December 2020

HIGHLIGHTS

- Bank of Canada actions have pushed mortgage rates to record lows
- Canadian economy bounced back in the third quarter, but the second wave looms
- Bank of Canada on hold, but when will quantitative easing end?

Mortgage Rate Forecast								
	2020				2021			
Term	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F
Prime Rate	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.45
5-Year Qualifying Rate	5.04	4.94	4.79	4.79	4.79	4.79	4.84	4.84
5-Year Average Discounted Rate	2.80	2.49	1.99	1.84	1.84	1.90	2.05	2.20

Source: Bank of Canada; BCREA Economics; Rate Spy

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.

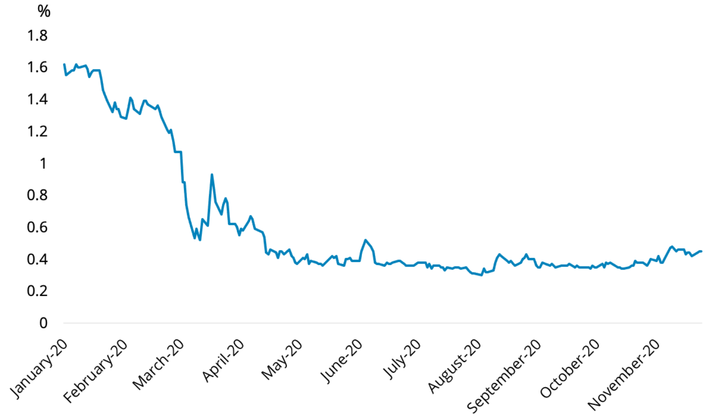
Mortgage Rate Outlook

Canadian mortgage rates were driven to a new record low in the fourth quarter as the Bank of Canada focused its program of quantitative easing (QE) at the middle of the Canadian yield curve. With the Bank buying $4 billion in 5- and 10-year bonds per week, the benchmark 5-year Government of Canada bond fell to as low as 0.30 per cent and dragged 5-year fixed rates to an average of 1.84 per cent.

Along with a massive expansion of its balance sheet to facilitate QE, the Bank of Canada has also reaffirmed its plans to keep its overnight policy rate at 0.25 per cent until it sees slack in the Canadian economy fully absorbed. Given current forecasts for economic growth, that may not occur until 2023, meaning these low rates will be around for quite some time. There are, however, other factors in the economy and financial markets that may push mortgage rates marginally higher over the next year.

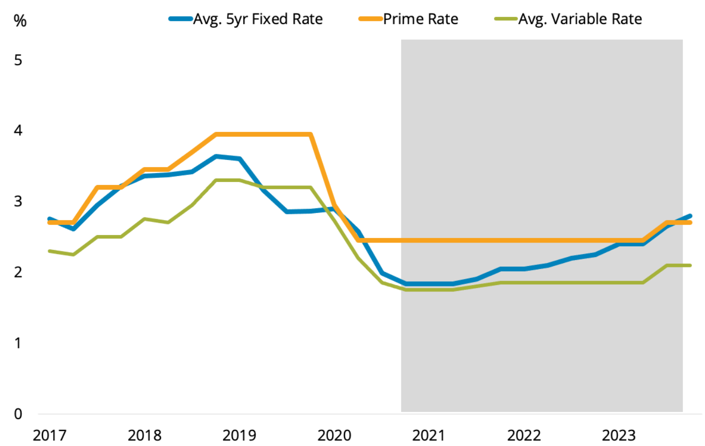
Canadian 5-year bond yields jumped about 15 basis points on the announcement of a successful vaccine as markets re-evaluated timelines for a potential end to the COVID-19 pandemic and a

Canadian 5-Year Government of Canada Bond Yield



Source: Bank of Canada

Forecast Mortgage Rates

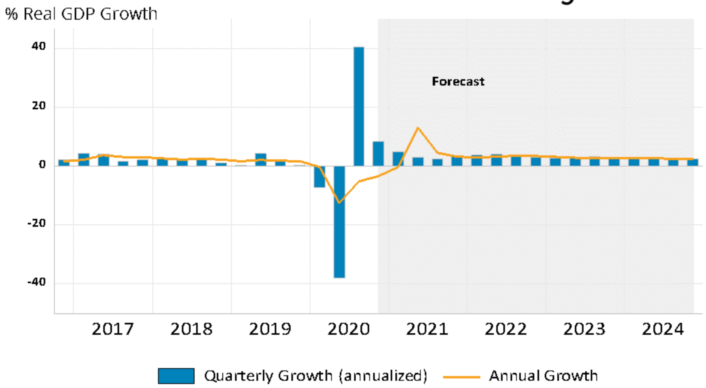


Source: BCREA Economics; Bank of Canada; RateSpy full economic recovery. It remains to be seen whether the impact of this brighter outlook will overcome the dark winter of rising COVID-19 cases. However, as the eventual recovery does kick into what we expect will be high gear early next year, the speed and strength of that recovery will dictate the eventual duration of the Bank of Canada's QE. A faster recovery will mean an earlier end to QE and, as the Bank's bond purchasing slows and the need for the Government of Canada to finance deficits grows, there will be some upward pressure on government bond yields. As a result, while the prime borrowing rate and variable mortgage rates will likely be flat over the next year, we anticipate that 5-year fixed rates may rise modestly by the middle of 2021.

Economic Outlook

Following a record contraction of the Canadian economy in the first half of 2020, the third quarter saw a vigorous rebound in economic growth. Real GDP grew 8.9 per cent, or 40.5 per cent on an annualized basis, bringing the economy back to within 4 per cent of its pre-COVID-19 level. The distressing second wave of COVID-19 and the restrictions it has necessitated have jeopardized the recovery that's currently underway.

Unprecedented Swings in the Canadian Economy



Source: Statistics Canada; BCREA Economics

However, we still expect the economy to post positive real GDP growth in the fourth quarter of 2020, though there is the risk that a renewed fear of public spaces combined with targeted restrictions will prompt a modest retracing of output.

The ultimate economic impact of COVID-19 by the end of 2020 will be a Canadian economy that is about 2 per cent smaller by year-end. That said, promising results from vaccine trials should lead to very strong growth in 2021 as pent-up spending floods back into the economy. We expect Canadian real GDP will grow by an average of 4 per cent over the next two years.

Monetary Policy Outlook

The Bank of Canada is committed to holding its overnight policy rate at 25 basis points until slack in the economy is absorbed. The injury to Canadian output caused by the pandemic suggests this will not occur until 2023. Even a relatively faster recovery would mean that the output gap – the Bank of Canada's primary measure of slack in the economy – is not fully closed until near the end of 2022.

The current size of the output gap, along with low energy prices, is holding Canadian inflation well below its target of 2 per cent. Total CPI inflation is trending under 1 per cent while the Bank of Canada's measures of "core" inflation remain below target despite the massive expansion of the Bank's balance sheet necessary to facilitate its QE program. The first stage of tighter monetary policy from the Bank will be how and when it decides to taper its bond purchases over the next year. With a firm commitment to keeping the overnight rate at its current level, we may start to see a divergence in variable and fixed rates by early summer as fixed rates creep marginally higher.

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