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How Concerned Should Homebuyers Be About Fed Interest Hikes?

It is no surprise that headlines like "Fed Hikes Rates" may discourage prospective home buyers, but ***they should not be discouraged.*** **Jaxzann Riggs**, owner of **The Mortgage Network**, explains why.

Let's Talk Home Financing

By JIM SMITH Realtor®

The "Federal Reserve" is the central bank of the United States. Founded by an act of Congress in 1913 with the primary purpose of enhancing the stability of the American banking system, the "Fed" is charged with helping to set "monetary policy" for the United States. It sets the "federal funds rate" which is ***the interest rate that banks charge each other to borrow or lend excess reserves overnight***.

"Monetary policy" refers to the actions undertaken by the Federal Reserve to influence the availability and cost of money and credit offered to consumers and businesses to help promote national economic goals.

You may have also heard the term "quantitative easing." Quantitative easing (QE for short) is a policy or strategy which has recently been used by the Federal Reserve. During the COVID pandemic, the Federal Reserve not only cut the "Fed funds" rate to zero but it also purchased mortgage-backed and other financial securities to increase the supply of money for homeowners. This encouraged more lending to consumers and businesses. While the result of the policy remains to be seen, most economists suggest that it caused mortgage rates to be held artificially low. The combination of low rates and low housing inventory (construction of new homes fell dramatically following the 2007-2008 fiscal crisis) created the "inflation" of home values with which we are all familiar.

Some assume that the Federal Reserve sets mortgage rates… they do not, but they do ***influence*** mortgage rates. The Fed controls short-term interest rates (mortgage rates are long-term rates) by increasing them or decreasing them based upon the state of the economy. When the economy is struggling, the Fed lowers the rates, allowing banks to borrow money at a lower rate to lend to consumers. When the Fed decides the economy may be overheating (read inflation) they tighten the money supply by raising the Fed funds rate. While this does not directly increase mortgage rates, lenders must eventually do the same to keep up with their costs to borrow money from the Federal Reserve.

On July 27th, the Federal Reserve announced a three-quarter percent interest rate hike, and during that week the average 30-year fixed mortgage rate fell one quarter of a percentage point. When there is talk of the Fed raising their rate, mortgage rates can spike, but they typically correct by the time that the increase is actually announced.

Recent positive unemployment figures may cause the Fed to raise rates once again, but the Fed's chairman, Jerome Powell, has also indicated that there may be a pause on future increases in order to assess their impact on the economy.

We all know that higher rates reduce purchasing power for buyers, but there have been some positives to higher rates. Fewer buyers in the market mean that inventories are rising, and sellers are willing to help buyers with "interest rate buydowns." Buying at the right price is important, but asking the seller to help with the cost of an "interest rate buydown" instead of offering a lower purchase price will have much more impact on a buyer's monthly mortgage payment. Buyers are qualified for monthly mortgage payments versus loan amounts, so reducing the rate on your new home loan increases your buying power.

If you have lending questions about your personal circumstance, Jaxzann Riggs is standing by at **(303) 990-2992**.