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A Message from Ted Rood:

"Great, great insight by Matthew Graham here. Pure eloquence on the Fed's role in shaping economic policy."

Trump Vs The Fed: A Public Service Announcement

Mortgage rates **did nothing interesting** today, as is typical for the days before and after a major holiday. Tangentially related and significantly more interesting is the President's criticism of the Fed and Fed Chair Powell. I think this is very much worth discussing around the holiday table (not politics, but rather, fiscal and monetary policy's effect on interest rates).

Before I continue, I'd like to go on the record as being devoutly politically agnostic. Everything I've written for the past 12 years here is on record, unedited. Feel free to browse back through the pages of history. You'll find no evidence of political bias. The same will be true of the following. I'm strictly commenting on the realities of fiscal and monetary policy. I don't care who's in office, but I care about what's true. By virtue of his office, the President gets the most air time and attention on these matters. He happens to be wrong on a few important points here, so I encourage you to share and discuss what follows.

Puppet Masters?

There's a tendency to think of the Federal Reserve as some sort of master of puppets, pulling the strings of the economy in a reckless, ill-advised, or manipulative way. Sadly, the reason for this is simple: the Fed isn't political. If you're a politician, you can talk trash about them and they won't be airing a negative campaign ad about you. They won't even really call you out very bluntly in congressional testimonies. At the same time, they are in charge of setting an extremely important policy tool that has the word "RATE" right in it! They're the perfect scapegoat in that regard.

To be fair, the Fed has certainly made mistakes. Their policies have certainly had unintended consequences. And those decisions certainly could have been made in such a way as to lessen those consequences. That said, Fed policy really only amounts to fine-tuning. The Fed has a range of responses to certain economic realities. Whether they err on the aggressive or conservative side of those policies, it's the underlying economic realities that are truly accounting for changes in rates in the long run.

National Average Mortgage Rates



Mortgage News Daily	Rate	Change	Points
30YR Fixed	7.51%	+0.01	0.00
15YR Fixed	7.04%	+0.01	0.00
30YR FHA	7.08%	+0.03	0.00
30YR Jumbo	7.52%	+0.02	0.00
7/6 SOFR	7.12%	-0.01	0.00
30YR VA	7.10%	+0.03	0.00

Rates as of: 11/16

MBS and Treasury

	Price / Yield	Change
MBS UMBS 6.0	98.68	-0.01
10 YR Treasury	5.1281	-0.0061
30 YR Treasury	5.4763	+0.0005

Pricing as of: 11/16 7:51PM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Nov 4	204.6	+6.23%
Building Permits	Sep	1.4M	+0.43%
Housing Starts	Sep	1.22M	-4.24%
New Home Sales	Sep	676K	-1.17%
Pending Home Sales	Aug	71.2	0%
Existing Home Sales	Oct	3.99M	+0.25%
Builder Confidence	Oct	29	-9.38%

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Specifically, we know the Fed will raise rates based on some favorable combination of "full employment" and "price stability." Both those terms are open to some interpretation (hence the Fed's range of possible stances, and the resulting criticism), but generally speaking, decades-low unemployment and core inflation running around 2% fit the bill. We have both of those things right now, so it's hard to begrudge the Fed its slowest-paced rate hikes in modern economic history.

One might argue that the Fed should slow its pace of rate hikes due to the risk of an economic downturn. The Fed would be the first to agree with that contention, and I'd argue that any marked deterioration in economic data will almost certainly prevent the Fed from hiking rates in 2019. As it stands, they've just taken the opportunity at last week's meeting to decrease their forecast pace of hikes. That was a big deal as it's the first time it's happened since they began this rate hike cycle.

The bottom line to this "puppet master" label is that the Fed is more like the spotlight guy. They can choose to focus the light on certain parts of the stage. They could make the light bigger, smaller, or change the color. But ultimately, they didn't write the script. They didn't choreograph what's happening on stage. And the only way they could impact what's happening on stage is to do such a wild job with the spotlight that the actors on the stage begin reacting to it.

Why is the Fed being blamed?

