



## How Will a Rate Hike by Bank of Canada Affect Home Capital Group Inc.?

### Description

Mortgage lenders have experienced a tumultuous 2017 in Canada thus far. The crisis-laden **Home Capital Group Inc.** ([TSX:HCG](#)) has stolen headlines, and the industry faces mounting questions in the face of growing consumer debt and the promise from the Bank of Canada that interest rates will soon begin to rise from their historic lows that have lasted for almost a decade.

As the year began, the housing boom in Ontario, centred in Toronto and the Greater Toronto Area, showed no signs of slowing down with areas experiencing gains upwards of 20-30% year over year. The crisis at Home Capital Group reached fever pitch when president and CEO Martin Reid was fired in March, and on April 26 the company announced that it was seeking a \$2 billion credit line in response to declining deposits. Shares dropped 65% when the news hit.

Shares of mortgage insurer **Genworth MI Canada Inc.** ([TSX:MIC](#)) fell 7% the same day. Mortgage lender **Equitable Group Inc.** ([TSX:EQB](#)) declined 31%.

In response to these conditions, in late May, the Ontario government announced regulatory changes in an effort to cool the housing market; it slapped on a 15% foreign buyers' tax. The Ontario government also partnered with the Canada Revenue Agency to strengthen reporting requirements on real estate purchases and sales.

Pessimism since these events has been alleviated somewhat by the \$400 million purchase by **Berkshire Hathaway Inc.** of Home Capital shares as well as the extension of the \$2 billion credit line sought out by the company at better terms than those offered by the Healthcare of Ontario Pension Plan.

Home Capital stock shot up more than 27% on the back of the news. The purchase drove up the share price of Genworth and Equitable Group as well, moving upwards of 11% and 12%, respectively.

The Bank of Canada has followed up Warren Buffett's vote of confidence with its own, declaring that rates are due to increase after strong job and GDP growth in Canada. Customers at Home Capital, who often seek out these lenders because of their inability to qualify at traditional banks, could face an interest rate hike up to 200 basis points. This has the potential to drive monthly payments 10-25%

higher.

Investors who have been prompted to look at stocks linked to the Canadian housing sector must take into account the potential fragility of the market. The Bank of Canada appears to be committed to a period of tightening in response to positive economic trends. Rising rates could expose customers at Home Capital, Genworth, and others to potential rate shocks and a substantial rise in payments.

Economists expect a gradual rate increase from the Bank of Canada. **National Bank** has predicted two rate hikes of 50 basis points, which would bring the rate to 1% by the end of 2017.

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