



One reason home-loan rates have been high in recent years is that banks are buying fewer mortgage bonds. ZAK BENNETT/ BLOOMBERG NEWS

Why Mortgage Rates Can Move Quickly

It's about the 'arcane underpinnings' of the market for bonds that pool lots of home loans

Anxious home buyers are sometimes advised to watch out for the Federal Reserve's next move. In reality it is the bond market that bears watching the closest, and not just plain old Treasuries.

Long-term bond yields have been drifting lower because of a host of factors, including expectations that the Fed will soon start cutting interest rates but also rising risks of a recession.

The corresponding move in mortgage rates has been stunning: A daily tracker by Mortgage News Daily reported that 30-year fixed rates hit their lowest level since 2024 earlier this month and were at 6.29% this past Friday.

And on the Friday of the mostrecent government jobs report, which showed August hiring at a far slower-than-anticipated pace, 10-year Treasury yields fell 0.09 percentage point. Mortgage News Daily's 30-year fixed-rate tracker dropped by 0.16 point that day.

Plus, the spread between benchmark Treasury yields and mortgage bonds—a key input into mortgage rates—also has compressed sharply in recent days, according to data from Bank of America analysts.

Some of the rapid move in mortgage rates on offer is attributable to what Mortgage News Daily's chief operating officer, Matt Graham, described recently as "the arcane underpinnings" of the market for bonds that pool lots of mortgage loans, known as mortgage-backed securities.

← Note

Standard 30-year fixed-rate mortgage loans, such as those guaranteed by Fannie Mae or Freddie Mac, are often sold off by the originating bank or lender into the mortgage-bond market. These standardized bonds come in halfpoint buckets, or coupon levels. A bond at 6%, then one at 5.5%, and so on. Note

The upshot, according to Graham, is that "rates can drop more quickly than normal as they approach the upper limits of the next lower bucket."

What happens when expectations of future interest rates start to drop rapidly is that bond investors become willing to pay more for the next lower-coupon bucket. And mortgage originators in turn see better pricing in the market for loans that are now in demand for that lower bucket. Note

This is because mortgages at higher rates are more likely to get refinanced and paid back early, creating a risk for bondholders that they will have to reinvest their money at lower rates. In other words, they would rather have a bond with a lower payout but longer lifespan. Note

In the recent moves described by Mortgage News Daily, there had been a shift in investor preferences from the 5.5% coupon bucket, which can accommodate loans with rates from 5.75% to 6.625%, to the 5% one, which can accommodate loans with rates from 5.25% to 6.125%. The difference between loan rates and bucket coupons in part accounts for costs such as the fee charged by Fannie or Freddie to guarantee the mortgage.

There are other dynamics that also may feed into a downward feedback loop for rates. Some investors tend to hedge mortgage bonds by selling Treasuries—so falling rates can actually push them to buy more Treasuries to adjust those hedges, explains Jeana Curro, head of agency mortgagebacked securities strategy at Bank of America. That can push Treasury yields down even faster, in turn pressuring mortgage rates, too. Note

One big reason that home-loan rates have been high in recent years is that banks have been buying fewer mortgage bonds. If conviction gathers that long-term rates are headed down, it could become a self-reinforcing loop—though this outcome is far from certain.

Getting a mortgage is rarely a simple thing. But every once in a while, complexity can happen to work out in home buyers' favor.

—Telis Demos

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