



Mid Valley Financial

Mortgage Banker, Since 1985

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Inevitable Showdown Finally Arrives

In the wee hours of the morning following election day last year, markets were in a state of **complete disarray**--especially bond markets (which dictate rates). After a significant improvement initially, rates embarked on their single worst trading day since the 2013 taper tantrum. Did they know something back then about where we'd end up today?

Looking back at the [newsletter from 11/11/2016](#), there are some major clues. Here's an excerpt:

Markets knew exactly how Clinton would have governed, but Trump's likely policy path had to be extrapolated from plausible campaign promises, past precedent in the business world, and perhaps an episode or two of the Apprentice. Point being, markets had to have some dialogue and debate about what was likely to happen under the Trump administration.

The GOP sweep of the House and Senate was a wild card that kicked the dialogue into high gear. Light bulbs began going off in traders' minds, illuminating things like protectionist trade policies, hefty tax cuts, increased infrastructure spending, abandonment of the Fannie/Freddie conservatorship, the potential repeal of Dodd Frank, a dismantling of the Affordable Care Act, and a muzzling of the CFPB.

It's astonishing just how accurate the market's speculation turned out to be. Here we are just over a year later, **staring down the barrel** of several of the biggest risks outlined in the excerpt. To be clear, the "big two" are the tax cuts and the infrastructure spending.

As of this week, the Senate and the House have moved into "conference" in order to reconcile their respective versions of the tax bill (both have passed, but now they have to agree on a final version). In separate news, Trump said he'd announce an infrastructure spending plan in January 2018.

While we don't know what the reconciled version of the tax bill will look like yet, we can be **100% sure** that it will increase the deficit (same story for infrastructure spending, but we'll cross that bridge in January if and when we come to it). Increasing the deficit means the government either needs to **collect** more revenue or **borrow** more money.

Revenue can increase if taxes increase, or if taxpayers earn more money (same tax rate + more income = more revenue for Uncle Sam). On average, revenues certainly aren't increasing as a result of the tax bill, so additional

National Average Mortgage Rates



	Rate	Change	Points
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Mortgage News Daily

30 Yr. Fixed	6.89%	0.00	0.00
15 Yr. Fixed	6.33%	+0.01	0.00
30 Yr. FHA	6.33%	+0.01	0.00
30 Yr. Jumbo	7.05%	0.00	0.00
5/1 ARM	6.58%	0.00	0.00

Freddie Mac

30 Yr. Fixed	6.77%	-0.09	0.00
15 Yr. Fixed	6.05%	-0.11	0.00

Rates as of: 7/22

Market Data

	Price / Yield	Change
MBS UMBS 5.5	99.39	-0.01
MBS GNMA 5.5	99.78	+0.00
10 YR Treasury	4.2262	-0.0263
30 YR Treasury	4.4454	-0.0271

Pricing as of: 7/23 6:51AM EST

Recent Housing Data

		Value	Change
Mortgage Apps	Jul 10	206.1	-0.19%
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%

revenue **would have to** come from increased growth or increased government borrowing.

Even the most optimistic non-partisan estimates suggest that revenue growth won't offset **even half the cost** of the tax bill. That leaves hundreds of billions of dollars in increased borrowing needs for the government, and that's before broaching the topic of an infrastructure spending plan.

The government borrows money primarily through the issuance of Treasuries: government bonds purchased by institutions, foreign governments, day traders, money managers, pension funds, and even **old Grandma Dorothy** who gave me that funky-looking check thingy when I was 8 years old.

If the supply of those bonds rises relative to demand, interest rates in the US move higher. Moreover, if the policies in question help the economy, **inflation** could increase. Rising inflation makes Grandma Dorothy's savings bond worth a lot less as the years go by, so investors tend to **ditch** those if inflation picks up.

Back in 2016, traders didn't have to be **clairvoyant** to see that increased bond market supply was likely. The associated inflation risks only strengthened the case for bond traders to sell first and ask questions later. That's exactly what we saw in late 2016 and exactly **why** we saw it. It also helps explain why bonds jumped much more noticeably than stocks.

The **silver lining** here is that rates got a lot of the pain associated with the tax bill out of the way a year ago, simply by **hedging their bets** against reasonable legislative probabilities. Case in point, the materialization of the tax bill in recent months only created a **moderate** rise in rates (red circle in the chart below). Notably, the overall trend since the beginning of the year is still arguably "sideways to slightly lower (blue dotted lines).

