Mortgage rates rise, and this time, the Fed matters

NORTH PALM BEACH, Fla. -- March 30, 2006 -- The Federal Reserve raised interest rates, so mortgage rates went up, too -- just as surely as April showers bring May flowers. Right? Maybe this time, but not always.

Yes, the Fed hiked short-term rates. Yes, mortgage rates ratcheted upward for the first time in three weeks. But you can't draw a straight line between the two events and say A directly caused B. If an all-knowing economist with an artistic bent were to draw the linkage between the Fed's monetary policy and long-term mortgage rates, it would resemble a Rube Goldberg cartoon.

The benchmark 30-year fixed-rate mortgage rose 5 basis points to 6.44 percent, according to the Bankrate.com national survey of large lenders. A basis point is one-hundredth of 1 percentage point. The mortgages in this week's survey had an average total of 0.38 discount and origination points. One year ago, the mortgage index was 6.13 percent; four weeks ago, it was 6.27 percent.

The 15-year fixed-rate mortgage rose 6 basis points to 6.12 percent. The 5/1 adjustable-rate mortgage rose 9 basis points to 6.13 percent.

Mortgage rates' anticipatory rise

When the Fed raised its target for the federal funds rate by a quarter of a point Tuesday, the action came after weeks of hints from the central bank's officials. Bond traders had plenty of time to mull things over. They had two months, in fact: At the Jan. 31 rate-policy meeting, the Fed made it obvious that another rate hike was in store at the next meeting, eight weeks hence, on March 28.

Rates on 30-year mortgages tend to move up and down alongside yields on 10-year Treasury notes. Those Treasury yields gradually went up exactly a quarter point in the eight weeks between Fed meetings, from 4.53 percent on Jan. 31 to 4.78 percent March 28.

It's unusual for yields to move in lock step with the Fed's rate moves. In 2004 and parts of 2005, Treasuries and the federal funds rate often went in opposite directions. Short-term rates rose faster than long-term rates. They eventually caught up: Yields on two-year, five-year, and 10-year Treasuries were virtually equal. That, too, is uncommon -- usually, longer-term bonds have higher yields.

Where mortgage rates are headed

What does this mean for mortgage rates? With Treasury yields so flat across the board, a rise in short-term yields forces long-term yields to go up, too, and mortgage rates follow. If mortgages ride in tandem with the federal funds rate -- a big if -- the 30-year mortgage will rise another quarter point or so by the next Fed meeting, on May 10.

"Enough, already," says Bob Moulton, president of Americana Mortgage, a broker based on Long Island. He says he wishes the Fed "would leave us alone."

"I think they" -- meaning the Fed -- "need to look at the cooling housing market," Moulton continues. "Things are definitely slowing down, and rates have something to do with it."

All right, all right, fight inflation

He's not the only person who's ready to cry uncle. Anthony Hsieh, president of LendingTree.com, says he understands that the Fed is hiking rates to fight inflation, but for the sake of business, he kind of wishes the central bank would stop already.

"As much as I want the Fed to not do anything that's not necessary to not push this over the edge, they have to err on the hard side," Hsieh says. By "err on the hard side," Hsieh means that he believes the Fed would rather raise rates too high, keeping inflation in check but slowing the economy, rather than keeping rates too low and allowing inflation to get out of control.

The mortgage industry laments the cooling of the refinancing market. People are still refinancing, but "it's more need-driven than rate-driven," Moulton says. Instead of refinancing to grab lower rates, people are refinancing to get out of adjustable-rate mortgages, pay off the balances on their home equity lines of credit, raise money for home improvement or college tuition, or as part of divorce settlements.

Moulton is convinced that rates will continue to climb for a while, so it's better to refinance sooner than later.