Fed shocks market, decides not to taper

Rising mortgage rates halt beginning of QE wind down

By: Christina Mlynski - September 18, 2013

The **Federal Open Market Committee** decided Wednesday to keep purchasing additional agency mortgage-backed securities at its current pace to foster the ongoing housing recovery and fight unemployment.

In other words, the market was tricked -- no tapering just yet -- despite numerous predictions of a $10 billion reduction in monthly asset purchases by the Fed.

The FOMC made that conclusion after members met this week and announced that although the housing sector is strengthening, "mortgage rates continues to rise further and fiscal policy is restraining economic growth."

As a result, the central bank will continue purchasing agency MBS at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion a month. Yields on 10-year Treasurys dipped from a daily high of 2.9% to below 2.8% on the news. Yields on **Fannie Mae** and **Freddie Mac** bonds also dropped, according to Bloomberg, with spreads between MBS and the 10-year swap winding 6 basis points closer.

"The committee sees the improvement in economic activity and labor market conditions since it began its asset purchase program a year ago as consistent with growing underlying strength in the broader economy," FOMC members said.

They added, "However, the committee decided to await more evidence that progress will be sustained before adjusting the pace of its purchases."

The vote for the statement was 11 to 1 with Esther George, president of the **Federal Reserve Bank of Kansas City** dissenting because she was concerned that the continued high level of bond-buying program increased future economic risks.

The majority of mortgage analysts noted that the Fed's decision to not begin scaling back its monetary stimulus wasn't bad news — it was just not what was desired.

"Concerns over budgets, deficits and payments along with other news are tending to keep consumer and business confidence from expanding as rapidly as one would expect," explained **National Association of Realtors** economist Jed Smith.

He added, "Currently, existing-home sales are at levels significantly above those of last year and should remain positive for the foreseeable future – in terms of sales and price. Given interest rates, household formations and gradually easing conditions most economists project increasing growth."

The decision not to start tapering reflects the Fed's view on the health of the overall economy, specifically the state of the housing market.

Trulia (TRLA) chief economist and vice president of analysts Jed Kolko believes the central bank's choice to not begin winding down its MBS purchases for two reason.

"Mortgage rates will rise less, or fall more, than if they had started tapering, and economic growth should be faster with the tapering delay, which could help housing demand if young adult's job prospects improve," Kolko noted.

In August, FOMC members confirmed that they were 'broadly comfortable' with the timeline Fed chairman Ben Bernanke put into action for tapering its monetary stimulus as long as economic conditions continued to improve.

However, with a volatile market since May into September, changing the pace of asset purchases did not seem appropriate given the recent rise in mortgage rates, drop in refinance volumes and debate over who will head the Federal Reserve.

Overall, the Federal Reserve has been committed to low rates for some time and the recent announcement is a continuation of that.

"Ultimately mortgage rates will continue to drift upwards, with some downward pressure on price increases," pointed out **Cato Institute** director of financial regulation studies. Mark Calabria

He concluded, "Mortgage rates also incorporate inflation expectations, so to the extent the Fed does not keep those expectations in line, rates will also increase."