Five year mortgage rates are increasing

While we were sitting around the living room, watching the news on television and bragging about how our strong dollar was keeping our interest rates down, the U.S. dollar barged in and raised the rent. Close behind was the bloated U.S. trade deficit.

These two have wreaked havoc with financial markets, forcing up the cost of borring money. One big bank raised its mortgage rates by a quarter of a percentage point on Wednesday. Other lenders said that was not enough.

Bankers borrow money on the wholesale market, mark it up and lend it to consumers. Lately, the markup has been squeezed too thin, they say. Indeed, bankers are having to pay almost as much for money as they are charging for mortgage loans.

At 11.75 per cent, the five-year mortgage rate is as high as it has been since February, 1986. That's when the U.S. dollar first teetered and fell

Your Business

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against the European currencies and the yen.

At the time it looked as if the Canadian dollar would fall even further. So the Bank of Canada stepped in and cranked up interest rates. Higher interest rates tend to offset the threat of a falling currency in the eyes of foreign investors.

SUDDEN JUMP

The five-year rate jumped two full percentage points from December, 1985, to February, 1986. By May, 1986, it had returned to 9.75 per cent. The sudden jump shows how much nervous currency markets can hurt homeowners. It also shows how short-lived these market disruptions can be.

Last Friday, as the dollar faltered, the U.S. central bank raised its discount rate for the first time in three years. The discount rate is the U.S. version of the bank rate.

The half-point increase appeared to have little effect on Canadian rates at the time. That's because we keep a confortable cushion between our rates and theirs -- ours are always higher.

But the damage was being done behind the scenes, on bond, money and currency markets around the world. Now fears that the U.S. trade deficit will worsen, scaring investors out of their U.S. dollars, have punctured our interest-rate cushion.

The future will be revealed Sept 10. The U.S. Government will release its July trade numbers. If the shortfall has not improved substantially from last month's $15.7 billion (U.S.), high interest rates will persist. If the monthly deficit is less than $14.5 billion, things could improve.

NOT ENOUGH

Sherry Atkinson, chief economist at Burns Fry Ltd., a big investment dealer, says better trade numbers will not be enough to stem the dollar's decline. The U.S. Fed will need to use strong rhetoric and another half-point increase in interest rates. If Dr. Atkinson is right, borrowers could be in for a rough road ahead.

The big question now is how long will it last? What started out as a temporary blip in interest rates has lasted six weeks already, and some bankers say there is no end in sight.

But the seeds of a turneround have already been planted. Beneath the surface, the U.S. trade deficit has begun to improve. Because of an economic law know as the J-curve, trade numbers get worse in dollar terms before they get better when a currency is realigned. The greater volume of exports is offset by their lower dollar value. So if the trade reversal is not apparent today, it will show up next month or the month after.

In the meantime, people with money to tuck away in bonds or guaranteed investment certificates will be earning attractive rates.

The lesson in all this is straightforward. We may feel exempt for awhile from the troubles that beset our American neighbors. But sooner or later they will hit us too, often with more devasting force.

Housing market at a transition stage

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Mortgage rate increases are worrisome because there's a magic number at which people will stop buying houses. No one knows what it is. Usually, its measured by the five-year rate, even though few people may choose that term. Some say people stop buying when the five-year mortgage rate reaches 15 per cent; others say it's 12 per cent.

If the 12 per cent camp is right, the real estate market may soon grind to a halt. Last week, several big lenders raised the five-year mortgage rate to 11.75 per cent, the highest it has been since February, 1986.

Sales already have begun to slow. Re/Max International, real estate brokers, report that homes sales slowed in the second quarter in every province but Alberta. Alberta is recovering from the second big economic slump in five years, caused by last year's drop in oil prices. Re/Max measures how many days it takes a home to sell.

Meanwhile, builders are building like never before. Work on new homes in August was the busiest it has been since 1978, Canada Mortgage and Housing Corp. says.

Most of these homes have already been sold. Builders who have not presold their houses could be forced to trim their prices.

Builders also wory that with so much activity this year, they may be left with little to do in 1988. Housing starts could slump after this year's big boom, particularly in southern Ontario.

The speculative bubble that carried Toronto house prices to new highs has burst, but the market is still relatively healthy. Outside the big centres, though, activity is slowing. The Canadian Real Estate Association calls it a market in transition.

Nationally, house sales slowed over the summer compared with the previous summer. July home sales in 24 cities failed to match last year's. Since then, things have picked up a bit, but this could be nipped in the bud by rising mortgage rates.

Average house prices are not a particularly good measure of what is really happening in a market. But they do reveal the growing discrepancy between different cities, and how expensive it is to live in and around Toronto.

The average house price in Toronto was $186,698 in July, the real estate association says.

This compares with $95,297 in Montreal -- a bargain by comparision. Winnipeg also looks like a good deal, with an average house price of $80,413. Victoria is nicely priced at $107,862, and Greater Vancouver, with its warm climate, is a reasonable $139,351.

Prices are highest in the Caledon Hills outside of Toronto, where house prices easily surpass $200,000, Re/Max reports. In Toronto, too, it is hard to find a house for less then $200,000.

In Milton, Whitby and Ajax, prices range from $140,000 to $160,000, Re/Max says.