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Housing Can Survive Higher Rates

The US withdrawal from the Iran nuclear deal dominated the news this week. This will arguably impact rates, albeit in a subtle, roundabout way. The housing market won't care much, but it's not without its own challenges.

Interest Rate Considerations

It takes a bit of work to connect recent interest rate moves to the Iran news. In fact, there's really not much of a connection--if any. Moreover, if we do end up seeing a connection, it won't be something that happens in a **big, obvious** way. Rather, it would materialize slowly and it would be muddied by a multitude of more relevant variables.

Inflation is at the heart of the issue. Bonds are essentially loans. Investors purchase bonds in exchange for the right to receive payments over time on a predetermined schedule. If the cost of a ***Grande Skinny Caramel Macchiato*** was $4.55 when the investor initially bought a bond, and if the monthly payment received on the bond was $4.55 after taxes, the investor could enjoy that delicious beverage once a month (or purchase one for someone who enjoys drinks with long names).

But now say inflation brings the cost up to $6.10. Because the terms of the bond are predetermined, the investor will have to order something with fewer words or in a smaller size. **Inflation erodes the purchasing power** of dollars and thus erodes the returns realized from investing in bonds. The investor is still getting the same $4.55, but that $4.55 won't buy what it once did.

A certain amount of inflation is always assumed, but it's when there is a risk that inflation will increase that bond investors demand lower prices. When bond investors demand lower prices, it's the same as demanding a higher rate of return. It's this sentiment that **causes rates to rise**.

To get a quick idea of **how important** inflation is to bonds/rates at the moment, we need only look at a chart of bonds with volume. Whereas the big jobs number (nonfarm payrolls, or NFP) is the perennial top dog in terms of economic data that impacts bonds, the big inflation number (the Consumer Price Index, or CPI) has recently drawn out much more volume.

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.25%	-0.03	0.00
15 Yr. Fixed	6.68%	-0.07	0.00
30 Yr. FHA	6.64%	-0.06	0.00
30 Yr. Jumbo	7.45%	-0.03	0.00
5/1 ARM	7.32%	-0.03	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00

Rates as of: 5/6

Market Data

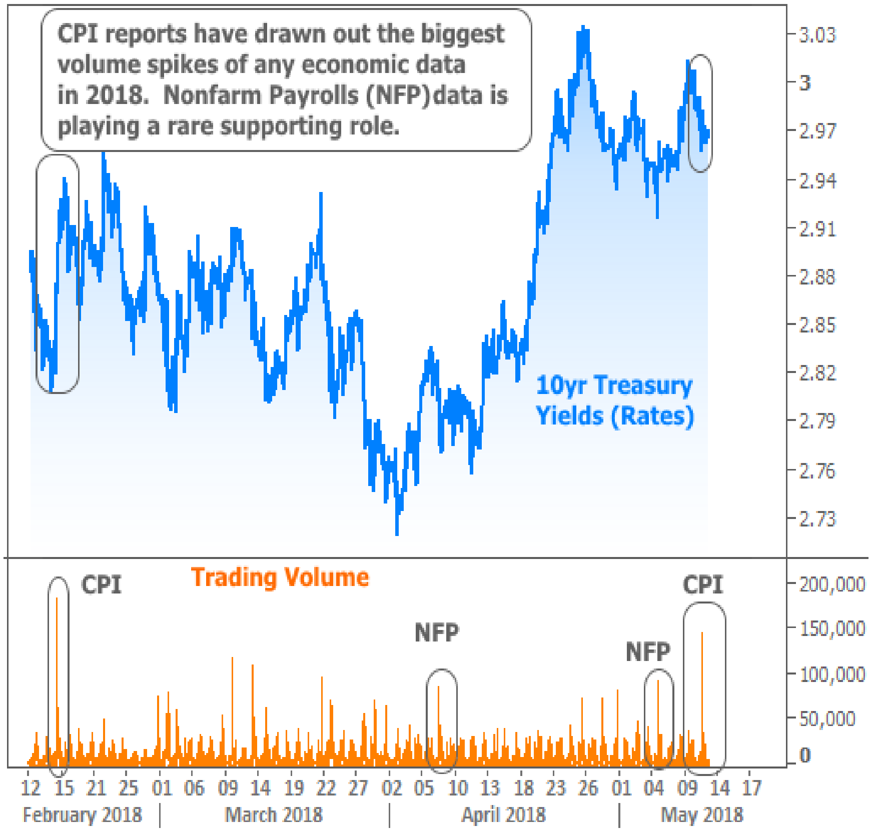
	Price / Yield	Change
MBS UMBS 6.0	100.06	-0.02
MBS GNMA 6.0	101.01	-0.02
10 YR Treasury	4.5027	-0.0111
30 YR Treasury	4.6609	-0.0102

