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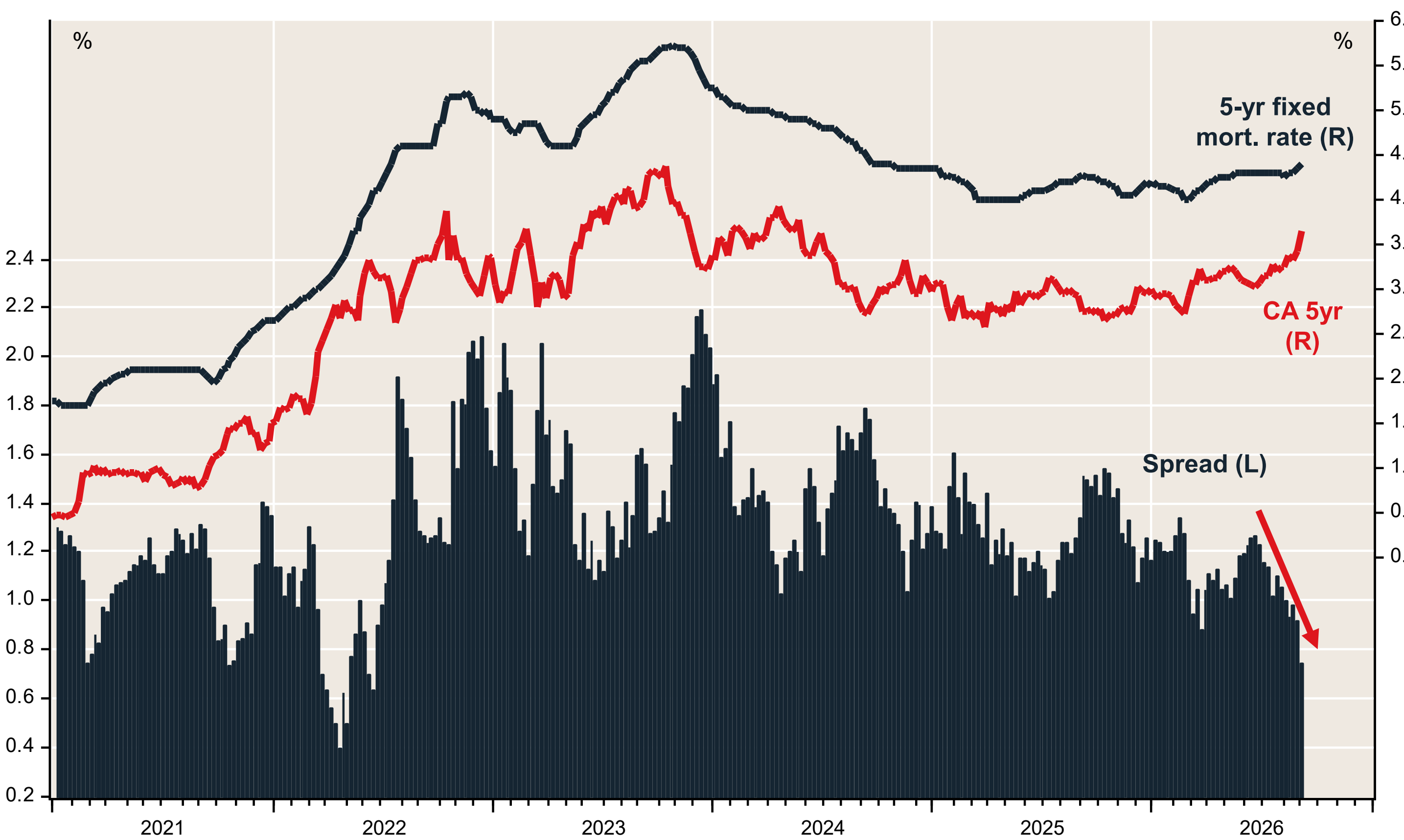
Canada Watch

By Daren King & Kyle Dahms

U.S. bond yields surged across the entire yield curve today, with the 5-year yield rising 15 basis points to 4.76%, its highest level since October 2023. Two factors are at play. On the one hand, the escalating conflict in Iran and soaring energy prices are leading investors to anticipate a more restrictive monetary policy than expected. On the other hand, concerns about the U.S. fiscal trajectory have intensified following President Trump's promise to send a $5,000 check to every American in the event of a victory in the midterm elections, a commitment that would significantly worsen an already difficult-to-finance deficit. Canada has not been spared by this surge in global rates, quite the contrary: the Canadian 5-year rate rose by 16 basis points to 3.65%, a peak not seen since May 2024. The spike observed today, however, is not an isolated event but is part of an upward trend that began after the low in February, before the conflict in Iran began. Over this period, the U.S. 5-year Treasury yield rose by 118 basis points, compared with 92 basis points for its Canadian counterpart. However, the impact on Canadian mortgage borrowers has remained more contained so far, as the fixed mortgage rate for a 5-year insured loan has risen by only 40 basis points over the same period. As shown in today's *Hot Chart*, this divergence between the cost of bond financing and the rate offered to households has narrowed the spread between the two to just 75 basis points, its lowest level since June 2022 and well below the average of approximately 135 basis points observed since late 2023. Such a narrow spread puts pressure on lenders' margins and is likely unsustainable in the long run. Mortgage rates are therefore likely to rise in the coming weeks, in a context where property prices have stabilized after several quarters of decline. According to our estimates, the **National Bank Affordability Index**—which measures mortgage payments as a percentage of income—is expected to remain flat in the third quarter before rising by 1.1 percentage points in the fourth quarter, marking the first deterioration in affordability in three years.

Canada: Improving affordability is at risk

5-Year Canadian Bond Yield and 5-Year Fixed-Rate Insured Mortgage Rate



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