Lock or Float?

Locking in a good home loan rate weighs heavily on the minds of most homebuyers, and it should. Each fraction of a percent potentially means huge savings over the life of the loan. Homebuyers want predictions on what to expect. They seek out certainty in what is an uncertain market.

So…why is it so hard to nail down home loan rates?

The reality is that many factors influence home loan rates, and these factors are pretty significant:

- **The "Big 3" economic indicators**
- **Geopolitical events**
- **Mortgage Backed Securities**

This e-book provides a helpful overview of these factors and how they influence home loan rates.

The "Big 3" Must-watch Economic Indicators

The ebbs and flows of the economy have a direct impact on home loan rates. Below is a high-level overview of the big economic indicators—gross domestic product, inflation and unemployment—as well as how they correlate with rates.

GDP Report

GDP is the widest measure of the state of the economy. It is the aggregated monetary value of all goods and services. When GDP rises, demand for money rises and interest rates go up. **Watch for it: 8:30 a.m. EST on the last day of each quarter.**

Inflation

Two reports track the rise in the cost of goods and services over time. Typically, as inflation increases, interest rates increase and vice versa.

Core Personal Consumption Expenditures, or PCE, is the Fed's preferred index which measures the prices paid by consumers for goods and services without the volatility of food and energy. **Watch for it: 8:30 a.m. EST around the first or last business day of the month.**

Core Consumer Price Index, or CPI, measures the change in prices over time for goods and services without the volatility of food and energy. **Watch for it: 8:30 a.m. EST around the middle of each month.**

Unemployment - Non-farm Payrolls

Unemployment represents the total number of U.S. paid workers. If more jobs are created than expected, investments tend to shift from Bonds to Stocks, pushing interest rates higher. Farm payroll is excluded because it is seasonal and can skew the results without a significant economic impact. **Watch for it: 8:30 a.m. EST on the first Friday of each month.**

#1

Economic Growth

(Gross Domestic Product) Report

When GDP is rising (and the economy expanding) demand for money rises, pushing interest rates up. When GDP is falling (and the economy contracting) demand for money falls, pushing rates down.

#2

Inflation

As interest rates move lower, more people are able to borrow more money. The result is more consumer spending, economic growth, and inflation. As interest rates increase, consumers have less money to spend. With less spending, the economy slows and inflation decreases. A delicate balance is crucial for stability.

#3

Unemployment –

Non-Farm Payrolls Report

Largest indicator of labor market health.

Geopolitical Events

The old adage “knowledge is power” rings true when it comes to geopolitical events and their impact on home loan rates.

Whenever a geopolitical event occurs—and you’ll know because it makes news headlines—tensions rise globally. Within hours, investors look for less risky avenues to invest money. Most likely, money is going to flow into Bonds like Mortgage Backed Securities (MBS). In a nutshell, MBS provide a short-term safe haven for investments.

It’s hard to grasp the billions of dollars that move from Stocks to Bonds during geopolitical events. These moves, however, are quick and isolated in nature, meaning there will be little chance of repetition.

This shift from Stocks to Bonds tends to provide a short-term lock opportunity that homebuyers can leverage.

Mortgage Backed Securities: The Real Driver of Home Loan Rates

Mortgage Backed Securities, a type of Bond, provide a short-term safe haven for investments. Because they are less risky than Stocks, investment dollars tend to flow into them during geopolitical events. Mortgage Backed Securities are a type of asset-backed security that is secured by a mortgage or collection of mortgages. These securities are grouped into one of the top two ratings as determined by an accredited credit rating agency, and usually pay periodic payments that are similar to coupon payments. Furthermore, mortgages grouped into these securities must have originated from a regulated and authorized financial institution like a bank or thrift.

What is the Fed's Take?

When the Federal Reserve first embarked on lowering home loan rates in November 2008, they did it by directly purchasing Mortgage Bonds in the open markets. They took this action to ***"reduce the cost and increase the availability of credit for the purchase of houses."*** Ultimately, their goal was to ***"support housing markets and foster improved conditions in financial markets more generally."***

In addition, the Federal Reserve said Mortgage Backed Security purchases would reduce the available supply of securities in the market, leading to an increase in the prices of those securities and a reduction in their yields. In other words, when the price of Mortgage Backed Securities rises, home loan rates move lower. They work in an inverse relationship.