Pricing as of: 5/6 12:43PM EST

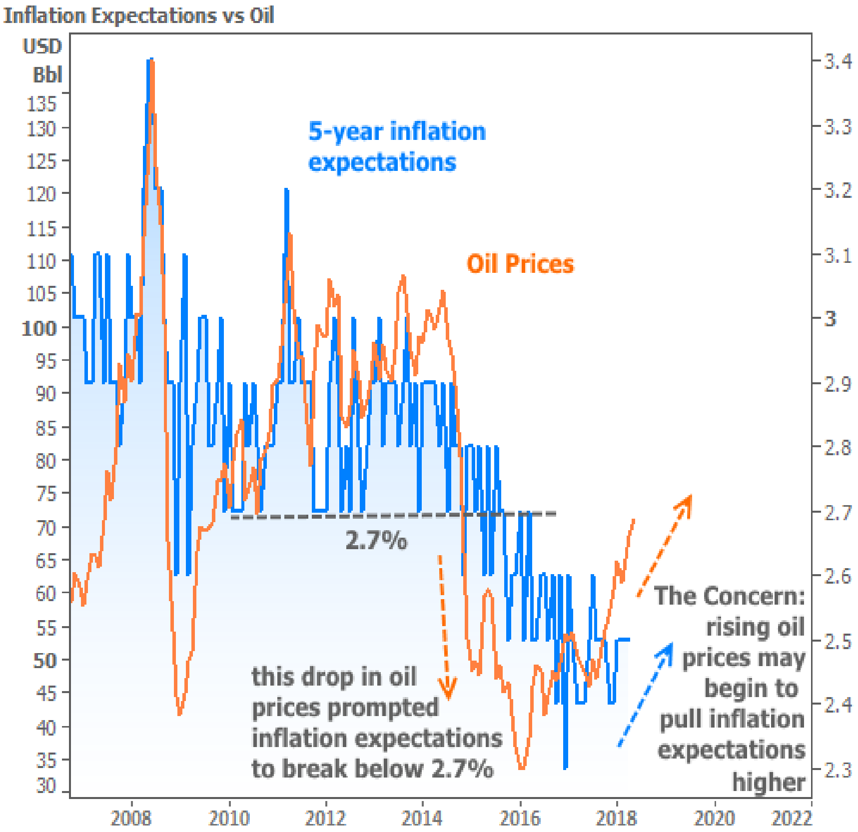
Recent Housing Data

		Value	Change
Mortgage Apps	Apr 24	196.7	-2.67%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

