U.S. Housing and MBS Market

Will U.S. Housing Sail on the QE in 2026?

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The Headlines:

Housing activity remains subdued due to high mortgage rates (~6.70%). A modest rate drop (50–75 basis points) could trigger limited refinancing, but a more substantial decline (150+ bps) is needed to meaningfully boost turnover and refinancing, especially for mortgages originated during the COVID era.

The forward interest rate curve suggests limited room for mortgage rate reductions in 2026, even with expected Fed rate cuts. Only a tightening of mortgage-backed securities (MBS) spreads could further lower rates, but even that might only yield a ~50bp decline.

Policy tools to meet the administration's goal of lower rates:

- Aggressive Fed Cuts: The next, potentially more dovish Fed chair could push for deeper rate cuts, potentially lowering mortgage rates.
- GSE MBS Purchases: Fannie Mae and Freddie Mac could buy MBS within their portfolio caps to tighten spreads, though the impact may be limited and short-lived.
- Quantitative Easing (QE): A renewed QE program, especially one including MBS purchases, could significantly lower mortgage rates and stimulate housing activity, though it risks increased inflation and affordability challenges.

Market Implications: We think the 1y10y would have significant return upside if the administration achieves its low rate goals. QE would potentially most benefit prevailing current coupon MBS during the program (3.5%–5.5%), with call-protected securities and certain derivatives (e.g., inverse IOs) likely to outperform. However, pure IO products and higher coupon non-call protected paper may underperform.

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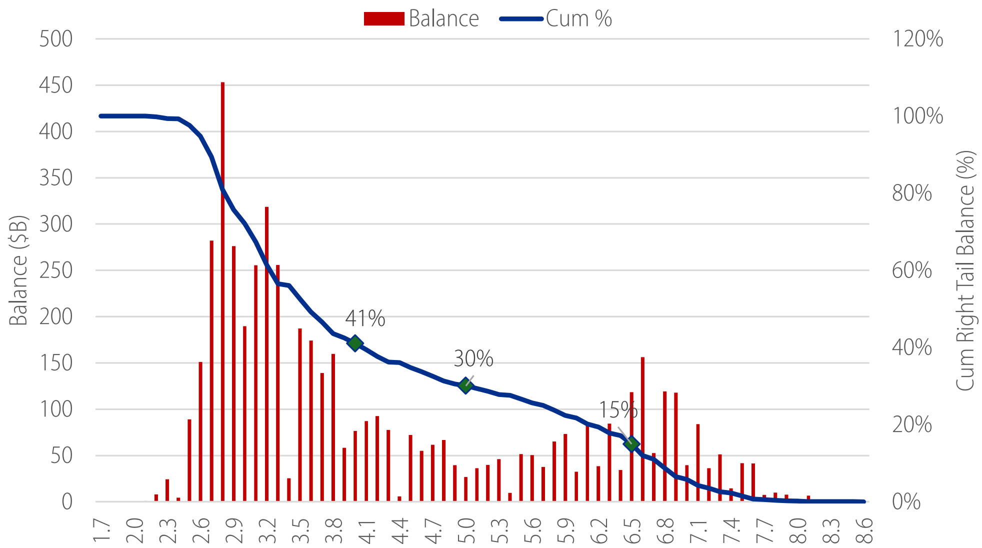
The Details:

Housing activity remains subdued across a range of metrics from turnover and existing home sales, refis, and home prices. With conventional mortgage rates around 6.70%, a roughly 50-75bp rally could trigger refinancing of recent (12-36 month old) mortgages. It could also reduce some amount of lock-in among borrowers with older lower rate mortgages. However, for the majority of the latter, mortgage rates need to decline another 75-100 bp to the low 5% handle or lower to generate meaningful incremental turnover and refis.

A 50-75bp rally in mortgage rates can trigger a refi wavelet, but a 150+bp rally is needed for a more meaningful refi wave and increased turnover on Covid era production.

Conventional 30-yr MBS balances distribution by WAC



Source: Hilltop Securities, RiskSpan.

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Top US officials from President Trump on down, Treasury Secretary Bessent, and FHFA Director Pulte have all spoken about the need for lower rates. Although the President and Secretary may be referring to the entire rates complex it is quite likely that mortgage rates are central in the mix. Director Pulte almost certainly is focused squarely on mortgage rates given his seat at the head of FHFA and the boards of Fannie Mae and Freddie Mac (GSEs).

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A market driven path to lower mortgage rates would likely include a combination of Fed rate cuts and a tightening of MBS spreads. However, the magnitude of this reduction appears limited if current forward market pricing is realized. The forward curve is pricing in roughly 4.5 Fed cuts (111bp cumulatively) over the next 12 months. However, the 10-yr rate one year forward is 4bp higher than the spot rate. This leaves only MBS spread tightening as the potential driver of lower mortgage rate (leaving aside the primary/secondary spread, which could have a marginal contribution as well). Under the most optimistic views on MBS spreads, this translates to perhaps a 50bp or so decline in 30-year mortgage rates.

The forward curve is implying a minimal scope for lower mortgage rates next year.

In order to achieve a further meaningful reduction in mortgage rates, additional Fed rate cuts (beyond that implied by forwards) and potentially other tools to take out mortgage duration might be necessary.

