

# *WestMichiganMortgageHelp.com*

## **WHAT'S THE INTEREST RATE?**

Written By: Harry Gribnitz

*In my monthly letter, I normally try to find a subject that I hope you will find interesting from outside the mortgage and real estate business. However the number of calls I have received over the last few months that started "What's the interest rate?" inspired me to try to provide a simple explanation of how mortgage rates are influenced (or not influenced) by the action of the Federal Reserve Board. Please understand that many scholarly texts and more than a few graduate business school theses have been written on the subject. I am going to try to summarize some basics in a few paragraphs.*

*The Federal Reserve Board attempts to influence the economy through the use of Monetary Policy. They adjust the Intended Federal Funds Rate (The lowest of short-term interest rates, which the banks charge each other for overnight loans.) The Fed tries to achieve the targeted Federal Funds rate by buying or selling U. S. Treasury or agency securities through open market operations (Federal Open Market Committee). Lowering the target rate is intended to boost the economy. Raising the target rate is often used to slow the economy and fight inflation. A secondary impact is to influence the stock market as investors often react to the Fed's effort to influence the economy by buying or selling stocks.*

*Mortgage rates are influenced by the Bond Market, rather than by the Stock Market. Lenders often sell mortgages to the Secondary Market investors. Secondary Market investors include Fannie Mae and other financial institutions. Fannie Mae issues Mortgage Backed Securities (MBS) to provide a flow of funds into the mortgage industry. Fannie Mae MBS are highly liquid securities that are traded on Wall Street through security dealers. The bond yield (effective interest rate) is determined by the marketplace.*

*If you haven't fallen asleep or thrown this letter in the wastebasket in frustration, let's try a simple example. Last November and December the Stock Market was falling in response to a slowing economy. Investors moved their money from stocks into the relative safety of the Bond Market including MBS. The flow of money into bonds raised the price of bonds and lowered the effective interest rate. Without any action by the Fed (Federal Funds Rate had been 6.50% since 5/2000), 30 year mortgage interest rates dropped from about 8.5% to about 7.5%. When the Fed announced its first rate cut on January 3rd and second cut on January 31st, the publicity made the general public more aware, but had little actual influence on mortgage interest rates.*

*Over the last three months, the Stock Market has continued to react to all the various economic, political and psychological factors that influence the price of stocks. Those of you who follow the*

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*Dow, have been watching it fluctuate wildly. We have watch mortgage rates follow a similar pattern of rapid movement in the range of about 7% to 7.5%. As I have told many of you over the last few months, the current low rates may present an opportunity to buy a new home or refinance your current home at historically low rates.*

Thanks,

Harry Gribnitz  
Your Home Loan Specialist for Life!

*PS: Please continue to support my business by referring friends, relatives and co-workers.*

*PPS: As I indicated, this letter is a deviation from my normal letter themes. Your feedback is welcome.*