

Rates and Prices: What to Expect in 2010

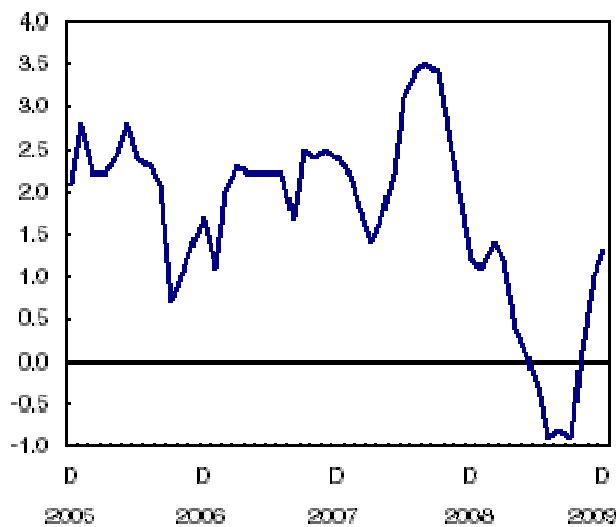
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I am often asked what I think is going to happen to mortgage rates and home prices by my clients. While it is difficult to be able to predict these things more than 6 months out, we can look to some broad indicators to get an idea what we can expect to see during the rest of the year. When making my assessment I take the following things into account:

Inflation: Perhaps the item with the largest direct influence on short-term rates, inflation has been tracking under the target that has been set by the Bank of Canada. The Bank has a 2% Core Inflation target, with an acceptable range of 1%-3%. If inflation is tracking above 2% the Bank generally increases its overnight lending rate in order to slow down inflation, and reduces it when it is under the target. With both Total (see Chart) and Core Inflation tracking well below the 2% target look for short-term rates to be pretty stable this year.

The 12-month change in the Consumer Price Index

12-month % change

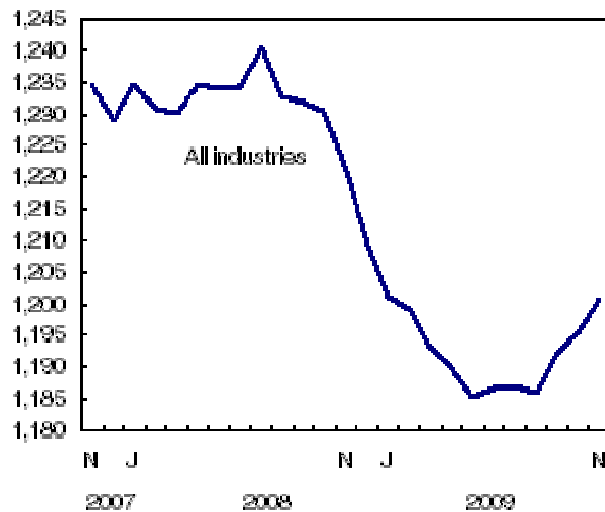


Source: Statistics Canada

Unemployment: Unemployment is that indicator that can best sum up which way the tide is moving. As unemployment stabilizes and then starts to steadily decrease we will likely see more people feeling more confident about their futures. The result is that they will buy bigger ticket items and increase their consumption in general. Unemployment has been hovering around 8.5% for almost a year. (Chart) This means that we will likely see a little less pressure on House Prices in the next 12 months as a result of unemployment improving.

Real gross domestic product continues to increase in November

billions of chained (2002) dollars



Source: Statistics Canada

Government Intervention: Not normally on the radar, government intervention played a large role in 2009's economy and in the housing industry. With the government buying up billions of dollars of Mortgage Backed Securities to keep the flow of mortgage money available they also kept rates low. Now that they have completed their MBS purchases the rates on fixed rate mortgages may rise as there may not be enough demand on the open market at the current rates.

The Government also put pressure on the Bank of Canada to lower its overnight lending rate so that the Prime Rate would drop. This had the impact of making short-term financing for business and consumers very inexpensive. It is likely that these rates will rise a little during 2010 but not enough to make rates unattractive. We can't possibly raise our rates substantially until the USA does the same, as it would make our Loonie too expensive vis-à-vis the US dollar and kill what's left of manufacturing in Canada.

The USA Factor: The US is where the credit crisis started and it is where it is going to have to end before things can change a whole lot in Canada. Benjamin Tal, Senior Economist with CIBC World Markets predicts that the US will see another dip in housing prices before they see the end of 2011. More than 10 million households are in a negative home equity position of worse than 20% in the USA. For those people a strategic default – failing to pay even though they could – is a very real option. Out of the 2 million foreclosures (in the US) during 2009, approximately 25% were strategic. Besides that, there are 15 million Americans unemployed, leading many to believe that there won't be a real turnaround in the US take affect until mid-2011. This means that our economy will have a hard to expanding unless we can find another market to buy our goods and services.

Regional Differences: While there are a number of factors that would lead people to believe that housing prices and mortgages rates will stay stable for another year or so it is important not to forget about local and regional factors. In Guelph, we have been hit by a higher than average unemployment rate due to the amount of layoffs in the manufacturing sector, and oddly enough prices rose in 2009. Some reasons for the rise were that there still seems to be too little supply of housing for the demand. The university and college play a vital role in supporting home prices, as in any university town, and they will continue to do so in the coming year. Guelph was also designated a “Places to Grow City” by the Government of Ontario, and as a result we will continue to see people being encouraged to move here.

So here’s my prediction: Fixed mortgage rates will be 0.75% higher by the end of 2010. Variable Rate Mortgage rates will be 0.25% higher because the Bank of Canada won’t raise its rate much until the US does (and that isn’t likely when there are 15 million Americans out of work). Housing prices will increase 3% this year on average with some markets vastly outperforming others. Guelph will likely see its home prices increase by 3% this year.

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