What Direction are Interest Rates *Really* Headed?

1) Context - Let's first look at the key elements and actions driving interest rates and economic activity right now
    a) Liquidity crisis
        i) Remember 2008. The capital markets dried up and the huge gaps had to be filled. Now is similar but with an entirely non-economic cause.
        ii) "The Bank of Canada is meeting twice a week with the leadership of the Big-Six Banks. The cost of funds for the banks has risen sharply. CMHC is buying large volumes of mortgages from the banks, which, along with CMB purchases by the central bank, will shore up liquidity." Dr. Sherry Cooper of DLC
        iii) CMHC has acted to provide liquidity for the Banks by buying mortgages, and has bumped the numbers once already. This frees up lending capacity.
        iv) Federal gov't has acted to provide liquidity for businesses by way of loans, tax and other deferrals, and now also in paying 75% of payroll for small business (annual payrolls of $50k to $1 million). Large corporations are more 'on their own'.
        v) Federal gov't has acted to provide liquidity for individuals with several programs, the largest being the $2,000 monthly to all with COVID-related loss of income.
        vi) Bank of Canada has acted to provide liquidity for businesses and individuals by lowering the Overnight Target Rate 3 times in 10 days, a total of 1.50%. Biggest and fastest cuts ever.
        vii) Commercial financing is largely frozen right now.
    b) Graphic: Mortgage Rate Forecast for Next Week

2) Paradox -- prime rate down; but mortgages not tracking
    a) Factoids
        i) Prime directly drives only Variable mortgage and HELOC and PLCs.
        ii) Fixed rates are driven primarily by Gov't of Canada Bond Yields.
        iii) Hi-ratio insured mortgage rates are lower than uninsured rates. That is counter-intuitive to the inherent relative risks.
    b) **Variable** rates are down by 1.50%, but the discounts to prime have nearly disappeared.
        i) Hi ratio insured from Prime less 1.0% or better, to Prime less 0.2% at best.
        ii) Uninsured from Prime less 0.5% or better, to Prime less 0.0% at best.
    c) **Fixed** rates are wildly gyrating, the first increases ~2 weeks ago was about increasing spreads on banks cost of money. Since then it is supply and demand, due to reduced staffing levels, massive inflow of mortgage payment deferrals calls, and huge volumes of applications (now dropping).
    d) Due to the above: Fixed rates are up ~0.50% over the last week, a bit less for hi-ratio insured mortgages, after dropping initially when the Bond market yields crashed.

3) Where we are today – 3 CHARTS
    a) https://www.ratehub.ca/prime-mortgage-rate-history
    b) https://www.ratehub.ca/5-year-variable-mortgage-rate-history
    c) https://www.ratehub.ca/5-year-fixed-mortgage-rate-history

4) Normal BoC action: inflation low -- rate low; inflation high -- rate high (and why)
    a) BoC mandate is to keep inflation within a range, that is adjusted from time to time.
    b) For the foreseeable future, liquidity issues will be paramount. That will last at least until our economy, and that of our major trading partners, is largely back up and running.

5) Why rates might go up instead
   a) Currently:
      i) Volume -- lenders can't keep up. This will return to near-normal as deferral calls diminish, and buyers stop buying.
   b) Next is about Risk – see below Michael Campbell's MoneyTalks thoughts this week:
      i) "What happens when lenders worry about mid-term and long-term lending? Then you have no market"
      ii) "How long can Central Banks keep interest rates low when increasing risk demands that they rise? It's like loading a spring. Will it take 1 month, 12 months, 18 months? No-one knows, but the risk is there."

6) What to expect over the next 90-180 days
   a) Bank Prime Rates: Banks might not pass through some or all of the last BoC cut, although that would give them a bad look at a time of tremendous uncertainty for Canadians.
   b) Variable rates: I believe the discounts to Prime should return somewhat close to previous levels, but likely only once the economy is up and running to a reasonable level.
   c) Fixed rates: I believe should come back down as the Bond markets settle – **BUT** - that might not happen, depending on how much higher the costs of supporting Canadian economy goes. And it could go up exponentially.
   d) Lenders will reduce LTV limits in various markets. Some lenders will (and already have, vacate various markets and/or various products lines. One Monoline is out of the Prairies, and another is out of uninsured lending in Alberta. This is driven by investors backing away from perceived risks, and by Monoline capacities due to reduced staffing etc.
   e) Given that more than half the mortgage industry is working from home, allow 30 to 45 days minimum for purchases to close.

7) Crystal Ball
   a) My crystal ball appears to be faulty over the last two weeks. Each day it shows me a different future.
   b) We are in uncharted waters. National economies world-wide are more interconnected than ever. There are more moving parts than ever before.
   c) Liquidity is the big risk issue. The risk is whether or not it is manageable. Some pundits think it will eventually prove to NOT be manageable, that the BoC, CMHC and the federal government will run out of capacity to provide liquidity.
   d) We have been in an ultra-low interest rate environment for over a decade now. Many in the financial world have been predicting for several years an interest rate rise. Some base this in part on the growing under-funded pension liabilities created by such low rates for so long. John Mauldin is one of those. https://www.mauldineconomics.com/
   e) No-one knows where interest rates are going in the longer term. Rest assured they will go up and they will go down, but we don't know when or in what order.

8) What are we to do?
   a) Cash is King, so preserve your cash. Take all payment and other deferrals that you can get. Preserve available capital in your HELOCs.
   b) If you want a home equity line of credit, apply yesterday. Recessions are not conducive to great HELOC deals.
   c) Variable rate mortgage may be the way to go until Fixed rates settle down and drop back down, then lock in if you want to.
   d) If you get a five-year fixed rate, try to pick a lender with a fair interest rate differential penalty.
   e) If you are truly concerned about, or your financial stability is vulnerable to interest rise shock, consider a 7-year 10-year term fixed rate mortgage. I have seen 7- year and 10-year rates as low as 3.24 % within the last couple of weeks.
      i) Note- These low long term rates tells us the some of the institutional lenders believe rates will indeed remain low for 7-10 years.
   f) Protect yourself in all your debt management decisions, and whatever you do, do it as fast as you can reasonably do it, and based on your risk tolerance. Less tolerance means be more protective.