Rates and Volume

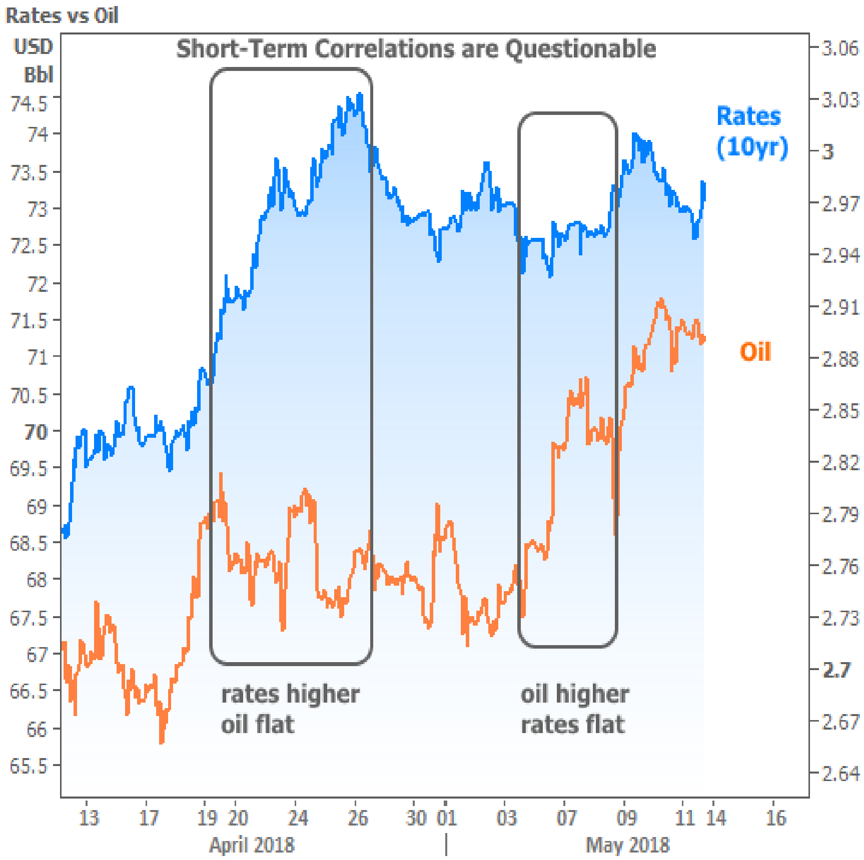


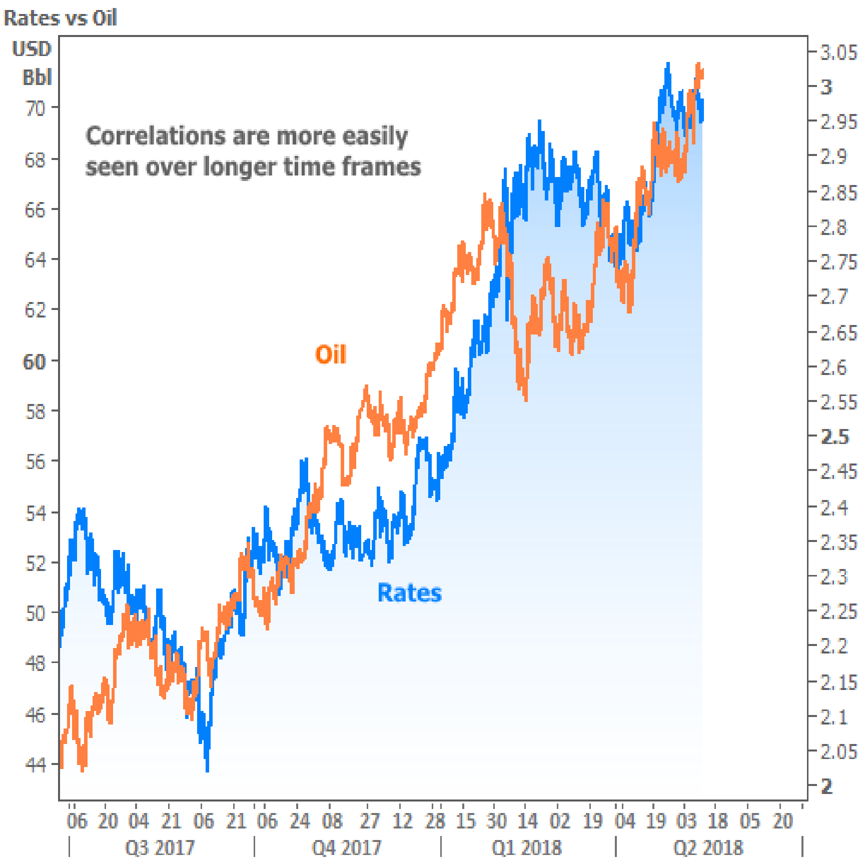
If inflation matters so much to bonds, **what matters to inflation?** Oil is a key consideration because it's generally connected to transportation costs. If a company has to pay more to move its goods, some of those costs are passed on to consumers (known as "supply push" inflation). Granted, this isn't a perfect relationship because consumers are less able to contribute to inflation from the demand side ("demand pull" inflation) if they're paying more at the pump. These subtleties account for the imperfections in the following chart, but the general idea holds true.



Investors are **keeping a close eye** on the bounce in oil prices and the potential bounce in inflation. They're worried we'll see **"the reality"** in the following chart finally shift toward **"the fear"** when it comes to the most important inflation number (Core annual CPI).

