



# Mortgage Rate Forecast

## LOW MORTGAGE RATES TO CONTINUE

### HIGHLIGHTS

- Mortgage rates remain unchanged but could feel pressure from US Federal Reserve
- Canadian economy slowed by Alberta wildfires
- Bank of Canada likely on hold until 2018

Mortgage Rate Forecast								
	2016				2017			
Term	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
1-Year	3.14	3.14	3.14	3.14	3.14	3.14	3.24	3.24
5-Year	4.64	4.64	4.64	4.74	4.79	4.79	4.79	4.79

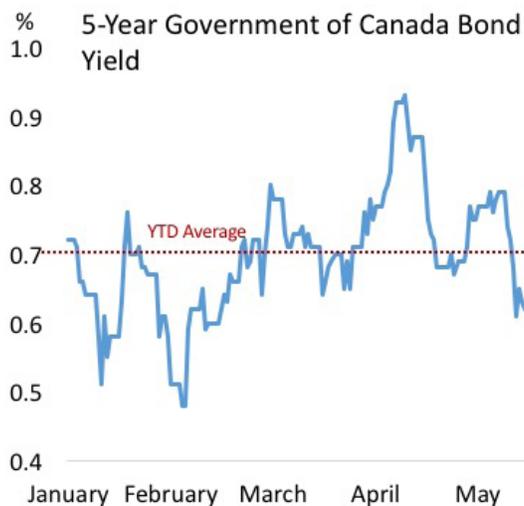
Note: Data is average of weekly rates

Source: Bank of Canada; BCREA Economics

### Mortgage Rate Outlook

It was another uneventful quarter for mortgage rates with the posted five-year fixed rate remaining unchanged for the fourteenth consecutive month. While posted mortgage rates remained relatively placid, the benchmark five-year

Mortgage Rates Steady Despite Volatility in Underlying Five-Year Bond Yield



Source: Bank of Canada

bond yield, from which mortgage rates are priced, has been much more volatile this year. The yield on five-year bonds has been as low as 0.48 per cent and as high as 0.9 per cent but has largely oscillated around 0.7 per cent in 2016.

The outlook for mortgage rates continues to hinge on factors external to Canada, namely the direction of oil prices and the direction of US monetary policy. With regard to oil, prices have moved higher recently, but still remain well short of levels from two years ago. Nevertheless, rising prices should provide a modest lift to incomes in key oil producing provinces while diminishing the need for further loosening of interest rates by the Bank of Canada.

In the US, the timing of a potential rate hike by the US Federal Reserve (the Fed) was called into question after a softer than expected labour market. Employment growth in May disappointed at just 38,000 new jobs and overall job growth has clearly slowed in recent months. The poor job numbers from May had a clear and immediate impact on Canadian bond yields as investors repriced their expectations of a June rate hike by the Fed, sending the five-year interest rate below 0.6 per cent for the first time since February.

Moreover, the upcoming referendum to settle Britain's membership in the EU, the so-called "Brexit," will add further uncertainty to global financial markets. If policymakers were not so determined to raise rates, global risk and already modest economic growth would likely keep the Fed from raising interest rates again this year. However, the Fed seems intent to normalize interest rates at a pace that some would argue is not justified by incoming economic data. If that eagerness to tighten wins out, there will likely be some upward pressure on Canadian five-year yields by the end of the year, and therefore a slight increase in the five-year posted rate. Our forecast is for the five-year fixed to end the year 10 basis points higher at 4.74 before rising gradually in 2017.

### Economic Outlook

The Canadian economy recovered from a sluggish end to 2015, but that recovery looks to be both underwhelming and short-lived. Economic growth in the first quarter was widely expected to come in north of 3 per cent thanks

to a very strong January. However, the economy ultimately expanded just 2.4 per cent and softened substantially toward the end of the quarter. Further compounding matters, wildfires in Alberta have halted oil production and other economic activity with initial estimates pointing to more than a 1 per cent drag on Canadian real GDP. Our forecast is for a pick-up in growth starting in the third and fourth quarter as the rebuilding effort in Alberta gets underway and increased federal government expenditures provide a boost to growth.

