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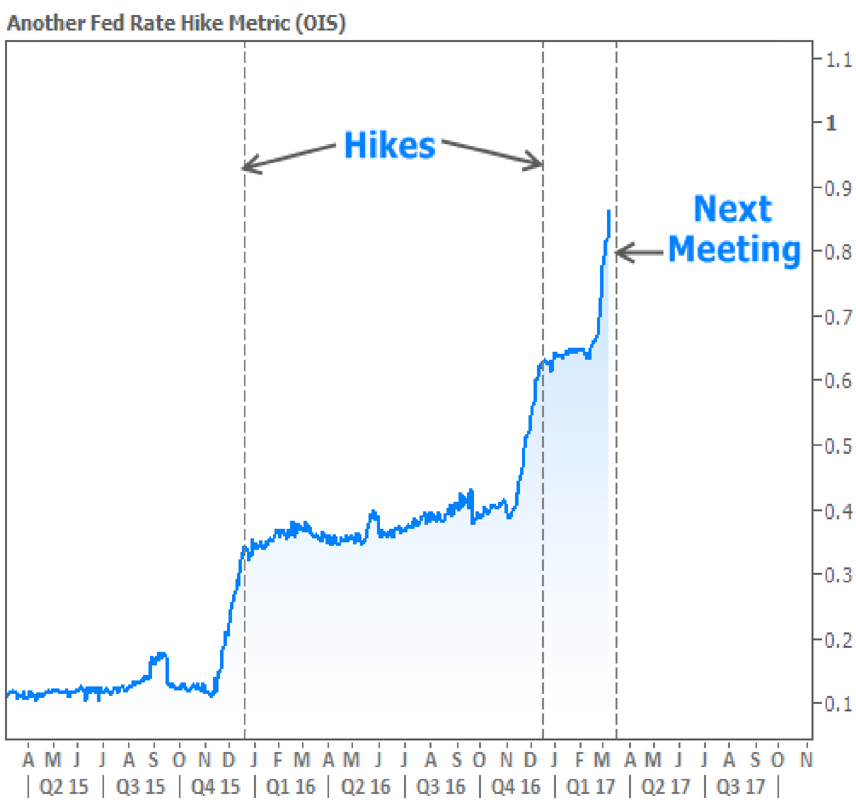
Fed Rate Hike Next Week is Pointless!

Next week's Fed announcement is a hot topic. Market metrics and surveys of economists suggest ever-increasing odds of a rate hike. As such, it may come as a surprise to learn that a rate hike is **pointless** in terms of its impact on financial markets, but there's a catch.

It's pointless because at **no time** in recent memory have financial markets been so certain that the Fed will make a particular move. There's actually no way a Fed rate hike could be any **more** likely than market metrics suggest.

Among those metrics, one of the most reliable is the "overnight-indexed swap" market (or "OIS"). Simply put, it reflects the rate banks are charging each other for short-term borrowing. Given that the Fed Funds Rate is the **final word** in short-term borrowing, OIS closely tracks the expected Fed Funds Rate in the month leading up to a potential rate hike. This is easy to see in the following chart.



The trajectory of the blue line over the past month means billions of dollars are **already actively prepared** for next week's hike... done deal... pointless to wonder anymore. It would take something truly astonishing (in a bad way)

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%

for that to change.

But while the rate hike itself is pointless, the Fed meeting will still be quite relevant. In fact, another piece of info coming out on Wednesday afternoon will likely be **the most important** data of the week.

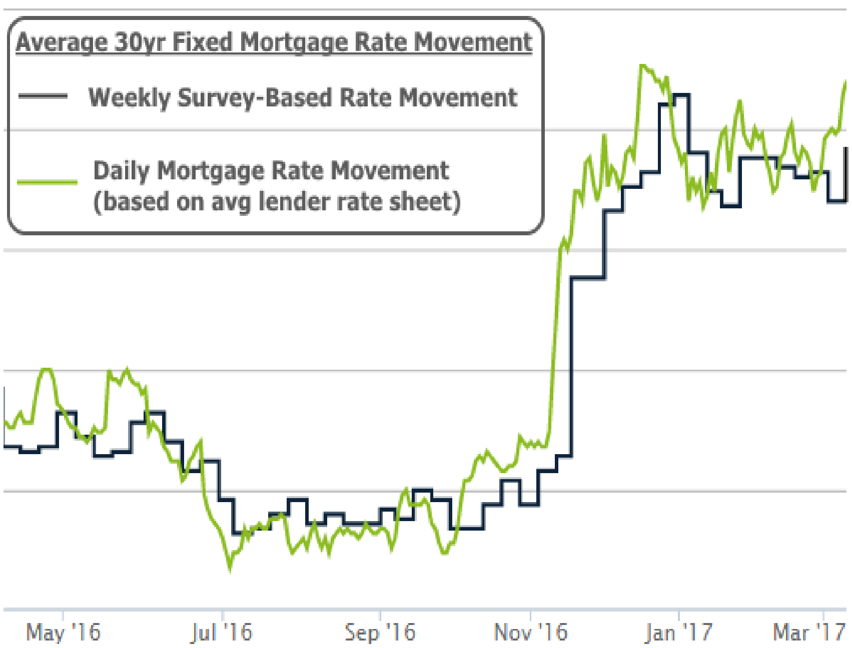
Along with the policy statement (where the Fed officially announces the hike), the Fed releases economic projections 4 times per year. Sometimes referred to as "the dots" (due to the dot plot used to convey some of the data), these projections are **critical** in shaping market expectations about Fed policy **beyond** Fed day itself.

