Stewart Agency Financial Advisory Services

Economic Summary, 1Q25

Wait. What? Only two Fed Funds rate cuts in 2025? Maybe none? What happened to all the anticipated rate cuts? $%$@!. And why do the mortgage rates keep going up? Lest we forget, there have never been signs of a weak economy, cooling in spots, yes, but weak, never. The market has always been overly optimistic about the Fed's rate cuts. Remember in October of 2023 when the market was ecstatic about their expectations of eight rate cuts in 2024? At least we had three –with the December rate cut teetering on oblivion (the decision to make the rate cut was a close call and several signs pointed to the cut being irresponsible). Even in October of 2024, the market expected two to seven cuts with only two Fed meetings ahead of them. Maybe the market's expectations reflect more their hopes and dreams rather than sound, fact-based reality. The real question now is, 'what if inflation picks up more than it has recently, either by a strengthening economy or other inflationary factors?'

We finished 2024 with three Fed Funds rate cuts and a Fed Funds rate range at 4.25 to 4.50 percent. Unfortunately, the 10-year treasury rate moved upward immediately, resulting in a 10-year rate of 4.48 percent and a 30-year mortgage rate of 6.67 percent. Both have continued to move upward since.

Rate cuts finally, but the 10-year and 30-year mortgage moved indirectly … $%$@!

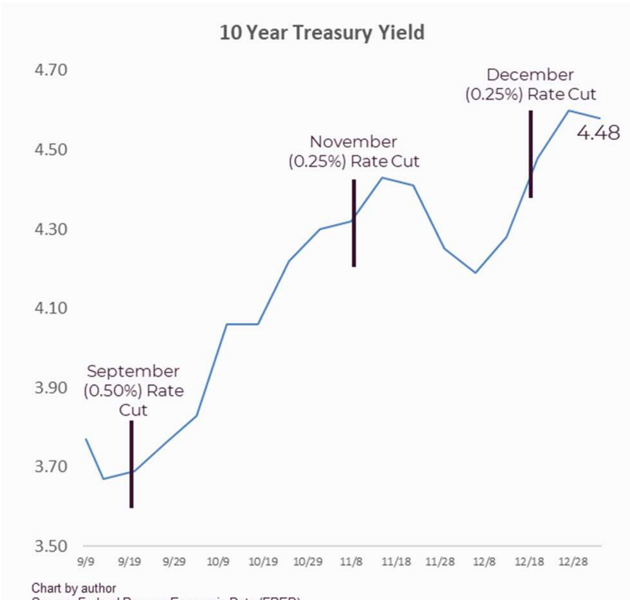


Chart by author
Source: Federal Reserve Economic Data (FRED)

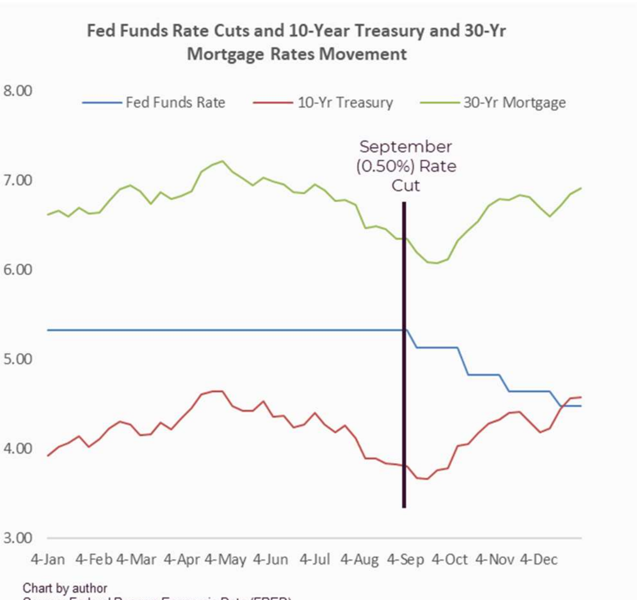
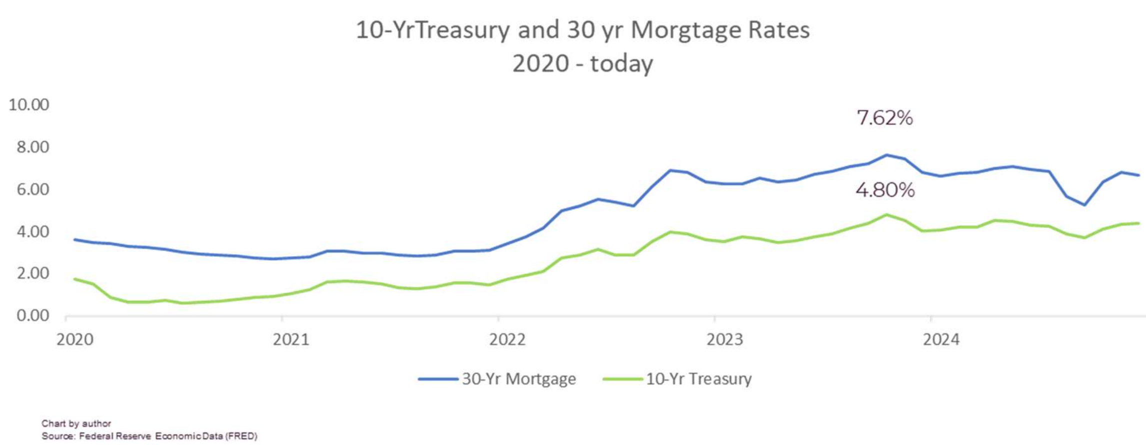


