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Why Lower Mortgage Rates Would Cure All That Ails the Housing Market

Because of the recent spike in rates, it's not a buyer's or a seller's market

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Ask someone what's wrong with today's housing market, and you won't just hear complaints about hefty mortgage rates. Prices are also way too high, they'll say. And there's barely anything on the market.

What they might not realize, though, is that all three of these problems can be traced back to the same root cause. If it weren't for the mortgage-rate extremes of the last three years, everything would be better.

“We've never seen such a rapid rise in rates following a period of rates in the 2s and 3s,” said Dean Baker, senior economist at the Center for Economic and Policy Research. “That's why we've never seen the market so locked in as it is now.”

It all boils down to this: Because mortgage rates rose at the fastest pace in four decades and aren't budging, few people who got the ultra-low rates of the pandemic buying boom want to sell their house — even for a lot of money. That, in turn, is making a national shortage of properties much worse. And because buyers are fighting over the few homes that do go on the market, even the high borrowing costs aren't bringing record high property prices back down to earth.

So with rates now near 22-year highs, both buyers and sellers are feeling stuck: The market hasn't been this unaffordable for a would-be buyer since the 1980s. And selling a house makes little sense if the cost of borrowing the money for a new one is more than double what it was only two years ago.

“It's a bad market for everybody,” said Mark Zandi, chief economist at Moody's Analytics. It's “not working for either seller or buyer.”

The average interest rate on a 30-year fixed loan was in the 4%-5% range during much of the decade leading up to the COVID-19 pandemic in 2020, but it dropped to a record low of less than 3% after lockdowns crushed the economy. By November 2022, amid surging inflation, the average had climbed 4.1 percentage points in just one year, topping 7%. That's more than it's risen in any other 12-month period since 1981.

“It's a logjam, and it's unique,” said Dan Roccato, a finance professor at the University of San Diego who comments on the economy for Fox News. “Sellers are locked in place because they don't want to give up their 3% mortgage, and new buyers are locked out because they can't afford a 7% mortgage.”

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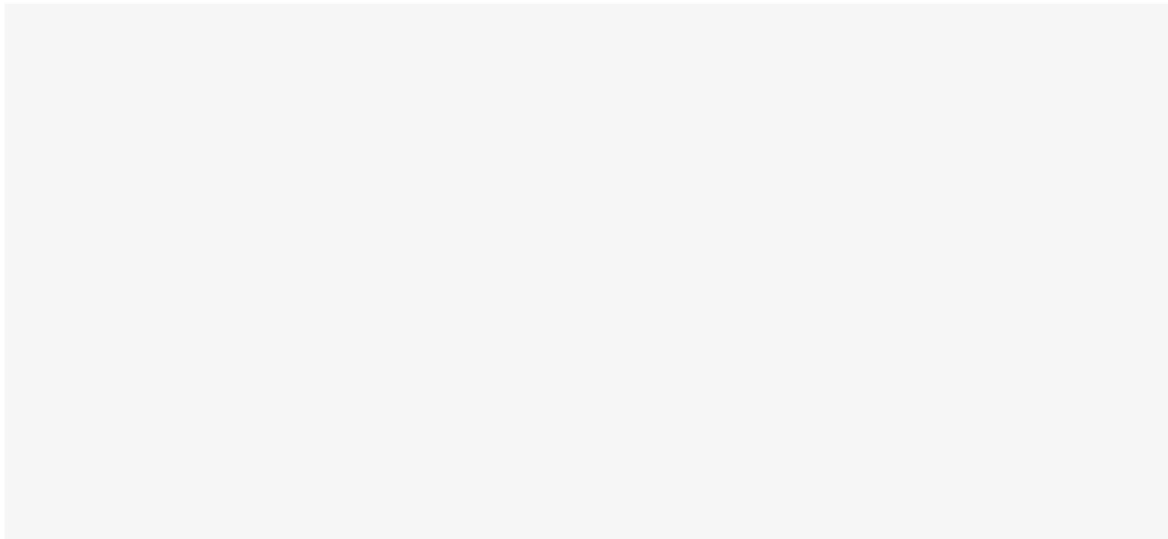
This of course means a lot hinges on when mortgage rates drop significantly. And yet it's unclear when we can expect the downside of the roller coaster, especially now that the average for a 30-year loan has been stuck in the 6%-7% range for a year now — longer than forecasters predicted.

Unfortunately, it all depends on perceptions of inflation, an unpredictable number in its own right.

Inflation is the main driver of higher mortgage rates because most home loans are packaged into bonds that are sold to investors who demand higher yields when inflation will eat away at their returns.

Mortgage rates jumped so high so fast because of last year's spike in consumer prices, which also spurred increases in the central bank's benchmark interest rate. And now, even though inflation has improved dramatically in the past year, rates will depend on whether investors and central bankers are convinced that it's no longer a threat.

Earlier this year, major housing forecasters were predicting that the 30-year would average in the 5.4% to 5.9% range by now — the third quarter of the year — but it has stayed in the high 6% to low 7% range instead. Inflation even unexpectedly ticked back up a little bit in August, suggesting the housing market freeze isn't thawing any time soon.



The mortgage-rate extremes of the last three years have gridlocked the housing market. MoMo Productions/Getty Images

"Inflation is like the opposite of a roller coaster," Roccato said. "It goes up fast, and it comes down slow."

And what about the last time there was a more rapid run-up in the 30-year average, in 1981? Over the next 12 months, the average dropped by 4.5 percentage points. But back then it declined from a jaw-dropping 18.4%, so the usefulness of that comparison may be limited.

A forecast last week from Wells Fargo economists saw the 30-year falling to the high 5% range next year after peaking at 7.05% this quarter. Last month the Mortgage Bankers Association predicted it would fall to 5% by the end of next year from an apex of 6.8% in the current quarter.

The "magic number" would be 5%, according to Roccato.

"At 5%, the logjam breaks," said Roccato. "We have better affordability for buyers and we have sellers more willing to trade in their low rate they got during the pandemic."

To be sure, the whiplash of mortgage rates isn't the only reason home sales over the past year have languished, falling well below even their pre-pandemic levels, according to the National Association of Realtors.

Prices are so high not only because of the dearth of listings, but because they surged during the buying fever of the pandemic, rising more than three times as fast as in the years prior. And the shortage, though worse because of the high cost of borrowing, first became an issue in the fallout from the 2008 financial crisis, which wiped out scores of homebuilders.

"We still have a lot of baggage from that crisis that exacerbated the lock mentality we saw emerge as rates plummeted at the onset of the pandemic," said Diane Swonk, chief economist at KPMG and an adviser to the Federal Reserve Board of Governors.

Mortgage holders are staying put because almost two-thirds of them have a rate at 4% or below (many people refinanced during the pandemic if they didn't buy).

That means there are only about half as many homes for sale than during much of the decade prior to the pandemic and only a third as many as there often were before that. The 1.1 million homes for sale in July was the fewest recorded for any July in records dating back to 1999, according to the National Association of Realtors.

"Even though there are fewer buyers in the market, they have to compete with others because of the limited supply," said Lawrence Yun, NAR's chief economist.

According to a summer survey by NAR, 34% of Realtors said the main reason their latest client didn't make a purchase was the shortage of affordable choices, 18% said it was high mortgage rates, and 9% said it was the steep prices. That means a drop in rates would diffuse the biggest obstacle for the majority of people.

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