Last FOMC Meeting of the Year: Fed Raises Fed Funds Rate as Expected

It marks the end of an era as the Fed raised its Fed funds target range to 0.25%-0.50%, an increase that hasn't happened in over nine years since June of 2006. This increase ends an unprecedented period of record-low rates which were a part of the Fed's controversial policies designed to stimulate the US economy after the worst financial crisis since the Great Depression in 2008. The FOMC lowered its benchmark rate to near zero in December 2008, three months after the collapse of the investment bank Lehman Brothers Holdings, Inc. and 10 months before unemployment peaked at 10%.

The vote was unanimous to hike the Fed funds rate up a ¼ point from its recovery range of 0-0.25% to its new range of 0.25%-0.50%. Jason Grote, President of Central Coast Lending, "was not at all surprised by the rate hike. There had been so much talk and warnings letting everyone know before the meeting that a rate hike may occur that it was expected. Furthermore 90% of economists expected it."

The Fed predicts "gradual" and "data dependent" rate increases ahead. The majority of members project the rate to be 1.5% or lower by the end of 2016 and include a predicted total of 3 rate hikes within the year. It is predicted to be at 2.4% in 2017. In the statement released following the meeting of the Federal Open Market Committee, they expect "economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run. However, the actual path of the federal funds rate will depend on the economic outlook as informed by incoming data." Fed policymakers stressed they intend to move gradually and in small increments, and will pull back if the economy falters. The team of policy makers judged the US economy to be expanding at a "moderate pace" and the labor market, they said, has shown "considerable improvement." Inflation remains below the committee's 2% target, but the committee remains confident it will get there in the "medium term." The falling energy prices and commodity costs are believed they will soon subside and prices will begin climbing again.

The Fed's rate hike is only the most recent in a string of gradual steps away from crisis era policy. In other moves, the discount rate, the interest rate charged to commercial banks and other depository institutions on loans they receive from their regional Federal Reserve Bank's lending facility, has also been lifted by ¼ point to 1.00% from 0.75%. The Fed is also increasing interest on excess reserves to 50 basis points from 25 basis points. The reverse repo rate is increased to 25 basis points from 5 basis points.

Perhaps no sector has benefited more from ultra-low Fed rates than the housing market, which was devastated by the real estate crash. Home sales are expected to total around 5.7 million this year, up from 5.4 million in 2014 and 4.6 million in 2011. This recovery can at least partly be due to the low 30-year fixed mortgage rates, keeping borrowing costs low for buyers. They remain below 4%, down from 6% in 2008. Steady job income and economic growth are also supporting today's healthy housing market. 30-year mortgages are priced off of mortgage backed securities which track the 10-year Treasury note yields. These yields do tend to rise as short term rates climb. This week's Fed hike of a quarter of a percentage point is expected to have no immediate impact on Treasury or mortgage rates; markets were expecting this increase and have already priced in the move.

Grote agrees and says he "is not convinced this rate increase will affect mortgages very much. Since a rate hike was expected markets already accounted for it, making effects of the decision minimal. We will see in the next week if it slows anything down including: GDP, jobs, consumer spending etc. If that is the case, the Fed can reverse its decision to increase rates."

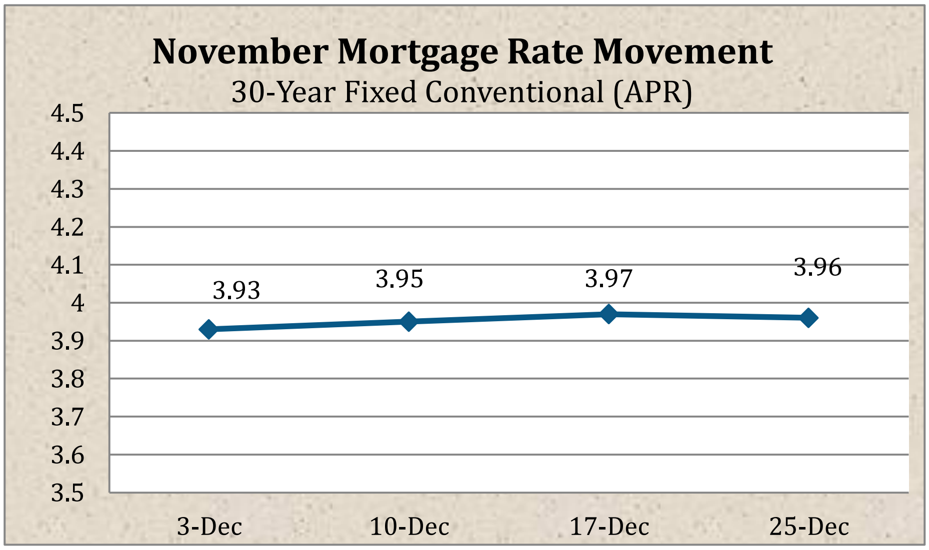
Scan code for full article of FOMC Meeting

Tax Deductibility

On December 18, the president signed legislation that renews the tax deductibility of mortgage insurance premiums for qualified buyers. It is effective for purchase and refinance transactions closed after December 31, 2014. Mortgage insurance premiums payed or accumulated after December 31, 2014 through December 31, 2016 may qualify for tax deductibility on the borrower's federal tax return.

Mortgage Rates

Mortgage rates during the month of December have remained flat, with very little change in APR. The APR remained just below 4%, though it is predicted that in early 2016 the rate will rise above 4%. Freddie Mac anticipates the rates will gradually increase to an average 4.4% for the year.



News Briefs

Mortgage Applications

Mortgage application activity increased in the week of December 18th. Purchase applications, after remaining flat in the beginning weeks of December, increased by 4% in the week and have a 37% increase in its year on year comparison. Mortgage applications increased also by 7.3% in the week of December 18th, as borrowers reacted to the Fed's decision to raise interest rates.

FHFA House Price Index

The Federal Housing Finance Agency (FHFA) House Price Index covers single family housing using data provided by Fannie Mae and Freddie Mac. Home price appreciation is respectable up 0.5% in FHFA's October report for a year on year rate of + 6.1%. Prices are strongest in the West and mountain region up 7.9% and 8.9% respectively from last year. The 6% rate for home prices is a positive factor helping to reflate the economy.

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