Chart by author
Source: Federal Reserve Economic Data (FRED)

Remember, the Fed sets the Fed Funds rate, not the 30-year mortgage rate. With the first rate cut in September, the bond market panicked, thinking the Fed was trying to get ahead of a recession because the cut was greater than expected at a half-percent point rather than a quarter point cut. Market concerns around economic health pushed the 10-year treasury up. Since then, the market, living up to its fickle nature, is panicking because of fears of inflation which, in turn, is pushing the 10-year upward. As if the world is not confusing enough…

We have a strong economy. But there is an underlying sense of uncertainty and policy confusion as the new administration barrels into the White House. The new administration undoubtedly leans toward pro-market economics, which in theory is great for businesses and the consumer. We should expect some level of corporate tax cuts and the implementation of tariffs on imports in some form. It is the uncertainty of the latter that is creating consternation in the 10-year treasury. The 10-year treasury rate is predicated on future growth and inflation expectations. As President Donald Trump careened past his Jan. 20 inauguration, the market remains increasingly anxious about his pledge to impose widespread tariffs on imports.

Tariffs are largely viewed as inflationary which will create interest rate uncertainty and less demand for treasuries, which, in turn, will push yields higher. Investors and banks are demanding higher yields because of future interest rate uncertainty and the potential for higher rates in the future. Unfortunately, higher 10-year rates equal higher 30-year mortgage rates. In fact, based on futures options, the market (take it with a grain of salt) sees the 10-year heading to 5% in the near term.[1] The last time the 10-year rate was near 5%, in October 2023, the 30-year mortgage rate was 7.62%, which was also a 20-year high-mark.



Now, before we let out more expletives, whether the threat of tariffs is more talk than anything else, or whether they will be used more as a negotiation tactic rather than implementation, and, if implemented, whether these tariffs are implemented in a targeted fashion (e.g. 60% on China) or broad in scope (e.g. 10% across the board), and at what pace they will be implemented, is all up in the air and all of which can impact any presumed inflation. It may be

[1] Gertrude Chavez-Dreyfuss. "Options market positioned for US Treasury 10-year yield to hit 5% in near term". Routers. Jan 10, 2025.

much ado about nothing. The US continues to be the deepest and most stable market globally and that should help keep yields in a reasonable range. **Either way, as of now, the 10-year is reacting negatively, and we in the title business are feeling the impact.**

Lastly, we should expect some level of corporate tax cuts which, in theory, are good for consumers and businesses. But if tax cuts are not financed by spending reductions, they will increase an already bloated fiscal deficit and further revive inflation. And there are possible labor rate impacts, particularly in the construction sector, from changing immigration policies.

