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Fed's rate cut might push 30-year mortgages below 3%

By Brad Finkelstein

The Federal Open Market Committee's coronavirus-fueled 50 basis point rate cut stands to potentially send 30-year fixed-rate mortgages below the 3% level, but with rates reaching all-time lows in the Treasury market, spreads between government debt and mortgage-backeds may be poised to widen.

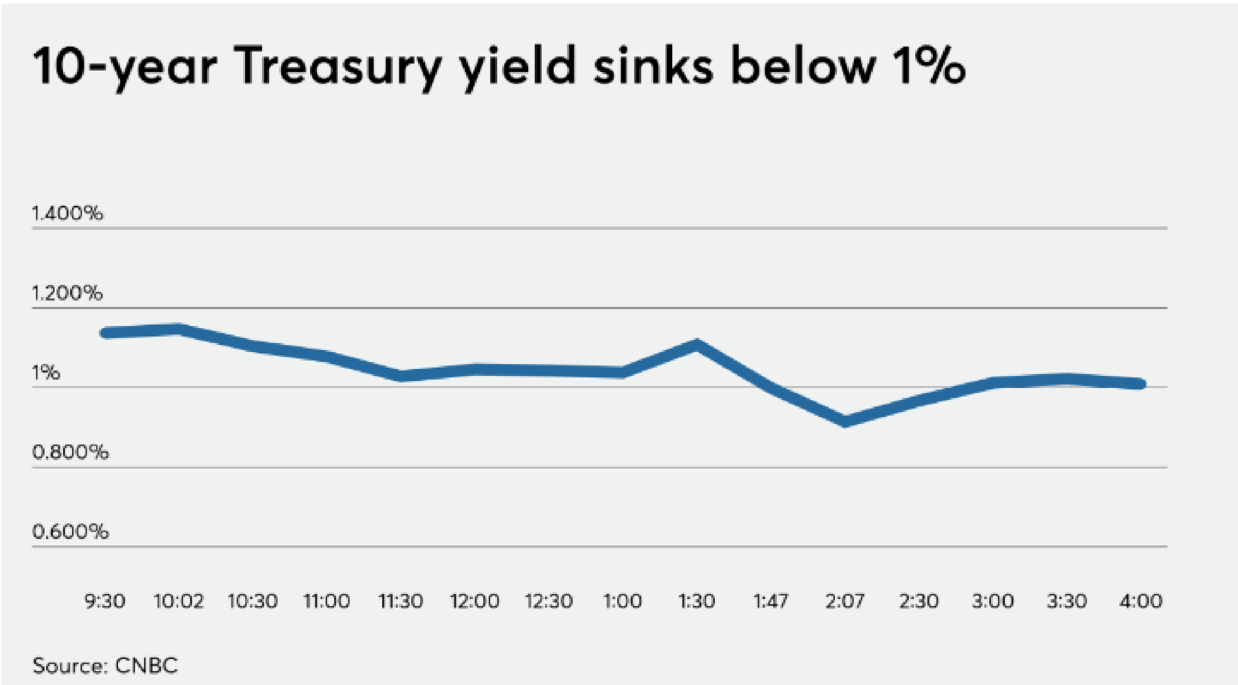
Equity investors' initial positive response to the move was short-lived. A rally in stocks quickly gave well to selling and the Dow Jones Industrial Average fell more than 900 points before retracing some losses. As stocks tumbled, investors flocked to Treasurys and for the first time in history the 10-year yield broke below 1%, bottoming at 0.92% before rebounding back to 1% by late afternoon.

At yields that low, the spread between the 10-year Treasury and long-term mortgage rates will have to expand, said Mark Fleming, chief economist for First American Financial, due to inflexible add-ins like servicer fees and risk-based pricing from the secondary market.

Those expense-related items contribute 1.5 to 2 percentage points of the mortgage rate. "So it's not that the 30-year directly follows the 10-year Treasury down to zero. There's going to be some sort of a floor," Fleming said.

"That being said, that floor is certainly flirting with something below a 3% mortgage as a potential possibility. If the 10-year Treasury stays for more than just a few hours below 1%, there is certainly the potential for repricing of mortgage rates further down than they were this morning," he said.

