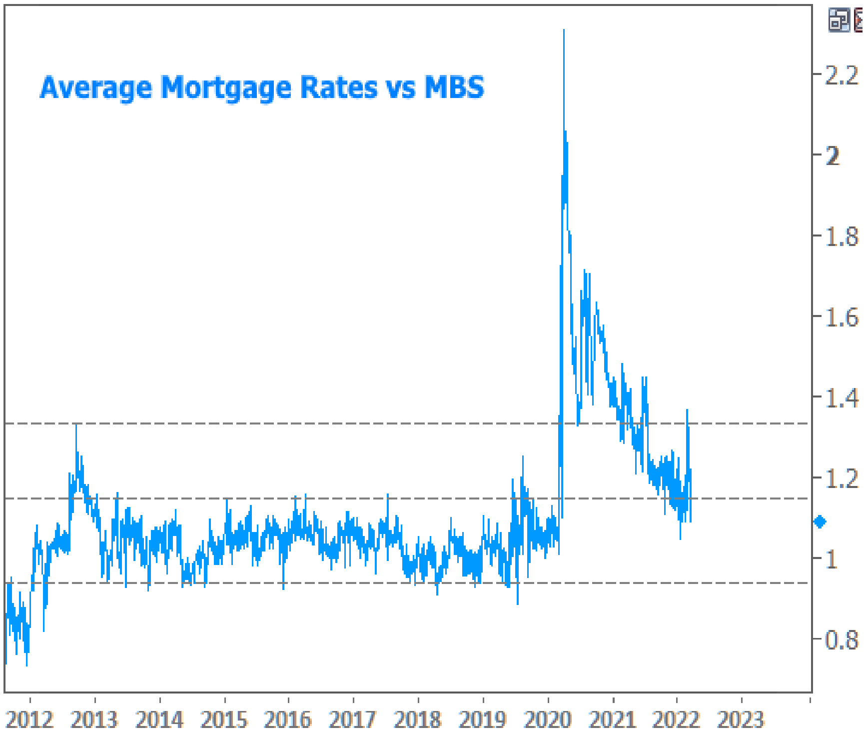
To bring all of this esoteric "yield curve" business back to the world of mortgage rates, it's important to understand that, although a 30yr fixed mortgage may technically be able to last 30 years, most don't. The average life span tends to operate in a 5-10 year range. It's always a bit of a moving target because it's a consumer's choice to move or refinance. Analysts agree that the average life span is much shorter than normal right now and that's not doing mortgage rates any favors.

To understand why, just consider the 2yr vs 10yr concept above. In that example the shorter-term rate is moving higher faster than the longer-term rate. The same holds true for 5yr Treasury yields, which are a much more direct match for the estimated life span of a mortgage these days. As such, it's no surprise to see mortgage rates doing better versus 5s than 10s. The following chart shows the gap between 30yr fixed rates and 5/10-year Treasury yields. The higher the line, the worse mortgage rates are doing compared to the broader bond market.



Even when we focus on the 5yr Treasury note, mortgage rates are still spiking by comparison. This is a result of multiple factors. Some of them have to do with esoteric bond valuation issues that arise at times of rapid market movement. The simplest factor, however, is that the Fed is no longer buying new MBS or Treasuries and relative to the total size of the market, the Fed constituted a bigger percentage of guaranteed buying demand for mortgages. Lower relative demand = lower prices and higher yields (aka "rates") all other things being equal.

Are lenders being greedy? Actually, no. The following chart shows the average 30yr fixed rate versus mortgage-backed securities (MBS) levels. The lower the line the tighter lender margins are, in general. Due to increased costs that hit the market after covid, we wouldn't expect a quick return to the historical baseline, but other than that, margins are as tight as they've been since the start of the pandemic.



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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Mar 15				
8:30AM	Feb Core Producer Prices YY (%)	8.4	8.7	8.3
8:30AM	Feb Core Producer Prices MM (%)	0.2	0.6	0.8
Wednesday, Mar 16				
7:00AM	w/e MBA Refi Index	1778.3		1829.7
7:00AM	w/e MBA Purchase Index	269.5		267.6
8:30AM	Feb Retail Sales (%)	0.3	0.4	3.8
8:30AM	Feb Import prices mm (%)	1.4	1.5	2.0
10:00AM	Mar NAHB housing market indx	79	81	82
2:00PM	N/A FOMC rate decision (%)	0.250 - 0.500	0.375	0.125
2:30PM	Powell Press Conference			
Thursday, Mar 17				
8:30AM	Feb Building permits: number (ml)	1.859	1.850	1.895
8:30AM	Feb Build permits: change mm (%)	-1.9		0.5
8:30AM	Feb Housing starts number mm (ml)	1.769	1.690	1.638
8:30AM	Feb House starts mm: change (%)	6.8		-4.1
8:30AM	Mar Philly Fed Business Index	27.4	15.0	16.0
8:30AM	w/e Jobless Claims (k)	214	220	227

Event Importance:

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

Date	Event	Actual	Forecast	Prior
9:15AM	Feb Industrial Production (%)	0.5	0.5	1.4
Friday, Mar 18				
10:00AM	Feb Exist. home sales % chg (%)	-7.2	-1.0	6.7
10:00AM	Feb Existing home sales (ml)	6.02	6.10	6.50
10:00AM	Feb Leading index chg mm (%)	0.3	0.3	-0.3
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
10:00AM	Feb New Home Sales (ml)	0.772	0.810	0.801
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
10:00AM	Mar Sentiment: 1y Inflation (%)	5.4		5.4
10:00AM	Feb Pending Home Sales (%)	-4.1	1.0	-5.7
10:00AM	Mar Sentiment: 5y Inflation (%)	3.0		3.0

5 Ways to Save Money on Vacation Rental Properties

1. Rent directly through property owners: If you book an apartment, condo or house through an owner rather than a property management company or resort, you can sometimes avoid the mark-ups charged by the middleman.

2. Book at the right time: According to NerdWallet, the best time to book an Airbnb in order to score the lowest median price was four weeks in advance.

3. Be flexible with your dates: Rental property rates vary a lot throughout the year, though rates are higher during an area's peak season. For this reason, being flexible with your travel dates can help you save some cash.

4. Book properties farther away from popular tourist attractions: Proximity typically comes with a price, so look for places that are farther from the tourist hot spots. For example, beach houses that are a few blocks from the ocean typically are several hundred dollars cheaper per week (or even per night) than beachfront properties.

5. Find friends to split the cost with you: With vacation rental properties, you have the option to book an entire home. If you can find another family or friends to travel with you, you might pay less for a big home once you split the cost than if you booked a property just large enough to accommodate your family.

Contact me for more information. 702-303-0243 or TPayne@loandepot.com

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