The Bank of Canada Turns Dovish: Time to Buy Mortgage Lenders?

Description

Bank of Canada governor Stephen Poloz struck a cautious tone on September 27 when it came to future interest rate moves. Poloz said that interest rates could move "in either direction." He emphasized that the Canadian economy was still highly susceptible to shocks, and a cooling housing market combined with debt worries are still worthy of concern.

The Canadian dollar dropped on the news as experts, and analysts were surprised after a seemingly bullish tone in early September. **Bank of Montreal** chief economist Douglas Porter criticized Poloz after the September 6th rate hike for failing to effectively communicate the intentions of the Bank of Canada.

The reaction from alternative lenders is even more interesting as we near the next interest rate decision. The stock prices of **Home Capital Group Inc.** (TSX:HCG) and **Equitable Group Inc.** (TSX:EQB) have remained largely flat following a chaotic spring and early summer for the housing market. In recent quarterly reports, both companies predicted slower loan growth due to new mortgage regulations introduced by the OSFI. The foreign buyers' tax instituted by the Ontario government has also had an immediate impact on home purchases from foreign buyers — down 1.6% in the Greater Toronto Area from April to August.

There is little doubt that the expectation of continued interest rate tightening has also had a significant impact on investor sentiment. With Canadian citizens holding record high debt-to-income, the proposition of tightening was viewed as being bearish for the housing market. Now, with the potential for rates remaining static or even dropping depending on economic conditions, it could change the outlook for housing in the next few years.

RioCan Real Estate Investment Trust (TSX:REI.UN) and **H&R Real Estate Investment Trust** (TSX:HR.UN) have dipped along with other REITs during this period. With this development, investors in search of attractive income in their portfolios may be justified to look in the direction of REITs again. RioCan offers a dividend of $0.14 per share with a dividend yield of 7.1%, and H&R REIT boasts a 6.5% yield at $0.12 per share.

Should investors see the comments as a green light to buy alternative lenders?

In a previous article on alternative lenders, I emphasized the cautious tone taken by the Bank of Canada following the September 6th rate hike. Investors now face a fluid rate environment. The OECD has maintained the GDP growth forecast for Canada at 2.3% for 2018. Canada has managed to dramatically overshoot expectations in 2017. Though economic growth has been strong, it is expected to slow in the second half of this year, and policy experts are urging caution.

The housing industry has been a strong point for the Canadian economy this decade, making up a growing portion of GDP. If and when economic growth slows, policy makers may look to ease borrowing costs to reignite the market. At this uncertain stage, lower growth has largely been priced in for Equitable Group and especially for Home Capital. Both could be attractive buys heading into the last months of 2017.

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