BRITISH COLUMBIA REAL ESTATE ASSOCIATION

Mortgage Rate Forecast

MORTGAGE RATES SET FOR MODEST RISE IN 2016

HIGHLIGHTS

- Qualifying rate steady but offered rates moving higher
- Canadian economy bounces back from first half contraction
- Bank of Canada moves to the sidelines in 2016

Mortgage Rate Forecast

	2015				2016			
Term	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
1-Year	2.89	2.89	2.89	2.89	2.89	2.89	2.89	3.00
5-Year	4.76	4.64	4.64	4.64	4.79	4.79	4.93	5.11

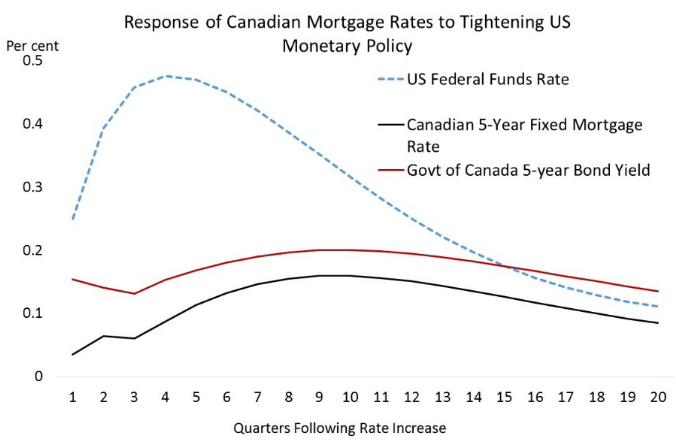
Note: Data is average of weekly rates

Source: Bank of Canada; BCREA Economics

Mortgage Rate Outlook

While the benchmark qualifying rate for Canadian mortgages has not changed in eight months, offered or discounted mortgage rates at banks and other lenders have recently moved higher. The average 5-year rate offered by lenders has increased about 20 basis points in recent weeks to 2.79 per cent and the discount from prime lending rates on variable rate mortgages has narrowed from 60 to 40 basis points. Rather than reflecting changes in underlying economic factors, these increases are largely due to regulatory and other market structure changes that are pushing banks' cost of capital higher.

US Monetary Policy Putting Modest Upward Pressure on Canadian Mortgage Rates



Source: BCREA Economics; Bank of Canada, US Federal Reserve

While these recent increases are likely one-time adjustments, the forthcoming normalization of US monetary policy will likely be a more persistent factor in determining future mortgage rates. Surveying the economic landscape, the case for the US Federal Reserve (the Fed) to raise rates is mixed at best. While the US unemployment rate is at its lowest level in seven years, the US economy is still, by most measures, far from what economist consider its potential or full-employment level. Economic growth in 2015 has been solid, if not brisk, and measures of inflation show that prices remain muted with inflation trending well below the Fed's 2 per cent target.

Despite the mixed evidence for doing so, after seven years of holding its target overnight rate at zero, the Fed is determined to raise its overnight rate at its upcoming meeting in December. Given that markets have already priced in a rate hike, the focus of the Fed's December meeting has shifted to how much guidance is given regarding how quickly the Fed plans to move after its initial hike.

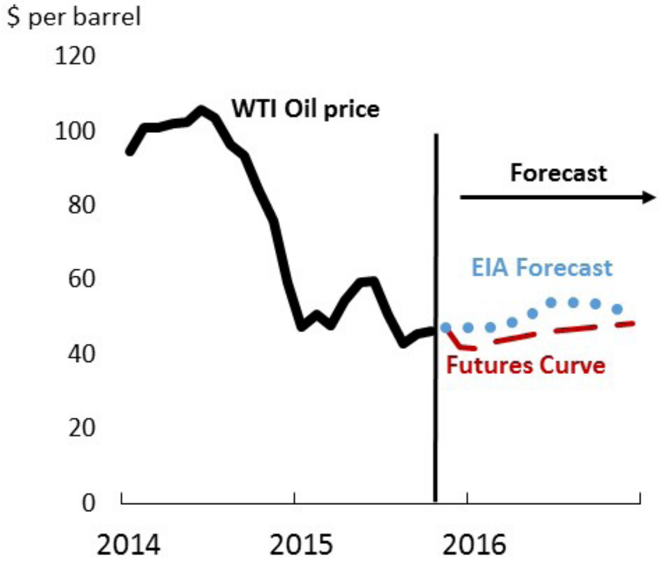
We expect the Fed to go very slowly in raising rates, with the overnight federal funds rate being brought to 0.75 per cent by the end of next year. That magnitude of a rate hike has in the past correlated with a modest increase of about 20 basis points in Canadian 5-year bond yields which is then partially passed through to 5-year fixed mortgage rates. Canadian bond-yields have already drifted higher in anticipation of Fed tightening, rising 20 basis points since September.

