

MORTGAGE RATE WATCH

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Mortgage Rates Finally End This Week's Losing Streak

After starting out at the lowest levels in more than a year on Monday morning, mortgage rates had done nothing but increase through Thursday afternoon. The bounce was abrupt by typical standards with the average 30yr fixed rate rising nearly 0.3% in just 3 days.

Friday brought a small amount of relief as the underlying bond market finally leveled off. Mortgage rates are based on bonds and bonds take cues from several sources. One key motivation is the level of "supply." In other words, "how many bonds are being sold."

Supply in non-mortgage-specific bonds still has an impact if the bonds are closely related. Reason being, if investors are compelled to buy lots of bonds, the yield (aka "rate") generally needs to move higher to garner sufficient demand. This was the case this week as it related to US Treasury auctions. Mortgage-backed bonds stick to a very similar path compared to their Treasury counterparts. As such, rates/yields moved higher across the board.

With all that in mind, Friday would have been the least surprising day to see an end to the mini upward spiral in rates because it was the first day without a big new Treasury auction for the week. It also saw the lowest supply of corporate bond issuance (another category of bonds that can put some upward pressure on rates amid moments of excess supply).

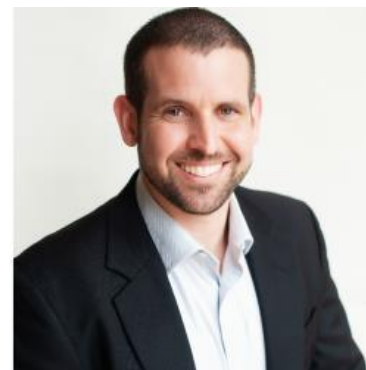
In the week ahead, the market's focus will shift from supply back to economic data. Next Wednesday brings the release of one of the most important economic reports, the Consumer Price Index (CPI). This is the first major measurement of inflation for the month of July. If it confirms the friendly trends established in May/June, it would likely reinvigorate the recent downward pressure on rates seen last week. But there's an equal chance the data disappoints to the upside, thus causing further rate increases in the short term.

How does this fit in with widespread talk of Fed rate cuts?

First off, the day to day gyrations in the bond market represent a separate issue from the Fed rate decision. Bonds could move up and down quite a bit before mid-September and the Fed could still end up cutting its policy rate. If that happens, the market will already be in position for that rate cut, and it won't represent any newly tradable news.

It would take quite a shift in the recent econ data for the market to abandon its expectations for a Fed rate cut, but if both of the CPI reports between now and then were much higher than expected, and if the next jobs report shows a big bounce back from last week's low numbers, it is possible the Fed could sit on its hands for another 6 weeks (emphasis on "possible"). Markets currently view the more likely scenario as the data confirming the wisdom of a 0.25% Fed rate cut. If the data is even friendlier, we could see a 0.50% rate cut.

Either way, it all depends on the intervening data, and the first big dose of that arrives with Wednesday's CPI.



Tim Pillsbury

Branch Manager -
Mortgage specialist,
AmRes Corporation

www.nolalender.com

P: (985) 777-2837

2065 1st Street
Slidell Louisiana 70458
NMLS#101822