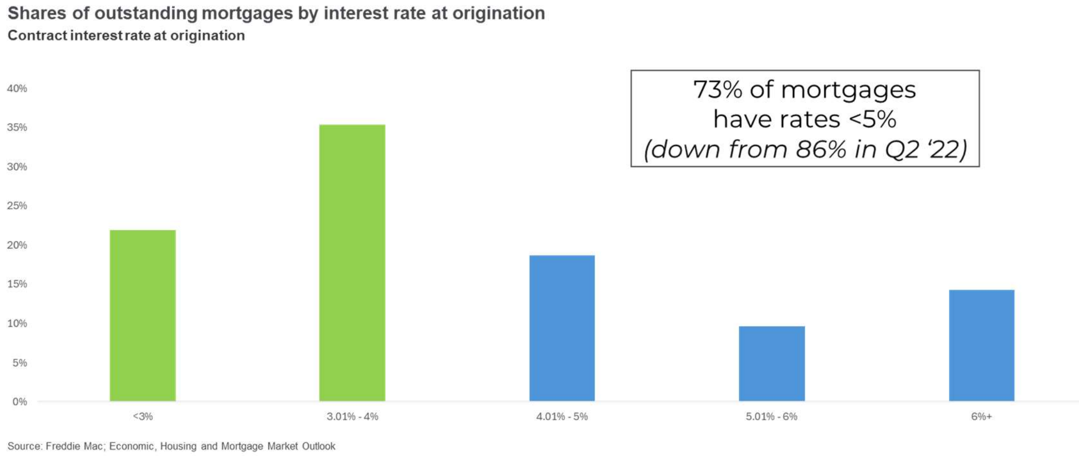
Hence, we may be wise to temper our expectations of a declining 30-year mortgage rate in 2025. What we see now, may be what we get. That said, if the new administration manages tariffs and tax cuts responsibly, and the market maintains its strength without inflation, then it could be a decent year for title agencies. And there are signs of an improving title market which can provide some optimism. The last two months have seen a year-over-year increase in home sales, at 3 percent and 6 percent respectively, which are the first months in the last thirty-eight when we have seen positive year-over-year growth.

As for the data, the annual inflation rate for the United States is now **2.9 percent (as of the Jan 15th report), an increase of 0.2 percent from the prior month's 2.7 percent**, which is a turn from the recent downward trend, moving us back towards the 3 percent and above territory.

For these reasons, the **30-year mortgage rate continues to increase since the beginning of October and sits at 7.20 percent** as of January 24th[2]. The **10-year treasury rate** has increased to **4.53**. The rate remains high based on a five-year historical average of 2.63, (although, the 10-year treasury rate historical average since 1962 is 5.85% which leads one to wonder if our expectations are based on our experience of an unusually long period of a low interest rate environment after the Global Financial Crisis of 2008) **creating a 2.67 spread** to mortgages, a spread that is typically 1.50 to 1.70. In addition to interest rate uncertainty, Basel III's proposed higher capital charges will increase fees and risk coverage making affordable mortgages less available to households. Is a 150-basis point spread achievable, or should we expect a 200-basis point spread whichever way the 10-year moves? If the 10-year rate does reach 5 percent, should we reasonably expect 7.0 percent mortgage rates, a rate which makes loosening the 'lock-in' effect more daunting. If you've read these quarterly reports before, you know that 73% of homeowners have mortgages with rates of less than 5 percent which, while cooling (prior quarter's percentage was 76%), is still a driving force of low existing housing inventory, and, to some extent, high prices. A 4.0 percent 10-year treasury with a 200-basis point spread sets the 30-year mortgage rate at a possible breaking point of 6.0 percent, while a 30-year mortgage rate under 6.0 percent, the market opens and dissolved the 'lock-in' effect more quickly.

[2] Mortgage Bankers Association Weekly Mortgage Applications Survey January 29, 2025 release.

Life events are causing moves, but the ‘lock-in’ effect remains a challenge to the market, given the risk of increasing 30-year mortgage rates …



December inventory levels remained low and decreased to a 3.9-month supply from last month’s 4.0 months but are better than last year’s November level of 3.5 months. And, as mentioned, home sales increased 6% to 4.15 million versus December 2023 supply of 3.91 million.

From a macroeconomic perspective, GDP growth continues increasing at an annual rate of 3.1 percent in the third quarter of 2024, again driven by consumer spending. Unemployment decreased in December to 4.1 percent from the prior month’s 4.2 percent, which highlights a strong economy but further indicates potential for inflationary risk. Remember, the September rate cut was due to concerns around the multi-month increase in unemployment, not tamed inflation. The S&P solidified a three-month decline in December dropping 2.5 percent below November, although still up 23 percent year-to-date (after 26.3 percent in 2023). However, even with a weak December, the index hit fifty-seven new highs during the calendar year, the fifth most in history, and brought its two-year gain to 53.19%.[3]

