Aggressive Rate Hike Is Next as Home Prices Soar 22%

Description

Many real estate experts and economists agree that the initial rate hike of 25 basis points by the Bank of Canada (BoC) in March 2022 won't cool down the housing market. It will take a significant increase or multiple increases by Feds to end the home-buying frenzy.

A *BNN Bloomberg* article said that besides pushing prices higher, Canadians are accumulating debts. Statistics Canada's national balance sheet data shows the value of real estate owned by households rose 453.3% from 2020. From $1.5 trillion, the figure went up to $8.3 trillion in 2021.

Because of the low interest rate environment, need for larger spaces, and immigration flows, the prices of houses, including land and buildings, appreciated by a record 22%. The supply shortage and speculators drove prices higher too. Now, financial stability risks exist.

Given the latest data on household debts and drop in the unemployment rate to 5.5% last month, the BoC could be more aggressive in the second round of rate hikes. **CIBC** Capital Markets' economist Andrew Graham predicts three straight interest rate hikes after the first. The central bank will then pause to review the economic situation.

Impact on borrowers

Canada's Big Five banks increased their prime lending rates by 25 basis points also to 2.70%. **RBC**, **BNS**, **BMO**, and CIBC have uniform rates, while the mortgage prime rate of **TD** is higher at 2.85%. The change to their prime rates will affect variable mortgages, credit lines, and home equity lines of credit (HELOC).

According to Dan Pultr, SVP, Strategic Initiatives at TMG The Mortgage Group, every 0.25% increase in prime rate means an additional $12 to $13 in monthly interest per $100,000 debt and 25-year amortization. If the BoC implements three or more quarter-point rate hikes, monthly interest costs would be considerably higher by year-end.

National Bank of Canada (TSX:NA) reports that more than half or 53% of recent homebuyers have variable rates in their mortgages. Thus, they would be paying higher monthly payments, as rates increase. However, borrowers can elect to convert to a fixed rate to avoid this scenario.

Defence through volatile times

For income investors, National Bank is a solid investment option. Despite the heightened market volatility, the $33.42 billion bank reported higher profit and trading revenue in Q1 fiscal 2022. In the quarter ended January 31, 2022, net income and trading revenue jumped 22% and 23.7% versus Q1 fiscal 2021.

NA's CEO Laurent Ferreira said, "When you have heightened levels of volatility, often, it does drive more transactions, so we did see more trading activity with our clients during the first quarter."

Ferreira assures clients and investors that the bank has positioned itself defensively. He said about volatility, "No one's immune. But the way we built the business is we want to make sure that through volatile times, we can keep growing our franchise."

If you invest today, NA trades at $97.75 per share and pays a 3.56 dividend. Analysts' 12-month average price target is $110.73, or a 13.3% potential upside.

Evaluate your options

Rate analyst Rob McLister said, "Depending on your lender, some let you lock into a three-year or four-year fixed, so you can ride out the initial part of the rate-hike cycle … Then hope that things slow down with rates three or four years from now."

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