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Interest Rates, Real Estate, and Borrowing

The Fed’s September 2024 decision to start lowering the fed funds rate marked a big policy shift from recent years’ rising rates. Its effects will ripple through various sectors of the economy.

For the real estate market, lower interest rates generally mean good news. As the Fed cuts rates, mortgage rates tend to follow suit, although not always in perfect sync. Federal funds rate cuts have a direct impact on short-term interest rates. Other factors also influence mortgage rates, including long-term bond yields, inflation expectations, and each lender’s appetite for risk.

To understand the impact of easing rates, it’s helpful to look at this question through the eyes of two audiences: first-time homebuyers and existing homeowners.

While lower interest rates could encourage first-time buyers, home prices are near record highs and could remain prohibitive for some time. Home values have appreciated significantly since the beginning of the pandemic, so one or two rate cuts may not be enough to bring mortgage payments to a level where affordability meaningfully improves.

Existing homeowners have benefited from price appreciation, adding more than $14 trillion to their home equity. Having locked in ultra-low mortgage rates during the pandemic, these owners are unlikely to sell. Yet as rates fall, they may seek to unlock value by borrowing through home equity lines of credit (HELOCs). This form of borrowing, which slowed as interest rates climbed over the past few years, could help fund renovations, investments outside the home, and debt consolidation.

In his remarks over the past few years, Fed Chair Jerome Powell has used the word recalibration many times, suggesting that this easing cycle is about returning rates to levels that neither restrict nor overstimulate the economy. This begs the question: How fast and how far will the Fed cut rates? Fed economists will be watching the economic data for signs of recession, which would likely prompt faster or deeper rate cuts. At the same time, they are mindful of the possibility that inflation could reignite, which could slow its rate-cut trajectory.

Of course, housing is not the only sector that stands to benefit from falling interest rates. A lower-rate environment can reduce variable-rate debt on credit cards and auto loans, opening room in budgets for more consumer spending. Businesses may also step up their capital investments and hiring plans.