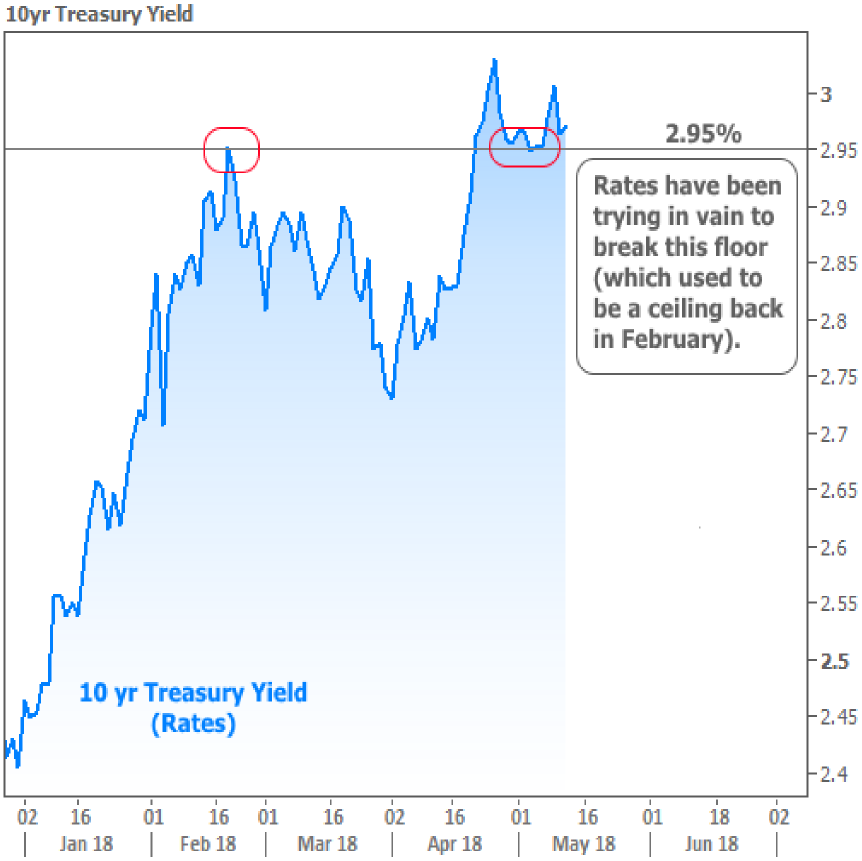
Given bonds' fear of inflation and inflation's relationship to oil, **we wouldn't be crazy** to assume oil prices can have an impact on rates. Granted, other variables make for questionable shorter-term correlation, but longer time frames look much less questionable.


Rates vs Oil
USD
Bbl
Short-Term Correlations are Questionable
Rates
(10yr)
Oil
rates higher
oil flat
oil higher
rates flat
April 2018
May 2018


Rates vs Oil
USD
Bbl
Correlations are more easily
seen over longer time frames
Oil
Rates
Q3 2017
Q4 2017
Q1 2018
Q2 2018

All this to say that to whatever extent the abandonment of the Iran nuclear deal puts upward pressure on oil prices in the US, it will also be contributing in some way to upward pressure on rates.

