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The 'Magic' Mortgage Rate That Could Unfreeze the Housing Market

The combination of higher borrowing costs and rising property values has iced over home sales, but experts see a point at which things could start to thaw

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It was only three months ago that mortgage rates were racing toward 8%, throwing off plans for the few home buyers who hadn't already been priced out of today's market.

But since then the outlook for inflation has improved, fueling a sudden reversal in the trajectory. Rates have now fallen firmly into the mid-6% range, and forecasters say things should only continue to get better.

The picture has changed so much, in fact, that economists at the mortgage giant Fannie Mae sharply lowered their numbers for the second month in a row last week, saying they now expect the average rate for new 30-year mortgages to fall to 5.8%, rather than 6.5% by the fourth quarter of this year. Just last month, they didn't see the average falling below 6.1% for at least another year after that — through the end of 2025. The month before that, they weren't expecting anything below 6.8% over the two-year period.

Even though rates are still more than double what they were in 2021, the recent declines have already saved some prospective buyers hundreds of dollars a month in a housing market so unaffordable that neither sellers nor buyers feel like they're in the driver's seat.

But some experts say mortgage rates in the 5% range could make much more of a difference, and not just by shaving more off the cost of their loan. Those rates might also draw out more sellers and may even help ease today's crazy selling prices.

"There is a magic number for fixed mortgage rates that I think would unfreeze the housing market," Ken Shinoda, a portfolio manager at DoubleLine who oversees some of the firm's mortgage-backed investments, wrote in a recent commentary. "That number has a 5% handle."

The U.S. housing market feels frozen because so few properties are changing hands. Last year just over 4 million homes sold — about 2 million less than in 2021 and the fewest for any year since 1995, according to the National Association of Realtors.

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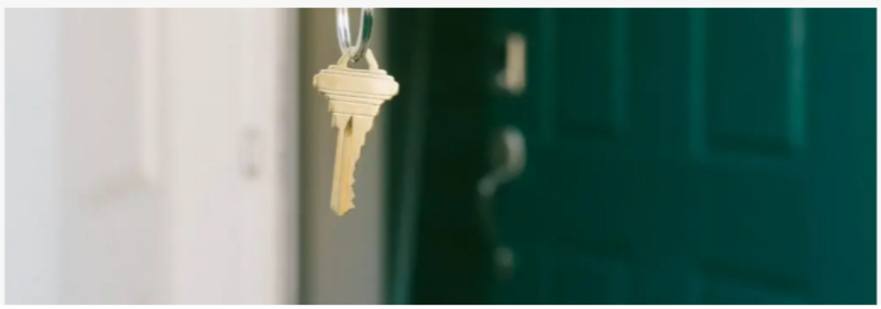
Sales are so sluggish because for the first time in decades, a typical family doesn't earn enough to qualify for a mortgage on a median-priced home at prevailing interest rates. When a spike in demand sent property prices soaring early on in the pandemic, millions of Americans were still able to afford a house because mortgage rates had fallen to incredible lows. But then the cost to borrow more than doubled in two years, and property values continued to rise.

The combination has defied normal patterns, not only pricing out many would-be buyers but also keeping the number of homes on the market at about half the level of what it should be, according to NAR. In other words, many of those same prospective buyers are families that might have otherwise sold their house, but can't afford to give up the 3% and 4% mortgages they got during the pandemic.

If rates get low enough, that so-called "rate lock' will lift, at least partially replenishing the stable of homes for sale and perhaps making buyers less eager at bidding time.



It was only three months ago that rates were racing toward 8%. Now forecasters are predicting somewhere in the pivotal 5% range by year end. Grace Cary/Getty Images

It's a "strange situation," but "home prices are ticking higher because of the lack of supply," Lawrence Yun, NAR's chief economist, said during a monthly call with the press Friday. "We need more inventory to get the market moving."

In December, homes around the U.S. sold for a median price of $382,600, 4.4% more than in December 2022 and the most for any December in NAR's records, he said.

Mortgage rates have had quite the wild ride. Less than three years after hitting a record low of 2.65% in early 2021, the average interest rate on a new 30-year fixed mortgage rose as high as 7.79% in October — the steepest it's been since 2000, according to data from Freddie Mac.

Since then the average has fallen by more than a full percentage point, reaching 6.60% this week. That means someone buying a $400,000 house with 20% down would now pay about $2,040 a month for their mortgage — almost $260 less than they would have in October. If rates reach 5.8% by the end of the year, as Fannie Mae predicted, the same $400,000 purchase would cost about $1,880 a month, roughly $160 less.

To be sure, interest rates are just one part of the affordability equation, and even if rates fall considerably more, some say prices will only get higher, not lower, when there are more buyers.

“The magic formula would be lower rates and lower prices, but that's not gonna happen if we didn’t get lower prices in a higher rate environment,” said mortgage broker Melissa Cohn, regional vice president at William Raveis Mortgage. “As rates start to come down, more buyers — especially first time homebuyers — will jump into the marketplace and they will help to keep prices up.”

Cohn expects 30-year rates to average between 5.5% and 5.75% by the end of this year, but is skeptical that will be enough to really motivate sellers.

Even if rates go to 5.75%, current homeowners won’t “be able to take that next step up easily” with prices continuing to increase, she said.

“Homeowners are going to find themselves locked into their homes for more than just the next six months. I think it's going to take rates having to really settle down to like 5% for people to really get excited about jumping back into the real estate market.”

The Fannie Mae economists, who now expect rates to get as low as 5.5% by the end of 2025, lowered their forecasts after Federal Reserve officials signaled inflation was tame enough that they could safely begin cutting the benchmark interest rate they had so aggressively raised in 2022 and 2023.

The Fed’s December statements effectively declaring “mission accomplished,” as First Trust economist Brian Wesbury put it, were widely interpreted as a sign that the central bank would “pivot” on the direction of rates, according to Fannie Mae.

The recent mortgage rate declines are already changing some attitudes, though it’s too early to tell by how much. Realtors are getting more inquiries, Yun said, and there’s been an uptick in mortgage applications in recent weeks, according to data from the Mortgage Bankers Association.

“There is plenty of evidence that buyers are starting to come out of hibernation as rates move lower,” Wells Fargo economists said in a note to clients Friday. “Financing costs are just one factor that goes into the decision to purchase a home, however. Home prices continue to rise, which may be offsetting lower rates.”

Skylar Olsen, chief economist at the real estate website Zillow, said mortgage rates will “play a massive role in determining [price] appreciation and affordability” but warned that they are “fickle things.”

After nine straight weeks of declines, the average has leveled off over the past three weeks, Freddie Mac’s data shows.

“Rates are going to continue to go down, just not in a straight line,” said Cohn, the mortgage broker. “Don’t be surprised when there are bumps along the way.”

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