BRITISH COLUMBIA REAL ESTATE ASSOCIATION

Mortgage Rate Forecast

"RISK OFF"

HIGHLIGHTS

- Mortgage rates have moved off year-to-date lows but may be heading back down
- Inflation worries are overdone
- Euro-Crisis Part 2? Bond yields lower on Greek debt concerns

Mortgage Rate Forecast

	2011				2012			
Term	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
1-Year	3.50	3.65	3.80	4.20	4.60	4.80	5.00	5.25
5-Year	5.34	5.55	5.60	5.80	6.05	6.10	6.25	6.50

Source: BCREA, Bank of Canada

Mortgage Rate Outlook

Mortgage rates in the second quarter evolved in-line with our March forecast, with the five-year fixed rate reaching as high as 5.69 per cent and the one-year rate hitting 3.7 per cent.

However, global financial markets are increasingly being defined by gyration between a "risk-on" (high demand for risky assets) versus "risk-off" (high demand for risk-free assets) paradigm. Given the current replay of last year's Greece driven Euro-crisis and disappointing economic data in the United States, markets are currently in a distinctly "risk-off" mode with capital pouring into risk-free assets and driving bond yields in Canada to year-to-date lows.

This downward pressure on government bond yields prompted a recent reduction in the five-year fixed yield to 5.49 per cent.

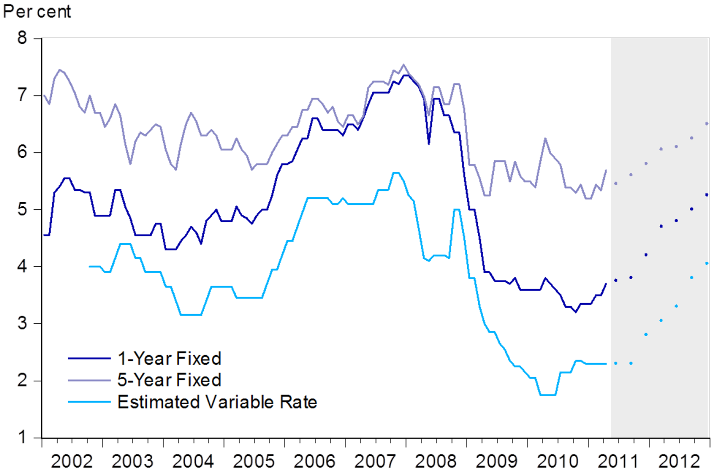
Assuming a reasonable solution to Greece's debt restructuring and an end to the Federal Reserves' bond-buying program ("QE2") in June, interest rates should move gradually higher in the second half of the year. Moderately higher government bond yields will in turn lead to higher mortgage rates, likely in the realm of 4.2 per cent for a one-year and 5.8 per cent for a five-year fixed rate mortgage by the end of the year.

Growth and Inflation Outlook

The Canadian economy enjoyed a strong first quarter with real GDP expanding 3.9 per cent, though this growth was largely driven by an accumulation of private inventories that is unlikely to be sustained.

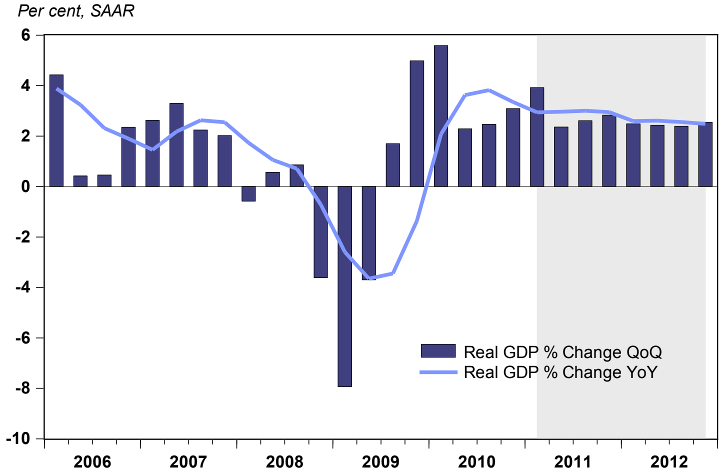
With first quarter growth in consumer spending flat, and a majority Conservative government looking to slash spending, the heavy lifting in the economy will be left to private business investment and the trade sector, the latter of which is being challenged by a high Canadian dollar. We are therefore anticipating that growth will slow substantially beginning in the second quarter to around 2.5 per cent for the remainder of the year. We are forecasting overall economic growth in 2011 to be 2.9 per cent, followed by 2.5 per cent in 2012.