Given stable inflation and moderate economic growth in the Canadian economy, pressure from rising US rates will likely be the main source of upward pressure on mortgage rates over the next year. We are forecasting that 5-year qualifying rate on mortgages will increase to 4.79 per cent in early 2016 before gradually rising to 5.11 by the end of next year.

Economic Outlook

The Canadian economy rebounded from a first half slump, growing close to 2.5 per cent in the third quarter. Employment growth has trended at about 12,000 jobs per month in 2015, but with significant volatility and regional disparities while the unemployment rate remains near

Oil Prices Set to Stabilize in 2016



Source: US Energy Information Administration, NYMEX

7 per cent. Growth for all of 2015 will likely register a paltry 1.2 per cent with stronger second half growth offsetting consecutive negative quarters in the first half of the year.

The outlook for growth in 2016 remains weighed down by low oil prices and the associated struggles in Canada's energy producing provinces. Higher oil prices would provide a welcome boost to economic growth, but increasing prices are contingent on more robust global demand which may not materialize. While the IMF is forecasting an uptick in Global GDP growth, key markets like China are expecting slower growth. As a result, both forecasters and futures markets are pointing to oil prices stabilizing moderately higher at close to $50 per barrel in 2016.

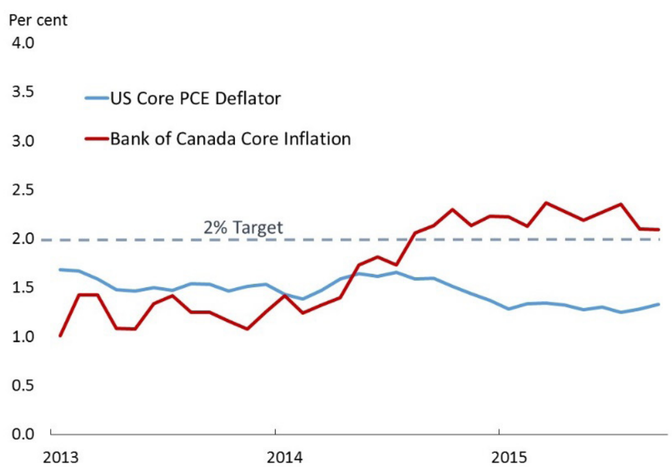
In addition, the economy may have to adjust to a slight increase in mortgage rates which could temper the pace of residential construction and home sales. Offsetting these downside risks is the low Canadian dollar, which should provide a boost to the trade and manufacturing sector. Overall, we forecast growth in the Canadian economy will pick-up next year to 2.4 per cent.

Interest Rate Outlook

Canadian and US monetary policy is set to diverge this month as the Fed begins its first tightening cycle in close to a decade while the Bank of Canada is on the sidelines after lowering rates twice in early 2015. In contrast with the US, core inflation in Canada has been at or slightly above the Bank's 2 per cent target for 15 consecutive months, largely due to a falling Canadian dollar pushing up the price of imported goods.

Absent a substantial recovery in global commodity prices, the Canadian economy will more than likely grow near its long-term trend rate over the next two years. That growth rate will keep inflation relatively anchored at or below its 2 per cent target. A baseline scenario of economic growth above 2 per cent, paired with low inflation and steady job growth should keep the Bank of Canada sidelined over the medium run. However, several quarters of steady growth following the oil price shock of late 2014 may convince policymakers that the economy is no longer in need of monetary stimulus injected into the economy via the two rate cuts in early 2015. If so, the Bank may shift back to a tightening bias with a potential rate increase as early as 2017.

Diverging US and Canadian Inflation



Source: Statistics Canada; US Federal Reserve

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