CALIFORNIA ASSOCIATION OF REALTORS®

Market Snapshot

Rate Hike Postponed, But Not Cancelled

One of the uncertainties that the housing market will face for the rest of the year and the upcoming 2016 is the timing and the magnitude of the federal funds rate increase. With the economy picking up steam since after the first quarter, and the employment data continued to strengthen, a rate hike was widely-anticipated in September. The federal funds rate was expected to be increased twice this year and to continue to slowly move higher in 2016.

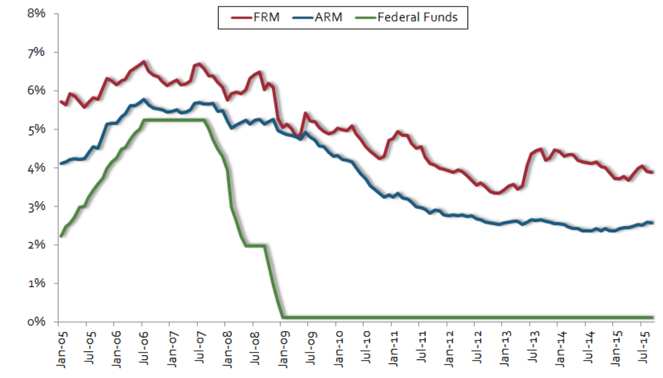
Instead, the Federal Reserve decided to hold off on raising interest rates for the first time in years in the September Federal Open Market Committee (FOMC) meeting. The Fed's move was not a complete shocker, but it was a surprise to many who believed that the economy has improved enough to compel the Fed to raise rates.

The Fed's decision-making in conducting monetary policy rests on two pillars: stable inflation and full employment. On the former, the Fed had said it was confident that inflation would eventually reach its targeted goal of 2 percent. With energy and other commodity prices declining in recent months, higher inflation as a result of a rate hike has not been a primary concern to the Fed. The labor market, however, is a concern to the Fed, despite the fact that it is approaching the Fed's goal of full employment. The Fed is worried that there are still structural problems in the labor market that have not yet overcome. One of those problems, for example, is the labor-force-participation rate, which continues to stay low relative to the underlying trend.

Recent signs of a global economic slowdown added even more reasons for the Fed to stay put with the fed funds rate in September. Emerging markets are vulnerable to a rising rate environment. An increase in interest rates could further damage the economic growth of these countries, which could result in a negative impact on the trade balance between the U.S. and these trading partners.

There is a possibility that the Federal Reserve may begin the normalization in December, but it is looking more and more likely that the Fed will have to delay the rate hike until 2016, as the U.S. economy may not be robust enough to warrant an increase. If the normalization process takes place gradually throughout the next two years, modestly higher interest rates should not present much of a direct challenge for California. However, with housing prices rising and mortgage markets far less flexible than in the past, home sales could quickly come under pressure if rates rise too quickly. Rising interest rates may also cause investors to become more cautious, taking some of the oomph out of the private equity, venture capital and commercial real estate markets.

FED FUNDS RATE HAS BEEN UNCHANGED FOR ALMOST 7 YEARS



SERIES: 30Yr FRM, 1Yr ARM, Federal Funds
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