USD SOFR (vs. FIXED RATE)

Tenor	Spot	12/31/2025	12 Mo	12/31/2026	24 Mo
1 Mo	4.34	3.83	3.23	3.20	3.27
3 Mo	4.32	3.77	3.24	3.18	3.28
6 Mo	4.19	3.67	3.25	3.18	3.30
1 Yr	3.95	3.49	3.24	3.26	3.33
2 Yr	3.60	3.38	3.28	3.33	3.41
5 Yr	3.53	3.49	3.50	3.57	3.65
7 Yr	3.63	3.62	3.65	3.71	3.79
10 Yr	3.79	3.79	3.83	3.89	3.95
15 Yr	3.99	3.99	4.01	4.05	4.10
20 Yr	4.07	4.06	4.07	4.10	4.13
30 Yr	4.01	4.00	4.00	4.01	4.03
3 Mo / 10 Yr	-0.53	0.02	0.59	0.71	0.67
2 Yr / 10 Yr	0.19	0.41	0.55	0.56	0.55

Note: Data as of 10-Jul-2025

Source: Bloomberg, HilltopSecurities.

In order to achieve a further meaningful reduction in mortgage rates, additional Fed rate cuts (beyond that implied by forwards) and potentially other tools to take out mortgage duration might be necessary. The interplay between the administration's desire for lower mortgage rates, Fed's inflation fighting mandate, and market factors remains uncertain. Moreover, the longevity of extraordinary measures is open to question.

A further 100bp cut would take SOFR to a low 2% range, which could in theory take mortgage rates down an additional 50bp or so assuming a roughly 50bp steepening of the 3m/10yr spread.

So, what other tools does the administration have to achieve lower mortgage rates?

The first tool would be the possibility of more aggressive cuts by the Fed under the next FOMC chair who is slated to take over mid next year. For the purposes of this discussion we assume that the incoming chair will be like minded with the administration on rates and sidestep the potential for the FOMC at large to push back. A further 100bp cut would take SOFR to a low 2% range, which could in theory take mortgage rates down an additional 50bp or so assuming a roughly 50bp steepening of the 3m/10yr spread. Of course, if the market views this as inflationary and steepens the curve further, the mileage may be lower.

The second tool in the toolkit might be the idea that the GSEs buy MBS in their retained portfolios. Again, for this discussion, we sidestep the thorny policy questions this entails. Before the GFC, the GSEs had very large retained portfolios and they acted as somewhat of an "OAS police", stepping in when OAS got wide and occasionally selling when OAS was too tight. This served as something of a stabilizer in the MBS market. However, that model is unlikely to be as effective in lowering mortgage rates in the current environment. The GSE retained portfolios are at roughly $180B combined as of May 2025 (https://www.fanniemae.com/media/55881/display and https://www.freddiemac.com/investors/financials/pdf/0525mvs.pdf). This leaves roughly $270B in remaining capacity

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under the current preferred stock purchase agreements with the Treasury (PSPA). Of course, the Treasury could renegotiate the PSPA to increase these limits, but we sidestep that as well for the moment. An announcement that the GSEs would purchase MBS to the maximum extent of their portfolio caps would most likely tighten spreads in the short run and therefore lower mortgage rates. However, to the extent that GSEs do this in an OAS framework, it would entail buying volatility, thus pushing up portions of the vol surface. In turn, this could diminish the magnitude of any nominal spread tightening. Moreover, given the magnitude of buying power involved, money managers could very well sell into any tightening making it short lived.

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Then there is the third tool – the QE bazooka. Clearly this is diametrically opposite to the balance sheet reduction path the Fed is on. And, invoking this tool under non-emergency conditions is likely to be strongly questioned by market participants and policy makers. That said, there is at least a possibility that it could be considered if the administration prioritizes rate reduction as a goal, has limited success through traditional market mechanisms, and has a receptive chair at the Fed. The full scope and duration of the impact of QE on mortgage rates and the broader rates complex would depend on the size, asset mix, and duration of any QE program. Limiting purchases to just Treasuries would potentially be less effective than a program that includes MBS purchases. At some point the market would have to contend with selling by money managers seeking to normalize their MBS overweights, but the pick-up in housing activity could be sustained for a meaningful period with this tool. Home prices could face upward pressure amidst increased demand. In terms of potential adverse consequences of QE, the key risk is the potential for increased inflation. The impact of housing affordability could be mixed between lower rates improving affordability and the potential increase in prices pushing affordability lower.

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In the rates market, a potential QE would imply significant return upside for the 1y10y. From an MBS market standpoint, the current coupon should benefit most directly from any QE, with the target drifting lower as rates decline. With the 30-year current coupon yield at 5.65%, the 3.5% through 5.5% coupons constitute the potential direct beneficiaries range. That said, lower coupons should also benefit from the duration takeout. Within higher coupons, call protected paper should benefit the most from the rate rally. Higher coupon non-call protected paper would potentially underperform. In derivatives space, call protected inverse-IOs should benefit from the increased carry and duration rally, and inverse floaters should benefit from their levered mortgage basis exposure. Pure IO product would potentially underperform.