ECONOMICS
Mortgage Rate Forecast

June 2023

HIGHLIGHTS

- Stubborn inflation has rates rising again
- How much longer can the economy shake off the impact of high interest rates?
- The Bank of Canada is back on the move

Mortgage Rate Forecast								
	2023				2024			
Term	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Variable Rate	6.35	6.95	6.95	6.95	6.95	6.45	5.95	5.7
5-Year Qualifying Rate(fixed)	7.24	7.24	7.45	7.19	6.95	6.75	6.65	6.55
5-Year Average Discounted Rate	5.24	5.24	5.45	5.19	4.95	4.75	4.65	4.55

Source: Bank of Canada; BCREA Economics; Rob McLister, Mortgage Rate Analyst

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.

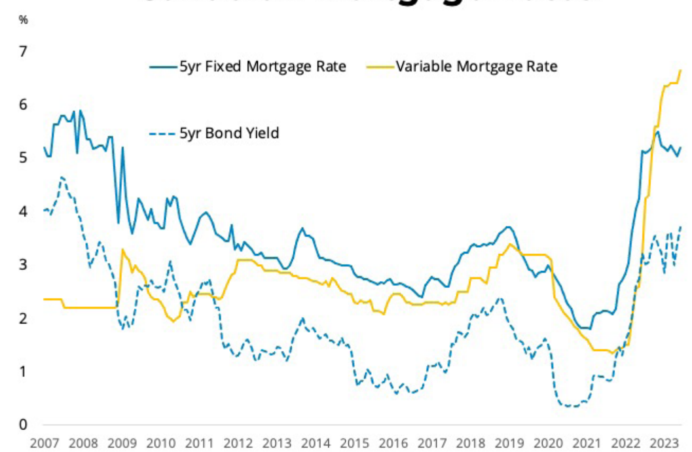
Mortgage Rate Outlook

Canadian bond markets dramatically changed course following the release of April's inflation data. After trending essentially sideways since March, the five-year government of Canada bond yield jumped roughly 70bps, rising back to previous peak levels as markets reacted to higher-than-expected inflation by revising expectations upward for the path of Canadian monetary policy. Those expectations were further bolstered by stronger than forecasted first-quarter economic growth and a strong Canadian labour market. The new consensus appears to be that the Bank of Canada will have to raise rates further to slow the economy and bring inflation back to its 2 per cent target.

While the Canadian yield curve remains deeply inverted, as it has been for the past ten months, the spread between three-month treasuries and ten-year bonds is at 160 basis points, the largest inversion since the early 1990s and historically predictive of recessionary conditions ahead. Should the economy slow as anticipated over the second half of 2023, five-year bond yields will likely return to below 3 per cent. However, the economy has been remarkably resilient in the face of higher interest rates. Consequently, mortgage rates will probably move higher this summer and stay higher than previously expected until inflation shows meaningful improvement in falling back to target.

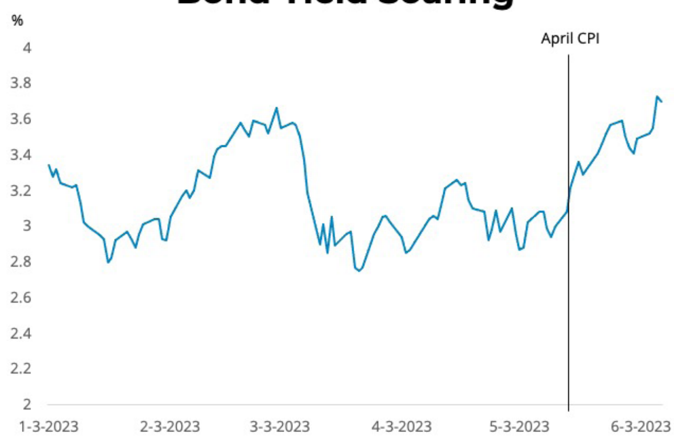
As a result, we are forecasting the average five-year fixed mortgage rate to stay above 5 per cent this year, likely rising back to 5.3 per cent before eventually declining in the fourth quarter of 2023. Variable rates are forecast to rise to 6.9 per cent, factoring one more rate hike by the Bank of Canada in July. However, if the economy weakens as expected and inflation resumes its path toward 2 per cent, we may see rate cuts by the central bank early next year.

