

Leery of leverage

By Taylor Schleich, Warren Lovely

A [few weeks ago](#), we looked at Canadian mortgage activity, exploring the implications for the mortgage market going forward, the broader economy and swap spreads. With a fresh month of data (September) available we thought it natural to provide an update.

Not surprisingly given the rate surge in early autumn, mortgage activity was way down in September. Chartered bank origination fell nearly 25% from August. Even though September is traditionally a down month, that's the sharpest deceleration in at least 10 years. At \$32 billion, the level might not seem all that low given that it's right in line with the 2015-19 September average. But consider home prices are 40-80% more expensive today. After adjusting for the size of mortgage needed to buy a representative home, today's activity is much worse. Only September 2022 is a reasonable comp and of course the backdrop for that month was the BoC tightening 300 basis points over just six months (with more coming).

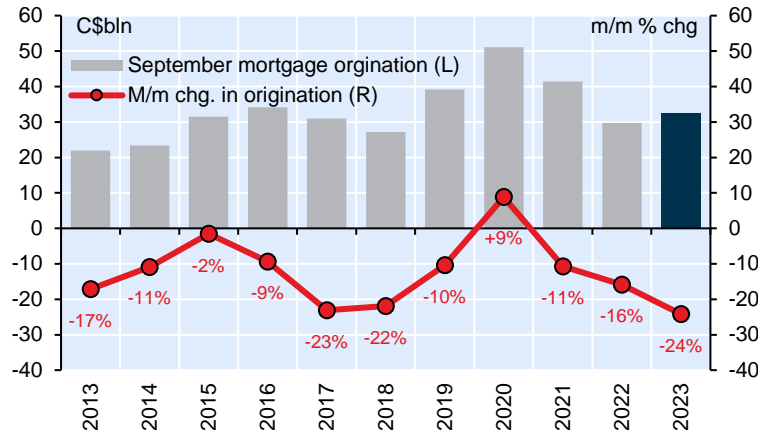
It's also not the case that Canadians are shunning banks for alternative lenders. There's been a sharp slowdown in mortgage credit growth at chartered banks *and* non-bank lenders alike. Together, the 3.4% Y/Y growth in outstanding residential mortgage liabilities of Canadian households is the slowest in over 20 years.

What of product selection? A relatively cheaper 5-year mortgage rate looks to be driving more homebuyers to lock in for long, despite historically (and presumably temporarily) elevated rates. Indeed, the share of fixed rate origination in the 5-year bucket rose again in September. It's still historically low but if this discount persists/grows, this share should rise further. For many buyers, the cheapest rate is the only affordable rate. Moreover, acceptance of 'higher-for-longer' might lead some to lock in and avoid as much uncertainty as possible. BoC officials are [helping to ingrain this](#), telling Canadians to brace for an era of higher borrowing costs.

Bringing it around to swaps, one might assume that the lower bond yields of recent weeks will pass through to the mortgage market, driving a pick-up in origination, thus putting upward pressure on spreads. However, we'd note lenders have so far been reluctant to pass on lower yields. Rates on offer today are only *slightly* down from mid-October and are still up versus September. In other words, there's no clear catalyst for an imminent/material pick-up in activity. That should limit paying by mortgage hedgers and keep downward pressure on spreads, a trend we've seen of late. Meanwhile, the 5-year fixed discount might mean the share of paying tilts more to the 5-year sector, pushing the swap spread curve steeper.

Chart 1: September mortgage origination was sluggish...

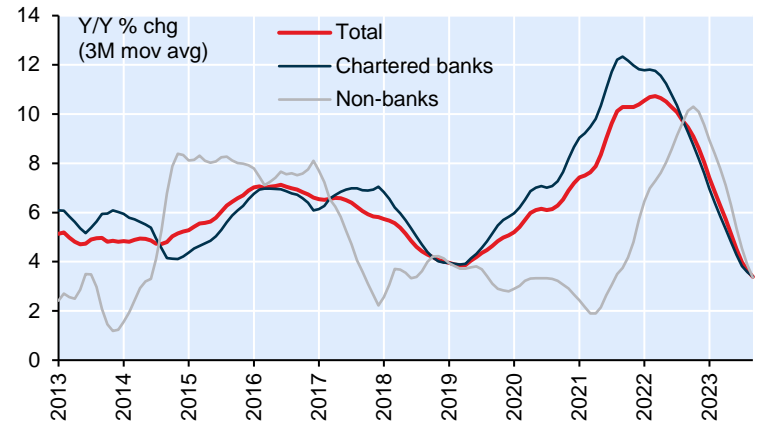
September mortgage origination (L) and change versus August (R)



Source: NBF, BoC | Note: Reflects total of insured and uninsured mortgage origination

Chart 2: ...at bank and non-bank lenders

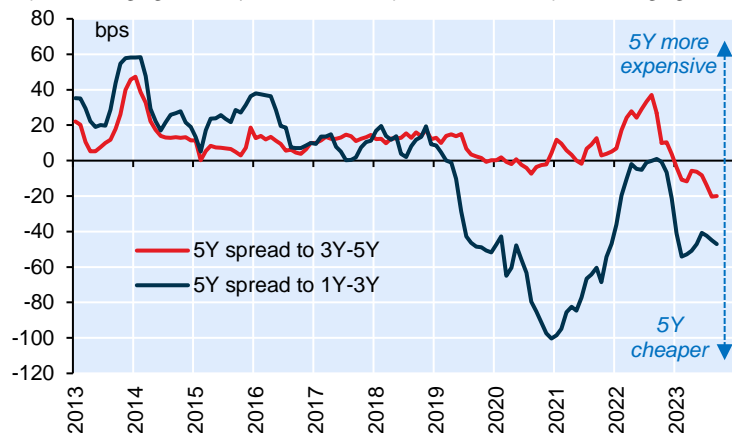
Smoothed growth in household residential mortgage credit o/s



Source: NBF, StatCan | Note: Latest data point refers to Sep-23

Chart 3: 5-year mortgages offer the cheapest rates...

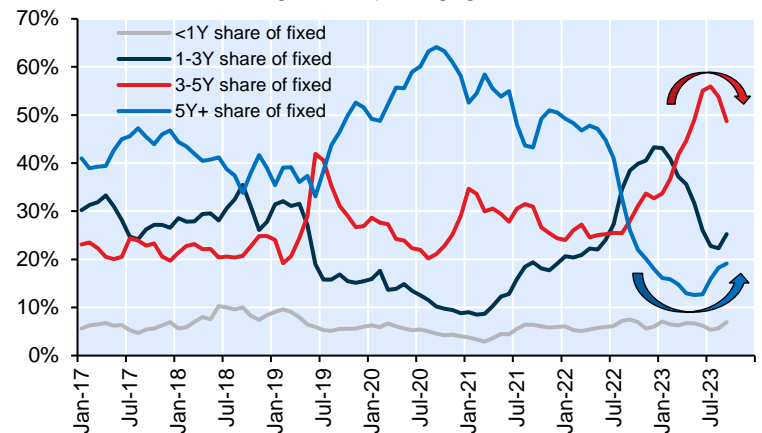
5-year mortgage rate spread to 1 to 3-year and 3 to 5-year mortgage rates



Source: NBF, BoC | Note: Rates are average of insured/uninsured weighted by origination

Chart 4: ...driving a pick-up in 5Y origination (from very low levels)

Share of total fixed rate origination by mortgage term



Source: NBF, BoC

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