The next 60 days will be crucial for central banks and variable-rate mortgage borrowers

ROBERT MCLISTER >
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Central bankers worldwide are spooked – like a herd of zebra catching wind of a lion pride.

The predators they fear are inflation and inflation expectations. And those are more significant threats than they thought just weeks ago, particularly the latter.

The thing about inflation is that it depends largely on what we expect it to be. If Canadians see it going in the wrong direction, like it did last month, they fear it's a trend. So they take inflationary actions like buying more things sooner –before prices rise – and asking for higher wages.

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People have also been trained by companies to accept unusually high price increases. That's a crucial inflation driver that's hard to quantify. Businesses have become experts at convincing us that 10-per-cent-plus annual price increases are justified, whether they are or not.

It's a tough cycle to break but the Bank of Canada and its global peers have no choice but to kill these mindsets. And the only way to do it is with aggressive interest rate increases, hikes that leave no doubt the central bank means business.

What the Bank of Canada must do

In the last few months, policy-makers around the world have raised rates in surprise fashion. We're talking Britain, Australia, Norway and New Zealand to name a few countries – and, of course, Canada. All are finding core inflation more difficult to tame than anticipated.

That's an anxiety-maker for variable-rate mortgage borrowers. Families are now watching in dread of higher payments, which is exactly what we'll get if bond market investors are right.

As this is being written, financial markets are pricing in two more hikes in Canada this year. That would take the benchmark prime rate to a multi-decade high of 7.45 per cent. This is a far different scenario than expected a few months ago when markets were more sure that inflation was contained.

The next 60 days will be among the most crucial in this rate-hike cycle. That's because policy-makers expect the economy to now slow, given more restrictive credit conditions. If it doesn't, the bank may go overboard to stamp out inflation for fear of falling behind the curve again.

What to watch out for

Any reprieve from the rate pain will depend heavily on four developments:

- **Higher unemployment** (Next jobs report: July 7)
- **Slowing GDP** (Next GDP report: June 30)
- **Tumbling core inflation** (Next inflation report: June 27)
- **Easing home values** (Next real estate board reports: first week of July)

One could sit around and anguish over all these data points, but folks are better off doing two things:

First, prepare for at least another half a percentage point rate hike even if we don't get it. That jump would add another $30 a month to adjustable-rate payments, for every $100,000 of balance on a 25-year amortization.

Second, if the family budget's tight, lower spending any way possible. That's easier said than done for families living paycheque to paycheque, but hike cycles last just a few years, not decades. Try to ride this out until more economic cracks start showing. Once those cracks become fissures, the BoC will signal that rate relief is on the way.

Nothing's guaranteed in the world of monetary policy. If there's another global event that drives up inflation, that changes the conversation. But odds are good that inflation will react to extreme rate increases the way it has in the past – and fall back into the central banks' target range by some time next year.

But when that starts to look likely, don't expect the Bank of Canada to give an all-clear message until the very last minute. Its pause signal in January helped home prices blast off, counteracting attempts to wrestle down inflation. It won't make that mistake again.

Lowest nationally available mortgage rates

TERM	UNINSURED	PROVIDER	INSURED	PROVIDER
1-year fixed	6.24	True North	6.19	QuestMortgage
2-year fixed	5.89	HSBC	5.79	Ratehub
3-year fixed	5.54	HSBC	5.49	QuestMortgage
4-year fixed	5.49	Ratehub	4.99	True North
5-year fixed	5.19	HSBC	4.79	Nesto
10-year fixed	5.99	Ratehub	5.74	Nesto
Variable	6.15	HSBC	5.65	Nesto
5-year hybrid	5.67	HSBC	6.24	Scotia eHOME
HELOC *	6.95	HSBC	N/A	N/A

* Home equity line of credit.
SOURCE: ROBERT MCLISTER; DATA AS OF JUNE 22.

Rates are as of June 22, 2023, from providers that advertise rates online and lend in at least nine provinces. Insured rates apply to those buying with less than a 20 per cent down payment, or those switching a pre-existing insured mortgage to a new lender. Uninsured rates apply to refinances and purchases over $1-million and may include applicable lender rate premiums. For providers whose rates vary by province, their highest rate is shown.

Robert McLister is an interest rate analyst, mortgage strategist and editor of MortgageLogic.news. You can follow him on Twitter at @RobMcLister.

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