

MORTGAGE RATE FORECAST

ECONOMICS DECEMBER 2009

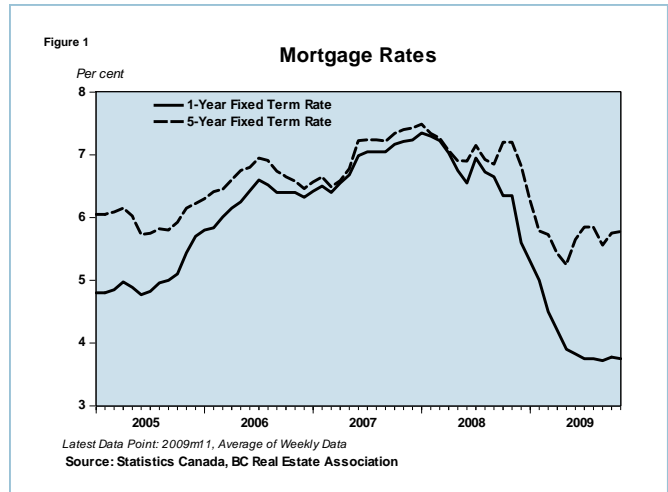
MORTGAGE RATES TO EDGE UP THROUGH 2010

Home buyers will benefit from a low mortgage rate environment through much of 2010. The BC Real Estate Association forecasts borrowing costs to rise more quickly during the tail-end of 2010 and through 2011.

In line with previous forecasts, mortgage rates have fluctuated within a narrow range in recent months. Precluding discounts offered by lenders to clients with preferred credit histories, posted 1-year fixed term rates have ranged from 3.60–3.90 per cent, while posted 5-year fixed term rates ranged from 5.49-5.85 per cent since June (Fig.1). At the end of November, the posted 1-year rate settled at 3.60 per cent, while the 5-year rate fell to 5.59 per cent. Low mortgage rates have fueled housing demand across the country, leading to a V-shaped recovery in MLS® residential sales.

Mortgage rates will inevitably rise from current levels. Today's low interest rates are the product of a global coordinated effort to mitigate the worldwide economic downturn through fiscal and monetary stimulus. The resulting cuts to short-term central bank interest rates, when combined with continued economic weakness, higher investor risk aversion and lower inflation expectations drove bond market yields lower and contributed to declines in administered interest rates for products such as mortgages. As the economy gradually improves and signs of sustained stabilization emerge, expect a partial reversal of stimulus measures and interest rate hikes.

The Bank of Canada (BoC) reiterated its conditional commitment to keep its policy interest rate at 0.25 per cent until the end of the second quarter of 2010 on December 8. BCREA expects the BoC to hold off until the fourth quarter of 2010 before raising rates, reflecting a relatively fragile economic recovery and low inflation pressure. A 50 basis



point (bps) increase in the policy rate is expected at that time, with a further 175 bps in hikes through 2011. Variable mortgage rates which are tied to prime rates should increase by the same magnitude.

Fixed-rate term mortgage rates, which move closely with bond yields and deposit rates of similar maturity will likely edge up more slowly through 2011. These increases are expected to be modest as a high Canadian dollar temper growth prospects, and a tepid labour market and production overcapacity lower inflation expectations. This will moderate upward pressure on borrowing costs for fixed-rate term mortgages.

Mortgage Rate Forecast								
	2009		2010F				2011	
Term	Q3	Q4E	Q1F	Q2	Q3	Q4	Q1	Ave
1-Year	3.74	3.70	3.80	4.00	4.40	4.85	5.00	5.50
5-Year	5.74	5.75	5.70	5.85	6.00	6.25	6.50	6.95

