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Uncertainty in interest rates will have big impact

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Last week, I was watching the pundits debate why the stock market had crashed over several days. They all agreed that the problem was a little bit of the China syndrome, Euro-crisis, etc. But mostly, they pinned it on the Federal Reserve chairman Bernacke and his recent, somewhat understated, opinion that the economy was improving and therefore the Feds may "taper" on the amount of stimulus bond buying that they will continue to do.

There was no presumption of interest rate hikes, but purchases of Treasuries began to fall, thereby pushing interest rates up anyway, and the stock market dropped over 500 points within two days. In other words, there was a little mayhem on the financial streets of America, and a lot of worry about what "tapering" would do to our housing recovery.

All of this activity occurred just after a Wall Street Journal article was written on why interest rates would not cause problems, even if they do rise modestly. The article argued that the housing recovery was well on its way, and that a small increase in the interest rate would be absorbed by the housing market without problems. The article also went on to say that stimulus from the Fed was not really the cause for the improved activity in housing. Rather, "it was simply a matter of low supply and high demand" (as if demand is not juiced by low interest rates!). Are you confused enough yet? Will interest rates rise quickly? Does it matter?

Let's look at the fundamentals. There are many reasons why the housing market has improved. First, jobs have been modestly increasing, creating both demand and money to back it up. Young millennials are tired of living with their parents. Record high rents are creating viable alternatives for purchasing. There has been constrained supply of new building of the last several years, thus creating scarcity and higher pricing. And, yes, low interest rates have helped those young people and others move into the housing market.

If all of this is true, however, how could the mere mention of stimulus tapering drop a stock market by 500 points? On the other extreme, how could the WSJ story say that rate changes were not very important? Wasn't the stimulus, after all, all about keeping rates low? The answer is that, there is still no answer, only wildly different opinions. As they have said, we are in uncharted waters. In this land of uncertainty, small moves, and vague rhetoric can all lead to volatility.

Most agree that stimulus has been important all along, and low rates are critical to the housing market. Stimulus has in fact kept interest rates low, with one of the main purposes to stimulate housing. It is not to be taken for granted, and tapering, which by definition is a slow withdrawal, will nonetheless have an impact on those rates. Both stimulus and tapering are artificial manipulation of financial markets, and they will both have an impact, for good or bad. There is no question in my mind, that stimulus has "worked", and the loss of it will probably be painful.

The near future will tell how much housing demand will be affected by higher interest rates. But, just today the news is that the 30-year mortgage rate had the highest jump since July 2011 and the

largest one-week increase since 1987. This rate change alone has increased the monthly payment on a 30-year loan from \$1320 to \$1520. With that level of shift, don't count on "no impact."

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