Today's Rate Recovery Looks a Bit Bigger Than It Really Is

There's no question that today was one of the few recent examples of a "good day" for most of the bond market and, consequently, mortgage rates. The average lender was at least an eighth of a percent lower from yesterday. That would be a huge move on almost any other day, but it's par for the recent course, and it merely begins to undo the damage from what has been the sharpest rate spike since the 80s.

Depending on the details of a given loan scenario and the way that options are presented to prospective borrowers, some rate quotes may have dropped by as much as a quarter of a point from yesterday. This absolutely massive day-over-day move has rarely been seen, ever. In fact, there are zero examples (apart from March 2020, which we don't really count), since our day-over-day records began in 2009.

Part of the reason is that our rate index accounts for the tricky, esoteric market phenomenon responsible for these sorts of drops. The culprit is the structure of the bond market that underlies mortgage rates (MBS or "mortgage-backed securities"). Much like US Treasuries are offered in certain flavors based on their life span (i.e. 2, 3, 5, 7, 10, 30 years), MBS are offered in certain flavors based on their coupon (the rate that, in combination with the the "price" of a bond, governs its overall rate of return).

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Here's the catch, those "flavors" are like buckets that loans fall into before being traded by investors. Each bucket only allow a certain range of interest rates. When rates rise/fall rapidly, new buckets are quickly brought online, but investors might not want to put loans in them just yet because there aren't enough other traders interested in those buckets. This results in a situation where two adjacent rates (5.25% and 5.125% in this case) are actually priced about the same. In some cases, 5.125% is priced BETTER than 5.25%.

Confusing, yes. But the reason is that 5.125% is permitted in a lower bucket of MBS than 5.25%. Until that next higher bucket is more desirable for traders, this paradox could continue. In today's case, it simply meant that lenders who were quoting 5.375 yesterday could move down to 5.125% today, even though market movement only suggested a 0.125% improvement.

NOTE: 0.125% is still absolutely fantastic! Again, 0.25% hasn't ever really happened (as long as we've been keeping records).