

MORTGAGE UPDATE

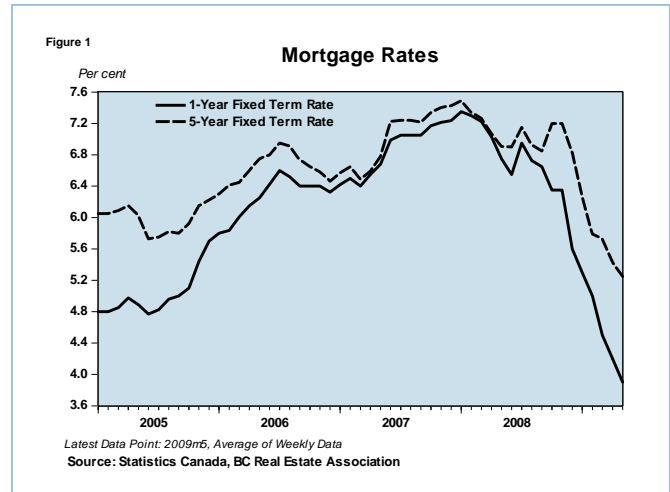
ECONOMICS JUNE 2009

WHERE DO WE GO AFTER HITTING BOTTOM?

Consider it one of the few positives floating in a sea of negatives during the current recession. In a period beset by job losses, drops in home prices and lower consumer confidence, mortgage borrowing costs have dropped precipitously for buyers and owners. This has fueled a modest uptick in homeownership demand from early year lows and provided opportunity for some current owners to refinance at lower rates.

Since the end of April, posted mortgage rates have settled at decades low levels- precluding any discounts often offered by lenders to clients with preferred credit histories. The one-year borrowing cost on a fixed term mortgage fell to 3.9 per cent at the end of April, marking a 170 basis points (bps) decline since the end of 2008 (Fig. 1). The five-year fixed term mortgage rate fell to 5.25 per cent, down from 6.5 per cent during the same period. These rock-bottom mortgage rates should move up in the quarters ahead—particularly for longer fixed term mortgages.

Existing households and new buyers with variable rate mortgages should see their borrowing rate remain flat until the second quarter of 2010. BCREA forecasts a 0.75 percentage point increase through 2010 as prime rates rise to meet changes in the Bank of Canada's (BoC) target overnight rate. The BoC kept its target for the overnight rate at 0.25 per cent on June 4 after lowering it by a cumulative 425 basis points (bps) since December 2007 in a bid to spur economic activity during a deepening recession. The BoC stated that the target overnight rate would likely stay at this level until the end of the second quarter in 2010, conditional on its inflation outlook. BCREA forecasts a cumulative rate increase of 75 bps by the end of 2010 as economic prospects improve and global interest rates rise from record lows.



closely with bond yields and deposit rates of similar maturity are expected to edge up this year and next but remain near record lows by historical standards. Longer-term bond yields have risen quickly since the first quarter of 2009 despite low short-term rates, suggesting that the market expects higher inflation and interest rates in late 2010. However, BCREA forecasts a more modest rise in fixed term mortgage rates over the next two years as higher inflation expectations are tempered by a slower than expected economic recovery, an elevated Canadian dollar and weaker labour market.

Mortgage Rate Forecast								
	2009				2010F			
Term	Q1	Q2E	Q3F	Q4	Q1	Q2	Q3	Q4
1-Year	4.93	3.98	3.90	4.00	4.25	4.40	4.50	4.50
5-Year	5.93	5.45	5.90	6.00	6.10	6.25	6.25	6.35

¹ Average of weekly data

Source: Bank of Canada, BCREA Forecast

Is Higher Inflation on the Table? (Page 2)

