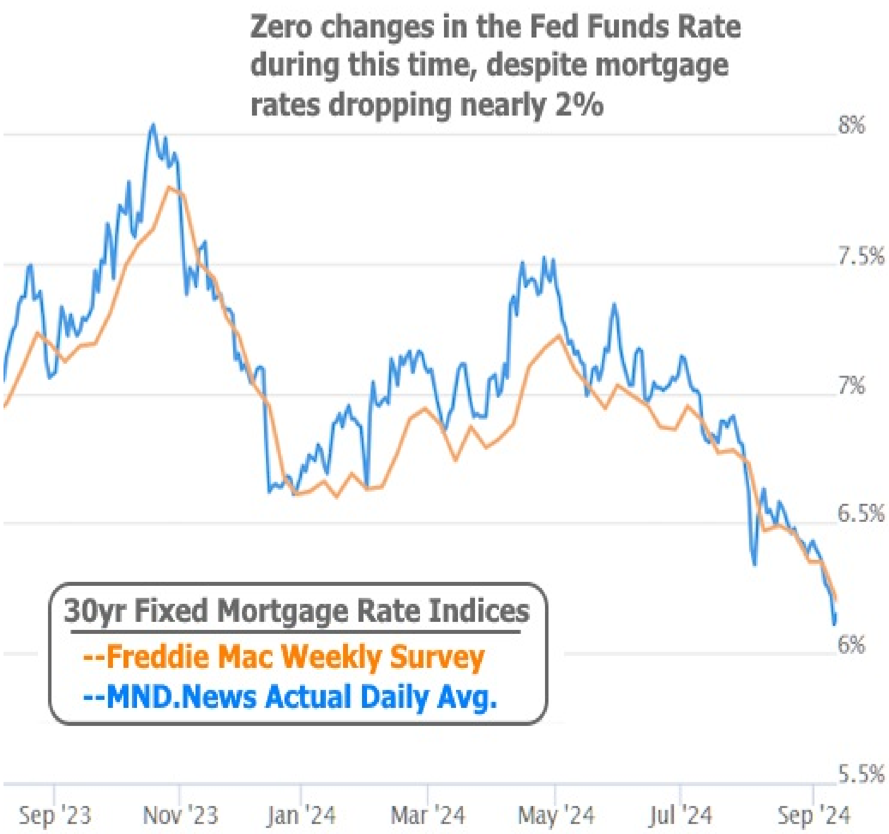
Why Fed Day Matters Even Though Mortgage Rates Are Already Lower

It's a foregone conclusion that the Fed will be cutting rates on Wednesday, September 18th. As exciting as they might sound, mortgage rates have already reaped the rewards.



If you'd like to understand this with a simple, nuts and bolts example, just consider the numerous occasions where mortgage rates have fallen BEFORE and moved HIGHER AFTER the Fed has cut the Fed Funds Rate.

