



Bank of Canada rate increase unlikely until September.



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Government spending, both federally and provincially, will revert from having driven one-third of growth in 2010 to subtracting nearly 1% off growth by 2012. That's a huge swing, and one reason why the Bank of Canada has been so hesitant to raise interest rates. Other reasons include a tepid US economy and strong Canadian dollar.

This led the Bank to hold the line on rates in May, something it will probably do again in July. However, the current lull in

economic growth looks to be a one-time hit from gasoline prices and temporary supply chain disruptions. If this gives way to a re-acceleration, rates will have to rise. Holding them low for too long could fuel what may already be an overshoot in housing prices. This would require a sharper run-up in rates down the road, which would make a smooth house price adjustment less attainable.

Overnight rate likely to be .75% higher by year end.

While government fiscal tightening, slow US growth, high Canadian dollar and a fading commodities rally all cause the Bank of Canada to postpone rate hikes, there are risks in waiting too long—namely, potential inflation which could lead to steeper rate increases in the future. Therefore, we believe the Bank will take the gradual approach and start raising rates in September. By the end of the year, the overnight rate is likely to be .75% higher than it is now.

Locking in versus continuing to float.

There have been repeated delays in Bank of Canada rate increases over the past several months. In this environment, continuing to remain in a variable rate mortgage has its advantages. However, rate increases will eventually come, and the later that happens, the steeper they could be. To help decide which mortgage strategy is right for you, talk to your mortgage broker for a no-cost analysis of your financial situation.

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