Written Testimony of

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Chairman Whitehouse, Ranking Member Grassley, committee members, thank you for the opportunity to speak with you on such an important topic. It is an honor to be here.

With the recent increase in mortgage rates, housing has become substantially less affordable today than just a few years ago. Let's compare two families: Family one purchases the median-priced home with a twenty-percent down payment at the 30-year fixed mortgage rate available in January of 2021. Family two purchases the same home at today's mortgage rate. Family two will pay an *additional* \$800 per month and an *additional* \$285,000 in interest payments over the life of the loan. For a family making the median income, the additional mortgage payments of \$800 per month constitute 20% of disposable income.[1]

This prohibitive increase in the cost to purchase a home comes at a time when the price of all goods and services are increasing dramatically. The good news is the rate of inflation has been coming down. The bad news is that changes in the *price level* since 2020 have made essentials like groceries 25% more expensive.[2] Inflation is a tax on everyone and families are still feeling the pinch. Housing costs are, by far, the largest item in a family's budget. If housing becomes more affordable, this makes food, education, childcare, transportation, and all other necessities more affordable as well.

What does this analogy have to do with the budget of the United States government? The only difference between these two families is the mortgage interest rate. This interest rate is tightly connected to the interest paid on the 10-year U.S. Treasury Bond. Since 1990, these two time series have moved in lock-step with a near-perfect correlation of 0.98.[3] As the common phrase reminds

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[1] Home prices, mortgage rates and income pulled from `https://fred.stlouisfed.org/`.

[2] CPI Inflation Calculator `https://www.bls.gov/`.

[3] Correlation is monthly observations of 30-Year Fixed Rate Mortgage and 10-Year Constant Maturity from 1990:1

us, correlation is not causation. But in this case, the economics are clear, causality runs from the 10-year yield to mortgage interest rates, not the other way around. If the interest rate on the 10-year Treasury increases, mortgage rates will increase; if the 10-year yield falls, mortgage rates will also fall. Of this, I am confident.

So, what determines the interest rate on a 10-year U.S. Treasury? This question is much more difficult to answer, however, the long-run foundational anchor of U.S. sovereign debt must be fiscal policy. There are three important considerations here:

First, in response to the Financial Crisis of 2008 and the Covid-19 Pandemic, the Federal Reserve engaged in a policy called quantitative easing that depressed the 10-year yield below market-based equilibrium. This diminished the sensitivity of long-dated maturities to fiscal policy over the last 15 years. These policies are currently being undone. As quantitative easing gives way to quantitative tightening, fiscal policy will once again take center stage in price discovery for the Treasury market.

Second, paying interest to bond holders or debt service is now the third largest expense of the federal government only behind Social Security and Medicare. Debt service will soon exceed one trillion dollars per year if it hasn't already. The CBO projects debt service to grow to 3.6% of GDP over the next decade, an all-time high.[4] Bond traders, recently burned by unanticipated inflation to the tune of a record-breaking 46% decline in bond prices, are now much more leery of inflation-inducing fiscal expansions. When inflation is anticipated, higher rates of interest are required to compensate for the lost purchasing power. As debt service grows, it will crowd out other spending needs.

Finally, increases in government spending to support the economy during the Pandemic were on par with increases to finance World Wars I and II. Following the great wars, through a reduction in spending and increases in tax revenue, debt-GDP ratios gradually, yet substantially, declined. This is consistent with economic theory: shocks, like wars and Covid, should be smoothed over time. However, no such fiscal consolidation is currently on the horizon. Sizable deficits are projected for the foreseeable future. This will certainly put upward pressure on the 10-year Treasury yield.

When it comes to housing affordability, there aren't many things more important than mortgage rates. Given that mortgage rates track the value of U.S. debt very closely, fiscal policies initiated by this committee have a direct impact on housing costs. While other countries have struggled to reopen following the Pandemic, the strength of the U.S. economy has been on full display. This economic growth can and should be used to coordinate a well-thought out and gradual fiscal consolidation, consistent with optimal economic theory; such a consolidation would make housing more affordable.

to 2024:1. Data available from `https://fred.stlouisfed.org/`.

[4] CBO Publication 58946 `https://www.cbo.gov/publication/58946`.