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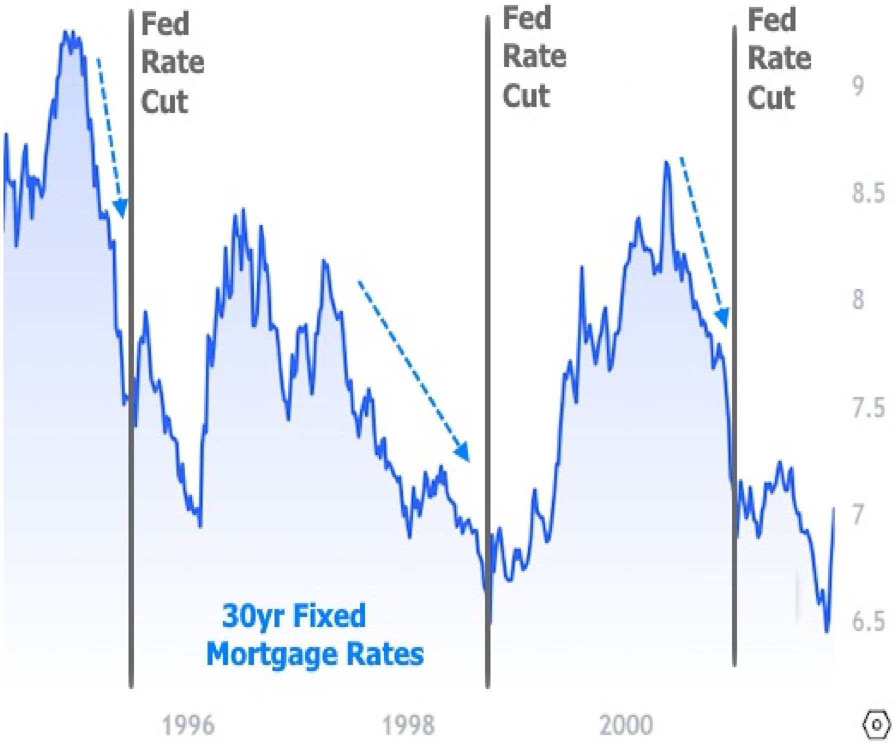
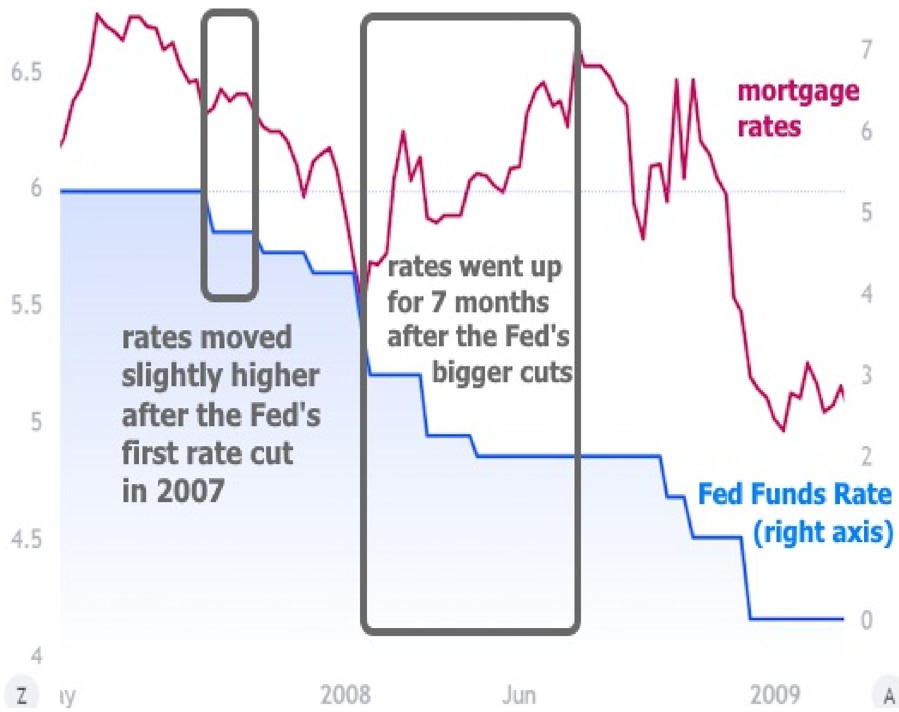
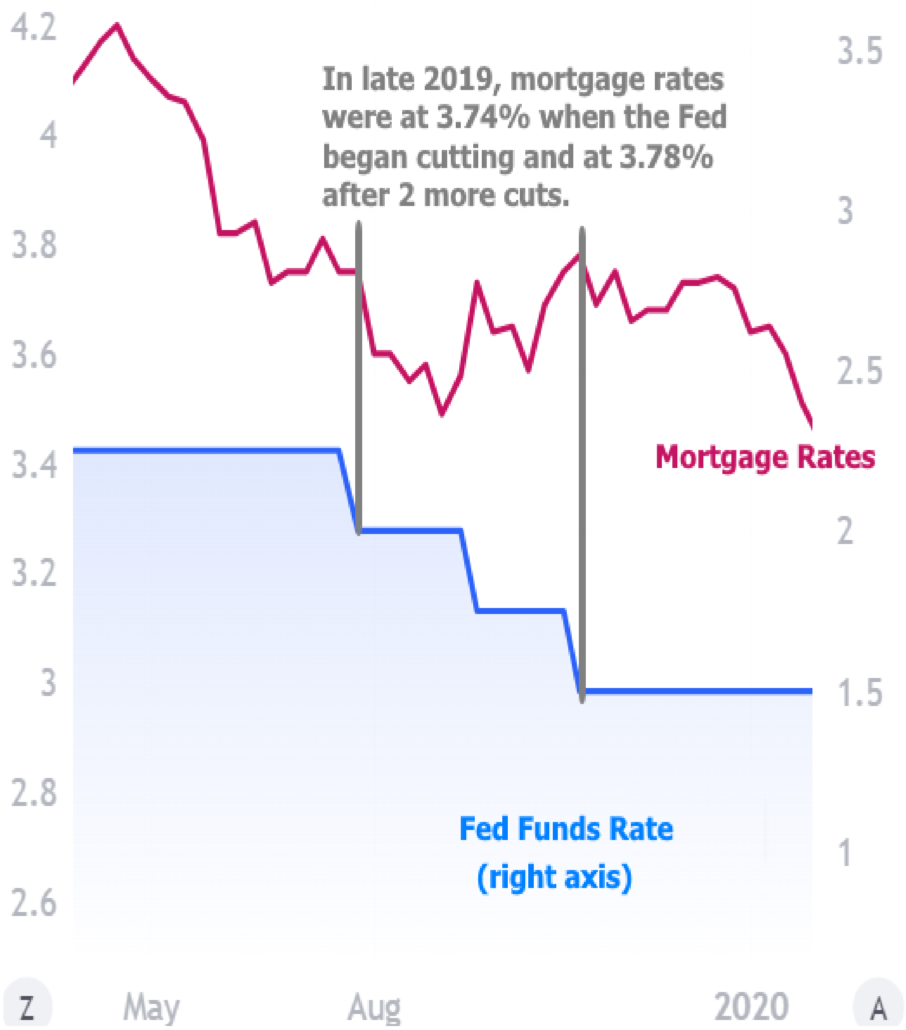


