CALIFORNIA ASSOCIATION OF REALTORS®

Market Snapshot

To taper or not to taper?

To everyone's surprise, at its meeting last week the Federal Reserve decided not to reduce the pace of bond purchases. The bond-buying program, also known as quantitative easing, was re-launched last year with the hope to stimulate economic growth and hiring by keeping interest rates down and encouraging households and businesses to spend and invest. The Fed has been purchasing $85 billion of bonds every month. Quantitative easing program increased the Fed's holdings of securities to nearly $4 trillion. As a result, low interest rates have significantly impacted activity in the housing market which has been on the rebound since the beginning of 2012.

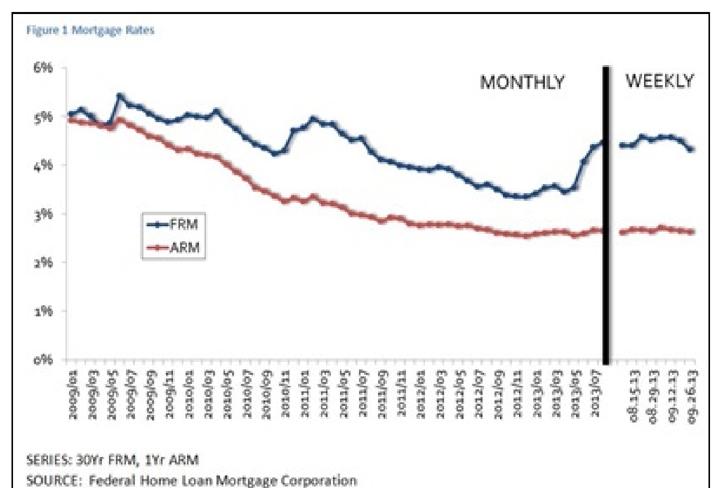
After insinuation in May that the Fed will start reducing the rate of purchases in the fall of this year, mortgage interest rates rose about one percentage point to 4.5 percent on a 30-year fixed rate mortgage. While a 4.5 percent mortgage interest rate is still relatively low when compared to historical levels, the increase had an adverse impact on the housing market and eroded affordability for many buyers.

Why did the Fed decide not to taper bond purchases and what does it mean for you?

Put simply, when the Fed looked at economic numbers earlier in the year and then again last week, they realized the economic growth did not quite live up to the expectations. On one hand, the Fed's May signal sent long term interest rates rising which put a damp on the growth. Consequent tightening of financial conditions slowed the pace of improvement in the economy and labor market. Labor market has been among the most worrisome aspects of the economy for Fed officials.

Following a strong beginning in 2013, employment growth slowed this summer. The unemployment rate has however fallen substantially since the Fed launched its bond-buying program last year and is currently at 7.3 percent in August from 8.1 percent a year ago. Much of the drop unfortunately came from workers who decided to exit the labor force. While initially the Fed said they would taper the bond purchase program when the unemployment rate hits 7 percent - that benchmark is not set in stone. Meanwhile, the inflation outlook did not change as inflation indicators remained well below the 2 percent target. In the most recent statement, the Feds said that there is no single number they will focus on until broad economic recovery and overall improvement in the labor market is seen. In fact, Fed's lowered their growth estimates for this year and next.

Unfortunately, while the Fed's decision confirmed the economy is still moving at subpar rate, the news was received positively by investors who enjoy the prospect of continued easy money policy. For home buyers, the good news is that mortgage interest rates decreased again and a rate on 30-year mortgage floats around 4.13 percent. The difference in monthly payments between a rate of 4.5 percent and 4.13 percent on a median priced home of about $442,000 is about $100 per month. The difference in monthly payments, though not substantial, does help some households.



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