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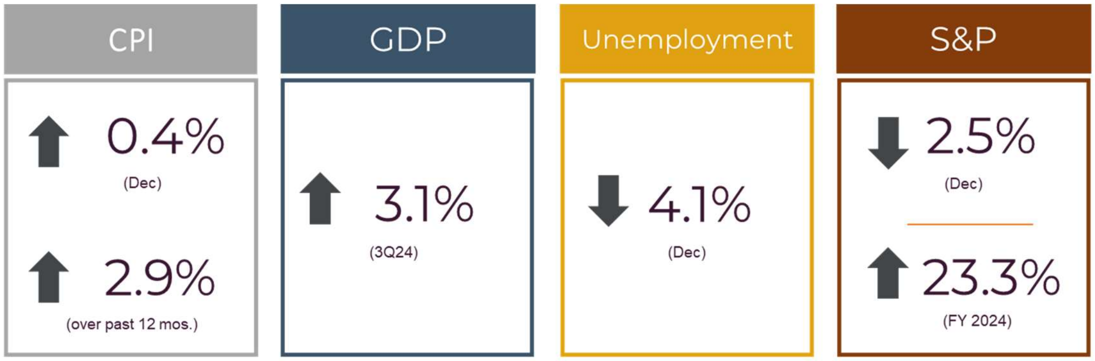
[3] Howard Silverblatt. “U.S. Equities Market Attributes December 2024”. S&P Global.



Arrow represents trend from prior period

With this economic backdrop, it appears the economy is stable if not strong. The question whether the Fed will pause a moment and monitor the data for a possible uptick in inflation or continue with rate cuts has been answered, no rate cut after the January 29th meeting.

We should expect muted Fed actions with respect to rate cuts, at least in the first quarter of 2025; and we must assume a scenario exists where we do not see a Fed rate cut until inflation begins again a multi-month downward trend. It may be counter to what the market desires, but there is no justifiable reason to introduce a rate cut with a strong economy, inflation concerns (if not increasing), and decreasing unemployment. The economy appears strong with rates as they stand. The question for title agencies is whether the first quarter of the new administration brings with it the implementation of international tariffs and to what extent and scope, and, more importantly, how the 10-year treasury rate will react to potential inflationary policies. We should have some clarity about the administration's approach to tariffs in the first quarter and with clarity and certainty, the 10-year should come down, in theory, and with it, the 30-year mortgage rate.

However, Fannie Mae and MBA continue to see the 30-year mortgage interest rates above 6 percent in 2025 with slight relief at the back end of the year, while MBA suggests a 7% rate in 1Q25. We hit that this week.

Residential interest rates continue to hover above 6 percent and are likely to remain there through 2025.

Residential Interest Rate Forecast January 2025

30-Year Fixed-Rate Conventional Mortgages

Fannie Mae

	Q1	Q2	Q3	Q4
2024	6.7%	7.0%	6.5%	6.7%
2025	6.7%	6.6%	6.5%	6.5%
2026	6.4%	6.4%	6.4%	6.3%

MBA

	Q1	Q2	Q3	Q4
2024	6.7%	7.0%	6.5%	6.7%
2025	7.0%	6.9%	6.7%	6.5%
2026	6.4%	6.4%	6.4%	6.4%

As for sales volume, Fannie Mae and MBA residential real estate forecasts for 2025 have come down from their fall forecast of 9.0 percent but remain a welcome improvement from 2024's average 3.8 percent year-over-year growth. If the 10-year rate moves downward and approaches the low four percent range in the first or second quarters, we could see lower 30-year mortgage rates and regain some year-over-year growth greater than 5 percent, especially if the ReFi market gets relief. How the first quarter plays out from a macroeconomic and policy standpoint will be important.

From a home price perspective, the average forecast increase is 2.5 percent, down from 2024's 4.6 percent at $424.8K. However, with continued low inventory and significant pent-up demand, when interest rates do come down and buyers jump back into the market, pressure on home prices might only increase. Home affordability continues to be a concern.

As assumptions around interest rates falter, 2025 YoY performance forecasts are somewhat muted but a welcome improvement from 2024 and 2023.

Existing Home Sales Forecast

January 2025
Sales -- Thousands *Annual*

	2024	2025	2026
Fannie Mae	4,058	4,150	4,500
MBA	4,046	4,260	4,540
Percent Change - *Year-Over-Year*			
Fannie Mae	-0.8%	2.3%	8.4%
MBA	-1.8%	5.3%	6.6%

Median Price Forecast

January 2025
Median Price -- *$ Thousands*

	2024	2025	2026
Fannie Mae	$ 422.8	$ 437.6	$ 445.0
MBA	$ 406.0	$ 412.0	$ 415.0
Percent Change - *Year-Over-Year*			
Fannie Mae	5.8%	3.5%	
MBA	4.6%	1.5%	0.7%