Mortgage Rates Set to Rise Modestly in Second Half



Source: BCREA, Bank of Canada

Economic Growth Will Slow from Q1 Rate



*Latest Data Point: 2011Q1, * Real GDP (chained 2002 dollars) growth at annualized rates*

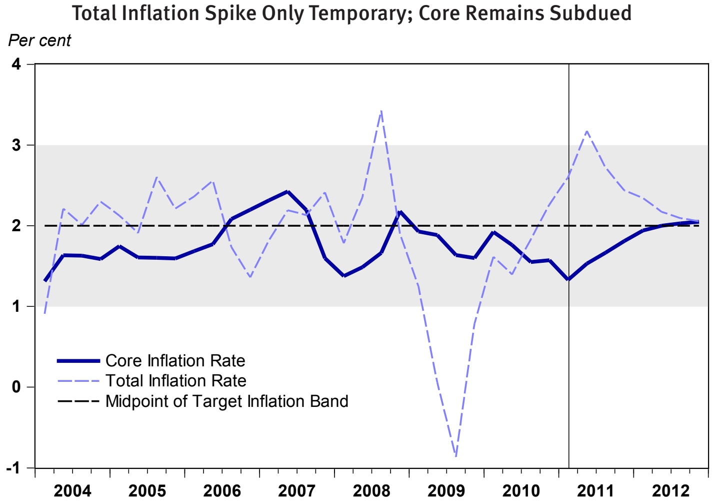
Source: Statistics Canada, BCREA

The recent increase in Canadian inflation to over 3 per cent in consecutive months has some fearing a new trend of higher inflation ahead. While total inflation is certainly higher, this is exactly what we would expect given a nearly 25 per cent increase in energy prices since February.

However, inflation measures the rate of change in prices, not the level, and so as commodity prices stabilize (even if they remain at higher levels) the rate of inflation will decline. Moreover, there is little danger of inflation spiralling higher due to commodity prices unless those higher commodity prices are being passed through to wages or other core prices, and there is currently no evidence of that occurring.

Indeed, April's core inflation registered just 1.6 per cent. We expect that both core and total measures of inflation will converge to the Bank of Canada's 2 per cent target by the end of 2012.

Total Inflation Spike Only Temporary; Core Remains Subdued

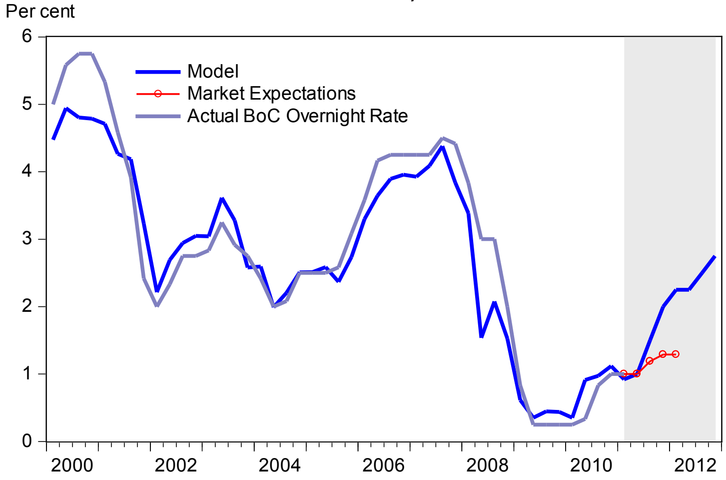


Source: Bank of Canada, Statistics Canada, BCREA Economics

Interest Rate Outlook

Model estimates of the Bank of Canada's overnight rate imply that, given the current outlook for growth and inflation, the overnight rate should increase gradually beginning in the third quarter of 2011, approaching 3 per cent by the end of 2012. However, the latest flare up over European sovereign debt and a stream of weak US economic data may send up a caution flag to the Bank of Canada. Indeed, markets are already pricing in a more cautious Bank of Canada. Derivatives that trade off of the Bank's overnight rate are currently pricing in only 50 basis points of interest rate tightening over the next nine months.

Model vs. Market Expectations



Note: Market Expectations Derived from Overnight Index Swaps
Source: Bank of Canada, Bloomberg, BCREA

However, given the hawkish tone set by the Bank of Canada's May 31 statement following its decision to keep rates at 1 per cent, we anticipate that the Bank will resume raising interest rates earlier, and in greater magnitude than the market currently expects. That said, it is becoming increasingly likely that the current global economic climate will push rate hikes into the fall rather than the summer as we previously expected. Our forecast is for the Bank to bring its overnight rate from 1 per cent to 1.75 per cent by the end of 2011 and to 3 per cent by the end of 2012.

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

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1420 - 701 Georgia Street West, PO Box 10123, Pacific Centre, Vancouver, BC V7Y 1C6 | Phone: 604.683.7702 | Fax: 604.683.8601 | Email: bcrea@bcrea.bc.ca