We expect the Canadian economy will grow at a 1.5 per cent pace in 2016 before accelerating to 2.3 per cent in 2017. Headline inflation is forecast to trend modestly higher given the increase in oil prices as well as rising gasoline prices resulting in a shortage due to refinery shutdowns in Alberta. Given the current slack in the economy, core inflation, which excludes temporary fluctuations in food and gas prices, is expected to remain stable at roughly 2 per cent.

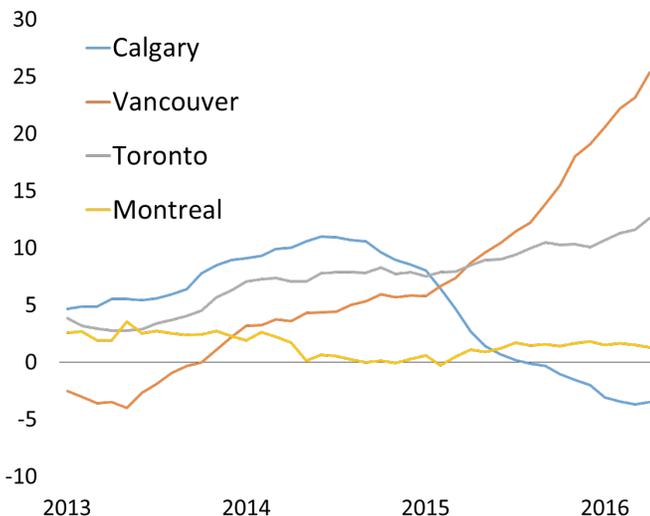
### Interest Rate Outlook

The Bank of Canada continues to be caught in the same dilemma that has confounded monetary policy since the financial crisis. While parts of the nation and the economy may benefit from further stimulus, rising home prices in select markets and associated household debt burdens present a significant vulnerability that the Bank would perhaps prefer to restrain through higher interest rates.

Recognizing that the blunt force of higher interest rates is not the appropriate tool to target disparate Canadian housing markets, the Bank has largely concentrated its efforts on its inflation mandate, leaving housing policy to the Department of Finance. With inflation held in check by flagging commodity prices and slow growth and the Bank reticent to attack growing household debt through monetary policy, there is currently very little reason to anticipate that the Bank of Canada will tighten interest rates. Given the current outlook for economic growth, the likelihood of the Canadian economy returning to its full-potential level before 2018 remains low. That means that inflation should remain below target over the next two years, keeping the Bank on the sidelines for the foreseeable future.

### Regional Disparity in Canadian Housing Markets

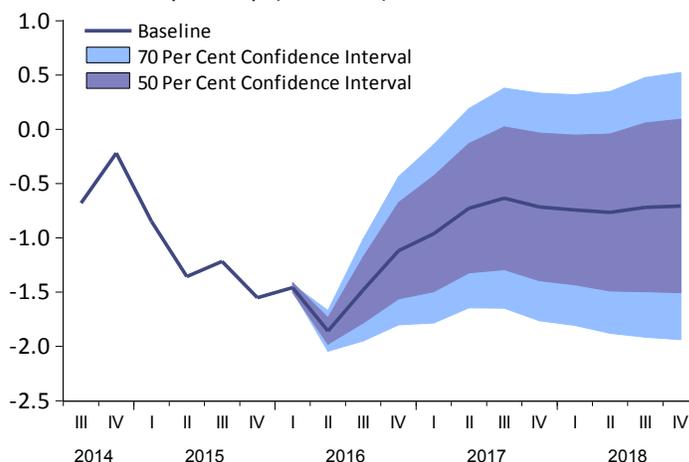
% Change in Home Prices of Major Canadian Cities (Year-over-Year)



Source: CREA Home Price Index

### Canadian Output Gap Still a Long Way from Closed

Canadian Output Gap (Per Cent)



Source: BCREA Economics

Send questions and comments about *Mortgage Rate Forecast* to: Cameron Muir, Chief Economist, [cmuir@bcrea.bc.ca](mailto:cmuir@bcrea.bc.ca); Brendon Ogmundson, Economist, [bogmundson@bcrea.bc.ca](mailto:bogmundson@bcrea.bc.ca).

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