Housing Crash 2020: Could Mortgage Rates Hit 0%?

Description

The mortgage rates in Canada changed in a remarkable move. The benchmark five-year mortgage rate reported by the Bank of Canada fell for the third time in 2020, easing the pressure faced by real estate investors who were under stress to pay their mortgages.

The mortgage rate decreased from 4.94% in May to 4.79%, which had already fallen from 5.04% in March. These mortgage rates are the lowest they have been in three years. A significant number of house-hunting Canadians who previously could not qualify for mortgages can afford to borrow money to purchase houses.

Consistently declining mortgage rates

Most borrowers do not have to pay the actual benchmark posted rate for their mortgages. However, the posted rate is useful to assess the borrowers as part of the financial stress test. This check makes sure home buyers have the financial power to make future mortgage payments if the rates increase from their current rates. A drop in the benchmark rate makes the stress test a breeze.

The decreasing benchmark posted rate is not a surprise considering the falling underlying rates. A family that earns $100,000 each year could qualify to take out a fixed-rate mortgage for a home valued at $523,410 under the previous rate with a 10% down payment. Under the new mortgage rate, the same family can qualify for a mortgage on a house worth $531,230.

Will the mortgage rate hit 0%?

After falling for the third time this year, you might have started wondering if the mortgage rate will gradually hit 0%. While the decrease in rates can help many Canadian families afford mortgages, it is not too significant a decline. It only has a positive effect on Canadians close to qualifying for mortgages. It makes no difference for Canadians who've already qualified or to those who were not close to qualifying.

As for declining to 0%, it is impossible. Canadian financial institutions have been cooperative with financially stressed Canadian borrowers through decreasing mortgage rates and mortgage deferrals. However, the banks still rely on mortgage payments as a substantial revenue stream.

Banks will need to continue earning money, and it is highly improbable that the mortgage rates can even come close to 0%. If you are an investor with a bank like the **Royal Bank of Canada** (TSX:RY)(NYSE:RY), you should not worry about it. The bank will not eliminate its revenue source.

The banking sector reported a massive increase in provisions for credit losses in the second quarter due to COVID-19 and the lockdowns. However, the Royal Bank of Canada continues to inspire confidence in its investors. RY is up by more than 34% from its share prices in the March 2020 bottom.

Trading for $97.10 per share at writing, RY pays its shareholders at a juicy 4.45% dividend yield. The $138.21 billion market capitalization bank has a strong balance sheet that can help the bank weather the current storm. A decrease in mortgage rates will likely impact its revenue, but the effect will likely be nominal. The reduction of rates will allow more Canadians to qualify and increase their potential revenue in the long run.

Foolish takeaway

While the mortgage rate declined for the third time this year, it is unlikely to spell bad news for operators in the finance sector. I think that the Royal Bank of Canada could be a valuable investment to consider. The stock is still trading for a 6.23% discount after three months of gains.

I think investing in the stock could earn you substantial long-term profits through its capital gains and dividend income.

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