10yr Treasury Yield vs Stocks



While it's **possible** that rates have some more rising to do in the event the tax bill is passed, I'd argue bond markets have already mostly adjusted. It will take other developments to fully shape near term rate momentum.

Two of those developments **arrive next week** in the form of monetary policy announcements from the Fed and the European Central Bank. Whereas government spending pushes rates higher by increasing the supply of debt, **the Fed** moves rates by "deciding" where short-term rates need to be in order to balance growth and inflation. They then buy/sell accordingly, thus forcing rates to their preferred level.

We can already be **100% certain** that the Fed **will** hike rates again next week. Put another way, if rates are moving higher next week, it **WON'T** be because the Fed hiked its policy rate. But the Fed also releases important information 4 times a year that helps market participants gauge the future path of rates. Next Wednesday is one of those 4 times.

The European Central Bank (ECB) will follow on Thursday with its own policy announcement. Their course is fairly well set for now as they've already announced a 50% decrease in bond purchases in the first 3 quarters of 2018. Traders will nonetheless be looking for clues about how the ECB will handle certain problems that might arise during that time.

With the central bank announcements, a potential finish line in sight for the tax bill, and important inflation data to be reported, next week could see big moves in rates. One mitigating factor is that mortgage rates haven't been quite as volatile as 10yr Treasury yields (the best benchmark for following mortgage rate momentum). That said, if Treasuries break above certain ceilings (like 2.42%), mortgage rates will be forced to follow--reluctant though they may be.

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Recent Economic Data

Date	Event	Actual	Forecast	Prior
Monday, Dec 04				
10:00AM	Sep Factory orders mm (%)		1.3	1.2
Tuesday, Dec 05				
10:00AM	Nov ISM N-Mfg PMI	57.4	59.0	60.1
Wednesday, Dec 06				
7:00AM	w/e Mortgage Market Index	408.3		390.0
7:00AM	w/e Mortgage Refinance Index	1313.9		1205.1
7:00AM	w/e MBA Purchase Index	250.6		244.7
8:15AM	Nov ADP National Employment (k)	190	185	235
8:30AM	Q3 Productivity Revised (%)	3.0	3.3	3.0
8:30AM	Q3 Labor Costs Revised (%)	-0.2	0.2	0.5
Friday, Dec 08				
8:30AM	Nov Non-farm payrolls (k)	228	200	261
8:30AM	Nov Unemployment rate mm (%)	4.1	4.1	4.1
10:00AM	Dec Consumer Sentiment	96.8	99.0	98.5
10:00AM	Dec 1yr Inflation Outlook (%)	2.8		2.5
10:00AM	Dec 5yr Inflation Outlook (%)	2.5		2.4
Monday, Dec 11				
11:30AM	3-Yr Note Auction (bl)	24		
Tuesday, Dec 12				
8:30AM	Nov Core Producer Prices YY (%)	2.4	2.3	2.4

Event Importance:

No Stars = Insignificant

☆ Low

★ Moderate

★★ Important

★★★ Very Important

Date	Event	Actual	Forecast	Prior
Wednesday, Dec 13				
7:00AM	w/e Mortgage Market Index	398.8		408.3
8:30AM	Nov CPI mm, sa (%)	0.4	0.2	0.1
8:30AM	Nov Core CPI Year/Year (%)	1.7	1.8	1.8
2:00PM	N/A FOMC rate decision (%)	1.250 - 1.500	1.375	1.125
Thursday, Dec 14				
8:30AM	Nov Import prices mm (%)	0.7	0.7	0.2
8:30AM	Nov Export prices mm (%)	0.5	0.2	0.0
8:30AM	Nov Retail Sales (%)	0.8	0.5	0.2
8:30AM	w/e Jobless Claims (k)	225	234	236
10:00AM	Oct Business Inventories (%)	-0.1	-0.1	0.0
Friday, Dec 15				
9:15AM	Nov Industrial Production (%)	0.2	0.3	0.9
9:15AM	Nov Capacity Utilization (%)	77.1	77.2	77.0
Wednesday, Jan 10				
1:00PM	10-yr Note Auction (bl)	20		
Thursday, Jan 11				
1:00PM	30-Yr Bond Auction (bl)	12		

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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