

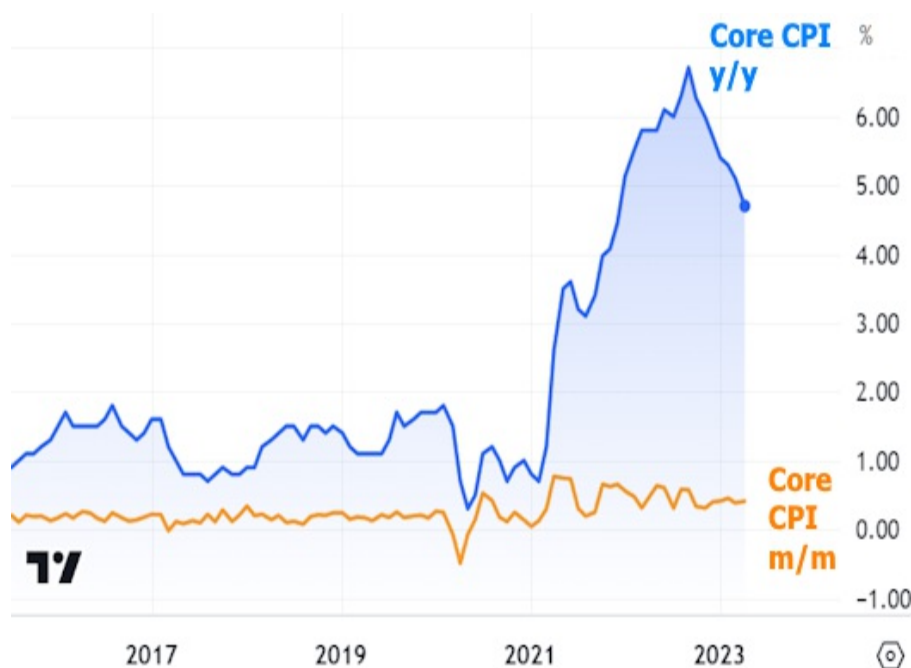


Rates Seen Staying Higher For Longer. Blame Canada?

In a surprising turn of events, this week's biggest market mover for interest rates was a policy announcement by the Bank of Canada (BOC). The event was credited for prompting a re-think of the US Federal Reserve's rate outlook.

Specifically, the BOC hiked rates despite about half the market believing it would hold steady. While the odds that the Fed holds steady at next Wednesday's announcement are quite a bit better, the argument this week was that central banks might err on the side of tough love as opposed to trusting that inflation would subside.

If we look at year-over-year numbers, it seems clear that inflation is subsiding. The following chart shows both monthly and annual versions of the Consumer Price Index (CPI) at the "core" level (which excludes more volatile food and energy prices). Core CPI is the most relevant inflation data as far as rates are concerned. The next release is next Tuesday, one day before the Fed announces whether or not it is hiking rates again.



If we zoom in on the monthly number only, we see a different theme. Inflation is still well above target levels and still trying to make up its mind on the direction of the next move.



Roland Wilcox

Owner / Loan Officer,
Sierra Capital Mortgage Co.

P: (626) 449-8545

1055 E. Colorado Blvd.
Pasadena CA 91106
245214





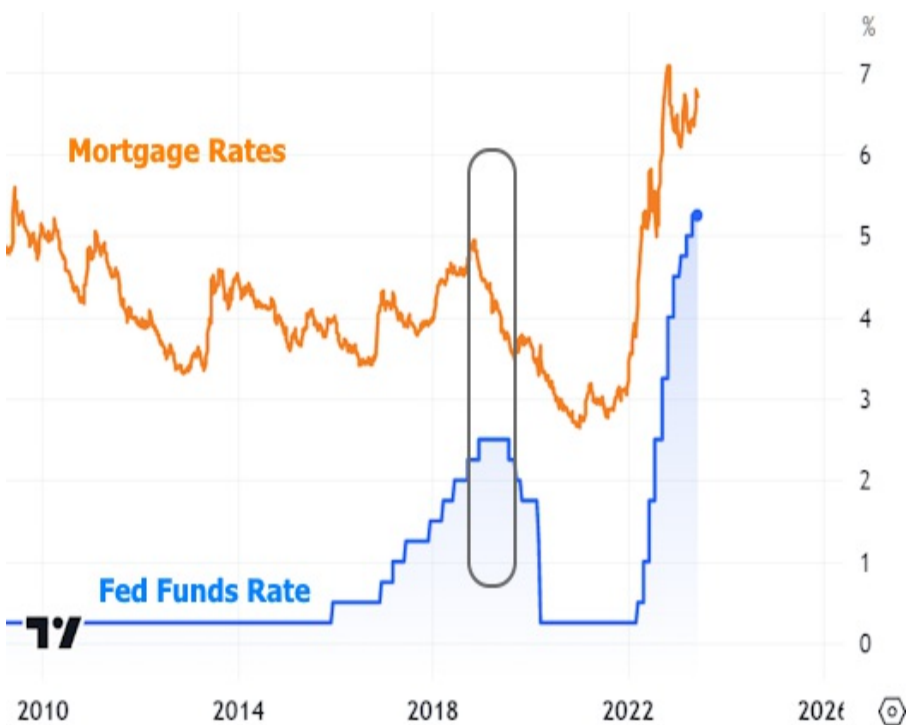
This inflation dynamic is responsible for the division of opinion on the Fed's next move. Actually, it would be better to think of the uncertainty in terms of the longer-term Fed Funds Rate path. Indeed, the Fed is unlikely to hike next week (unless CPI is far above expectations). Traders have been more interested in adjusting their expectations for where the Fed will be by the end of the year. Less than a month ago, futures markets were betting on a full point of rate cuts by December. As of Friday, the same metrics suggest the Fed might not be cutting rates at all in 2023.



Note, all of that upward movement in the blue line happened well before any news out of Canada this week. Things just happened to be fairly slow in the bond market as investors knew they were waiting for a much bigger week ahead. The BOC rate hike definitely got the market's attention in the short term, but the higher Jobless Claims data pushed yields right back down the following day. The following chart highlights those events as well as the other bigger influences on rates, starting with last Friday's jobs report. (Note: Jobless Claims and the "jobs report" are two different data sets. They occasionally disagree).



At this point, we should stop to ask how much we really care about the Fed Funds Rate (the thing the Fed has been hiking at the fastest pace in decades). While there is broad correlation with mortgage rates, there are numerous examples of longer-term rates moving in the opposite direction from the Fed. Things get especially tricky when the Fed is done or almost done hiking. Note the drop in mortgage rates the last time the Fed Funds Rate hit the sort of plateau the market is currently predicting.



In addition to getting the rate hike (or "pause") decision itself, next week also brings the quarterly release of the Fed members' rate outlook for the next few years. No one expects clairvoyance, but the forecasts offer insight to the Fed's approach to rate hikes (or pauses, or cuts) moving forward. Last but not least, Fed Chair Powell will hold the customary press conference 30 minutes after the 2pm ET announcement of the rate decision and updated forecasts. That all happens on Wednesday with the previous day bringing the CPI data at 8:30am ET.