BRITISH COLUMBIA REAL ESTATE ASSOCIATION

Mortgage Rate Forecast

MORTGAGE RATES EXPECTED TO RISE IN SECOND HALF OF 2017

HIGHLIGHTS

- The Fed vs. Trump: conflicting policy goals could push rates higher
- Data on jobs and growth point to optimism for the economy
- Stronger than expected Canadian economy on track to close output gap next year

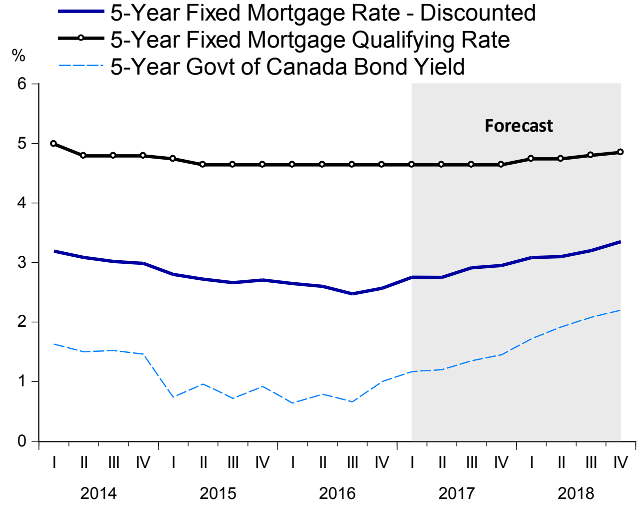
Mortgage Rate Forecast

	2017				2018			
Term	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
1-Year	3.14	3.14	3.14	3.24	3.24	3.34	3.44	3.64
5-Year Qualifying Rate	4.64	4.64	4.64	4.74	4.74	4.79	4.79	4.84
Average 5-Year Mortgage Rate	2.75	2.75	2.90	2.95	3.05	3.10	3.20	3.35

Source: Bank of Canada; BCREA Economics; Rate Spy

Note: The 5-Year Average Rate is the average residential mortgage rate contracted through Canadian lenders and reflects discounts from the qualifying rate.

Mortgage Rate Forecast



Sources: BCREA, Bank of Canada, Rate Spy

Mortgage Rate Outlook

After an initial upward adjustment in global interest rates following the US presidential election, bond markets have since adopted a wait and see approach to US economic policy. As a result, the yield on the benchmark five-year bond has stayed constant through the first quarter of the year. Consequently, Canadian mortgage rates have also remained relatively unchanged. However, we could see some upward movement in interest rates over the second half of 2017, due to a stronger Canadian economy and a large degree of policy incoherence in the United States. Indeed, for the first time in several years, US monetary and fiscal policy seem to be at cross purposes. The US Federal Reserve, seeing an economy close to its estimate for full employment, has signaled its intention to raise rates multiple times this year.

The Trump administration, on the other hand, continues to publicly push for measures that would likely be inflationary, including a budget replete with ramped up military and infrastructure spending and tax cuts for the wealthy. Estimates of how these plans may impact the US budget deficit are difficult, since few details have been released. It is safe to say that increased spending, combined with reduced revenues, will widen the deficit while providing a temporary bump to economic growth. Most importantly, both of those outcomes will lead to higher interest rates in the United States, putting upward pressure on interest rates globally.

The Canadian mortgage market is still processing changes to mortgage regulations made in the fall of 2016, the most important of which made the five-year posted rate the qualifying rate for all insured borrowers. Therefore, the posted qualifying rate may not be as responsive to higher rates as in past years. The average five-year mortgage rate offered by lenders at a discount to the posted rate moved higher toward the end of 2016, but has softened slightly heading into the always important spring season. We expect rates to remain somewhat stable over the first half of 2017 before rising by as much as 20 basis points toward the end of the year, as markets gain clarity on the direction of US policy.

