Mortgage Rates Drop Sharply After Fed Announcement

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The pace of the spike in mortgage rates over the past several days has been nothing but **staggering**--especially considering it began when rates were already near their highest levels in more than a decade. From an average level of 5.55% for a top tier 30yr fixed quote on Thursday, the average lender was up to 6.28% by yesterday afternoon.

The drama **began** with last Friday's Consumer Price Index (CPI), a key inflation report that showed prices rising faster than expected. Inflation is biggest concern for the Fed at the moment, and the biggest reason for their increasingly aggressive efforts to push rates higher in 2022.

CPI alone **wouldn't** have been worth the drama we witnessed, however. The frenzy of the past few days was compounded by the fact that the financial market knew there was a Fed announcement coming up on Wednesday AND that the Fed was in its regularly-scheduled "blackout period." During the blackout period, the Fed refrains from public comment on monetary policy. **In other words,** markets were flying blind as to what the Fed's response might be to the CPI data, and imaginations ran wild.

When we finally heard from the Fed today, the initial reaction suggested the market's **wild imagination** was actually fairly accurate. The Fed hiked its policy rate by the same 75 basis points (0.75%) predicted by Fed Funds Futures (tradeable contracts that allow markets to bet on the level of the Fed Funds Rate). Not only that, but the initial reaction in bonds (the place we'd expect to see the most visible reaction, and the financial instruments that dictate interest rate movement) was fairly sideways.

How can that be?! If the Fed hiked 75bps, wouldn't mortgage rates rise by 75bps?

This question is a **popular source of frustration** for those of us in the industry. The short answer is that the Fed Funds rate doesn't dictate mortgage rates. At best, big changes in Fed Funds Rate expectations typically translate fairly well to mortgage rate momentum. The bottom line though is that by the time the Fed actually hikes or cuts, mortgage rates have already reacted to whatever the Fed was likely to do.

Back to today's positive turn of events for rates... It wasn't until Fed Chair Powell made one key comment that bonds felt a significant measure of reassurance. **What did Powell say?** It was actually quite simple. Powell does not expect 75 basis point rate hikes to be common and that the next meeting would involve a decision between that and 50 basis points.

For a market that was "sure" we'd be seeing 2 consecutive 75bp hikes, this was worth a reprieve from the recent stress. Importantly, by hiking 75bp at this meeting and by leaving it on the table for the next meeting, Powell also showed markets he's serious about righting the Fed's wrongs on the inflation front (the "wrongs" being that the Fed let policy run too hot for too long and underappreciated the tenacity of the current inflation regime).

The bond market rejoiced with the bonds that specifically underlie mortgage rates improving enough for the average lender to drop rates at least a quarter of a point. Some lenders dropped rates by more than that, depending on the starting point. By that I mean that the drop in rates depends on the actual level of yesterday's rate quote. If it was 6.75%, for example, some lenders dropped all the way to 6.25% (**one of the biggest single-day drops in history**), but if it was 6.25, the same lender may have only dropped about a quarter of a point (still phenomenal, but not 2x phenomenal).

As has been and continues to be the case, the mortgage market is a highly stratified and highly volatile environment right now. There are no issues regarding credit availability (i.e. money is available to lend and there are no "signs of stress" as some irresponsibly-worded articles have asserted recently), but it's not all sunshine and lollipops regarding the buying and selling of mortgage bonds on the secondary market. This affects prices and rates both in terms of elevated rate levels and volatile movement, moment-to-moment. The other notable effect is that loans that previously allowed the lender to pay borrower closing costs are instead requiring borrowers to bring cash to the table.

Whether or not rates continue to drop is a matter of debate and uncertainty. What we saw today was a reasonably logical un-puckering after the bond market worked itself up too much in recent days. In the bigger picture, the most meaningful rate recovery can only come from reassuring data on inflation. As I'd been advising for the past few months, that will take several months to to play out. Between now and then, we expect a volatile sideways range. That range was rapidly expanded this week, but the high rates seen yesterday should serve as the ceiling for now. It would take new, disturbing developments in inflation for that to change.