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Bank of Canada Increases Overnight Rate by 0.50% (50 basis points):

WHY? AND HOW IT COULD IMPACT YOU.

October 26th, 2022

Great Mortgages. The Right Insurance. Expert Advice.

On October 26th, the Bank of Canada increased its overnight rate by 0.50% (50 bps) lifting it to 3.75%.

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The increase was on the lower end of expectations as most economists were projecting a 0.50% or 0.75% rate increase. Lenders will follow suit by raising their Prime Lending Rates from 5.45% to 5.95%.

Why did the Bank of Canada (BofC) increase their overnight rate by 0.50%?

In its accompanying press release and supporting monetary policy report, the BofC provided context for its increase by stating: "...the economy continues to operate in excess demand and labour markets remain tight....The effects of recent policy rate increases by the Bank are becoming evident in interest -sensitive areas of the economy: housing activity has retreated sharply, and spending by households and businesses is softening..."

"... In the last three months, CPI inflation has declined from 8.1% to 6.9%...however, price pressures remain broadly based, with two-thirds of CPI components increasing more than 5% over the past year... The Bank expects CPI inflation to ease as higher interest rates help rebalance demand and supply, price pressures from global supply disruptions fade, and the past effects of higher commodity prices dissipate. CPI inflation is projected to move down to about 3% by the end of 2023, and then return to the 2% target by the end of 2024...."

"... Given elevated inflation and inflation expectations, as well as ongoing demand pressures in the economy, the Governing Council expects that the policy interest rate will need to rise further...We are resolute in our commitment to restore price stability for Canadians and will continue to take action as required to achieve the 2% inflation target."

While the October BofC increase was expected, they have not shut the door on a further increase when they meet again on December 7th, 2022. As at the time of writing, many banks/economists anticipate that after one more increase in December, the overnight rate will remain flat during 2023 and begin a slow descent back to the 3.0% range by the end of 2024.

"We are resolute in our commitment to restore price stability for Canadians and will continue to take action as required to achieve the 2% inflation target."

- Bank of Canada, October 2022

What could this mean for you?

While the Outline Financial team is on standby to discuss how these changes may impact your specific circumstances, we have included a few scenarios below that cover our most frequently asked questions from existing mortgage holders as well as those looking to secure a mortgage.

Scenario 1: I currently have a variable "non-adjustable" mortgage (VRM), how will this impact me?

- In this scenario your mortgage payment will remain the same, however, a higher proportion of each payment will go towards paying interest vs. principal. The net impact is an extended amortization (total amount of time to pay off your mortgage will be longer).

- What can you do? As the variable rate remains below fixed rates, you could keep everything the same and continue with the same monthly payment. Alternatively, you could increase your mortgage payment to ensure you remain on pace with (or close to) your current amortization schedule.

- Be aware of your Trigger Rate / Trigger Point. As interest rates rise, there may be a point where your set VRM payment can no longer cover the interest calculated (and charged) on the outstanding mortgage amount. This is known as the Trigger Rate. In this scenario your mortgage may have an increasing balance unless the payment is increased enough to cover the outstanding interest.

- For questions on your payment strategy, trigger rate, trigger point, or to review potential pros/cons of converting your current VRM into a fixed mortgage, please reach out at any time.

Scenario 2: I currently have a variable "adjustable" mortgage (ARM), how will this impact me?

- In this scenario, your mortgage payment will automatically increase to ensure you keep pace with your current amortization schedule. If you would like to discuss future interest rate projections, or the potential pros/cons of converting your ARM into a fixed mortgage, please reach out at any time.

Scenario 3: I currently have a fixed-rate mortgage, does the recent change impact me?

- If you have a fixed-rate mortgage, there is no impact on your mortgage payment (or amortization) as you have received a guaranteed rate for the duration of your mortgage term. Only when your mortgage comes up for renewal, or if you sold and purchased a new home, would you potentially be impacted by higher rates.

Scenario 4: I am currently looking to secure a new mortgage, a pre-approval, or refinance an existing mortgage.

- Fixed or Variable? While each circumstance is unique, there are a couple of key points that you will want to keep in mind if trying to decide between the two.

- Variable rate mortgages are directly impacted by the Bank of Canada as described in Scenario 1 and 2 above and your interest costs will move up or down based on the BofC rate decisions making them more volatile. However, variable rate mortgages are generally more flexible than fixed rate mortgages in terms of penalties if you ever need to break your mortgage.