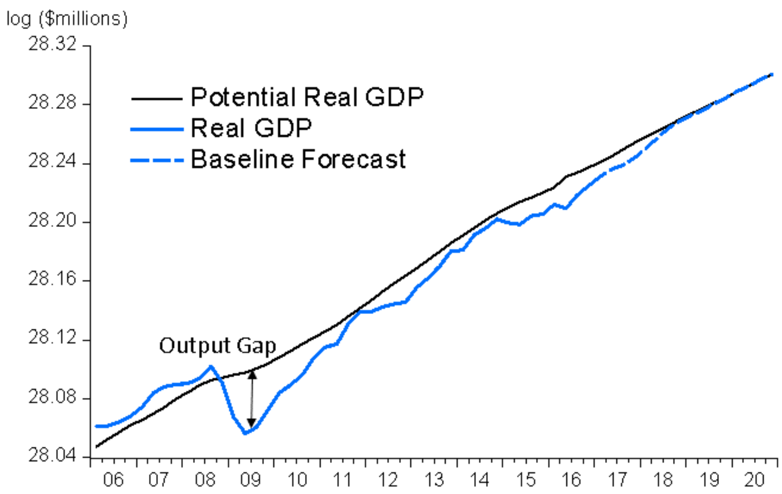
Economic Outlook

The Canadian economy has shown signs of significant momentum in recent months. Not only did real GDP grow a better than expected 2.6 per cent in the fourth quarter of 2016, but third quarter growth was revised up from an already strong 3.5 per cent to 3.8 per cent. Moreover, job growth has been stellar with employment increasing by an average of 36,000 jobs per month over the past six months, and first quarter 2017 real GDP is tracking at close to 3 per cent. Accelerated growth in the second half of the year was partly the result of the Alberta resource sector bouncing back following summer wildfires, however export growth, new home construction and consumer demand have all been robust. As the economy builds on this momentum, we forecast that the Canadian economy will post 2.2 per cent growth this year and next.

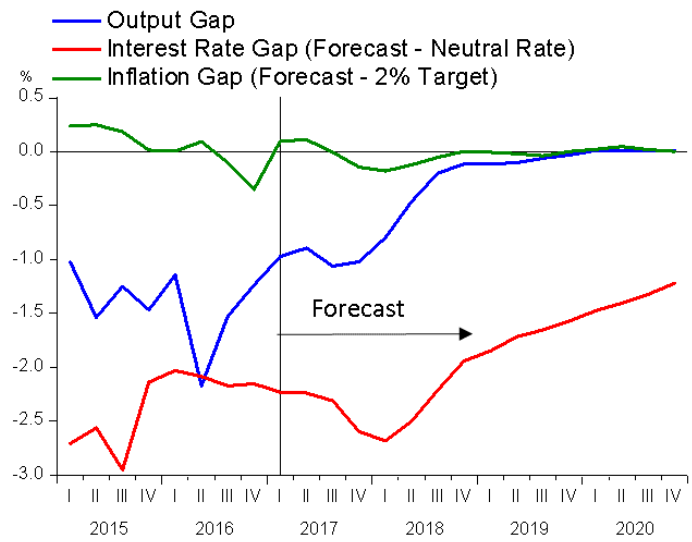
Interest Rate Outlook

While economic growth seems to be strengthening, the trend in inflation remains slightly below the Bank's 2 per cent target. However, given the Bank of Canada's estimated potential or long-run trend economic growth rate of 1.5 per cent, a sustained 2 per cent growth in real GDP would eliminate slack in the economy as early as 2018, putting upward pressure on inflation. In theory, once the output gap is closed and inflation has returned to its target level, the so-called "interest rate gap," the difference between the current overnight rate and its long-run equilibrium level, should also close to keep the economy from over-heating. In practice, the interest rate gap will close much later, as central banks tend to smooth rate adjustments over time. As pronounced uncertainty remains the prevailing theme of 2017, the Bank will certainly be extra cautious until it has clarity on the trade and tax policy intentions of the United States.

Mind the Gaps: Slack in the Economy Set to be Eliminated by 2018



Source: Bank of Canada, BC Real Estate Association



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