



MBS: The Real Driver of Home Loan Rates

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We've heard it over and over!

Reporters in financial media who present information on the Bond markets continually make erroneous assumptions about the relationship between home loan rates and the U.S. 10-year Treasury Note.

This happens for one reason—while most financial reporters may understand the Bond markets in general, they aren't mortgage experts and don't fully understand how home loan rates are determined.

Financial reporters often tie home loan rates to the performance of the U.S. 10-year Treasury Note—**but this is a mistake!** In reality, home loan rates and the intra-day re-pricing that occurs are determined by the performance of Mortgage Backed Securities (also called MBS or Mortgage Bonds), not the U.S. 10-year Treasury Note.

What is the 10-year Treasury Note?



The 10-year Treasury Note is a barometer for the health of the economy and one of the most widely watched securities in the world. When the yield on the 10-year Treasury Note is between 4 to 5 percent, it signals that the economy is running on all cylinders. While the 10-year Treasury Note

is extremely valuable in ascertaining the strength of the economy, it takes a backseat to Mortgage Backed Securities when lenders are pricing loans.

What are Mortgage Backed Securities?

Mortgage Backed Securities are a type of asset-backed security that is secured by a mortgage or collection of mortgages. These securities are grouped into one of the top two ratings as determined by an accredited credit rating agency, and usually pay periodic payments that are similar to coupon payments. Furthermore, mortgages grouped into these securities must have originated from a regulated and authorized financial institution like a bank or thrift.

What is the Fed's Take?

When the Federal Reserve first embarked on lowering home loan rates in November 2008, they did it by directly purchasing Mortgage Bonds in the open markets. They took this action to **“reduce the cost and increase the availability of credit for the**

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purchase of houses.” Ultimately, their goal was to “support housing markets and foster improved conditions in financial markets more generally.”

In addition, the Federal Reserve said Mortgage Backed Security purchases would reduce the available supply of securities in the market, leading to an increase in the prices of those securities and a reduction in their yields. In other words, when the price of Mortgage Backed Securities rises, home loan rates move lower. They work in an inverse relationship.

The biggest takeaway is that when the Fed announced its purchases of Mortgage Backed Securities in 2008, there was no mention of the 10-year Treasury Note! If the U.S. central bank deemed that Mortgage Backed Securities dictate home loan rates, there should be no question as to what security is the determining factor of mortgage rate movements.

Mortgage Market Guide is Here to Help

Just remember, when a reporter on your favorite news program says something about interest rates, that person could have been covering the Westminster Dog Show or the latest fashion trends the week before. So please don't rely exclusively on mortgage advice from a person on your television screen.

FIXED RATE MORTGAGE-BACKED SECURITIES								
Security	Last Sale	Day Change	9:30AM EST	10:00AM EST Thu	10:30AM EST Thu	11:00AM EST Thu	11:30AM EST Thu	12:00PM EST Thu
FNMA 30-Year 4.0%	\$104.50	9bp	0bp	19bp	16bp	16bp	19bp	22bp

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