BRITISH COLUMBIA REAL ESTATE ASSOCIATION

Mortgage Rate Forecast

INTEREST RATES TO REMAIN IN HOLDING PATTERN

HIGHLIGHTS

- Canadian mortgage rates to be relatively constant in 2015
- Is Canada at risk of a technical recession?
- Bank of Canada holding out hope for good news on the economy

Mortgage Rate Forecast

	2015				2016			
Term	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
1-Year	2.85	2.85	2.85	2.85	2.85	3.00	3.14	3.14
5-Year	4.76	4.64	4.64	4.79	4.86	5.05	5.15	5.24

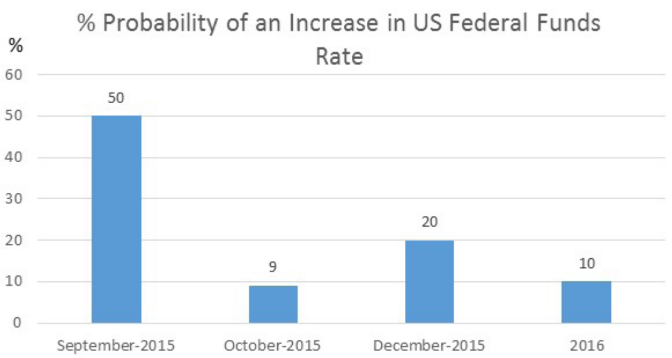
Note: Data is average of weekly rates

Source: Bank of Canada; BCREA Economics

Mortgage Rate Outlook

Canadian mortgage rates have, more or less, held steady in the second quarter after trending surprisingly downward to start the year. The 5-year fixed rate, the qualifying rate for all insured mortgages, remains at 4.64 per cent, the lowest level on record. Key bond yields, from which mortgage rates are priced, have risen from their own record-low levels; however, those increases have yet to nudge mortgage rates higher and are unlikely to do so during the important spring/summer home-buying season.

Will the US Federal Reserve Raise Rates this Year?



Source: Bloomberg News Survey of Economists (June 5-9)

With the Canadian economy unexpectedly contracting in the first quarter, due to last year's dramatic decline in oil prices and the associated downtrend in CPI inflation, there is very little upward pressure on borrowing rates.

Given the current state of the Canadian economy, perhaps the most immediate threat to the current low-rate environment is the prospect of tighter monetary policy from the US Federal Reserve (Fed). After being effectively cut to zero during the financial crisis of 2008, the Fed's overnight target rate has been kept at that level for the past seven years. Fed Governor Janet Yellen and other key members of the Federal Open Market Committee have indicated an intention to begin increasing rates this year. However, there are many reasons to believe that the Fed will not, or at least, should not, raise rates this year. The US economy contracted in the first quarter, although there is argument over the cause. Some analysts attribute the decline to more severe than expected weather and labour disruptions, while others see a technical problem with how statistical agencies in the US are seasonally adjusting the data.

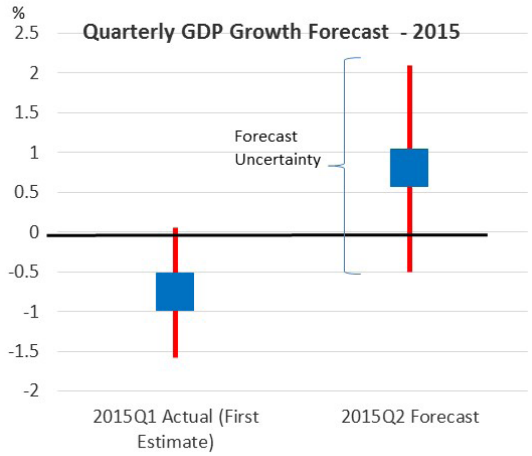
Whatever the cause, it is clear that the US economy is not currently performing at the level many expected it would in 2015. While the job market continues to post solid employment gains and the US unemployment rate is sharply lower, neither wage nor inflation have responded as expected to tighter labour markets. Add in a dose of uncertainty from seemingly endless debt negotiations in Europe, and there is a strong case for the Fed to hold off on raising rates this year.

Even so, we have built into our forecast some modest uplift in long-term bond yields this year which could translate to a moderate rise in mortgage rates. We forecast that the five-year fixed rate will end the year at 4.79 per cent while the 1-year rate will remain at 2.85 per cent.

Economic Outlook

The Canadian economy contracted 0.6 per cent in the first quarter, a much worse outcome than the Bank of Canada's pessimistic prediction of zero growth. Naturally, a negative quarter begs the question of whether or not Canada is in a recession, the standard definition being two consecutive quarters of negative growth. With one down quarter already on the books and parts of the economy still reeling from low oil prices, it is possible that the Canadian economy could experience a brief and shallow recession this year.

Risk of a Recession?



Note: First quarter GDP will be revised with the release of second quarter GDP data.
Source: BCREA Economics; Statistics Canada

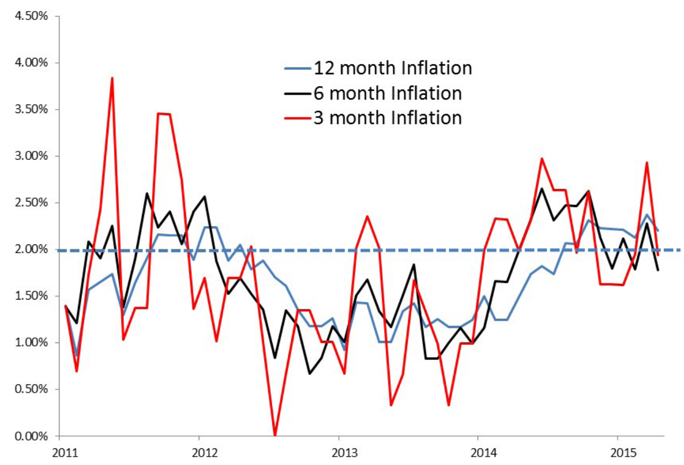
With oil prices stabilizing and core inflation firming around its 2 per cent target, a further loosening of monetary policy is becoming more unlikely, although a worse than expected first quarter has prompted renewed speculation of further interest rate cuts. However, if economic growth recovers over the next couple of quarters in-line with the Bank's forecasts, attention will shift once again to the timing of future rate increases.

While the door is certainly open for a further reduction in the Bank's overnight rate, ultimately, we predict that the Bank will opt to remain on hold for the rest of the year. While the first quarter was significantly worse than expected, there is little that the central bank can do to combat the primary factors dragging the economy down at the start of the year: low oil prices and unanticipated sputtering of the US economy. Rather, we believe that the Bank will continue to pin its hopes on continuing stability in global oil prices and a second half US economic recovery spurring Canadian exports.

More importantly, Canada is a diverse economy and the negative oil shock has not had symmetric impacts across the country. Consumer spending in non-oil producing regions remains very strong and housing markets in Ontario and BC are on pace to post multi-year highs in sales. In contrast, oil-producing regions of the country have been facing the brunt of the oil shock via lower exports, business investment and wages.

We forecast that the Canadian economy will ultimately avoid a technical recession in 2015; with growth of close to 1 per cent in the second quarter before accelerating to 2.5 per cent in the second half of the year. For 2015 as a whole, growth is likely to register about 1.5 per cent.

Measures of Core Inflation Still Hovering Around 2% Target



Source: Statistics Canada

Interest Rate Outlook

The Bank of Canada has kept its target for the overnight rate unchanged at its past three interest rate decision since surprising markets with a rate cut in January.

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