

They're a sign of a healthy economy and a portent of lower home prices.



LIFE SCIENCE

Hurray for Higher Mortgage Rates

The average 30 year mortgage rate last week popped up to 7.28%, the highest in three years and more than double the average for 2020-21. The press tells us this bodes ill. Rising mortgage rates will make homes less affordable and could hurt the economy.

Just the opposite. Today's higher mortgage rates herald a return to normalcy and make homes more affordable over time. They are a sign of a healthy and strengthening economy. Note

The real risk isn't that the housing market will collapse because fewer people can afford homes, but that housing regulators relax underwriting standards to help borrowers take out bigger mortgages than they can afford. This is what the Biden team did when mortgage rates rose in 2022, which merely fueled higher prices and taxpayer risks. Note

The press presents the current 30-year mortgage rate as a historical aberration. It isn't. Millennials may not recall a time when rates were as high. For most of their adult lives, rates ranged between 2.5% and 5%. But that was the aberration. Note

The 30-year mortgage rate averaged 8% between 1971 and 2019 and hovered between 7% and 9% during most of the 1990s, when the economy grew 3.4% annually on average. Economic growth has generally been stronger during periods of higher mortgage rates. Note

One reason is that the 30-year mortgage rate tracks the 10-year Treasury rate. When the economy or inflation heats up, Treasury yields rise. Mortgage rates follow. In recent months, the economy and inflation have accelerated, pushing up mortgage rates. Note

After the 2008-09 financial panic and again during the pandemic, the Federal Reserve bought trillions of dollars in mortgage-backed securities along with Treasuries. This had the effect of suppressing mortgage rates. But as the Fed tightened, it reduced its portfolio of mortgage-backed securities, causing rates to drift up. Note

Banks have become more reluctant buyers of mortgage-backed securities, which has also pushed up rates. Reduced bank buying of mortgage-backed securities is a salutary development. During the pandemic, when the government sent trillions of dollars slushing through the economy, bank deposits ballooned. Banks invested a large share of their deposits in mortgage-backed securities because these were considered safe and relatively liquid assets. Plus, demand for business loans was weak. As interest rates rose, banks found themselves sitting on depreciating assets. Note

Silicon Valley Bank's large portfolio of mortgage-backed securities plunged in value, contributing to its ultimate failure in March 2023. Banks now demand a higher yield premium on mortgage-backed securities to compensate for the risk that rates will rise and their value will decline. This, too, has had the effect of pushing up mortgage rates. Note

Because of the strengthening economy, business loan demand has increased and banks now have many more productive ways to invest deposits. Bank loans to businesses have surged over the past year and now surpass their holdings of mortgage-backed securities. This is good, although competition for credit also boosts mortgage rates. Note

The silver lining for home buyers is that higher mortgage rates suppress demand, especially by investors. Higher interest rates combined with elevated home prices, plus slow growth in rents, make housing a less attractive investment. Note

The National Association of Realtors reports that 15% of sales in August were for a "non-primary residence," down from 21% a year ago. Investment properties and second homes made up only 4% of new mortgages guaranteed by Fannie Mae in the second quarter, compared with about 8% from 2019 to 2023. *Note*

Note that the decline preceded this summer's law restricting institutional investors from buying single-family homes. The Trump team deserves credit, however, for curbing government mortgage-relief programs that repeatedly waived payments for delinquent borrowers. Foreclosures rose as a result, by 47% over the past year for mortgages backed by the Federal Housing Administration.

This isn't a cause for panic. Foreclosures, suppressed by the Biden team, have merely returned to prepandemic levels. This has freed up more homes for buyers and returned demand and supply to a healthier equilibrium. "The ample supply of homes for sale on the market is giving homebuyers better opportunities to negotiate," the NAR reports. *Note*

The result: slower home-price appreciation. Wages are now growing at about twice as fast as home prices. If this trend continues, Americans will be able to save more for down payments and buying a home will become more affordable.

One danger is that the Trump team will panic over rising mortgage rates and reduce already lax underwriting requirements to help borrowers. An average FHA buyer today has a 691 credit score and 45% debt-to-income ratio yet makes only a 2% down-payment, according to the American Enterprise Institute's Ed Pinto and Tobias Peter.

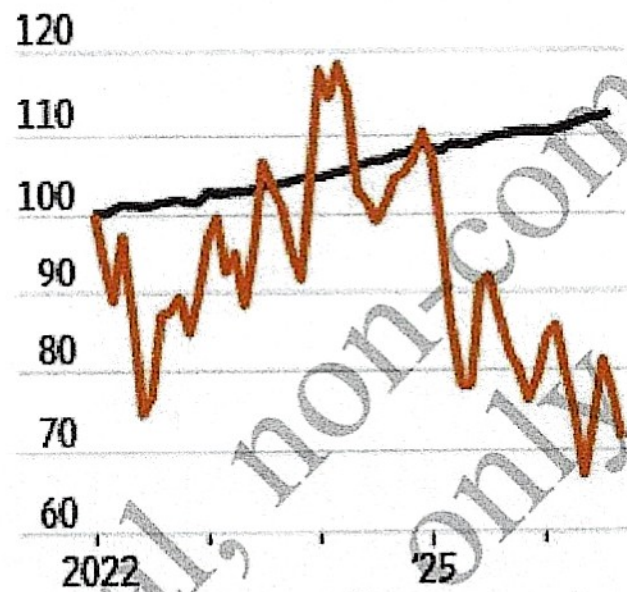
Easing requirements further would only goose demand and drive up prices, while increasing the risk of future defaults and losses for taxpayers who stand behind most mortgages. Better to embrace the reversion to normal mortgage rates and focus on lifting worker wages.

By Allysia Finley

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Bad mood, still shopping

■ Consumer sentiment
■ Real consumer spending



Note: Data indexed to January 2022
Sources: University of Michigan (sentiment),
Bureau of Economic Analysis (spending)

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