Canadian Mortgage Rates



Source: Bank of Canada; BCREA Economics, Rob McLister

April Inflation Data Sends 5yr GoC Bond Yield Soaring



Economic Outlook

In the first quarter, Canadian GDP exceeded expectations by expanding at an annualized rate of 3.1 percent. Following over a year of rate hikes from the Bank of Canada, the economy remains robust in many areas. A burst of economic growth at the start of the year supported a high first-quarter growth rate, but April's preliminary GDP estimate shows growth continuing into the second quarter. Although housing markets swooned in the immediate aftermath of rate hikes, they have shown signs of a solid recovery in recent months. At 5 per cent, the Canadian unemployment rate remains near record lows.

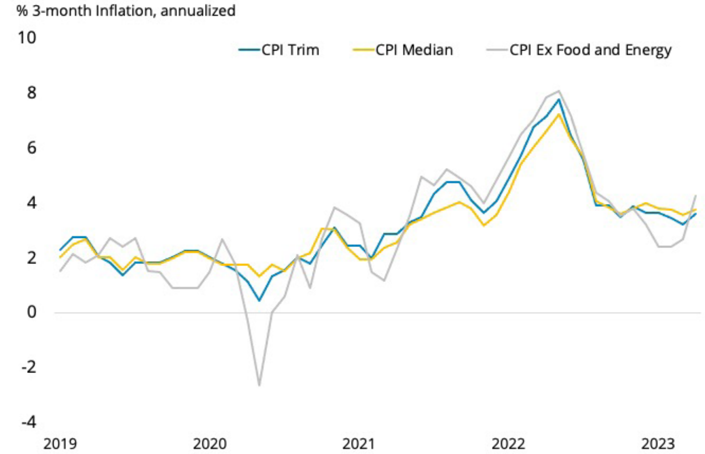
While the economy has thus far shrugged off the impact of higher interest rates, Canadian employment did decline in May for the first time since August 2022, and a slowdown in consumer spending in the second half of the year is likely, as the full impact of higher interest rates shows up in household debt-service costs. As a result, the risk of a brief recession remains elevated, and we expect the economy will only manage about 1 per cent growth this year.

Bank of Canada Outlook

After signalling a pause in its monetary tightening just a few months ago, the Bank of Canada has already changed course. While inflation has come down significantly, core inflation has been stubbornly trending around 4 per cent, and with home prices already recovering across the country, inflationary pressures are rising.

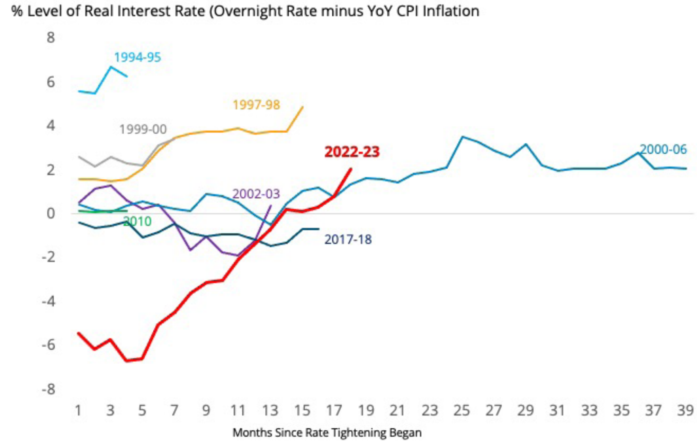
According to the Bank's estimation, interest rates will need to move higher to slow the economy and bring inflation back to its 2 per cent target. Regarding where the Bank's overnight rate needs to be to slow the economy, it's often more informative to look at the policy rate net of inflation, or the so-called, "real" interest rate. Even with the Bank's aggressive tightening, high inflation has meant that real rates were still negative until recently. In fact, the real policy rate has averaged about -1 per cent since 2010. Given the Bank's current forecast for inflation, and assuming the overnight rate will rise once more to 5 per cent, that would mean a 2 per cent real policy rate or about 100 to 200 basis points above what the Bank considers to be neutral for the economy and its highest level in more than 15 years. Whether the economy can withstand that level of rates remains to be seen, but the economy will likely slow, and the Bank will likely be lowering rates in 2024.

Is Inflation Stuck at 3 to 4 Per Cent?



Source: Statistics Canada

Real Rates in Past Tightening Cycles



Source: Bank of Canada

Send questions and comments about the *Mortgage Rate Forecast* to:
Brendon Ogmundson, Chief Economist, bogmundson@bcrea.bc.ca; Ryan McLaughlin, Economist, rmclaughlin@bcrea.bc.ca.

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