Fed Rate Cut
Fed Rate Cut
Fed Rate Cut
9
8.5
8
7.5
7
6.5
30yr Fixed Mortgage Rates
1996
1998
2000



6.5
6
5.5
5
4.5
4
7
6
5
4
3
2
0
mortgage rates
rates moved slightly higher after the Fed's first rate cut in 2007
rates went up for 7 months after the Fed's bigger cuts
Fed Funds Rate (right axis)
2008
Jun
2009



If you'd like to understand WHY that is possible and you missed the last two newsletters, they'll bring you fully up to speed.

Why You Might Regret Waiting For Better Rates After The Fed Cuts

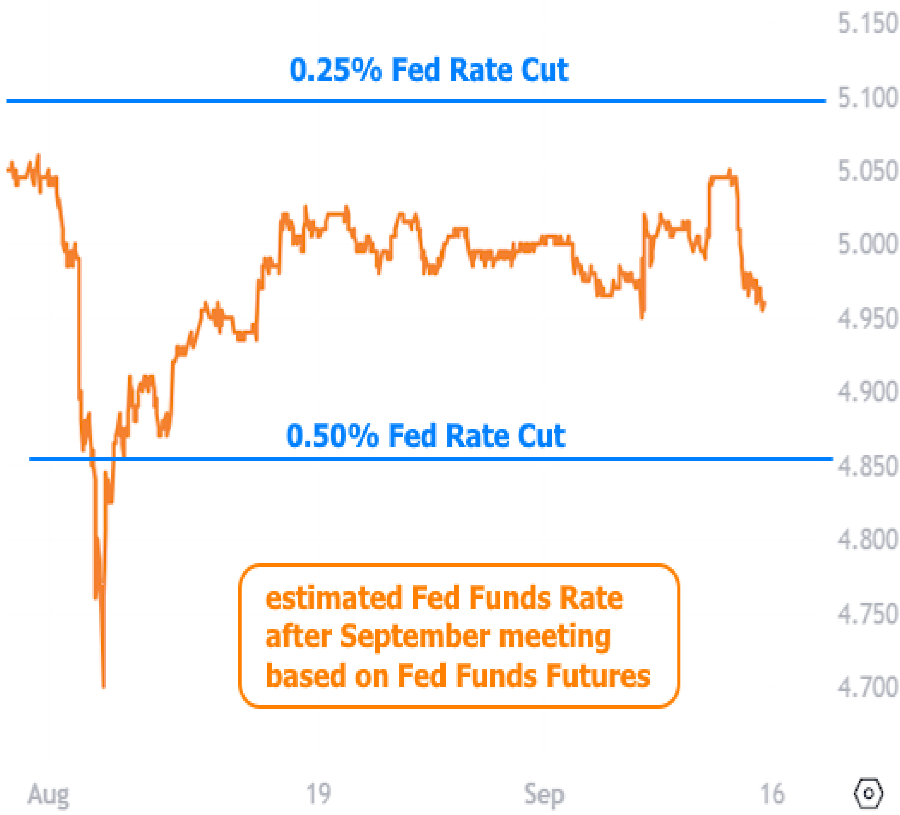
Here's Exactly What a Fed Rate Cut Will Do For Mortgage Rates

