Mortgage Rundown: ‘Inflation horror show’ could mean three years of misery for variable-rate borrowers

ROBERT MCLISTER
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED 16 HOURS AGO
UPDATED 3 HOURS AGO

Welcome to Mortgage Rundown, a quick take on Canada’s home financing landscape from mortgage strategist Robert McLister.

This is an “inflation horror show.”

That’s how BMO Capital Markets put it after the consumer price index hit a new three-decade high on Wednesday. At 6.7 per cent, the CPI made a mockery of the Street’s 6.1-per-cent expectation.

“We continue to look for the Bank of Canada to crank interest rates to neutral as quickly as possible,” BMO author Douglas Porter wrote in his Wednesday report.

And he doesn’t see the Bank of Canada stopping “until rates are above the midpoint of their neutral range, i.e., above 2.5 per cent.” That overnight lending rate would translate to approximately 4.95 per cent.

That means it’s going to be one hell of a stressful year for floating-rate borrowers. Those in a “prime minus one per cent” variable, for example, could see their rate swell to nearly 4 per cent. On March 1, that same rate was 1.45 per cent. That implies up to a 32-per-cent payment shock for those with an adjustable-rate mortgage.

But there’s hope, Mr. Porter says. “This may indeed be the apex for headline inflation, at least for now.”

Hmm. Does "at least for now" sound like a disconcerting qualifying statement to you? It does to me, and it shows just how unpredictable this inflation crisis is.

The Bank of Canada is likely just as dumbfounded. CPI is already almost one percentage point above its recent second-quarter inflation estimate.

"There is even a solid case for the BoC to hike by 75-100 bps in one shot," Scotiabank economist Derek Holt wrote on Wednesday. (There are 100 basis points, or bps, in a percentage point.) And he's been ahead of the consensus in forecasting this inflation debacle.

The prime rate is likely to continue to rise and then peak in the next 12 to 24 months, while bond market expectations tracked by Bloomberg suggest it could be another three years before rates start dropping again.

If you're in a floating-rate mortgage, however, the next three years will not go by quickly.

CREA's open bidding starts something big

This summer may mark the first baby step in what could be a sweeping change for Canadian real estate. The Canadian Real Estate Association (CREA) is launching a six-month pilot in B.C. in which sellers can opt to display offer prices online.

It's got haters of blind-bidding all excited. But the details may leave you wondering how much it'll affect home prices, and how fast.

At this point, CREA will not *require* that offer prices be displayed, largely for privacy reasons, it says; only offer ID numbers and the number of offers must be displayed.

"When the seller agrees to be part of Open Offers, they decide at that point if offer prices will be displayed," CREA chief executive officer Michael Bourque says.

Mortgage rundown: A dramatic increase in home-buying power can be yours, but it comes at a price

Mortgage Rundown: After this week's Bank of Canada rate increase, how high could mortgage rates climb?

In Ontario, sellers are not permitted to display offer prices online, but on Tuesday the province announced that it will allow them to display bids effective April 1, 2023. However, Ontario is not banning blind bidding.

Hiding bid prices makes "open bidding" a farce, but regulators could still mandate full offer transparency in time … if consumers complain loudly enough.

"We are clearly for showing offer prices in the system because consumers want to see prices," Mr. Bourque says. "But we can't force anyone to do anything."

"We'd [also] like to display sold data in Ontario, but [Real Estate Council of Ontario] tells us that because of privacy we can't do that. At the same time, you have Teranet that will sell you the information," he said, in reference to the private land registry company.

One pitfall of an open-bidding system is that, in many cases, offer transparency could worsen price inflation.

CREA did a study on how open auctions affect home prices because the Prime Minister suggested that the current offer method was leading to higher prices, Mr. Bourque says. "We knew that wasn't true because fundamentally the problem is lack of supply."

"If you look at jurisdictions with the most extreme prices who use auctions, those auctions actually lead to higher prices." he says.

"The government promised to ban blind bidding," adds Mr. Bourque, "but in the budget, it says they are now talking about working with the provinces, because what they realized is they can't do it [as real estate sales are provincially regulated.]"

The only way they could do it, he says, is by making it an offence under is the Criminal Code.

Another consideration concerning open bidding is that it will create oceans of data. If there are 17 offers on a property that went $100,000 over asking, for example, future buyers will see this and factor it into the next sale. Offer data would also help when a lender or appraiser questions a property's value. If the record shows that 17 people made offers, that's more telling than if just one person paid $100,000 over.

Mortgage rates this week

Last week's prime rate increase to 3.2 per cent boosted the lowest nationally available uninsured variable rate 50 basis points to 2.44 per cent (prime minus 0.76 percentage points). But if you like variable rates, you should love one-year fixed rates.

Some online brokers are selling them for just five basis points more. Hence, while a 2.44 per cent variable could be over 4 per cent by year-end, today's best one-year would stay at 2.49 per cent.

"We don't believe it's wise to make any five-year commitment in a time of extreme volatility," says veteran mortgage broker Ron Butler, of Butler Mortgage. Instead, he advises qualified borrowers to "take a very well-priced one-year fixed and then have a chance to review what is likely to be a more stable market in 12 months."

Unfortunately, the country's lowest one-year fixed rates are going up on Friday. So, they need to be locked in fast.

As for five-year fixed rates, you can still fetch them as low as 3.79 per cent, a rate that projects to have a lower hypothetical borrowing cost than a 2.44 per cent variable. That's assuming implied future rates in the bond market are roughly accurate, and you don't break the mortgage before five years.

Lowest nationally available mortgage rates

TERM	UNINSURED	PROVIDER	INSURED	PROVIDER
1-year fixed	2.79%	TD	2.59%	True North
2-year fixed	3.24%	Investors Group	3.19%	True North
3-year fixed	3.69%	Multiple	3.39%	True North
4-year fixed	3.69%	Alterna Bank	3.49%	True North
5-year fixed	3.79%	Alterna Bank	3.64%	Marathon
10-year fixed	4.44%	HSBC	3.94%	Nesto
Variable	2.44%	HSBC	2.04%	HSBC

TERM	UNINSURED	PROVIDER	INSURED	PROVIDER
5-year hybrid	3.17%	HSBC	3.19%	Scotia eHOME
HELOC	3.05%	HSBC	N/A	N/A

As of April 20.

Rates are as of April 20, 2022, 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.