ECONOMIC VIEWPOINT

Mortgage Payments in Canada: Movin' On Up

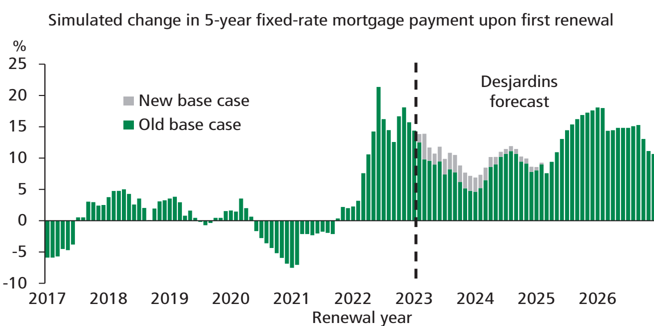
By Royce Mendes, Managing Director and Head of Macro Strategy, and Tiago Figueiredo, Associate – Macro Strategy

The maple syrup-like stickiness in underlying inflationary pressures along with a rebound in the housing market pushed the Bank of Canada to raise rates again in July. With our terminal policy rate forecast now 50bps higher than it was in our last publication on Canadian mortgage debt, it's time to update our simulations.

A higher terminal rate and a somewhat slower pace of rate cuts in 2024 will translate into more pain for households at renewal. Those with fixed-rate mortgages will be less affected by the higher interest rate profile (graph 1). But it shouldn't come as a surprise that variable-rate mortgages are more sensitive to the changes we've made in our forecasts (graph 2). The expected fall in payment shocks in 2024 is now less pronounced with the new rate profile. By the same token, the huge increase in payments expected in 2025 and 2026 for these mortgages is now even larger.

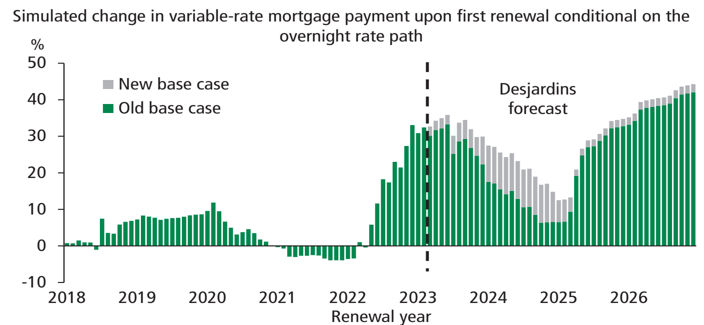
The most critical factor determining the payment shock for mortgages isn't the path for interest rates, but rather the prevailing rate at renewal (graph 3). For variable-rate mortgages, roughly two-thirds of the increase in payments is attributable to the higher interest rate. The other third is associated with the buildup of principal during the life of the mortgage, assuming borrowers didn't increase their payments before renewal. So although the higher path that interest rates are now expected to take will have an impact on outstanding balances and therefore payments at renewal, our simulations suggest that the interest rate on the date of renewal is a far more important determinant of the change in payment size.

GRAPH 1
5-Year Fixed-Rate Mortgages Are Set to Renew with Even Larger Payment Shocks in 2024



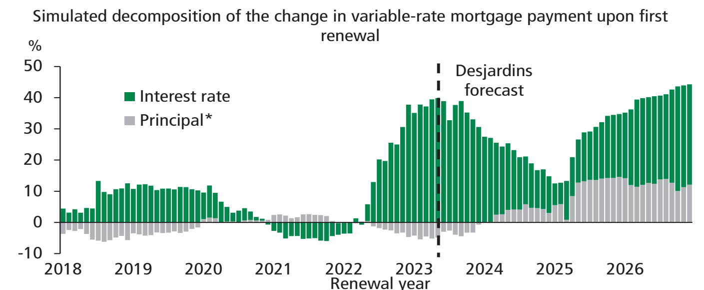
Sources: Bank of Canada and Desjardins Economic Studies

GRAPH 2
Higher Terminal Rates and a Slower Pace of Rate Cuts in 2024 Are Set to Put More Pressure on Renewing Variable Rate Mortgages



Sources: Bank of Canada and Desjardins Economic Studies

GRAPH 3
The Ultimate Level of Interest Rates at Renewal Is the Main Driver behind the Increase in Payments



*The contribution to the payment shock at renewal from principal looks at what the loan size would have been had interest rates followed market pricing at the time of origination and contrasts that with the realized interest rate path and our current projections for the overnight rate.
Sources: Bank of Canada and Desjardins Economic Studies

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.
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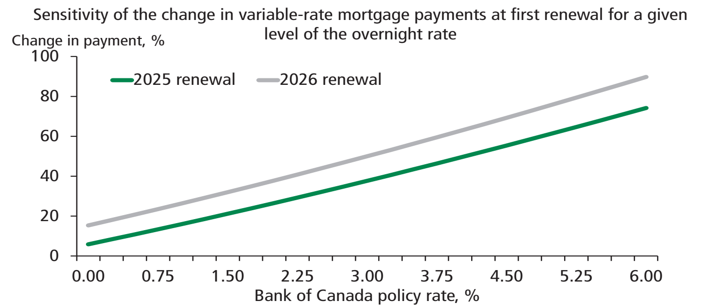
The key takeaway then is that the Bank of Canada can alleviate much of the pain in 2025 and 2026 by cutting rates more than what's currently being priced by markets. For first-time variable-rate mortgage borrowers renewing in 2025, our estimates suggest that the payment shock would decline by roughly 11 percentage points for each 100bps of rate cuts from now until renewal (graph 4). That number grows to 13 percentage points for mortgages renewing in 2026. In short, there will be pressure on the Bank of Canada to push rates to low levels in 2025 to prevent a subset of mortgage holders from running into serious financial difficulties. That reinforces the importance of getting inflation under control soon. Should central bankers be able to tame inflation in the near term, they can then shift their focus back to macroeconomic stabilization in the years ahead.

GRAPH 4
If the Bank of Canada Cuts Rates to Levels below Market Pricing, the Payment Shocks in 2025–26 Could Be More Manageable for Households with Variable-Rate Mortgages



Sources: Bank of Canada and Desjardins Economic Studies