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Too much, too fast? Bank of Canada risks a home price runup with key rate cut, experts say

The 50-basis-point drop could nudge enough people off the sidelines that a hot market is on the horizon.

Clarrie Feinstein || October 23, 2024

The Bank of Canada is walking a tight rope as they rapidly cut the key interest rate to salvage the country's sluggish economy while risking a drastic run-up in real estate demand and pricing.

The central bank announced Wednesday it's cutting its key overnight interest rate by 50 basis points — a half percentage point. That brings the overnight rate to 3.75 per cent.

The bank had already cut the overnight rate by 25 basis points three consecutive times, from a high of five per cent.

"They're in a difficult position, because the bank is counting on the economy being weak enough to put a cap on housing demand," said Philip Cross, senior fellow at the Macdonald-Laurier Institute and former chief economist at Statistics Canada.

"Housing over the last year has certainly softened but it hasn't crashed. With this latest cut, could it be enough to spark the housing market?"

The substantial decrease in the key interest rate follows September's surprisingly low 1.6 per cent inflation, which is below the bank's two per cent target. Because of this, the bank is now hoping to spur consumer and business spending, said Bank of Canada governor Tiff Macklem.

With the drop in interest rates, residential investment is expected to rise as "strong demand for housing lifts sales" and spending on renovations picks up, the central bank said in a press release.

Pent-up buyer demand is top of mind for many looking to jump into the market, as some buyers may want to get ahead of the impending influx of home purchasers.

Leah Zlatkin, licensed mortgage broker and LowestRates.ca expert, believes the rate cut could be the catalyst that motivates homebuyers to enter the real estate market, especially in Toronto, where affordability remains a significant barrier.

"The combination of a 50-basis-point rate reduction and the impending mortgage rule changes in December creates an opportune moment for buyers to make their move," she said. "With an abundance of properties available, the current market conditions are exceptionally favourable for potential homebuyers."

Starting Dec. 15, any purchasers of newly built homes will be able to stretch their mortgage an extra five years, allowing 30-year amortizations for insured mortgages. And buyers will be able to pay less than 20 per cent for a down payment for homes listed under $1.5 million, up from a previous threshold of $1 million.

If buyers wait for further rate decreases it might mean entering a hotter market than they bargained for.

"Once rates decrease to a point that the majority of buyers are comfortable with, the housing market will heat up quickly and prices will rise at the same time," she added.

However, Victor Tran, Ratesdotca mortgage and real estate expert, thinks buyers will wait for the final rate announcement of the year before making a move, as many are worried about moving ahead before the market "bottoms out."

"It's likely that we will now see an uptick in pre-approvals as buyers prepare to move quickly once they sense the tide is turning," Tran said.

Variable mortgage rates, which are directly tied to the Bank of Canada's key interest rate, have dropped to their lowest of 5.05 per cent, said Zlatkin. For current mortgage holders it offers some relief in their monthly payments, she said. The rate change may also be enough to nudge first-time homebuyers into the market, but with the stress test, the rates are likely still too high for them to qualify.

"This is good news for the overall consumer in the mortgage market," said Phil Soper, CEO of Royal LePage.

Lower rates will create some competition in the market and it also indicates that "normal rates" in the two or three per cent range are on the horizon, he added.

Toronto's condo market, however, won't recover as quickly as single-family homes due to the high level of inventory and first-time homebuyers, who often enter the market with condos, might need further rate drops to qualify for a mortgage.

For condo investors, rents haven't been able to cover the high mortgage payments of late and it may take more time for the math to make sense.

"It will be a delayed recovery for the condo market," he said.