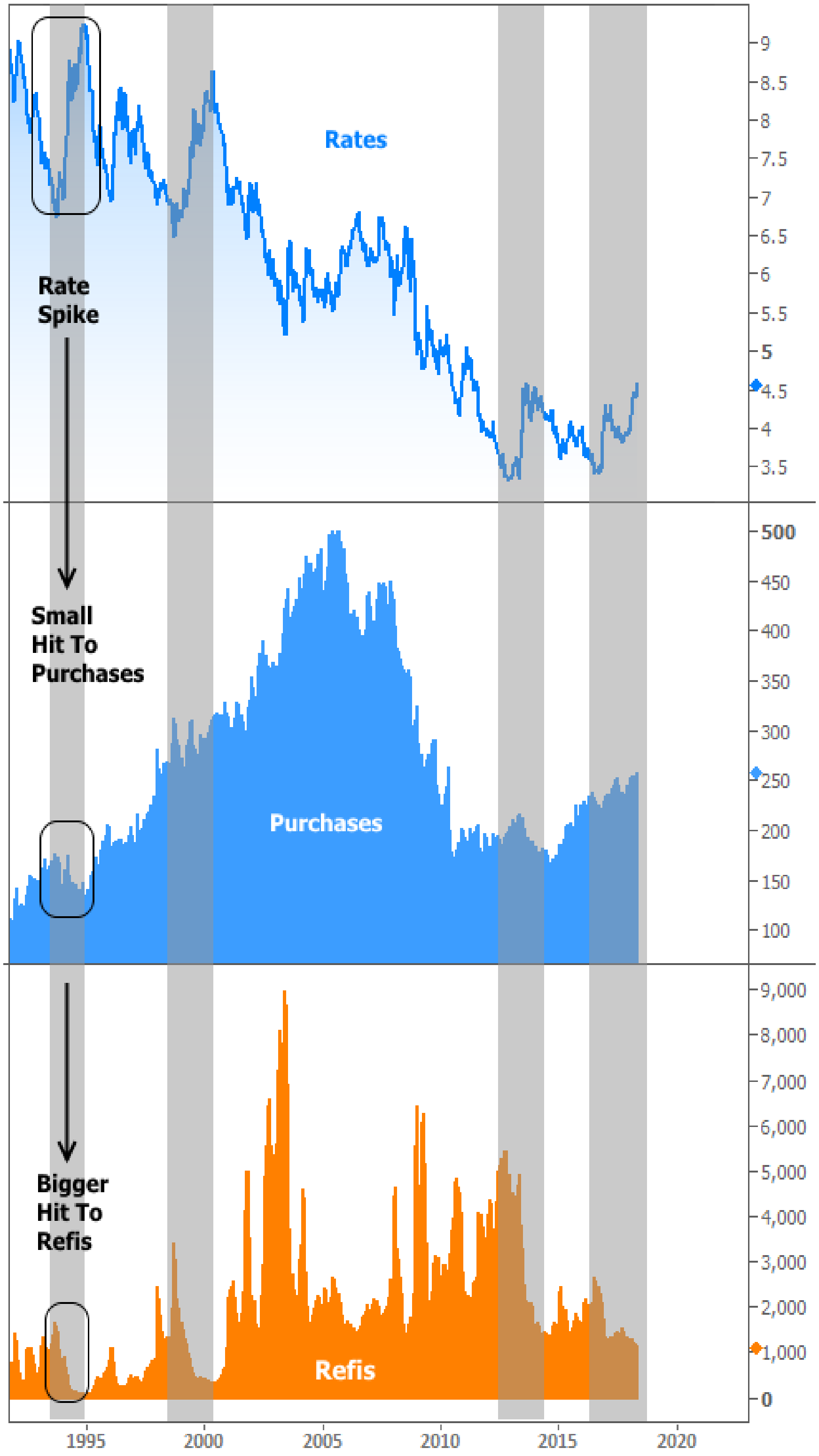
Upward pressure on rates is a **big deal** at the moment because they're currently very close to the **highest levels in more than 4 years**. Most recently, a key level has emerged in 10yr Treasury Yields (the yardstick by which all other long term rates in the US--like mortgages--are measured). Earlier this year, 2.95% acted as a firm ceiling for rising rates before finally giving way in late April. Since then, rates have made repeated attempts to get back below. All have failed.



Housing Considerations

As the chart above suggests, the inability to get back below 2.95% could mean that rates are forced to break above 2013/2014 highs--something that's definitely on the radar of many market watchers. Higher mortgage rates are obviously somewhat of a hindrance to the housing market, but **how much objective damage** could they cause? Past precedent is no guarantee, but it's encouraging (at least in terms of the ability of PURCHASES to weather the storms of rising rates).

The following chart shows past examples of mortgage rate spikes and the corresponding changes in purchase and refinance applications. Logically, **refis get hit hard**. Purchases, on the other hand, seem to escape with **barely a scratch**. This has been especially true of the current rising rate environment that began in late 2016.



In short, rates will have **SOME impact** on purchase demand, depending on how much they rise and how quickly, but there are more important headwinds. These include the **usual suspects** like ultra tight supply of new homes, and a shortage of skilled labor for builders. Both were noted in separate reports this week from the Mortgage Bankers Association and the National Association of Home Builders.

