

## MEICAP Results Pertaining to Interest Rates

The MEICAP model mirrored actual interest rate fluctuations almost perfectly over the past 40 years. A chart of the model results is presented below. The actual interest rate fluctuations are shown in blue and the model results are shown in red.

Many people believe the high interest rates during the late 70s and early 80s was a function of the oil embargos perpetrated by the OPEC countries. Indeed, these embargos directly affected oil prices and stagnated economic development across the western world but that alone was not the culprit of high interest rates.

The average American generates negative savings between the age of 15 and 26 (see "Foundation"). The oldest of the Baby Boom generation turned 15 in 1961 and then turned 27 in 1973. The youngest turned 15 in 1979 and 27 in 1991. Clearly, the bulk of Baby Boomers were in their negative savings cycle in the late 70s and early 80s. With money either being borrowed or coming out of savings accounts, a shortage of investment capital resulted and interest rates began their historic ascent.

In 1982, the pool of investment capital began to grow faster than the population as Baby Boomers established their careers. As a result, interest rates began to fall as lenders competed for the business. Although various market conditions resulted in short term fluctuations along the way, the trend of falling interest rates continued until 2003 when the pool of investment capital reached its peak and interest rates reached their trough.

The pool of investment capital shrinks at a very slow rate for the next 10 years or so but that should accelerate as Baby Boomers begin retiring en masse. We can expect rates to remain fairly low for the coming few years but they should begin rising quicker after 2013 and 2014 and the upward direction should continue all the way to 2027. After that, the Baby Boomers begin to thin out while their children (the echo Baby Boom) establish themselves in the positive savings period.

You can see from the graph the difference between the 2003 low and the 2027 high is about 3.00%. Keep in mind the graph displays the 10-year treasury yield index so the actual interest rates referenced are not relevant from a real estate perspective. However, using the best-case interest rate trough for 30-year fixed mortgages back in 2003 (about 5.50%) as a baseline would yield a proportional increase of 4.125%. It follows that best-case 30-year fixed mortgage rates should rise to about 9.625% by year 2027.

After that, the annual savings contributions of the echo Baby Boom more than offset the withdrawals from their surviving parents and the pool of investment capital begins to grow again, resulting in dropping interest rates. However, because the echo Baby Boomers do not represent the same disproportionate characteristics as their parents, we cannot expect rates to reach 2003 lows anytime in the foreseeable future.