And last but not least, for those who want to understand WHY but who don't like clicking links, here's a quick, bullet point recap:

- Mortgage rates can move every day whereas the Fed only meets once every 6 weeks
- The Fed communicates what it's likely to do
- Financial markets allow for bets on probabilities of Fed rate cuts
- Other bonds (like those that determine mortgage rates) are influenced by those probabilities
- As such, if the Fed says they're going to cut, and if the market is already betting on rate cuts, then mortgage rates have already moved lower in anticipation.

Despite all of that, Fed Day can still matter for a variety of reasons. That's especially true of this particular Fed Day because it is one of the most uncertain in terms of the outcome.

We've talked quite a bit about the Fed cutting rates, but not as much about the SIZE of that rate cut. This is one of those rarer instances where the market is fairly evenly split between expecting the cut to be 0.25% or 0.50%. That means about half the market is going to be surprised and when the market is surprised, volatility ensues. This wasn't necessarily destined to be the case earlier this week, but odds quickly returned to evenly split after a Wall Street Journal article made a case for the Fed having options on Thursday.



If the Fed Funds Rate (the thing that is being cut on Wednesday) were the only part of the announcement, a 0.25% cut would likely cause other interest rates to move higher while a 0.50% would do the opposite. The counterpoint is that some investors could worry that 0.25% is not a fast enough removal of restrictive financial conditions, thus leading to more bets on recession. In that scenario, mortgage rates could actually fall despite the smaller rate cut from the Fed.

Conversely, other investors could worry that a 0.50% cut is aggressive enough to reinvigorate inflation or overstimulate the economy, thus putting UPWARD pressure on mortgage rates despite a larger Fed rate cut.

But the rate cut itself is only one part of the announcement. At the exact same moment that the cut is announced, the Fed releases two other documents. The first is the policy statement that contains additional verbiage surrounding the rate cut. The rest of the interest rate world can view that verbiage as friendly, unfriendly, or neutral.

The other document is a summary of economic projections (SEP). One key component of the SEP is the chart of each Fed member's projection for the appropriate Fed Funds Rate at various points in the future. This is represented in a dot plot format and has become so influential that any devout market watcher knows exactly what you mean if you mention "the dots!"

In addition to the two documents released at 2pm ET, Fed Chair Powell holds a press conference at 2:30pm which includes a Q&A portion.

So we have:

1. The rate cut itself
2. The verbiage in the statement surrounding the rate cut
3. The SEP with the dot plot showing the rate cut outlook for future meetings
4. Fed Chair Powell's press conference

Any of those 4 items could exert upward or downward pressure on longer-term rates. All we know today is that mortgage rates have already baked in something between a 0.25% and 0.50% Fed rate cut.

What does all of the above mean? There will be volatility. It could be quite large when it comes to Wednesday and possibly Thursday. It has an equal chance of pushing mortgage rates higher vs lower, even though the Fed is certainly cutting its policy rate. Ultimately, the short-term volatility shouldn't have a lasting impact on bigger picture rate trends. Those will be more heavily influenced by the next big round of economic data in early October.