# The Fed Giveth; Will It Taketh Away?

**MARKET RECAP**

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More than 200 years ago, Mayer Rothschild, founder of the Rothschild banking dynasty, uttered one of the more profound observations on finance and power. “Permit me to issue and control the money of a nation,” said Rothschild, “and I care not who makes its laws.”

Rothschild recognized that money matters, and it matters a lot. Money is, after all, 50% of every transaction. The importance of how much money is in an economy and the interest to be charged on that money cannot be understated.

Because the quantity of money and the interest charged are so important, much time and attention are extended to the Federal Reserve. The Fed is, after all, our central bank and manages our money supply and the interest to be charged on that supply. When Fed officials speak, markets always listen.

Fed Chair Janet Yellen spoke to Congress this past Wednesday, and markets listened, and for good reason: Ms Yellen offered more insight on quantitative easing (QE) – the Fed’s purchases of Treasury notes and bonds and mortgage-backed securities (MBS) – and the direction of interest rates. In short, QE is going down and interest rates are going up.

As for QE, it’s likely to end by December. The Fed has already reduced its monthly purchases of Treasury notes and bonds and MBS to $55 billion per month effective in April. Should the Fed continue to reduce its purchases at the rate of $10 billion per month, as it has for the past three months, there will be no QE by January 2015.

As for interest rates, Ms Yellen hinted that they could commence rising within six months after QE ends. This means the fed funds rate, in particular, would likely begin to ratcheted up sometime in July 2015. The fed funds rate is currently near zero, and many market participants doubt it will stay there. Futures markets are now pricing a 0.50% fed funds rate by August 2015.

In short, we should expect meaningfully higher mortgage rates this time next year.

As for the here and now, Bankrate.com's and Freddic Mac's most recent weekly surveys actually showed the rate on the 30-year fixed-rate mortgage down week over week. But we need to note that these surveys were winding down just as Ms Yellen was winding up. On Wednesday, rates on most mortgage products moved higher, though not disconcertingly so.

We're even more convinced that we'll likely see 5% on the 30-year fixed-rate loan by this time next year. Note that we say "likely," not "guaranteed." Ms Yellen offered her projections with many caveats and hedges based on growth prospects. As it now stands, though, the Fed expects economic growth could run as high as 3.5% annually in 2015, with the unemployment rate falling to as low as 5.4%.

If the Feds more bullish forecasts come to fruition, rising mortgage rates shouldn't be feared. But that means it becomes more urgent to act sooner on locking in a loan rate. The window on the rates that prevail today will close sooner than many borrowers anticipate.

| Economic Indicator | Release Date and Time | Consensus Estimate | Analysis |
|---|---|---|---|
| S&P Case/Shiller Home Price Index (January) | Tues., March 25, 9:00 am, ET | 13.0% (Year-Over-Year Increase) | Important. Slippage in price gains will likely be seen in more local regions. |
| New Home Sales (February) | Tues., March 25, 10:00 am, ET | 450,000 (Annualized) | Important. Weather will have slowed sales for the month. |
| Mortgage Applications | Wed., March 26, 7:00 am, ET | None | Important. Low purchase activity suggests owner-occupied buyers remain sidelined. |
| Gross Domestic Product (4th Quarter 2013) | Thurs., March 27, 8:30 am, ET | 2.5% (Annualized Growth) | Important. GDP growth has slowed due in part to atypically bad weather. |
| Pending Home Sales (February) | Thurs., March 27, 10:00 am, ET | 0.1% (Increase) | Important. The sales freeze in recent month is showing signs of thawing. |

***Bring on the Warm Weather***

We'll venture to guess that nearly everyone is eager for spring and summer. Winter has been lousy in many regions of the country. Lousy weather, in turn, has been reflected in lousy home sales and construction data.

Weather was surely an influential variable in February, where existing home sales again disappointed. Indeed, sales slipped for the sixth time in seven months, with annualized sales posting at 4.6 million units. Year over year, sales are down 7.1%, the steepest decline in nearly three years.

Fortunately, there are signs that existing home sales will improve in coming months: Prices remain firm, with the median price rising to $189,000. As we've noted many times in the past, rising prices call forth more supply. Indeed, more homes are coming to market, with two million homes for sale in February compared to 1.88 million in January, according to the

NAR’s data . This bodes well for future sales.

On the construction front, housing starts slipped 0.2% to a 907,000-annualized rate in February. The good news is permits jumped 7.7% to a 1.018-million-unit pace after decreasing 4.6% in January. Once the weather warms, the bulldozers should return in force, as should the buyers.