ECONOMICS
Mortgage Rate Forecast

March 2023

HIGHLIGHTS

- Economic uncertainty driving substantial volatility in Canadian bond markets.
- Is the Canadian economy just slowing or something worse?
- Inflation trending the right direction, will that be enough to keep the Bank of Canada on hold?

Mortgage Rate Forecast								
	2023				2024			
Term	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Variable Rate	6.35	6.35	6.35	6.35	6.35	5.85	5.60	5.35
5-Year Qualifying Rate	7.24	7.19	7.05	6.95	6.95	6.75	6.65	6.55
5-Year Average Discounted Rate	5.24	5.19	5.05	4.95	4.95	4.75	4.65	4.55

Source: Bank of Canada; BCREA Economics; Rob McLister, Mortgage Rate Analyst

Note: Average five-year discounted rate is the average rate available in the market, offered at a discount from the posted five-year qualifying rate.

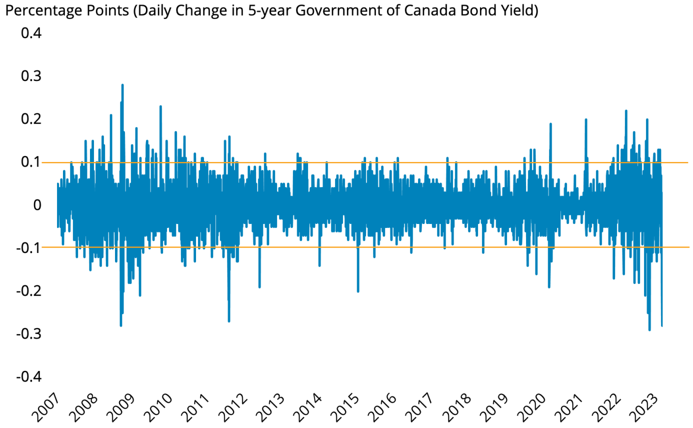
Mortgage Rate Outlook

Mixed signals from Canadian economic data are making the outlook for the Canadian economy somewhat cloudy. While labour markets remain very strong, economic growth appears to have stalled in the fourth quarter of 2022. Most importantly, the monthly inflation rate has significantly decreased, although it still remains high when compared to the previous year, with total CPI trending at 2.5 per cent annually over the past three months and core measures of inflation trending at between 2.5 and 3.5 per cent.

That mixed data has led to uncertainty about the economy's direction, which has expressed itself as significant volatility in bond yields as financial markets grasp for clues on future monetary policy decisions. Movements in bond yields that used to be relatively rare have become commonplace. Since 2007, the five-year benchmark bond yield has risen or fallen by ten basis points in a day just 5 per cent of the time. Since 2022, ten basis point moves are occurring 20 per cent of the time – or roughly every five trading days.

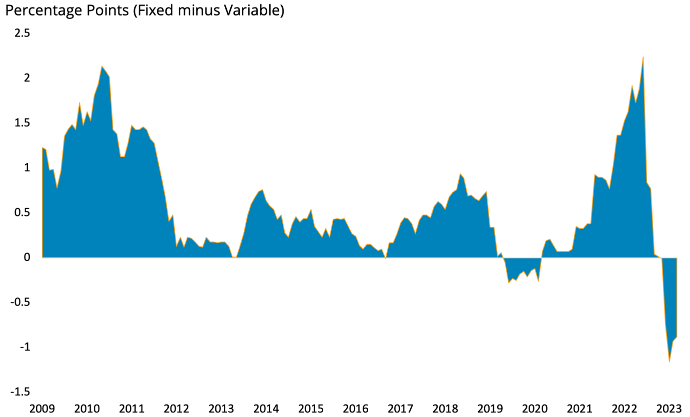
Moreover, of the 18 times since 2007 that the five-year yield has changed by 20 basis points in a day, 30 per cent of those occurrences have happened in just the past year. In just the week, volatility in bond markets increased even further when the failure of Silicon Valley Bank caused a flight to safety, pushing down US and Canadian long-term interest rates once again. During the past three months, the five-year bond yield rose from 2.8 per cent to nearly 3.7 per cent before falling to under 3 per cent. Our baseline is still for a sub-5 per cent five-year fixed mortgage rate by the end of the year, but clearly, there will be much volatility on the journey there.

Economic Uncertainty Driving Bond Volatility



Source: Bank of Canada; BCREA Economics

Spread Between Fixed and Variable Mortgage Rate



Source: Rob McLister, Mortgage Analyst

As long as the Bank of Canada remains on hold, and fixed rates experience only minor increases, the uncommon scenario of a notable negative difference between variable and fixed rates will persist.

