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Mortgages: Fixed vs Variable?

By Clinton Orr

There is a plethora of mortgage products on the market today. When selecting a mortgage, the basic question however, remains, should we select a variable rate mortgage or a fixed rate mortgage? Today's interest rate environment is unique and gives that question new meaning. We will start, however, with a review of the fundamentals, the basic criteria we can use to answer that question.

A variable rate mortgage has more risk than a fixed mortgage. The interest rate you pay on a variable mortgage can change with little notice. If interest rates in the economy change, whether it is an increase or a decrease, the rate on your mortgage will be adjusted. Usually the benefit of a variable mortgage is that the rate is lower than a fixed mortgage. Typically, when you are getting a mortgage, if you compare a fixed rate to a variable rate, the variable rate is lower. As explained above that interest rate is not set in stone and there is the risk that it could change throughout the life of the mortgage.

Fixed rate mortgages offer certainty. When you set up the mortgage you are locking in your rate, you know what your payments will be. If the interest rates in the economy change, it will not impact your mortgage. Fixed rates are locked in for period of time. When the term expires, the mortgage is renewed, and you lock in a new rate. The most popular mortgage in Canada is a 5-year fixed rate.

In a normal interest rate environment, the decision is usually whether you should select the low variable rate and take the risk that the rate could change or remove the risk and choose a higher fixed rate. In today's interest rate climate this decision has been flipped on its head. The yield curve has inverted, I will spare you a long-winded explanation of yield curve dynamics and simply say that at the moment short term rates are higher than long term rates. This is a rare event and has a wide range of implications for our economy. The inversion of the yield curve also impacts mortgage rates, now, fixed rate mortgages are lower than variable rates. A fixed rate mortgage offers certainty and, for the moment, the lowest interest rate.

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The yield curve inversion is a rare event and has created a unique situation in the mortgage market that I believe tilts our decision towards a fixed mortgage. That being said when selecting a mortgage there are multiple factors to consider, not just the interest rate. For example, how much of the mortgage are you allowed to prepay and are there any penalties? Discuss your situation with your mortgage specialist to ensure you get the mortgage that is right for your situation.

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