CenterState
CORRESPONDENT DIVISION

Market Update

Economic News

August 28, 2020

Fed Chair Powell's keynote address at the annual Jackson Hole Symposium of central bankers was the main event for the market this week and it didn't disappoint. His address was on the Fed's new Monetary Policy Framework, but it was not clear how much he would actually reveal about the policy ahead of its formal release in September. He actually revealed quite a bit, almost all of it actually. The essence of the framework is that now the Fed will adopt an average inflation rate targeting approach. What that means is if inflation lingers below the target, like we've seen for most of the last decade, the Fed will allow inflation to lift above the target for a period of time before rolling out rate hikes. Powell didn't detail any set methodology to this averaging approach, stressing they want to keep maximum flexibility around the policy. He once again mentioned the Fed Listens Tour where they held 15 community gatherings. He noted only towards the end of the expansion did jobs and wage gains start to flow to lower-income, disadvantaged communities. He's mentioned this in several speeches now so it obviously has struck a nerve with him. It's clear that while he is chairman, the Fed's dual mandate will be guided more by the full employment directive than the price stability mandate; that is, until we are back to something approaching full employment. The long-end of the Treasury market sold off on the assumption the Fed will let the economy run hot in the next few years to encourage fulsome job creation. The question we have is just because the Fed wants higher inflation can they make it happen? The track record over the past decade has not been good. Plus, how high are they willing to let yields rise on the long-end given the shortfall in full employment? We think not too high before QE is deployed in more force. Thus, we see long-end back ups here as buying opportunities rather than trend reversals.

You can add pending home sales to the long list of housing-related indicators that are pointing to a red-hot sector. Pending home sales for July were up 5.9% month-over-month beating the 2.0% forecast but off the 15.8% bounce in June. The rebound in June and follow-through in July propelled contract signings to the highest level since the housing boom 15 years ago. Also of importance, on a year-over-year basis (because home sales have strong seasonality), pending home sales rose 15.4% from a year ago versus 10.8% expected and 11.8% YoY in June. What's more, this is another of those housing reports based on contract signings and not closings so it's a more real-time look at the sector and that real-time look looks pretty strong.

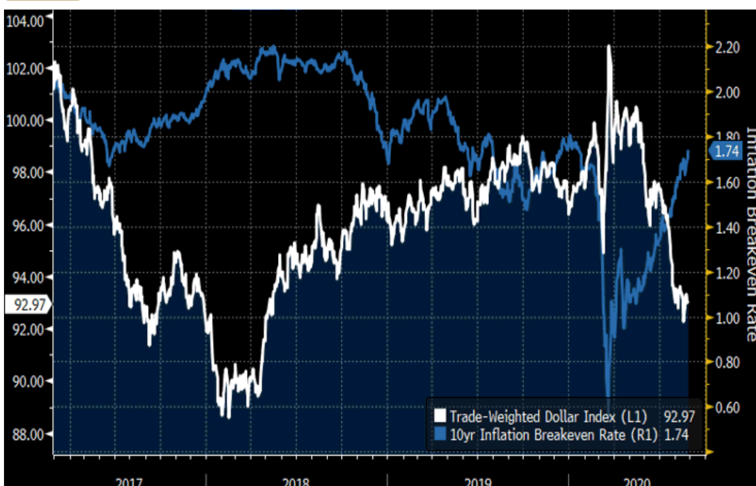
Controversial Refi Fee Delayed Until December 1

On Wednesday, August 12, both Fannie Mae and Freddie Mac announced a 50bp increase in what was called "Loan Level Price Adjustments" in the form of an adverse market refinance fee/Market Condition Credit Fee. The fee was set to start September 1st and was meant to offset expected credit losses by the mortgage giants due to the current economic environment. The fee was to apply to all refinance applications (cash out or no cash out), but not to purchase applications. The impact of the fee would have slowed some refi's and hence slow prepayments on those more cuspy coupon loans. Well, scratch all that. This week Fannie Mae and Freddie Mac announced they will delay the 50bp surcharge on most refinanced home loans by three months.

The Federal Housing Finance Agency, the mortgage giants primary regulator, said the extra fee would be delayed until December 1. The decision followed an outcry from industry groups and lawmakers who said the fee was inappropriate in the middle of a pandemic. The fee was designed to make up for the roughly $6 billion Fannie and Freddie are expected to spend in response to the pandemic, including billions they have had to set aside against possible loan losses.

The outcry over the fee was fierce from industry officials and it drew criticism from the White House, which said it would harm consumers. There was also criticism that it was contrary to efforts by the Fed to keep interest rates low. While the fee delay is welcome news to homeowners looking to refinance, it means the prepayment train will keep chugging down the track as the primary risk to mortgage investors today.

The Dollar and TIPs Breakeven Rates



Since Fed Chair Powell discussed the new Monetary Policy Framework that will guide the Fed in its quest to get inflation to its 2% target we thought we would show what's been happening to two of the keys to inflation and inflation expectations: the TIPs 10yr Inflation Breakeven Rate and the trade-weighted value of the US dollar. The chart shows the two and you can see the climb from the March panic lows in the TIPs breakeven rate (blue line) which is the implied rate of the CPI over the 10yr term of the TIP-security. Currently, it's 1.74% and while that's up from the panic low in March it's still around pre-pandemic levels and certainly well below the 2% target. Meanwhile, the dollar has had quite a fall in the last few months but that too seems to be stabilizing above levels from 2018. So, key indicators are bouncing in ways that imply increased inflation expectations, but we think it more countertrend moves from oversold levels than anything proclaiming inflation alarm.

Market Rates

Treasury Curve	Today	Chg Last wk.	LIBOR Rates	Today	Chg Last wk.	FF/Prime	Rate	Swap Rates	Rate
3 Month	0.09%	Unch	1 Mo LIBOR	0.16%	+0.01%	FF Target Rate	0.00%-0.25%	3 Year	0.254%
6 Month	0.10%	-0.01%	3 Mo LIBOR	0.26%	+0.01%	Prime Rate	3.25%	5 Year	0.359%
2 Year	0.15%	+0.02%	6 Mo LIBOR	0.31%	+0.01%	IOER	0.10%	10 Year	0.745%
10 Year	0.74%	+0.12%	12 Mo LIBOR	0.45%	Unch	SOFR	0.10%		

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