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4.5% Rates Possible?

The news is abuzz about the Treasury lowering home loan rates to 4.5% to stem the foreclosure crisis but details have been lacking. The Treasury Department stated it is looking for additional ways to help the struggling housing industry and believes lower rates are needed.

This idea is similar to the November 26th announcement from the Federal Reserve where they indicated the intent to purchase up to \$500 billion in mortgage-backed securities from Fannie Mae, Freddie Mac and Ginnie Mae. In addition they would buy another \$100 billion in direct debt issued by those firms. The November news caused bond prices to spike higher and forced mortgage rates lower. Just like any commodity, whenever tremendous buying interest exists, prices rise. Mortgage rates fell almost 1/2% in rate following the announcement. However, the following week market forces continued and rates spiked a bit higher from the recent lows.

It is important to remember that there are no details to the Treasury plan as of yet. The Federal Government does not directly dictate home loan rates. Rates are determined by price movements of Mortgage Backed Securities (MBS), which compete for investor funds in the open market. The Treasury can buy mortgage bonds on the open market but remember that they are not the only entity buying and selling these instruments.

The Treasury is in a very tough position in trying to manipulate home loan rates. Creating a new Federal mortgage program could be very risky. How would rates be set, who would qualify, and can the funds be used for purchases and refinances are just some of the questions being asked. The other critical concern is implementing such a program without destroying the current mortgage securities market. Doing so could have the unintended consequence of causing additional economic turmoil.

Rates are not going to 4.5% with the wave of a wand by Hank Paulson or Ben Bernanke. As a matter of fact, the massive borrowing to fund the TARP program has a negative effect on rates. At this time, the announcement still leaves a lot of uncertainty. **What we do know is that rates are at historic lows and house prices have moderated setting up a great scenario for people who need to refinance or are looking to buy a home. Waiting for rates to fall to 4.5% may leave people sorely disappointed.**