



Mortgage Rate Forecast

MORTGAGE RATES ON CRUISE CONTROL

HIGHLIGHTS

- Financial market volatility keeping mortgage rates low
- Fiscal policy to the rescue?
- Bank of Canada unlikely to act on interest rates this year

Canadian bond yields fell to as low as 0.48 per cent in the first quarter of the year, though have since bounced back modestly to around 0.8 per cent.

The US Federal Reserve is likely to take a much more cautious approach to tightening than was widely expected, with the outside chance of no further increases to its overnight target rate this year. Without the added pressure on rates from tightening monetary policy in the United States, a somewhat stagnant Canadian economy and modest inflationary pressures will likely keep Canadian government bond yields near their current levels. The prospect of improved economic growth toward the end of the year or higher than expected inflation stemming from the pass-through effect of the low Canadian dollar to imports may prompt a modest rise in bond yields by year end.

Mortgage Rate Forecast

	2016				2017			
Term	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
1-Year	3.14	3.14	3.14	3.24	3.24	3.24	3.34	3.44
5-Year	4.64	4.64	4.64	4.64	4.79	4.79	4.93	4.93

Note: Data is average of weekly rates

Source: Bank of Canada; BCREA Economics

Mortgage Rate Outlook

The beginning of 2016 was marked by tremendous volatility in financial markets. Global investor sentiment seems to change with every up or down-tick in oil prices, and the ensuing risk aversion has overwhelmed any potential pressure on bond yields that may have arisen from a tightening of monetary policy by the US Federal Reserve.

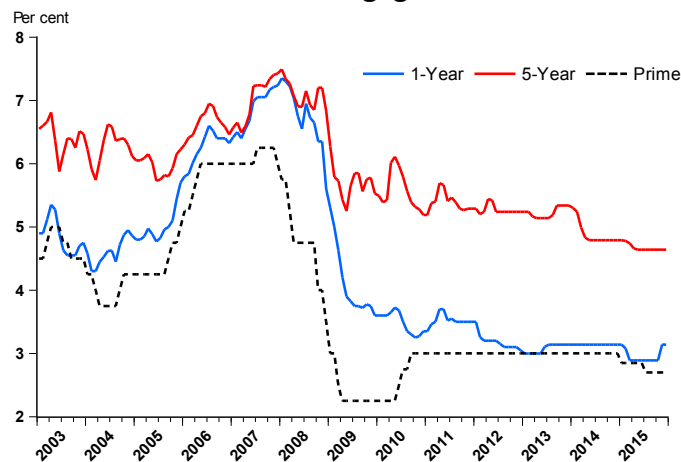
While the one-year mortgage rate moved slightly higher at the end of 2015, the five-year posted mortgage rate has remained unchanged for almost an entire year at 4.64 per cent. Our forecast is for that trend to continue, with the five-year qualifying rate remaining unchanged for most of 2016.

Economic Outlook

Canadian economic growth registered just 1.2 per cent for all of 2015, rebounding modestly after posting negative growth in the first half of the year. Still, the main factors weighing on the economy remain present in 2016, namely low oil prices and the associated knock-on effects on incomes and job growth in large swaths of the Canadian economy.

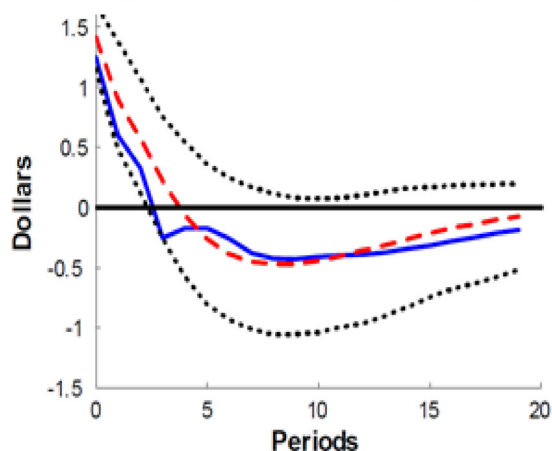
With the Bank of Canada approaching the limits of monetary policy, negative rates and other unconventional tools aside, the newly elected federal government seems intent on trying old-fashioned fiscal policy to boost economic growth. There is no consensus among economists on the efficacy of fiscal policy in boosting economic growth, particularly in a small economy like Canada's in which much of the stimulus could be lost to imports. While the federal government has not yet released its budget, it is expected to forecast a deficit of \$30 billion including extra government spending and tax measures to help stimulate the economy.

Posted Mortgage Rates



Latest Data Point: 2015m12, Monthly, Average of Weekly Data
Source: Bank of Canada, BC Real Estate Association

Response of GDP to Govt. Spending Shock



Source: Cayen and Desgagnés, "Impact of Temporary Fiscal Shocks on the Canadian Economy", April 2009, Bank of Canada Working Paper

Estimates of the fiscal multiplier for Canada, that is, how much additional economic activity is stimulated for each dollar of government spending, ranges from about 0.5 to 1.5. In reality, the impact of fiscal policy is highly dependent on the state of the economy. Adding stimulus in the form of government spending to an economy that is already at its potential will simply crowd out private sector activity or could be offset by tighter monetary policy. However, given the current state of the economy, fiscal policy may be more effective than usual since it is highly unlikely the Bank of Canada would offset higher government spending by tightening interest rates.

Even if there is disagreement on the multiplier, most economists agree that the impact of stimulus spending is only temporary, with most of the added growth coming in the quarter that the new spending occurs. If the federal government plans a stimulus of \$30 billion, growth could get a temporary boost on the order of 0.2 this year and 0.5 per cent in 2017. Our current forecast for the Canadian economy, including the impact of expansionary fiscal policy, is for growth of 1.6 per cent this year and 2.5 per cent next year.

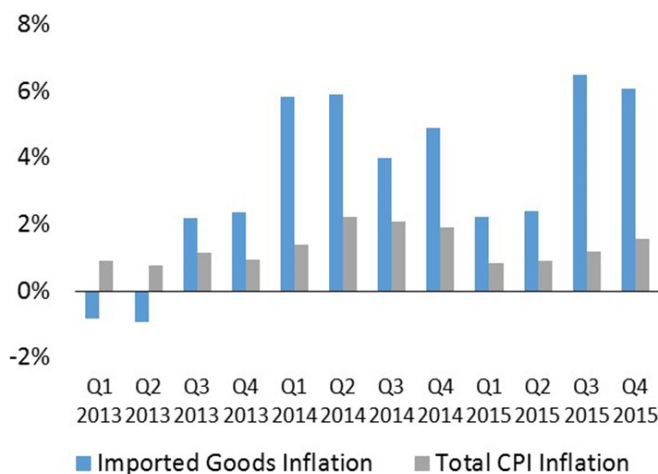
Interest Rate Outlook

The Bank of Canada, whose mandate is to target 2 per cent inflation over the medium run, has to strike a delicate balance given a struggling economy and inflation trending near its target. Low oil prices continue to vex the Canadian economy spurring job losses in energy producing provinces while also putting downward pressure on the exchange rate, which makes the cost of imported goods from heavy machinery to fresh produce more expensive.

We expect that weak economic growth will continue in the first quarter of 2016, but the possibility of an effective fiscal stimulus, a stronger US economy and a stabilization of oil prices points to stronger growth ahead. The door remains open for the Bank of Canada to reduce rates once more in 2016, though our expectation is that the Bank will remain on the sidelines throughout the year.

Fall in Canadian Dollar Is Pushing Import Prices Higher

Year-Over Year Inflation



Source: Statistics Canada

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