Interest rate redux: Yet another factor - by Daniel Calano

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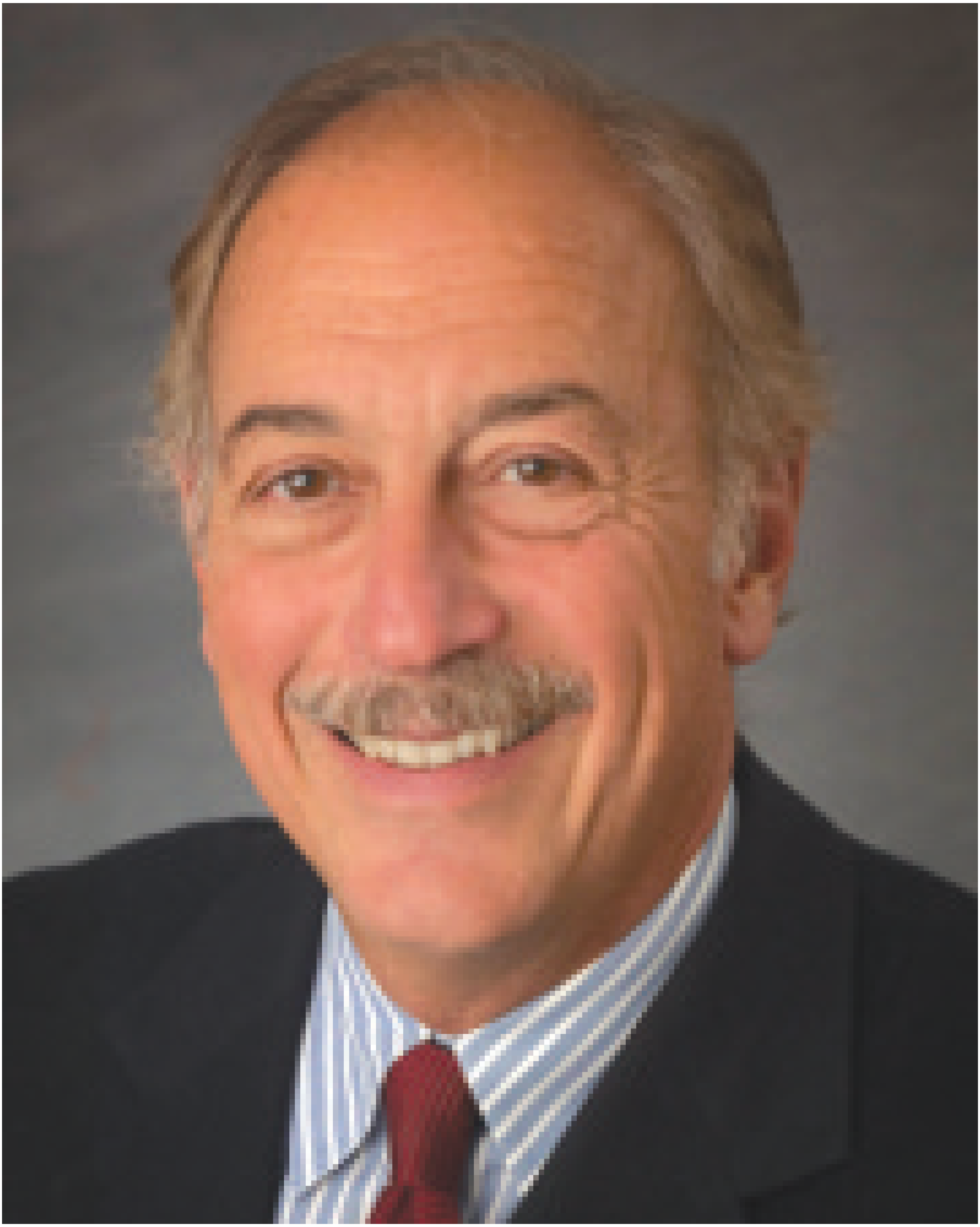

Daniel Calano

Last month, I wrote about the basic factors that kept interest rates high, and thus building or buying houses, as well as commercial projects, difficult to pursue. Factors included the Fed, bank, fears of inflation, wars, etc. It is complicated. Give it a read.

The most important point was that the Federal Reserve Bank, aka the Fed, was not in charge of those real estate lending rates. I was tired of hearing that, if the Fed lowered rates by a few points, more housing would be built, and thus could be more affordable through more supply.

I was amazed that brokers, builders, financial pundits, even President Trump thought that the Fed held the magic wand. After some research I discovered that the bond world was the key determinant, typically the 10-year treasury note. If it paid a high yield, borrowing rates would mostly stay high.

Not that I had any influence, but financial reporters began to speak more clearly of the impact of bond issuance and sales on long-term interest rates, as opposed to Fed control.

The science is complicated and variable. It turns out there are even more factors that can influence borrowing and building. For example, recently, the value of the U.S. dollar has been dropping, as compared to the overseas Euro value, ranging approximately by 9-10%. If long-term rates are lowered, U.S. bond rates drop, thus lowering purchasing interest of foreign buyers, for example, and thus the value of the dollar drops. As a result,ironically, it requires more dollars to buy materials and pay for labor. The word sea-saw comes to mind. We have to raise bond return rates in order to attract buyers back. A circular conundrum.

The good news is that research shows that lower borrowing rates is far more important than a strong dollar. All that said, one needs to keep up with the complexity, and circularity, of funding real estate. If we don’t, we could be committed to costly rates now, and miss lower rates later, when and if the negative factors settle down. In short, affordable building is still a ways off.

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