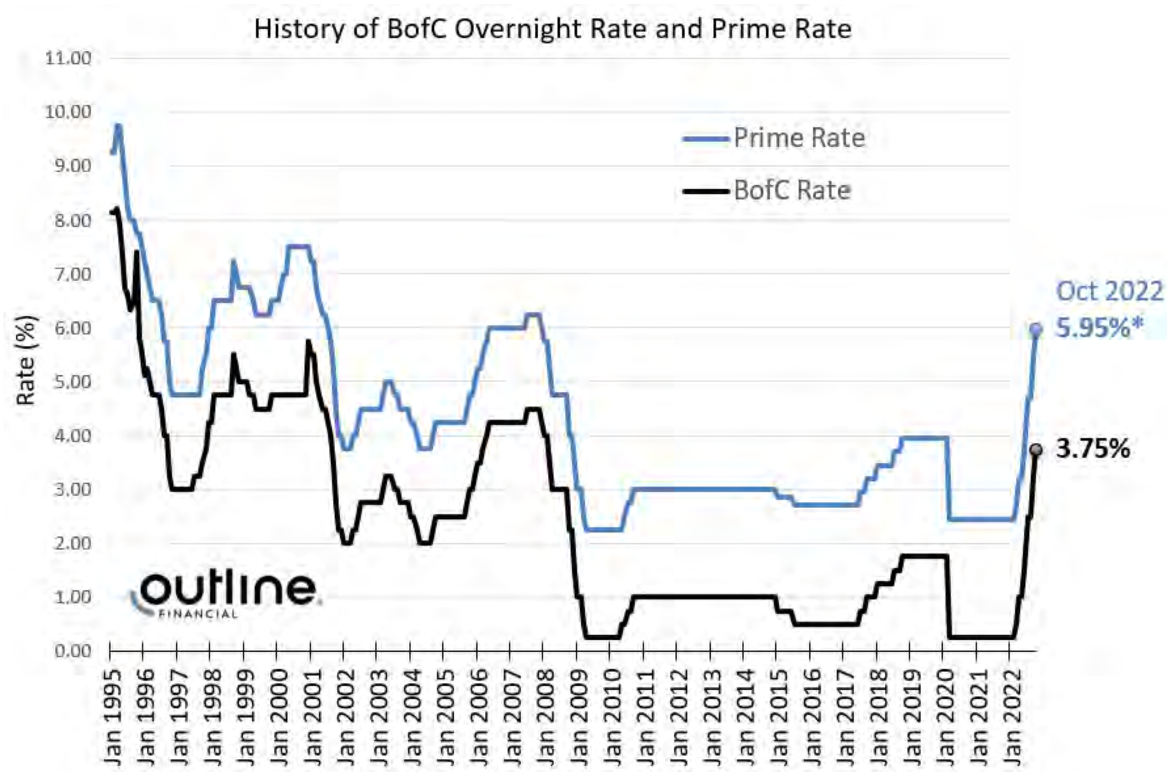
- 5-year fixed mortgage rates typically follow the Government of Canada 5-year Bond Yields which is the market's view/prediction of where interest rates will be in the future. The 5-year bond yields actually started moving upward back in early 2021 in anticipation of the Bank of Canada rate increase(s) we are now seeing in 2022. Bond yields (and fixed rates) have risen to levels not seen since 2007/2008.

- 2, 3, and 4 year fixed mortgages. As many economists believe our rapidly growing economy could turn recessionary in the next few years (resulting in lower interest rates), many clients are opting for shorter term fixed rates given the benefit of lower rates vs. the 5-year fixed, a fixed payment vs. the ARM, and a guaranteed interest rate vs. the VRM.

Important Reminder: Stress Test & Variable Rate Pre-Approvals

- Stress Test Reminder: To help ensure clients can absorb interest rate shocks, all banks and federally regulated lenders are required to qualify clients' based on a "Stress Test" interest rate set at the greater of 5.25% or the clients' actual mortgage rate +2.00%.

- Why does this matter? After the recent Bank of Canada increase, the stress test rate has increased for variable rate mortgages which will reduce a clients' borrowing/purchasing power (rule of thumb: each 0.5% increase in the stress test rate is equivalent to an approx. 4% reduction in borrowing/purchasing power). If you have an existing variable rate pre-approval, or would like to secure a pre-approval, please contact a member of the Outline Financial team so we can help quantify the impact of this change.



*Note: as at time of chart preperation, not all banks have announced the increase to their Prime Rate, although they will almost certianly follow the BofC increase.

For a customized analysis of which rate or product option might be right for you, please contact a member of the Outline Team as we are always on standby to help.

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Outline® Financial is a top-rated mortgage and insurance company offering a host of rate and product solutions from over 30 banks, credit unions, mono-line lenders, and insurers all in one convenient service. Outline® was formed by senior level bankers and financial planners that wanted to offer their clients choice with an exceptional service experience.

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