

*No article we've ever seen has done a better job at explaining why Fed cuts don't translate into mortgage rate reductions. And why, sometimes, Fed cuts can stimulate a rise in mortgage rates. Kudos to Editor Sloan of Newsweek.*

# Newsweek

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## Why Mortgage Rates Aren't Falling

by Allan Sloan, Wall Street Editor for Newsweek

If you think that Alan Greenspan really controls interest rates, you haven't looked at the mortgage market lately. Uncle Alan has cut short-term interest rates by 2.5 percentage points so far this year. But the rate on 30-year mortgages—the most popular choice among homebuyers—has barely budged. That rate averaged 7.22 percent last week, according to HSH Associates, only a freckle below the 7.31 percent it averaged for the first week of the year.

**Wait a minute. With the Fed cutting short-term rates like crazy, why haven't 30-year mortgages gotten cheaper? The answer is that modifier you probably skipped over: "short-term." The Fed controls short-term interest rates, but it doesn't control long-term rates. Most people blithely assume that long rates and short rates move in tandem—but they don't. And long-term rates are the key to what lenders charge for long-term, fixed-rate mortgages. "The Fed influences short-term rates to a very high degree, but it controls long-term rates to a lesser degree and sometimes not at all," says David Berson, chief economist of Fannie Mae, the nation's biggest supplier of mortgage money.**

The disconnect between short-term rates and long-term mortgage rates is logical, but most people don't know about it. "We're in a sound-bite world," says Keith Gumbinger, vice president of HSH Associates. "People hear that the Fed is cutting interest rates, and they think the Fed is cutting all interest rates. But it's not." That's why people bombard mortgage lenders with protests every time the Fed cuts rates but mortgages don't fall.

Here's the deal. The only economically significant rate the Fed controls directly is the federal funds rate — what banks charge each other for overnight loans. The Fed influences long-term rates by moral suasion, market clout and influence, but has no direct control of them. Because fixed-rate mortgages are long-term loans, they're heavily influenced by long-term rates, especially the rate on 10-year U.S. Treasury securities. If you look at an interest-rate chart, you'd see that as of Friday, 10-year Treasuries were yielding about 5.5 percent, up from 4.9 at the start of the year.

To see how little direct control the Fed has over long-term rates, consider last year. The 10-year Treasury rate and mortgage rates fell sharply, even though the Fed raised short-term interest rates. Hello? What's going on here? It's simple. The stock market loves short-term-rate cuts, but the long-term-bond market hates them. "When you cut short-term rates, you're adding to the money supply, and that has the potential to be inflationary," says Joseph Rosenberg, the chief investment officer at Loews Corp. Long-term lenders fear inflation, which erodes the value of their money.

So you can see that Alan Greenspan isn't the all-powerful free agent many people think him to be. He can't cut short-term interest rates blithely. He's got to worry about the long-term-bond market, as well as trying to stimulate the economy short term. The bottom line: if the Fed cuts short-term rates this week, don't expect mortgage rates to tumble. In fact, don't be surprised if mortgages rise, because long-term rates spiked up last week. Don't blame Uncle Alan. It's not his fault, it's the way the world works.