If the U.S. central bank deemed that Mortgage Backed Securities dictate home loan rates, there should be no question as to what security is the determining factor of mortgage rate movements.

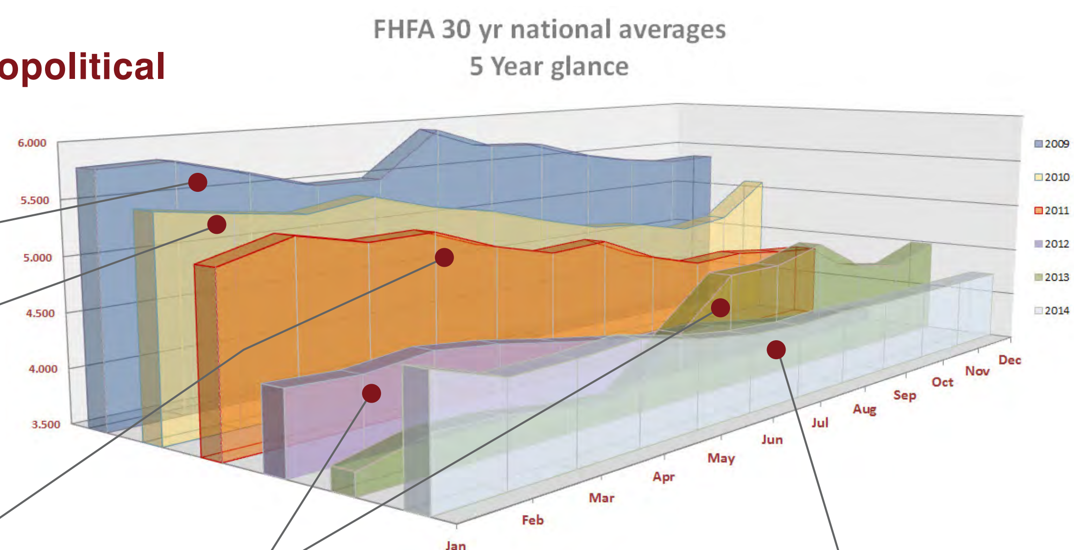
The Bottom Line:

When Bond prices improve, home loan rates improve.

Much like homebuyers looking to lock in the best rate for the life of their loan, investors seek out the best places to invest their assets.

Long-term economic indicators and short-term geopolitical events all can lead to uncertainty. When there's uncertainty, investors get nervous, so they shift money from Stocks to Bonds, which are less of a risk. Mortgage Backed Securities are one of these types of Bonds. The bottom line is: when Bonds prices improve, home loan rates improve.

Correlation Between Geopolitical Events and Rates



2009 – Rates declined until June. Rates increased as recession officially declared "over."

2010 – Stocks increase. Rates go up. Late March, investors flock to Bonds as Portugal's debt is downgraded, and Eurozone woes take front seat.

2011- In March, global Stocks continue to decline after Japanese earthquake and tsunami.

2012 –Slow U.S. recovery coupled with Eurozone debt woes kept mortgage rates at historic lows.

2013 – Second half of the year rallies; best Stock gains since 1997.

2014 – Rates impacted by worst Jobs Report since 2011, currency troubles in Argentina, South Africa and Turkey, a slew of companies missing forecasted earnings, Malaysian passenger jet shot down, deepening tensions between U.S. and Ukraine, Israeli-Palestinian conflict in Gaza, and more.

