Mortgage Rates Could Skyrocket as Bank of Canada Pulls Back

Description

The Bank of Canada announced today that it would end its quantitative easing program. The central bank also said that inflation was running hotter than expected and could compel it to raise interest rates sooner. In simple terms, Canadians should prepare for higher mortgage rates and lower stock or real estate prices.

Here’s what you need to know.

Mortgage rates

During the pandemic, the Bank of Canada stepped in to provide quantitative easing to support the economy. Effectively, they printed cash and kept interest rates low to help everyone (including the government) borrow cheaply.

The government, of course, used this cheap capital to provide benefits to ordinary citizens during the crisis. Individuals, however, used this cheap capital to buy houses and stocks.

Families could access record-low mortgage rates, because the Bank of Canada kept interest rates low. That’s pushed house prices to an all-time high. Now, the central bank is signaling that the money printing is ending, and the interest rates could rise soon.

This stance has already spooked the bond market. Canada’s five-year treasury bond yield jumped from 0.4% to 1.4% over the course of this year. That means mortgage rates will also rise.

Impact on economy

Roughly 20% of Canada’s economic activity is tied to real estate. If mortgage rates rise, house prices should drop or at least stagnate. Families were already struggling to afford homes, but with rising inflation and mortgage rates, home-buying activity could dip sharply.

Impact on stocks

Higher interest rates also have an impact on stock valuations. Some investors would prefer to earn a fixed return around 1% rather than hold a volatile stock that's unprofitable and overvalued. In other words, growth stocks with stretched valuations could come under pressure if interest rates rise.

What should investors do?

House and stock prices are still near record highs, which means it could be an ideal time for investors to take some profits. If interest rates move higher in 2022, the safest stocks could be the boring, undervalued ones with sizable cash flows and inflation protections.

Fortis (TSX:FTS)(NYSE:FTS) is an excellent example. The company has a manageable debt burden, which means higher interest rates shouldn't impact it much. Meanwhile, the utility company has plenty of pricing power to keep up with inflation. After all, energy bills are a core part of everyone's cost of living.

Fortis stock currently offers a 3.9% dividend yield and trades at a price-to-earnings ratio of 20. It's a safe bet if the stock market takes a dip in 2022.

Bottom line

The Bank of Canada has become one of the first central banks in the developed world to indicate higher interest rates and lower stimulus. Inflation concerns are mounting, and it seems other central banks could follow our lead.

This would negatively impact assets such as houses and stocks. But investors can seek shelter in essential businesses like utilities and energy providers.

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