

Short-Term Interest Rates on the Rise

Adjustable Rate Mortgage Holders Prepare for Increase in Interest Rates

Interest rates are on the rise and many home owners who have adjustable rate mortgages may see increases in their forthcoming annual adjustments.

Federal Reserve Chairman Alan Greenspan made it clear in 2004 that the Federal Reserve would be increasing short-term interest rates at a "measured pace." With the US Dollar at its weakest point in seven years, oil prices unstable and the evaluation of other economic indicators, the Fed Funds Rate was hiked seven times from 1.0% to 2.75% since June 2004 in an effort to curb inflation. Some economists believe it won't stop until the Fed Fund Rate hits 4.0%.

Consumers who foresee paying an interest rate that is significantly higher may want to consider refinancing to take advantage of the stability of a fixed rate mortgage.

Consumers with revolving debt accounts tied to the prime rate have seen the effect through rising interest rate charges, as the prime rate always rides 3% above the current Fed Funds Rate.

Mortgage interest rates are affected indirectly by these changes. An increase in the Fed Funds Rate has an impact on financial markets as a whole, but mortgage rates may go up or down based on the perception investors have of current economic statistics and their reaction to the Federal Reserve's after-meeting statements.



In general, when economic data indicates we have a slow-down occurring in our economy, investors tend to sell off stocks and reallocate that money to the safe haven of bonds and mortgage-backed securities. The purchase of mortgage-backed securities drives interest rates down. When economic data says there is growth in the economy, the stock market typically rallies and mortgage-backed securities sell off to fuel that stock market rally. This drives mortgage interest rates up.

Our current market reflects the reaction of investors reading between the lines on comments made by the Fed, and mortgage interest rates are going up. This will affect home owners with adjustable rate mortgages (ARMs) tied to indexes that are based on short-term interest rates. This includes the 11th District Cost of Funds (COFI), 12-Month Treasury Average (MTA), London Inter Bank Offering Rates (LIBOR) and others.

This doesn't mean that everyone with an adjustable mortgage is in trouble right away. Some indexes are more volatile than others. COFI moves much slower than other adjustable rate indexes, while the LIBOR fluctuates with more

volatility. But remember, when an ARM adjusts, the new interest rate is a sum of the borrower's fixed margin plus the current rate of the index the mortgage is tied to.

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This is also a good time for borrowers who started out in an adjustable rate loan due to a poor credit score to transition into a fixed rate loan if they can. Once a track record of making mortgage payments on time and in full has been established, this should have a positive effect on the credit score and there's a good chance the borrower may now qualify for a loan with a lower interest rate.

As with any decision to refinance, it is important to take the terms of the existing loan, the cost of the new loan, and the borrower's long-term needs into consideration. A qualified mortgage professional should help weigh out the options by providing a clear assessment of available loan programs for the consumer.

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