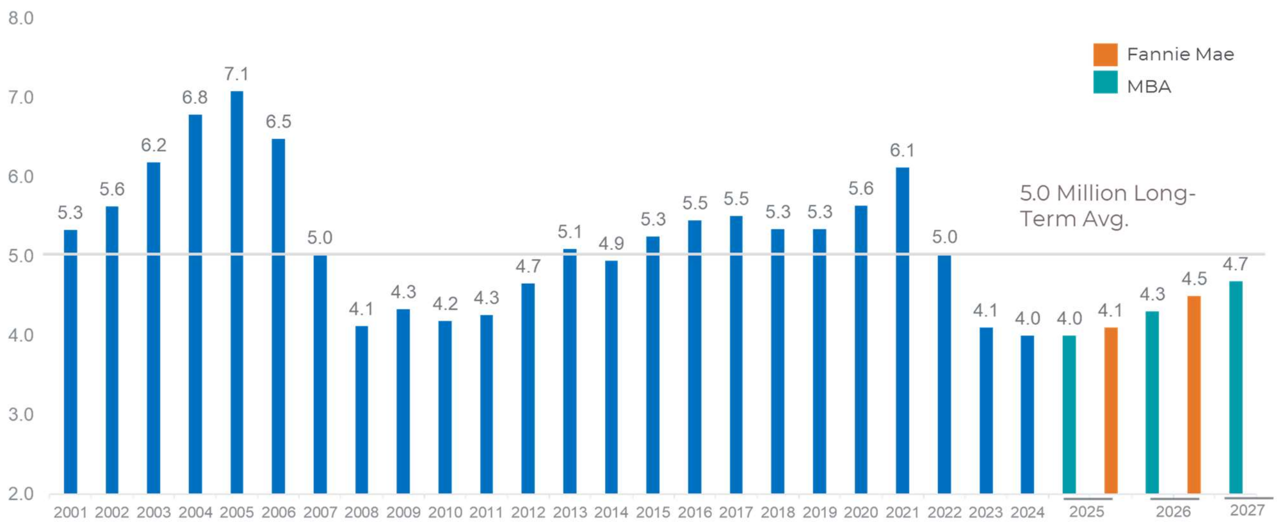
Sales Forecast by Quarter

Existing Home Sales Forecast
January 2025
Sales -- Thousands *Seasonally Adjusted Annualized Rate*

	2024	2025			
	Q4	Q1	Q2	Q3	Q4
Fannie Mae	4,094	4,013	4,080	4,206	4,300
MBA	4,044	4,065	4,157	4,313	4,505
Average	4,069	4,039	4,119	4,260	4,403
Percent Change - *Year-Over-Year*					
Fannie Mae	5.5%	-4.5%	0.7%	8.1%	5.0%
MBA	4.2%	-3.2%	2.6%	10.9%	11.4%
Average	4.9%	-3.8%	1.7%	9.5%	8.2%

Considering the broader picture, 2025 will be a slightly improved market, but perhaps still a transitional year toward the more normal 5 million existing home sales market. Recently, the 5 million target has slipped further out into 2028. As of January, existing home sales predictions came to 4.1 million in 2025 and 4.5 million in 2026.

U.S. existing home sales slowly trending to a more normal 5 million sales level.



Source: Fannie Mae and MBA Mortgage Finance Forecasts

Summary View

There remain signs pointing toward an improved market in 2025 although somewhat dampened over the past several weeks. Do you need to adjust your title agency's performance expectations against budget? How the first quarter plays out from a macroeconomic and policy standpoint will be important. 2025 may be similar to 2024 with a bumpy first quarter relative to our expectations only months ago. While businesses and the stock market are ecstatic about 2025, the bond market, arguably a bit more thoughtful around the longer-term, remains concerned about inflationary policies from the new administration, and as a result there is interest rate uncertainty and rising 10-year rates. If the market gets answers in the first quarter (maybe as early as the first week of February) to questions on how broad, how steep, and how immediate the new tariffs will be, and if those answers provide relief to inflationary concerns, mortgage rates may come down and with it a better title market. But at this point, given the many unanswered questions, the opposite scenario is just as viable with the 10-year treasury reaching 5 percent. Either way, life events will occur, buyers will adapt to higher rates, and any downward movement in rates will release quick pops in the market (which may be a defining characteristic of 2025). While the workout period for the lock-in effect will remain present and take time to normalize, houses will be sold. There is pent-up demand wanting and needing to jump into the market and title agencies need to be able to address the pops without burdening their operating expenses while the market adjusts in 2025.