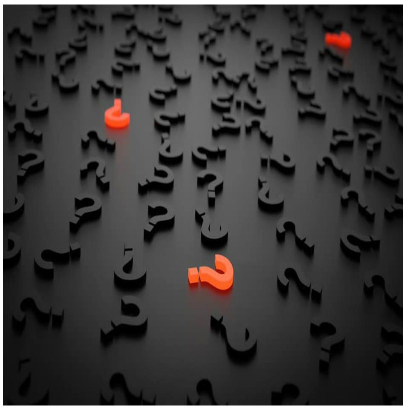

Could a January Rate Hike Sink Lenders?

Description

As 2017 wound down, the prospects of an early rate hike in 2018 appeared unlikely. The Bank of Canada stressed patience in evaluating how the housing market would respond to new mortgage rules in January. It also had concerns over record high Canadian consumer debt and ongoing NAFTA negotiations that had taken a difficult turn.

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In early December, the Canadian dollar lowered on expectations that the central bank would keep rates on hold until the late winter. However, heading into a key rate decision on January 17, forecasts have swiftly changed. All six Canadian banks are now projecting a rate hike on January 17.

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) chief economist Avery Shenfeld said that the central bank's recent business outlook survey should seal the deal for a rate hike next week. However, most executives still expect inflation to remain at or below 2% into 2020. Inflation has been a sticking point for central banks in North America and Europe. It continues to lag a key indicator alongside improving data in the midst of this long recovery.

I'd recently discussed the late 2017 surge in the stock prices of alternative lenders. A new stress test implemented by the OSFI for uninsured buyers had many experts and analysts sounding bearish signals for lenders to start 2018. The new mortgage rules combined with the threat of the first rate hike so early has seen that prophecy come to fruition.

Equitable Group Inc. (TSX:EQB), a Toronto-based alternative lender, has seen its stock fall 4% in 2018 thus far. **Home Capital Group Inc.** (TSX:HCG) has dropped 10.7% over the first five trading days of this year. An early rate hike could see the stock prices of both battered early on. But could this be a buying opportunity?

On December 14, 2017, Statistics Canada released numbers that showed Canadian household debt hitting a new record. Household credit market debt as a proportion of household disposable income climbed to 171.1% compared to 170.1% in the second quarter of 2017. The total net worth of Canadian households also dropped 0.1% to $10.61 trillion in the quarter.

A survey released in October 2017 by the insolvency firm MNP Ltd. revealed that 40% of Canadians said that they would be in financial trouble if interest rates were to rise. “It is clear that people are nowhere near prepared for a higher rate environment,” said MNP president Grant Bazian. Surveys like this have given the central bank pause over the course of recent rate decisions.

New prospective home buyers have already seen their purchasing power dented by the new stress tests. An interest rate increase could significantly sour the housing market and business for lenders to kick off the year.

The Organization for Economic Co-operation and Development said in November that a “disorderly correction” in Canadian housing could lower growth and “threaten financial stability.” Patient investors that are willing to bet on alternative lenders in this period of major turbulence could be rewarded later in the year. Industry experts expect real estate to stabilize and house prices to rise beginning in the spring.

CATEGORY

1. Bank Stocks
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TICKERS GLOBAL

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2. TSX:CM (Canadian Imperial Bank of Commerce)
3. TSX:EQB (EQB)
4. TSX:HCG (Home Capital Group)

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