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Interest Rates up for First Time in 7 Years

The Bank of Canada's first interest-rate hike in seven years has set in motion a complex unwinding of a near-decade-long era of easy money.

The central bank raised its overnight lending rate by a quarter-percentage-point Wednesday, to 0.75 per cent from 0.5 per cent, citing "bolstered" confidence that the Canadian economy has emerged from years of sputtering growth.

Canada's largest banks matched the central bank's move by raising their prime rates effective Thursday by a quarter-percentage-point to 2.95 per cent. Prime rates influence the cost of borrowing on floating-rate loans, including variable-rate mortgages, credit lines and student loans.

Bank of Canada justified the hike, saying they are increasingly convinced that the Canadian economy has "turned the corner" after a series of false starts, including the oil price plunge in 2014 and 2015.

The Bank of Canada's burgeoning optimism sent the Canadian dollar shooting up more than a full cent to nearly 79 cents (U.S.) on Wednesday as investors brace for further rate hikes in the months ahead.

The move to higher rates isn't just a Canadian phenomenon. Central bankers in the United States and Europe are also talking about ending emergency measures put in place to keep credit flowing after the 2008-09 financial crisis. U.S. Federal Reserve told Congress that the economy is now healthy enough to handle further steady increases in its benchmark interest rate as well as a start to selling its $4-trillion store of commercial bond holdings later this year.

One of the puzzles for the Bank of Canada and other central banks is that inflation is still low and falling. Central bankers typically raise rates to keep inflation in check. That isn't the problem in Canada, where consumer prices have been rising at well below the bank's 2-per-cent inflation target.

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Inflation may weaken further in the months ahead before getting back to the 2-per-cent target by the middle of next year as excess capacity in the economy fades, according to the Bank of Canada's Monetary Policy Report. The bank argues that recent declines in inflation are largely temporary – the result of lower gasoline prices, electricity rebates in Ontario, intense food price competition and unexpectedly weak car prices.

The bank is still being coy about when its next rate hike will come. The bank will "remain highly data-dependent".

Many economists are expecting at least one more rate hike this year, most likely in October, when the bank releases its next quarterly forecast.

Unless inflation continues to fall, Canadians should expect more rate hikes.

The Bank of Canada said the 3.5-per-cent annual pace of GDP growth in the first quarter will "moderate" over the rest of the year, but remain "above potential." Among other things, the bank expects consumer spending, exports and business investment to drive growth in the months ahead.

If you are on a variable mortgage there is no need to panic at this point, this is a small adjustment that has been expected. I myself will maintain my variable mortgage.

If you are looking to purchase in the near future, getting a 120 day rate hold will protect you from the potential October increase.

Please feel free to ask me any questions.

Sincerely,

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the Mortgage Group Inc.

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