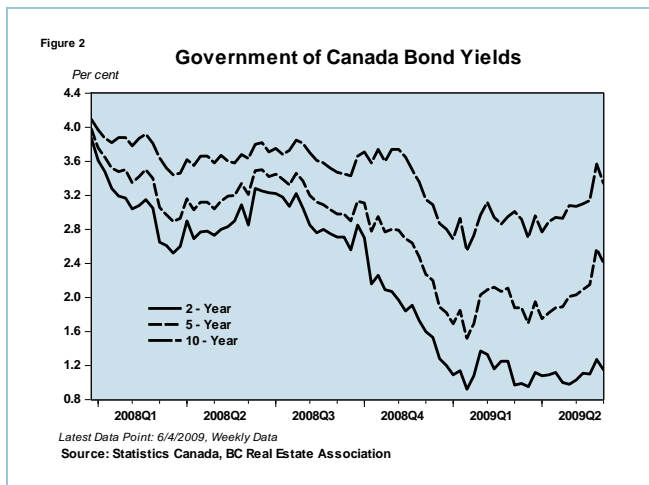


Fixed term mortgage rates, which move



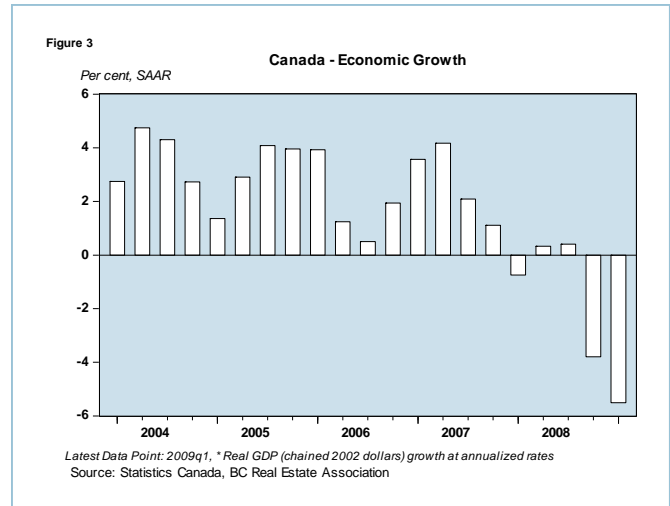
Is Higher Inflation on the Table?

Rising Government of Canada bond yields in recent months has reflected a move away from safe-havens and back into equities and renewed expectations that significant inflationary pressure may be waiting in the wings (Fig. 2). This has led to increased upward pressure on medium-term lending rates given that funds for these products are largely raised in bond markets and from deposits of similar maturity. While spreads between 10- and 2- year bonds are at the widest margin since early 2002 suggesting higher medium-term interest rates in the future, a number of economic factors suggest moderate inflationary pressure and point to a gradual increase in administered lending rates.



The worst of the current recession may have already passed. While the economy contracted sharply by 5.4 per cent in the first quarter, the weakest performance since 1991, the bulk of the declines occurred from November to January at the height of the global economic crisis (Fig. 3). Since this time, commodity and financial market conditions have improved, while consumer and business confidence have partly rebounded.

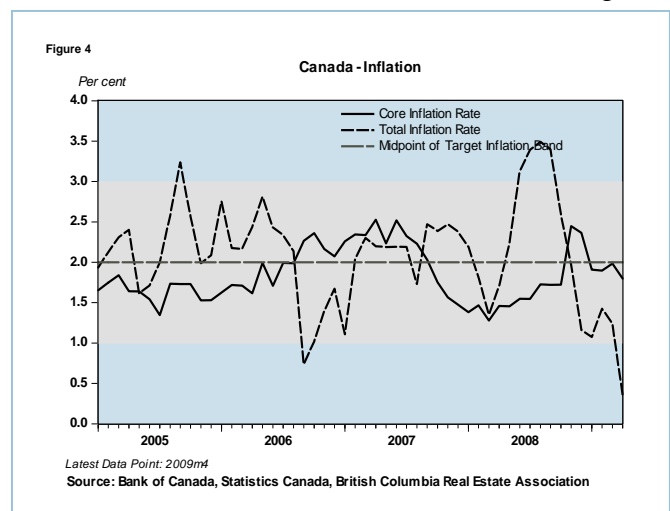
Nonetheless, there remains considerable excess capacity in the economy which will dampen some of the impacts that a modest recovery phase will have on inflationary expectations and future interest rates. While the rate of employment declines have stabilized from January highs, the economy continues to shed work-



ers. The national unemployment rate climbed to 8.4 per cent in May, the highest since June 1998. Continued job losses and downward pressure on incomes will factor into lower domestic spending while forcing retailers to offer further discounts to consumers.

Meanwhile, Canadian exporters continue to be dragged down by a global contraction in demand— particularly from the US. The recent appreciation of the Canadian dollar, reflecting US dollar weakness and a rebound in commodity prices, will make Canadian exporters less competitive on the global market, while lowering the cost of importing goods to Canada.

Inflation in Canada is expected to remain relatively low, albeit still higher than current levels and result in a modest increase in medium term interest rates (Fig.4).



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

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

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