



Hayfer Group
678-628-KATE



Not in Line?



This is a long one... Our friend/loan officer Shelly Vaughan sent this to us.

Mortgage rates jumped massively by 0.25% on Friday after a stronger-than-anticipated jobs report caused carnage to mortgage bonds and, consequently, mortgage rates.

In fact, the lowest rate of the year so far was the day before the Fed funds rate cut. And that brings to me a fairly complicated and often misunderstood relationship between the Fed rate cut and its impact on mortgage rate cuts.

Relationship between Fed Rate Cut and Mortgage Rates

Media tends to make you believe that Fed rate cut = Lower Mortgage rates. Headlines in an article in the New York Times only help to solidify that view. The article, entirely wrongly, suggests that the mortgage rates dropped after and because of the Fed rate cut. Nothing can be farther from the truth.

Mortgage rates had been falling for 6 weeks “before” the rate cut and actually went up the day of the rate cut.

Since then, mortgage rates have consistently trended higher, albeit slowly, until Friday’s employment report pushed them back to a two-month high.

If the Fed Rate doesn’t impact Mortgage Rates, what does?

The chart displays the trends of the Federal Funds Rate and the 30-year Fixed Mortgage Rate from 2004 to 2024, showing how these two key interest rates have fluctuated and interacted over the past two decades.

Key Observations

While both rates generally follow similar patterns, with the 30-year Fixed Mortgage Rate consistently higher than the Federal Funds Rate throughout the period, the problem is not with the pattern but with the spread.

The gap between the two rates has varied over time, with the mortgage rate generally 1-3 percentage points higher than the Federal Funds Rate. That’s why blindly following Fed rate cuts to assume that mortgage rates will follow the same pattern in the short run is foolish, as has been seen in the last few weeks. Mortgage rates were falling before the rate cut and have been rising since.

The pattern works, though, because the Fed cuts the funds rate when inflation seems to be cooling, a factor that works favorably for mortgage rates, too. So, while in the medium to long term, mortgage rates may follow the Fed rate patterns, homebuyers and homeowners don’t have months to wait for that pattern to fall into place.

Mortgage Rates are impacted by a myriad of macroeconomic and geopolitical news, sometimes even news that has very little to do with the US, like the European Bank’s rate decision or a banking crisis in China. That’s why mortgage rates can change on a daily basis, sometimes multiple times a day, even when the Fed may not have changed the rate for years.

The yield on Mortgage-Backed Securities (or MBS, for short) impacts mortgage rates directly. MBS are traded on Wall Street, much like stocks, and hence can change in value at any minute, which explains the volatility in mortgage rates.

What Happens to Mortgage Rates Now?

Mortgage rates are much harder to predict because of the reasons explained above. A geopolitical or economic event on the other side of the globe can significantly impact mortgage rates. Fed funds rates, on the other hand, are largely telegraphed by the Fed weeks or even months in advance and, other than minor variance, stick to the script.

Mortgage rates may well have reached their lowest level of the year. The mortgage rate for the rest of the year will depend on the strength of employment and the change in inflation, which will be much higher than the Fed funds rate. So, stop paying attention to useless things that the media asks you to focus on regarding mortgage rates. Keep an eye on more meaningful metrics that move the rates in the short term.

So, Should I wait to Buy or Refinance?

The beauty of getting a mortgage in the US is that you’re not stuck with the mortgage you get. When you’re buying a home, you should get a mortgage you qualify for and can afford. Similarly, when refinancing, get a mortgage that offers tangible benefits. If the rates don’t improve in the immediate future, you have a mortgage you like, and if they do, you can always refinance. Have your cake and eat it too.

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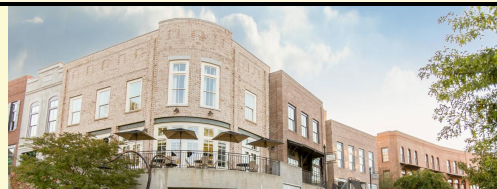


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