

March 2020

HIGHLIGHTS

- COVID-19 sends interest rates plummeting
- Canadian recession unavoidable
- Bank of Canada cutting rates, but how low?

difficult. What we do know is that the economy is in for at least a quarter of significant loss of economic output as measures to stop the spread of COVID-19, such as social distancing, sheltering in place and mandatory business closures, put a halt to economic and social activity.

Though mortgage rates have started rising as risk increases, we anticipate that measures implemented by the government, the Bank of Canada and other global central banks will help to calm fears over financial system liquidity and stem a longer-term spike in bank funding costs. As the economy recovers, mortgage rates will once again decline.

Of note, the Canadian government has postponed changes to the mortgage stress test. The qualifying rate for insured mortgages was set to change from the 5-year posted mortgage rate to the average 5-year fixed rate plus 200 basis points on April 6, with the B-20 stress test for uninsured mortgages to follow suit. By postponing this change, the government has muted the passthrough from monetary policy to the housing market, particularly since the 5-year posted rate has maintained at 5.19 per cent, despite the average 5-year contract rate falling to near historical lows. The impact of dramatically lower rates will still help those renewing or refinancing mortgages at lower rates by freeing up monthly cash flow due to lower mortgage payments.

Mortgage Rate Forecast

	2020				2021			
Term	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Prime Rate	2.45	2.45	2.45	2.45	2.45	2.45	2.45	2.70
5-Year Qualifying Rate	5.04	5.04	5.04	5.04	5.04	5.19	5.19	5.19
5-Year Average Discounted Rate	2.80	2.59	2.59	2.59	2.59	2.79	2.89	2.89

Source: Bank of Canada; BCREA Economics; Rate Spy

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.

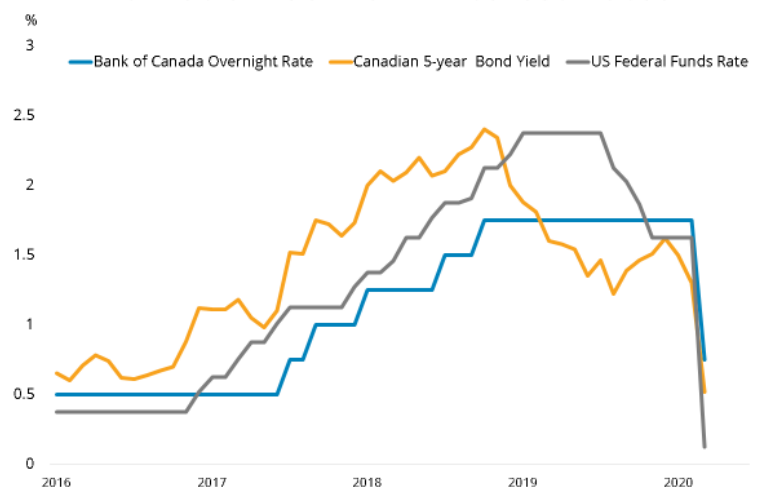
Mortgage Rate Outlook

The growing fears of the potential impact of COVID-19 resulted in a full market meltdown in late February, sending equity markets into free fall and global bond yields plummeting. On top of an already volatile situation, two of the world's largest oil producers, Saudi Arabia and Russia, have engaged in a price war that sent oil prices to levels not seen since the late 1990s.

The panic sent Canadian bond yields down sharply and prompted emergency rate cutting by the Bank of Canada. Variable and 5-year fixed qualifying mortgage rates have followed bond yields lower with the 5-year fixed rate reaching 2.59 per cent, its lowest level since 2016 and very near its lowest level on record.

How prolonged and just how serious this outbreak will be is still unknown, which makes forecasting extremely

Dramatic Decline in Interest Rates



Source: Haver; US Federal Reserve

Economic Outlook

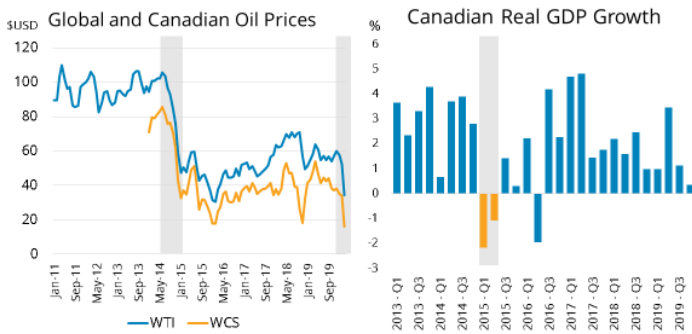
Economic growth in Canada slowed sharply to end 2019, even before supply chain disruptions due to both COVID-19 and interrupted rail service. Those factors alone were expected to slow growth in the first half of the year and now the Canadian economy is also dealing with plummeting oil prices resulting from a price war between Saudi Arabia and Russia.

There is tremendous uncertainty around the economic outlook beyond the first half of 2020 and a viral outbreak is not something that macroeconomists can model. The measures needed to stem the spread of infections are at odds with robust economic activity, which means we will see a sharp decline in retail sales, tourism, and other activity in the coming months.

Adding to that uncertainty is the dramatic drop in oil prices, which in the past has been enough on its own to turn Canadian GDP growth negative.

In model simulations, we estimate the combined impact of COVID-19 and the oil shock will tip the Canadian economy into a recession, including what may be a historic drop in output in the second quarter, followed by a robust recovery as activity returns to normal and the impact of the government's fiscal stimulus kicks in.

Oil Shocks and Canadian Economic Growth

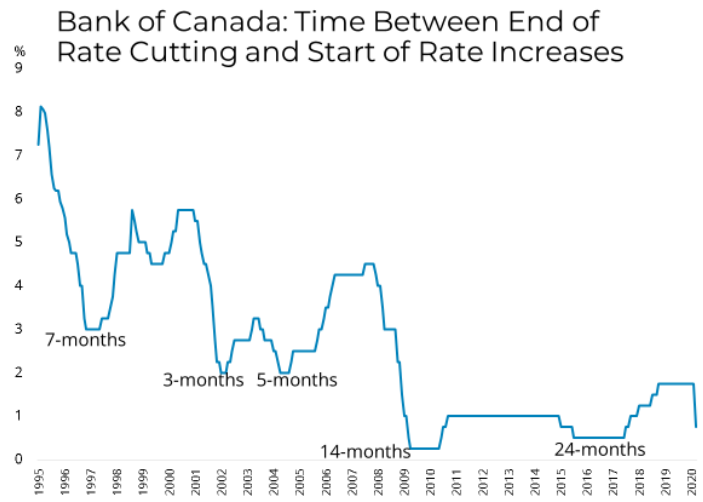


Source: Statistics Canada

Interest Rate Outlook

The Bank of Canada lowered its overnight rate by 100 basis points in the span of a week, an unprecedented action that is likely to be followed by subsequent rate reductions. With the economy facing a sudden stop in economic activity, most other considerations for the Bank are on the back burner and we expect the Bank to bring its overnight policy rate to 0.25 per cent.

In the past, when the Bank has aggressively lowered its policy rate, it has taken up to 24 months before there was a rate increase. If economic activity does post a strong recovery in the second half of 2020, we expect the Bank will maintain its policy rate at 0.25 per cent for the remainder of the year.



Source: Bank of Canada

Send questions and comments about Mortgage Rate Forecast to: Brendon Ogmundson, Chief Economist, bogmundson@bcrea.bc.ca; Kellie Fong, Economist, kfong@bcrea.bc.ca.

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