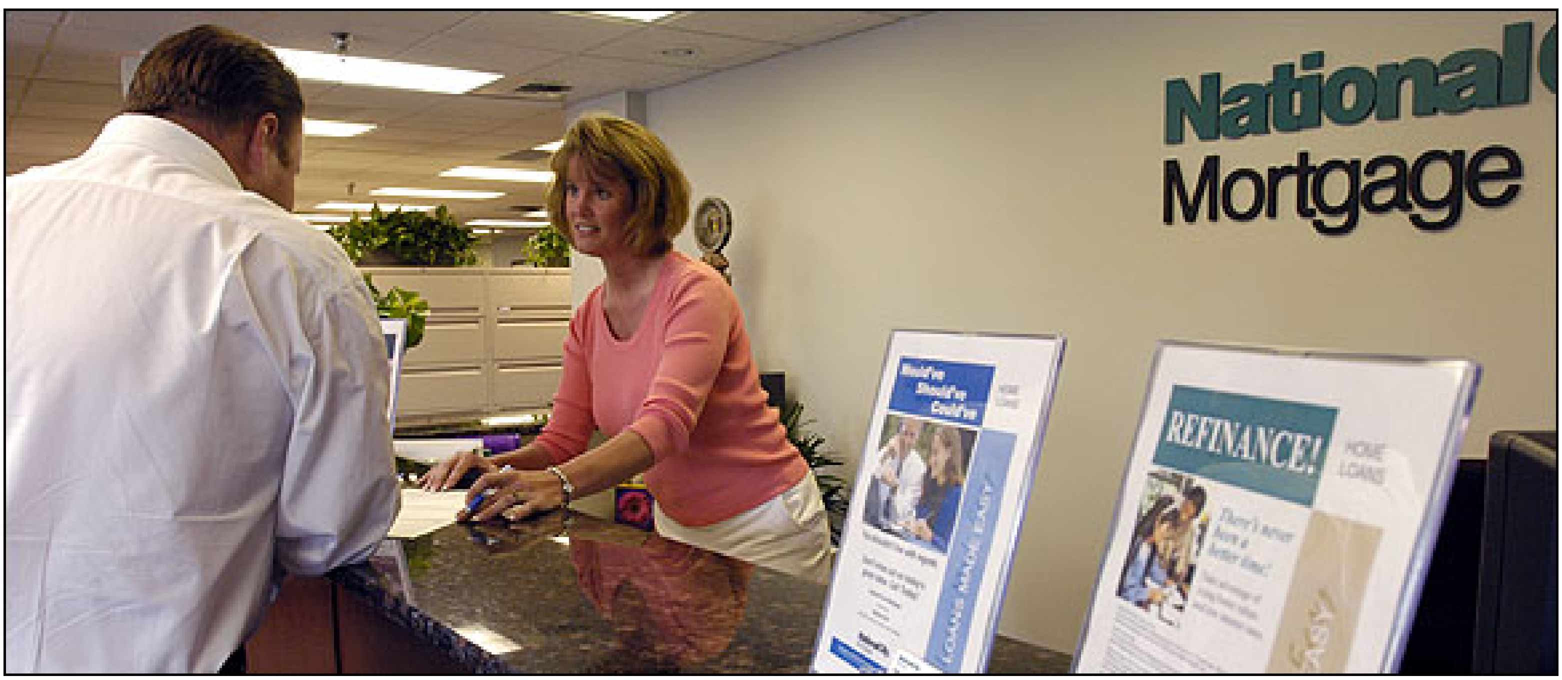
Mortgage Rates Defy Fed and Delight Consumers



Greg Sailor for The New York Times

Sandy Zimmerman of the National City Corporation, a major mortgage lender, talked with a colleague on Thursday in Dublin, Ohio, about rates.

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By DAVID LEONHARDT

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For the last year, the Federal Reserve has been conducting a relentless campaign to raise interest rates. In that same year, the rates that matter the most to many people - mortgage rates - have drifted back down, returning to near 30-year lows.

Low mortgage rates have lifted the nation's long housing boom to a new level, creating jobs and wealth but also worries that some local markets have turned into bubbles. Mortgage refinancing has also taken off again, injecting cash into households at a time when incomes are growing no faster than inflation for most workers.

"It's been fantastic," said Ed Schreyer, a 38-year-old executive in Cincinnati who has refinanced his mortgage seven times since buying his home in 2001 and refinanced the mortgage on a Colorado vacation home twice since buying it in 2003. "It's more cash in my pocket and less money going out the door."

Testifying before Congress yesterday, Alan Greenspan, the Fed chairman, called the current situation "clearly without recent precedent." Even as the Fed has lifted its benchmark short-term rate eight times since last summer in an effort to choke off inflation, the average rate on a 30-year mortgage has fallen to 5.61 percent, from 6.3 percent, according to BankRate.com. Mortgage rates are now slightly higher than they were in 2003, when they were the lowest in at least three decades.

