Weekly Market Review

October 6, 2014 — October 10, 2014

"If foreign growth is weaker than anticipated, the consequences for the US economy could lead the Fed to remove accommodation more slowly than otherwise" - Stanley Fischer—Vice Chairman of the Federal Reserve Board

Lesson of the Weak: Fed Speak Can Strongly Influence Rates

Over the weak, the Libor curve dropped anywhere between 10 and 15 bps from the 2-30yr points. Over the last two weeks, rates are down 10-20bps. Treasury rates have hit their lowest levels in 15 months, largely due to perception of a global slowdown (see Germany's recent economic reports on production and output). The most commonly quoted 30yr rate was 4.125% pushing mortgages to depressing lows. Aside from ISIL's advances on Kobani and continued Ebola concerns, there was little geopolitical chatter. Europe has been experiencing depressing growth, but this is hardly a new story. In the U.S, there was practically no new economic data point over the week. The Federal Reserve released their minutes, which was a bit softer than maybe some participants expected, yet nothing that would drive this rate movement. Excluding weakness in Europe, we must conclude that the result of the recent drop in rates is largely attributed to the various Fed Reserve speeches that came out Wed-Fri. The theme was largely cautious.

The Fed's new labor market indicator (LMCI) actually improved along with the unemployment rate hitting 5.9%. Despite these improvements, Kocherlakota suggested in a recent speech that the "distressingly weak labor market" and "sluggish inflation outlook" results in it being "inappropriate for the FOMC to raise the target range for the Fed Funds Rate". Dudley does echo this opinion "labor market still has too much slack and the inflation rate is too low" however he does feel that a mid 2015 rate rise is still reasonable. Charles Evens out of Chicago said that he would hold back a rate increase "until we have an awful lot of confidence that things are taking off". Fischer is very concerned about the rate of global growth (read this pieces headline quote). The conversation was incredibly dovish from the various Fed speakers. Furthermore, the IMF came out suggesting that most countries, and the global economy as a whole, would not meet growth targets that were set (dropped by .2% points). Japan, specifically, will fail to hit their 2% inflation target. Again, no new news has been released, but this helps inform why rates pushed down so hard this week, and over the last two weeks.

Perhaps there was just some pent up demand after the 3Q end which brought on large bond buying in the first two weeks of the month? I think that's a poor speculation. The week's depressing rates were all about the Fed. Investors who trade the securities that dictate mortgage rates were concerned that the September announcements on normalizing monetary policy would justify a move higher in rates. However, recent announcements have been a mixed to dovish so we likely see the market reflecting that change in opinion. We now have a new round of speculation which implies the that there isn't any dire need to move rates up. The release of the minutes drove the treasury and MBS market, and thus the mortgage market as a whole, to the lowest levels in over a year. Bullard was the only Fed president who had anything to say on the hawkish side, stating that the jobs report vindicates his view that rate hikes should come sooner rather than later.

The downward trade in mortgage rates continues to hold with most 30yr fixed quotes between 4 and 4.125% for good quality customers. Our current production has the 30yr conf rate at 4.19 and jumbo 7 bps less at 4.12%. There does seem to be a trend in J/C spread contraction. What is somewhat interesting is the floor/ceiling relationship that the 5/1 and 15 Yr conf rate seem to have. Ultimately, I have no idea why rates are dropping so much. Any recovery in European data will certainly stop some of the safe haven bond flows that drive mortgage rates so strongly. I suspect that we are nearing a floor, lenders will worry about floating, and any good PPI news next week will drive rates up.