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Trump vs Warsh: The 30-year Pressure Cooker

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The American Dream is a promise every president seeks to make to Americans: rising prosperity and the economic stability that gives anyone the chance to succeed. Home ownership is central to that aspiration. Since Trump began his second term, the yield on the 30-year government bond has risen from 4.85% to 5.27%. That may seem modest, but since February—when President Trump pledged to "Restore the American Dream"—mortgage rates have climbed from 5.99% to 6.71%. Over the life of a mortgage, that increase adds nearly $85,000 in cost and raises monthly payments by about $235 compared with taking out the same loan earlier in the year. These rates are not near record highs, but after a long period in which consumers grew used to much lower borrowing costs, the adjustment is significant, particularly for buyers who believed they were close to purchasing a home. The administration has previously directed Fannie Mae and Freddie Mac to buy $200 billion in mortgage-backed securities to ease the pressure, but that remains small relative to broader market moves.

Investors are testing the new Fed Chair, with concerns that near-term inflation is moving in the wrong direction and that, without Fed action, the impact will worsen. Kevin Warsh was recently appointed by President Trump after Trump grew increasingly frustrated with outgoing Chair Jerome Powell's reluctance to lower rates. Lower rates are clearly central to the current administration's plan to grow wealth in America. Despite the Fed's independence, investors are aware of the dovish expectations surrounding Warsh's selection. Market forces have steepened the yield curve, pricing in inaction today that investors believe will need to be offset later. They expect inflation to remain elevated without near-term policy movement and are therefore demanding higher future returns to compensate for the erosion of capital. Traditionally the market has been able to enact action from the Fed, with recent economic data supporting a need for a rate hike, the sentiment in speeches made in Jackson Hole would point to a move at the next meeting. Because of the current dynamics, a move to stabilize at the short end will help to alleviate some of the pressure in the long end, with a flattening of the rate curve. This would help not only potential homeowners but also the cost of issuance for the government. The level of borrowing continues to increase and due to the shift in rates has become increasingly more expensive to fund. The US Debt just passed $40 trillion, servicing the interest continues to increase and the level of debt is not expected to decrease – the tail of the curve is a problem.

Looking ahead to the September meeting, it appears that the market pressure is winning the battle, the inflation prints are unable to be ignored. A full 25bps hike is not priced in but the anticipation has increased to over 50bps in hikes before March next year. Comments from Fed representatives signaled as much, which almost instantly relieved some of the pressure on long dated rates. This flattening of the rate curve implies the market still has some hesitation about the outcome, but that at least short-term controls are being used to prevent further long-term pain. Rates increasing is never a positive headline for an administration that is set on lowering the base, however it is likely the shortest route to potentially get the rate below where it is today. A 6-month period of higher rates to stifle the impact of inflation could empower the Fed to be cutting rates in 12 months. The year post the financial crisis experienced below average inflation for nearly a decade, so time spent above the target rate is only expected, yet the compounding impact of higher inflation can be more destructive than low positive inflation. Either the Fed is going to have to move, or data surprisingly improve, as without this the hand of the market will potentially have to force a response, but it will come at a 30-year rate that is higher than today.

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