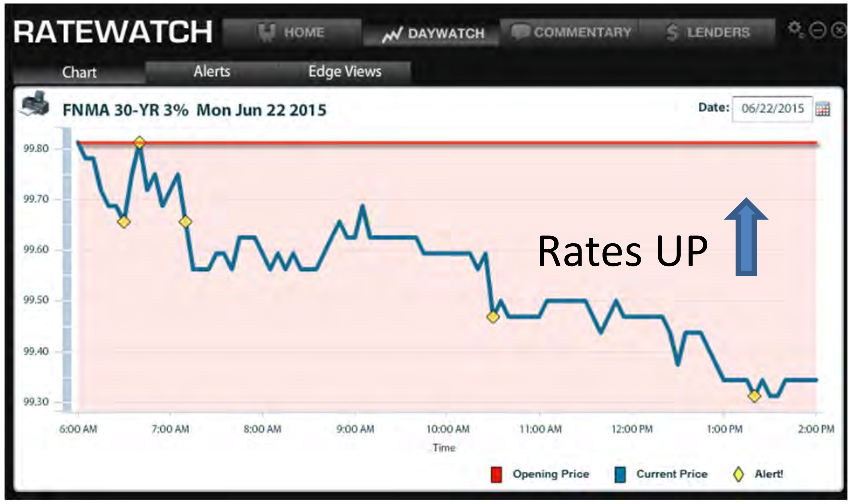
Forecast with Financial Literacy

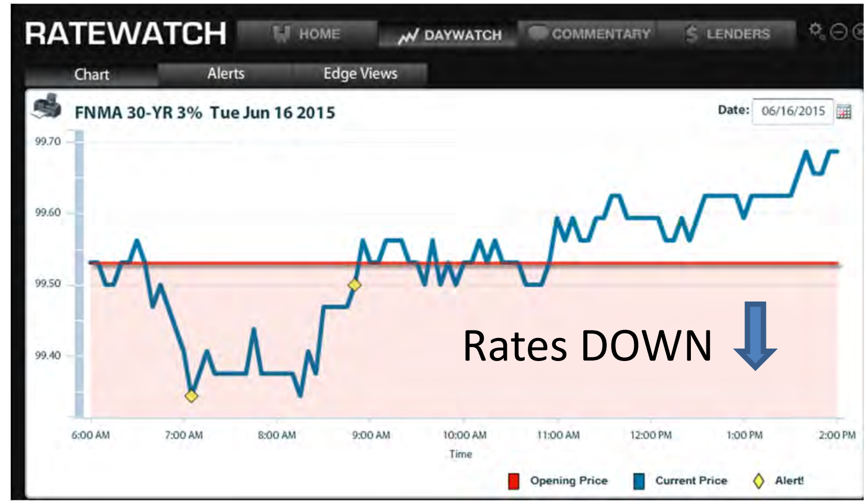
When it comes to forecasting home loan rates, you can't predict exactly where they will land. However, you can identify a consistency and repetition in market shifts by watching what happens with the "Big 3" economic indicators, geopolitical events, and Mortgage Backed Securities.

Rate Trend Tips

- **Consumer Spending Up ↑** = Interest Rates Increase ↑
- **Consumer Spending Down ↓** = Interest Rates Decrease ↓
- **Unemployment Up ↑** = Interest Rates Decrease ↓
- **Unemployment Down ↓** = Interest Rates Increase ↑
- **Geopolitical Events** = Interest Rates Decrease ↓ (Short Term)

You can now see why predicting whether rates will go up or down is such a challenge. On a daily basis; I use several programs that give indications in “real time” of what is happening in the market. The charts below are one such indicator. In addition I listen to daily commentaries by experts as well as other mortgage professionals. I can see a poll of what lenders are increasing or decreasing their rates – again in “real time.”





What should you do?

When deciding between locking and floating, you need to assess your situation. Every borrower has a unique story, and every day is different, so there is no hard and fast rule.

Some borrowers may not be comfortable with “letting it ride,” while others may be market experts and have a good handle on the direction of mortgage rates. Usually (not always), what’s bad for the economy is good for rates

- If you prefer to sleep at night and “like” where mortgage rates are at the moment, locking might suit you better than floating.
- And if you think mortgage rates aren’t going to get any better, again, locking is probably the move.
- If you can’t risk taking on a higher mortgage rate due to your loan qualifications, locking your rate would be very smart.
- On the other hand, if you think mortgage rates have room to fall, and you can stand to profit from it, you may choose to float your rate.

What can I do?

- I can provide you with up to the moment accurate quotes for what terms are available at any given time.
- I can create a Total Cost Analysis showing you what different interest rates will mean for your monthly payment and cost over time.
- I can discuss our policy for renegotiating if the market improves and you’d like to break your rate lock for a better deal.

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