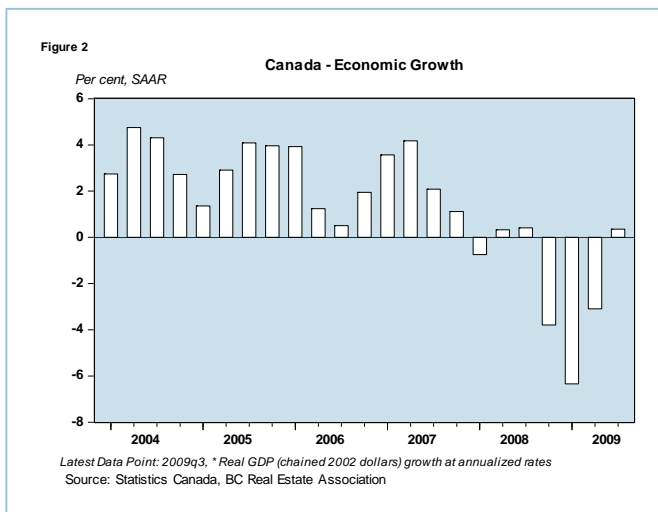
¹ Average of weekly data

Source: Bank of Canada, BCREA Forecast



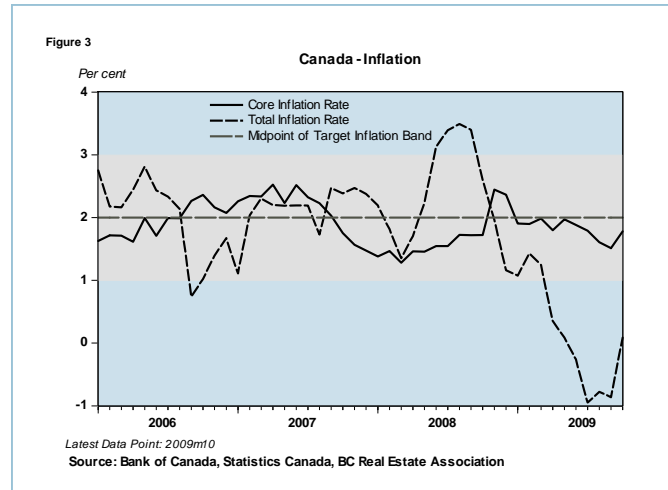
Consumers Underpin Growth

Canada's economy is recovering—but slowly. During the third quarter, the economy eked out a disappointing annualized growth rate of 0.4 per cent (Fig. 2). While this marked the first quarterly growth since the third quarter of 2008, it fell short of commercial bank forecasts and the Bank of Canada's October projection of 2 per cent. Nonetheless, September industry GDP growth was the highest since July 2008 and suggests that growth may further entrench in the fourth quarter as the global economy continues to mend.



Domestic demand has largely underpinned the nascent Canadian recovery, reflecting in large part the significant drops in interest rates. Retail sales have rebounded sharply and were down only 0.4 per cent on an inflation adjusted basis in September from last year as improvements to household balance sheets, low interest rates and higher consumer confidence fueled purchases. Spending in interest rate sensitive sectors has been particularly strong, with a marked increase in new and used vehicle sales. The mortgage rate induced rebound in residential real estate sales has also benefitted the insurance and finance sectors, and furniture retailers.

Despite an increasing number of positive indicators that support growth, interest rates are likely to remain near current levels during the next couple of quarters. Continued excess capacity in the economy will limit upward pressure on interest rates as inflation operates closer to



the lower bound of the BoC's 1-3 per cent target. October headline inflation was 0.1 per cent, the first gain since May 2009, but well below the inflation target as lower transport related costs and energy costs kept price growth low (Fig. 3). Core inflation, which excludes volatile components like energy was stable.

Inflation should rise in coming months, but not enough to induce BoC interest rate hikes until late 2010. Considerable slack exists in labour markets despite recent signs of stability and expansion. Meanwhile, the relatively high Canadian dollar is a considerable challenge for Canadian exporters and overall economic growth. Interest rate hikes would only create upward pressure on the exchange rate, dragging down economic growth and inflation. Finally, the global economic recovery is fragile and there is a risk of a pull-back.

BCREA forecasts a rise in the BoC overnight rate to a still low 0.75 per cent during the fourth quarter of 2010, with further increases to 2.5 per cent in 2011 reflecting a normalization of interest rates. A prolonged economic recovery, dampened inflationary expectations and relatively low short-term rates will mean a continuation of low mortgage rates for homebuyers over the next year.

Bryan Yu, Economist

604-742-2796

Cameron Muir, Chief Economist, cmuir@bcrea.bc.ca

Bryan Yu, Economist, byu@bcrea.bc.ca

The information contained in this report has been drawn from sources believed to be reliable, but the accuracy or completeness of the information is not guaranteed, nor in providing it does the British Columbia Real Estate Association assume any responsibility or liability.