The question is, are the responses by investors in both the stock and bond markets to the actual rate cut or to a sign that the Fed thinks the situation is more serious than previously thought?



For the housing market in general, as it relates to the coronavirus, "the dark irony of bad things like viruses, is that it creates fear and uncertainty, which drives investments to safe havens and one of the most popular ones being the 10-year Treasury," Fleming said

So from things like past pandemics through the market reaction to the Brexit vote have resulted in lower Treasury yields, with mortgage rates following. In turn that increased borrower purchasing power, Fleming said.

"So U.S. homebuyers get a purchasing power boost from these kinds of events and this one is no different. Whether you're a potential refinancer or a potential first-time homebuyer, you're purchasing power is substantially higher today than it was a week ago," Fleming said.

Furthermore, while these events cause large corrections in the stock market, they are followed by large rebounds when investors realize the situation is not as dire, he continued.

"The U.S. economy, backed by the healthy labor market, enters this period in a strong position," Joel Kan, the associate vice president of economic and industry forecasting for the Mortgage Bankers Association, said in a statement. "However, last week's financial market volatility and fears of a widespread coronavirus outbreak are clearly on the minds of policy officials. Long-term, further spread of the virus would likely dampen consumer confidence and spending, and ultimately slow economic growth."

The 10-year Treasury yield was already in historically low territory even before the March 3 drop, added Andrew Weinberg, a principal of Great Neck, N.Y.-based mortgage brokerage Silver Fin Financial.

Still, the size of the FOMC cut was "a bold move" that would give the economy a boost at a time it is slowing down because of the virus, he continued.

"A lot of clients will reach out to us on a day like this and ask 'what does this mean for my interest rate?' And it may not mean all that much when it happens," he said.

But consumers could see the effect in a lower prime rate, which could affect things like home equity loans, auto loans and credit card debt, that put money into peoples' pockets, he continued.

For TD Bank's home equity lending business, "we have not seen an immediate reaction but we expect to see some both from consumers who already have an equity product as well as consumers who might be in the market to borrow. It will likely impact both of those populations due to the decrease in the rate," said Jon Giles, head of home equity lending at TD Bank. He anticipates an increase in both new and repeat business as a result.

For homebuyers, more goes into the purchase decision than just the interest rate, Weinberg said. Still, "lower rates translate into a payment over the life of the loan. Perhaps just as importantly, the lower payment means that you can qualify for a slightly larger loan amount."

Even as the cut could boost the housing market, said Digital Risk Managing Director Jeffrey Taylor, there are some downsides as well.

"Borrowers are not seeing the needle move on mortgage rates just yet because mortgage providers simply do not have the capacity to fulfill the influx of requests they have in their pipelines," said Taylor in a statement. "Once lenders build up their capacity, mortgage rates will drop to an even lower rate than we are seeing today."

But there is a risk, albeit a low one, that if the virus spread continues, the housing market will grind to a halt because consumers won't be out shopping to purchase a new property, he added.

At a purchase-oriented lender like TruLoan Mortgage, it benefits from rate movements either way, said Managing Director Daniel Jacobs. But even he expressed some uncertainty.

"How long will rates be low, will the stock market respond and will there be a big bounce back or not? This doesn't follow a trend like an economic pattern. We're pretty positive about it but we don't know if rates are going to be low for a season, for a year or only a day," Jacobs said.

"The Fed reducing rates will not address supply-chain issues in the global economy. If someone doesn’t think their job is going to be affected by supply-chain issues then they may buy. This will have an impact as long as supply-chain issues are not severe."

For homebuilders, the situation in China has limited their access to items such as lighting, resilient flooring, plumbing fixtures and household appliances, plus stuff like particulate filter face masks used for construction purposes, a research note from the National Association of Home Builders said.

Meanwhile, "the policy change was consistent with recent declines for interest rates in the bond market," the NAHB said. "These declines should push mortgage interest rates closer to a low 3% average for the 30-year fixed-rate mortgage.

"However, the virus poses supply-side and potential growing demand-side challenges that are not precisely addressed by monetary policy."

— Bonnie Sinnock contributed to this report

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