In effect, the bond market - where long-term interest rates, including those for mortgages, are set - is stimulating the economy while the Fed is trying to stabilize it.

In his testimony, Mr. Greenspan warned that the economy faces significant imbalances and made it clear the Fed is not finished ratcheting up interest rates. [Page C1.]

The list of reasons for the falling rates is both long and controversial, taking in everything from the aging of the population to the economic growth of China. Economists generally argue that investor psychology also plays some hard-to-define role and that rates will soon rise. But they have been making the same prediction for the last year.

"Since I've been in the business in the mid-1980's, this is the biggest disconnect between the bond market and the economy I've ever seen - easily," said Ethan S. Harris, the chief United States economist at Lehman Brothers and a former Fed staff member. "You've got almost the exact opposite response in the bond market from the normal response."

Although they have vexed policy makers and economists, falling long-term rates have benefited Americans across the economic spectrum.

Bernard Post recently locked in a low mortgage rate for the next 30 years on a house in East Hampton, N.Y., so he would not have to worry if rates finally did start rising. "Essentially what I'm doing is buying some certainty in an uncertain world," said Mr. Post, 62, a lawyer in Manhattan.

Calvin S. Jackson, a 53-year-old college math teacher in Atlanta, decided he would start looking to buy his first house even though home prices have been rising.

"The current market makes it very, very encouraging to borrow money, to take a chance and buy a home," Mr. Jackson said. "This is the time to move."

In the past, a two-point increase in the Fed's benchmark rate has typically led to a one-point rise in long-term bond rates. Simple logic suggests that when the cost of borrowing money for a year goes up, as it has, so should the cost of a 30-year loan.

The Fed, after keeping its benchmark rate unusually low in the wake of the 2001 recession, began raising it almost a year ago as inflation picked up. At about 3 percent, annual inflation remains lower than it has been for most of the last generation, but it has begun pinching incomes and Fed officials are concerned it might accelerate.

Low interest rates, which encourage people to borrow and spend money, spur demand for goods and tend to push up their prices.

Since last June, the Fed has raised its benchmark interest rate, which sets the interest banks charge each other for overnight loans, to 3 percent, from 1 percent. Other consumer interest rates, like those on credit cards and car loans, have increased during the last year, but only slightly.

"It's a conundrum," Richard J. DeKaser, chief economist of the National City Corporation, a major mortgage lender based in Cleveland, said borrowing a word from Mr. Greenspan to describe the growing gap between long-term and short-term rates.

"It's in defiance of economic fundamentals."

Speaking by satellite on Monday to a monetary conference in Beijing, Mr. Greenspan named four widely cited causes for the mystery, but he cast doubt on each one. The most obvious explanation is that investors simply think the economy is weaker than Fed officials do. That would cause people to bid up the prices of bonds, which are a conservative investment; bond prices and interest rates always move in opposite directions.

But if the decline in rates were all about the economy, pieces of good economic news would halt it, even temporarily. That has not happened, Mr. Greenspan said.

He also questioned the widely held belief that foreign banks have kept rates low by buying United States Treasury bonds. Those purchases help keep foreign currencies inexpensive relative to the dollar and allow other countries to continue exporting cellphones, cars and other goods to the United States.

Mr. Greenspan argued that the effect of these purchases on interest rates had been only "modest," though. Long-term rates in other countries, where foreign banks have not been such active buyers, have also dropped, he said.

Two other factors- the fall in inflation caused by globalization and the buying of long-term bonds by pension funds trying to shore up their finances as baby boomers approach retirement - are helping keep rates low. But they do not explain the pattern of the last year, Mr. Greenspan said.

"World demographic trends are hardly news," he said.

The most similar period to the last year might be the late 1980's, when the Fed was raising its benchmark but mortgage rates stayed roughly flat, even dipping somewhat in late 1988. But rates were far higher then than they are now, making investors confident the Fed would soon take back its rate increases, which it did.

Today, the Fed seems unlikely to lower its rate anytime soon.

That has caused some mortgage bankers to urge homeowners to grab a 5 percent or 6 percent mortgage while they still can. "I think people have one more moment to lock in a low rate," said Ellen Bitton, chief executive of Park Avenue Mortgage, which has offices in New York and Palm Beach, Fla.

That might end up being great advice. It is also very similar to what bankers were saying a year ago.

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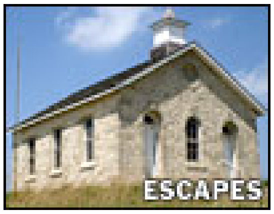

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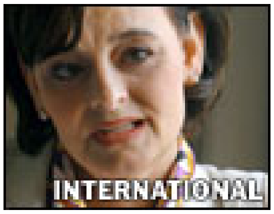

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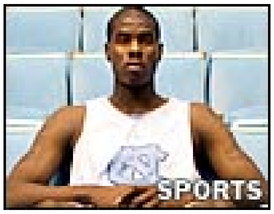

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