It was the dots that rocked bond markets (and thus, rates) in mid December 2016 (after all, you can see in the chart above that financial markets were already pricing-in the hike). And it's the dots that will **likely dictate** the direction and pace of the next move in rates.

As for probabilities, it only makes sense to be prepared for longer-term rates (like mortgages) to move higher after the Fed announcement. But keep in mind that financial markets are always doing their best to adjust **today's** trading levels to reflect their best understanding of how the **future** will unfold.

That means today's interest rates are **not only** taking the Fed hike into consideration but **also** likely reflect expectations about changes in the Fed's projections. There's some possibility the Fed's rate hike outlook will accelerate less than markets expect. In that case, rates wouldn't necessarily be marching to their doom (this isn't a prediction... just a reminder that there's room for rates to move either way next week).

We've certainly seen plenty of upward movement recently, with average 30yr fixed mortgage rates hitting **2017 highs** this week. The rate spike is actually a bit worse than most news stories suggest because most news stories rely on Freddie Mac's weekly survey. Although the survey is accurate in the long run, it can lag day-to-day movement--especially in the second half of any given week. Here's how this week's actual movement stacks up:



As the chart indicates, rates are close to long-term highs. For the housing market, the timing is poor. Just this week, CoreLogic reported that its home price index expanded at a slower pace for the **first time in 6 months**. Price gains are expected to contract to an annual pace of 4.8 percent by next January vs 6.9 percent recorded through January 2017.

Despite rising rates and the shift in prices, the average American **remains upbeat about the housing market**. Fannie Mae's National Housing Survey showed a surge in home-buying sentiment to its best levels since record-keeping began in 2011.

In economic news this week, the Labor Department reported strong job growth, with **nonfarm payrolls** rising 235k. Analysts were officially expecting a 190k increase, but markets were prepared for something higher based on an earlier report from ADP. This meant rates made their biggest move higher on Wednesday and were then able to take Friday's numbers from the Labor Department in stride.

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, Mar 07				
8:30AM	Jan International trade mm $ (bl)	-48.5	-48.5	-44.3
1:00PM	3-Yr Note Auction (bl)	24		
3:00PM	Jan Consumer credit (bl)	+8.79	17.10	14.16
Wednesday, Mar 08				
7:00AM	w/e MBA Purchase Index	235		231.0
7:00AM	w/e Mortgage Refinance Index	1357.6		1290.8
8:15AM	Feb ADP National Employment (k)	298.0	190	246
8:30AM	Q4 Labor Costs Revised (%)	+1.7	1.6	1.7
8:30AM	Q4 Productivity Revised (%)	+1.3	1.5	1.3
10:00AM	Jan Wholesale inventories mm (%)	-0.2	-0.1	-0.1
10:00AM	Jan Wholesale sales mm (%)	-0.1	0.5	2.6
Thursday, Mar 09				
8:30AM	Feb Import prices mm (%)	+0.2	0.1	0.4
8:30AM	Feb Export prices mm (%)	+0.3	0.2	0.1
8:30AM	w/e Initial Jobless Claims (k)	243	240	223
Friday, Mar 10				
8:30AM	Feb Non-farm payrolls (k)	+235	190	227
8:30AM	Feb Unemployment rate mm (%)	4.7	4.7	4.8
Tuesday, Mar 14				
8:30AM	Feb Producer Prices (%)	0.3	0.1	0.6
8:30AM	Feb Core Producer Prices YY (%)	1.5	1.5	1.2
Wednesday, Mar 15				
8:30AM	Feb Retail sales mm (%)	0.1	0.1	0.4
8:30AM	Feb Core CPI Year/Year (%)	+2.2	2.2	2.3
8:30AM	Feb CPI mm, sa (%)	+0.1	0.0	0.6
10:00AM	Jan Business inventories mm (%)	+0.3	0.3	0.4
2:00PM	N/A FOMC rate decision (%)	0.75-1.00	0.875	0.625
Thursday, Mar 16				
8:30AM	Feb Housing starts number mm (ml)	1.288	1.260	1.246
8:30AM	Feb Building permits: number (ml)	1.213	1.260	1.293

Event Importance:

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

Date	Event	Actual	Forecast	Prior
Friday, Mar 17				
9:15AM	Feb Industrial Production (%)	0.0	0.2	-0.3
10:00AM	Mar Consumer Sentiment Prelim	97.6	97.0	95.7
Tuesday, Apr 11				
1:00PM	10-yr Note Auction (bl)	20		
Wednesday, Apr 12				
1:00PM	30-Yr Bond Auction (bl)	12		