Despite the construction headwinds--or perhaps because of their effects (persistently higher home prices)--a Fannie Mae survey showed a record high in its Home Purchase Sentiment Index. And if you prefer to look at such numbers through **a darker lens**, increased selling interest could also be another reason to ask the question posed in last week's newsletter.

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Tuesday, May 08				
1:00PM	3-Yr Note Auction (bl)	31		
Wednesday, May 09				
7:00AM	w/e MBA Purchase Index	257.7		258.1
7:00AM	w/e Mortgage Refinance Index	1098.4		1104.9
8:30AM	Apr Producer Prices (%)	0.1	0.2	0.3
8:30AM	Apr Core Producer Prices YY (%)	2.3	2.4	2.7
10:00AM	Mar Wholesale inventories mm (%)	0.3	0.5	0.5
Thursday, May 10				
8:30AM	Apr CPI mm, sa (%)	0.2	0.3	-0.1
8:30AM	Apr Core CPI Year/Year (%)	2.1	2.2	2.1
8:30AM	w/e Jobless Claims (k)	211	220	211
Friday, May 11				
8:30AM	Apr Import prices mm (%)	0.3	0.5	0.0
8:30AM	Apr Export prices mm (%)	0.6	0.3	0.3
10:00AM	May 1yr Inflation Outlook (%)	2.8		2.7
10:00AM	May 5yr Inflation Outlook (%)	2.5		2.5
10:00AM	May Consumer Sentiment	98.8	98.5	98.8
Tuesday, May 15				
8:30AM	Apr Retail Sales (%)	+0.3	0.3	0.6
8:30AM	May NY Fed Manufacturing	20.1	15.00	15.80
10:00AM	May NAHB housing market indx	70	69	69
10:00AM	Mar Business Inventories (%)	0.0	0.1	0.6
Wednesday, May 16				
7:00AM	w/e Mortgage Market Index	376.5		387.1
8:30AM	Apr Build permits: change mm (%)	-1.8		4.4
8:30AM	Apr House starts mm: change (%)	-3.7		1.9
9:15AM	Apr Industrial Production (%)	+0.7	0.6	0.5
Thursday, May 17				
8:30AM	May Philly Fed Business Index	34.4	21.0	23.2
8:30AM	w/e Jobless Claims (k)	222	219	211

Event Importance:

No Stars = Insignificant
Low
Moderate
Important
Very Important

Date	Event	Actual	Forecast	Prior
10:00AM	Apr Leading index chg mm (%)	0.4	0.4	0.3
Wednesday, Jul 11				
1:00PM	10-yr Note Auction (bl)	22		
Thursday, Jul 12				
1:00PM	30-Yr Bond Auction (bl)	14		

Who is Mid Valley Financial?

Mid Valley Financial, located in Fresno, CA, is the Central Valley's premier destination for a wide range of residential and commercial real estate loans. Our commitment to excellence has made us a trusted partner for property buyers and investors seeking tailored financial solutions.

Why Choose Us:
With a track record spanning back to our inception in 1985, we have established ourselves as a reliable and innovative lender. We proudly serve properties exclusively within California, having funded loans in all 58 counties of the state. Our deep-rooted experience enables us to navigate complex loan scenarios with expertise and efficiency.

Our Approach:
At Mid Valley Financial, we prioritize your financial goals. Whether you're a first-time homebuyer, envisioning your dream property, refinancing an existing mortgage, or looking to tap into your property's equity, our seasoned loan officers offer a wealth of knowledge and over 300 years of collective experience. We ensure that your funds are prepared when you need them, providing a smooth and swift loan process.

Unlocking Possibilities:
As one of California's leading direct lenders, we've streamlined the loan process, minimizing obstacles that often deter borrowers. Many of our clients receive approvals within an hour, showcasing our dedication to quick and hassle-free solutions.

Your Journey with Us:
Contact the MVF team today and let us put your journey to property ownership on cruise control. Our mission is to empower borrowers while fostering enduring and meaningful relationships. With highly competitive rates, a commitment to transparency, and a dedication to your financial success, Mid Valley Financial is your partner in realizing your real estate aspirations.

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