Why Mortgage Interest Rates Will Rise Soon

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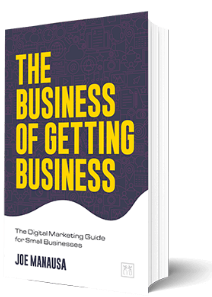

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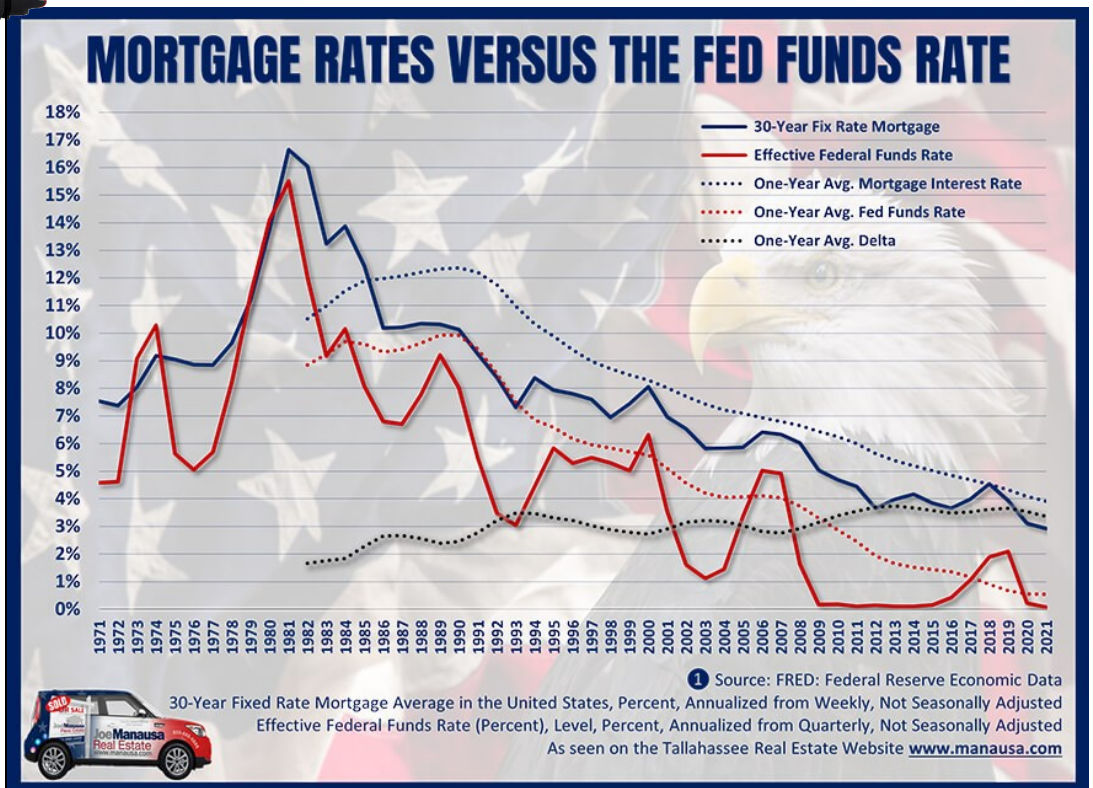

This graph shows 50 years of average mortgage interest rates (solid blue line) and 50 years of the effective federal funds rate (solid red line). The dashed lines reveal the one-year average of each rate.

The dashed lines reveal that the mortgage market does generally follow the federal funds rate, and the median difference between those two lines is 3.15%. Simply put, if the Fed moved the fed funds rate to 1% at their next meeting, you would expect mortgage interest rates to move towards 4.15% over the next year.

Again, they are not specifically tied together, but history has shown that the correlation exists.

So why does this matter?

The current federal funds rate is 0.1%, but signs of inflation are very obvious and several members of the Federal Open Market Committee (FOMC) have stated that they believe it is time to raise the federal funds rate to battle inflation.

In a recently published opinion, one FOMC member said using the traditional model for determining the proper federal funds rate, today's rate should be at close to 5%. If the FOMC acted on that (which they will not be doing), a federal funds rate of 5% would suggest mortgage interest rates moving above 8% over the next year. Again, that's not going to happen real soon, but with FOMC sentiments changing, we have to be expecting a rise in the federal funds rate no later than early next year. And that means we should anticipate a rise in the mortgage interest rates to follow.