To be clear, the Fed can certainly have a huge impact on interest rates. This was especially true of the quantitative easing era when they were buying huge amounts of Treasury and Mortgage-Backed Securities. The Fed used those tools to engineer a softer landing from the financial crisis, and they were only ever intended as temporary. They've clearly laid out (and largely executed) their gameplan for unwinding those policies. That game plan has been spelled out in black and white since June 2017, and the Fed has been hiking rates since December 2015. No one has taken exception to either policy until the stock market began tanking in Q4 2018.

If you read nothing else, read the previous paragraph again. I'll say it another way: the Fed's game-plan has been common knowledge for a year and a half. Before that, market mavens criticized the Fed for not raising rates and removing its bond-buying policies more quickly! There's been very little criticism of the Fed in 2018. In fact, I've never seen less criticism of the Fed in the 15+ years I've been watching them closely. It was only when stocks began tanking that criticism ramped up.

The Fed Funds Rate is a Red Herring

As we discussed above, it's been the Fed's bond-buying policies that have resulted in the biggest criticism over the years. The most recent criticism is centered on "higher rates killing the economy." Again, the Fed only has a limited range of actions when it comes to hiking their rate. No one disagrees that rate hikes were needed, and most still agree that 3.7% unemployment and 2.2% core inflation keep the Fed well within its rights to continue hiking.

But alas! The Fed Funds Rate is a red herring when it comes to "interest rates killing the economy." Rates, in general, rise for their own reasons and the Fed merely responds to the same underlying reasons. If one wishes to argue that higher rates are killing the economy, that's worth discussing, but it would be just as important to discuss why rates, in general, have risen.

So why have rates been rising overall?

Rates hate a few things: inflation, economic growth, strong stock markets (apart from the quantitative easing era where rates and stocks benefited simultaneously), and importantly, excess supply of debt for investors to buy. "Buying debt" is the same thing as investing in a loan, or loaning someone money. The more loans that are put up for sale, the more the borrower needs to pay in order to find an investor to buy it. Bottom line: rising supply of debt = higher rates, assuming the same level of demand.

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This supply/demand equation is extremely relevant because the President's tax bill created a revenue shortfall that had to be offset with increased borrowing (aka debt/supply) on the part of the US Treasury. This was one of the primary reasons rates moved higher as quickly as they did in 2017/2018. In addition to increased debt supply, the tax bill also had stimulative connotations for the economy as well as inflationary implications due to economic growth. In other words, the President did something that A)stood a good chance of stimulating an economy that was already doing just fine, B)creating inflationary pressures resulting from increased economic growth, and C)increased Treasury issuance all at once. It was the worst thing that could have happened to interest rates at the time.

Connecting the Dots

Simply put, a stock sell-off begs for scapegoats. The fed is an easy target, but it's been fiscal policy that's choreographed most of the upward pressure in rates over the past few years. The Fed just mans the spotlight. You can be sure that there would be no news about criticism of Fed policy if the stock market were still pushing into new all-time highs.

Most importantly, PLEASE NOTE that BOTH long and short-term rates have fallen significantly over the past 2 months. If stocks were truly so concerned about "higher rates," this significant reduction in rates should be worth some solace. Yet here we are on Christmas Eve with rates hitting their lowest levels in more than 6 months while stocks continue moving lower. The only conclusion is that stocks aren't nearly as concerned by higher rates as some might suggest.

The fact is that economic cycles don't last forever. Stocks may be sensing the mortality of this cycle. It's been one of the longest and biggest ever. It will eventually turn a corner no matter what interest rates are doing and no matter what fiscal policies are in play. It's a mistake to blame the Fed for causing the cycle. Such things are too complex and multifaceted to merit such myopic blame. Don't let the news make you dumber this Christmas. But be sure to fight that fight without getting political about it! No one needs that.

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Responsive service, experienced expertise

I've dedicated my 26 year mortgage career to client education, superior service, and honest answers. The lending landscape has changed dramatically the past few years, and continues to do so. My job is to ensure client partners' loans close quickly, without surprises, and I take that responsibility very seriously. Referrals are a responsibility I appreciate; they're a measure of trust, and that trust must be earned every day, on every referral.

Ted Rood 

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