Interest Rate Hike

Briefing Paper

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In a move that was expected by some—but that surprised others—the Bank of Canada (BoC) raised its overnight rate today from 0.75% to 1.00%. This 25 basis-point increase follows an identical rate hike in July. Both were spurred by upbeat economic data, with the most recent numbers showing that Canada's economy grew faster than any other G7 country in the second quarter of 2017.

Why do we care about the Bank of Canada's overnight rate?

One of the Bank's main areas of responsibility is to maintain inflation (that is, the rate at which consumer prices rise each year) within a broad band of 1-3%. To do this, the Bank sets a target level for the overnight rate, which is the interest rate at which major financial institutions borrow and lend one-day ("overnight") funds among themselves. It's changes in the overnight rate that influence other rates of interest, including those associated with mortgages, student loans, and savings accounts. Generally-speaking, as the overnight rate increases (or decreases), so too do all other interest rates; this is why the Bank's policy rate is often referred to as "trend-setting".

How will this latest interest rate hike impact house prices?

As we noted after July's rate hike, the impact of a 0.25% increase in mortgage rates is relatively small, reducing a household's maximum purchase price by about 2%, or increasing the monthly cost of a variable-rate mortgage by roughly $13 per $100,000 borrowed. While another rate change of this magnitude certainly won't fundamentally alter prices in the marketplace, the combined impact of the two recent rate hikes could see a household's purchasing power reduced by 4% (or by $4,000 for every $100,000 they have to spend). So, all else being equal, these rate increases should slow home price gains, which is in part what they are designed to do.

What can we expect in the coming months?

The Bank of Canada meets again at the end of October and in December, two points at which they could raise the overnight rate again. As the BoC stated as part of its recent release, future rate decisions "are not predetermined and will be guided by incoming economic data...as they inform the outlook for inflation". In other words, keep an eye on how fast Canada's economy grows in the final months of 2017. If it's anything like what we saw in Q2, we should be expecting rates to rise a little bit more.