Economic Outlook

Growth in the fourth quarter of 2022 was nearly unchanged from the prior quarter, following five consecutive quarters of growth and real GDP declined in the final month of the year. Declines in business inventories and business investment balanced out higher consumer and government spending and more favorable net trade. Higher interest rates are clearly impacting the most rate-sensitive sectors of the economy. Housing investment fell 2.3 per cent in the fourth quarter and was down 11.1 per cent in 2022. As tighter borrowing conditions impact the wider economy, we anticipate that growth will slow, and the labour market will soften.

The open question for the economy remains whether a recession is likely to occur this year. Given the pace and magnitude of tightening by the Bank of Canada, and signals from traditional recession warning tools like the slope of the yield curve, the recession probability is high. Our model shows two quarters of negative GDP growth starting in the second quarter before a recovery begins toward the end of 2024.

A complicating factor of course, is the trajectory for inflation. Any economic recovery is contingent on interest rates coming down sharply from their current level, which will not occur unless inflation is back under control.

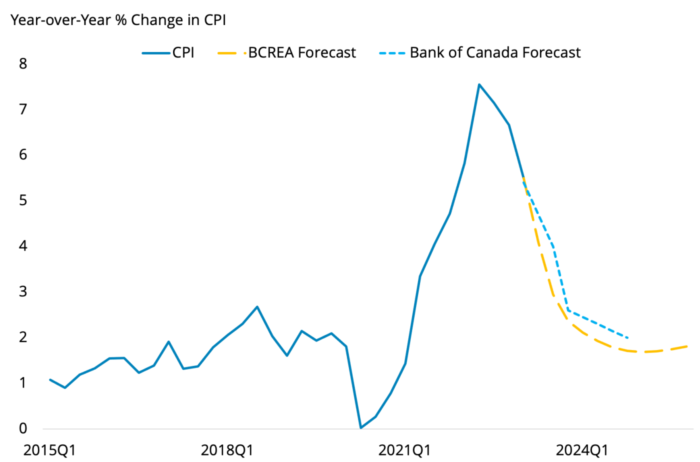
Bank of Canada Outlook

The Bank of Canada has moved to the sidelines while it judges the past year's impact of rate increases on the economy, particularly on inflation. Several factors point to inflation beginning to normalize this year. Barring a significant shift, gas prices will start to subtract from year-over-year CPI inflation. Additionally, raw materials and shipping costs should benefit from a downtrend in global commodity prices and a normalization of supply chains.

One complicating factor for the Bank of Canada is the potential for a more hawkish US Federal Reserve. A widening gap between Canadian and US interest rates would put downward pressure on the Canadian dollar, which would cause import prices to rise, adding to Canadian inflation.

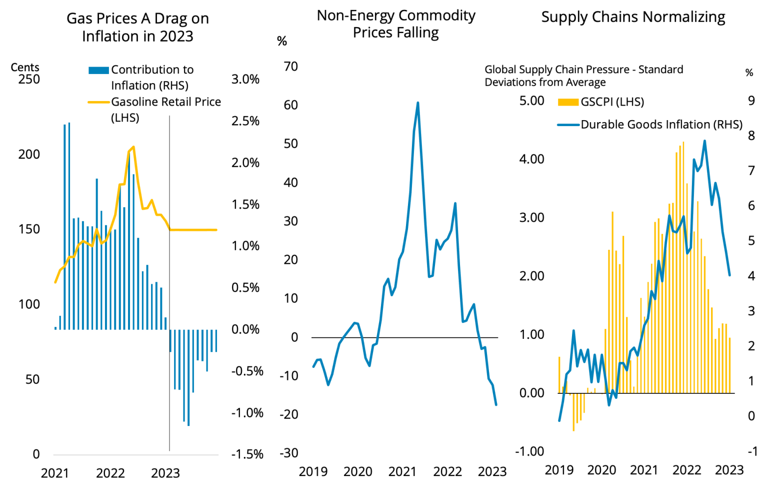
Nonetheless, we expect the Bank will remain on hold this year before lowering rates in 2024 once inflation returns to its target of 2 per cent.

Inflation Trending Lower



Source: BCREA Economics

Transitory Price Shocks Reversing



Source: Statistics Canada, Bank of Canada, Federal Reserve Bank of New York

Send questions and comments about the *Mortgage Rate Forecast* to:
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