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Title:
Capital Markets driving the cost of Mortgages

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Summary:
Interest rates and Borrowing are a current hot topic. Banks are keeping rates high at the moment, simply due to risk, but what underlines all this is the cost of lending money between the banks.

Keywords:
interest rates, borrowing

Article Body:
The capital that makes up your mortgage/ loan can come from a number of sources including other people's deposits and savings, stored up in the bank and other investors, all of which make up the Capital Markets. Of course, there isn't enough cash in the general consumers accounts to make up the capital needed for the mortgage markets so the majority comes from investors looking to buy debt instruments, which in this case are bonds.

The buyers of these bonds are looking for a good return on their investments, which is of course completely opposite to people looking for a low rate mortgage. In effect, you're borrowing money from an investor at a given rate (for you an interest rate and for the investor a rate of return). Of course, the investor is only willing to invest a certain amount of capital in such low yield bonds.

Now, the rates on a mortgage fluctuate from month to month and this rate is determined by how well 'mortgage bonds' are selling. A rise in sales will see a drop in yield and a drop in sales will see a rise in yield, thus attracting investors back into the market. The result of the average mortgage holder will be the opposite though. When investors leave the bond market, they will see a rise in mortgage interest rates.

Of course, the mortgage market is driven by a number of external factors, such as supply and demand but the greatest factors is that of inflation. Where inflation is low, the return for the investor is high, but when inflation increases, it devalues the investment and at the same time the mortgage. Suddenly a $120,000 mortgage can seem far less of a burden.

Inflation is kept under control by raising or lowering interest rates. When inflation is rampant, interest rates are raised, resulting in a rise in mortgage repayments.

Recent sub-prime mortgage lending issues in the US have had a knock on effect throughout the world. Billions of US dollars have been lost, simply because many of the associated bonds were bundled up and sold on to banks throughout the world. These mortgages were in effect over-subscribed in the states, with many people only able to afford a house with one of them. Unfortunately, the mortgages were being defaulted on and, having been sold on to UK, Hong Kong, German, French banks, they could not be easily recouped. The collapse in this market left many banks in serious problems. Losses could not be recouped and the bond market dried up as investors fled. New mortgages became difficult to find and their rates were much higher than previous. Interest rates have now been dropped so as to stimulate the market. Lenders have maintained bond rates at a higher level, giving them greater yield and the result will be a higher return for what is now percieved a greater risk.