

## BENTAL CIBC WORLD MARKETS ECONOMIST:

Reacting to media reports is a sure recipe for over reacting and potentiality making the wrong move. It is very clear that the economy is strong - with the labour market even stronger. The Bank of Canada has been raising rates and indicated that more "may" be needed. From the language of the bank we learn that the bank at this point does not see a need to "aggressively" raise rates, but to do it on a very gradual basis. Also note that the Bank knows that the impact of today's rate hikes will be felt only 8-10 months from now. The lag effect is something that is missed by the popular media.

A reasonable guess is that the Bank will move by another 50 basis points and that the 5 year rate will further rise by 15-25 basis points -all within the coming 3 months or so. (there is a risk of about 25% probability that the Bank will move by 75 basis points). We then might enter a period of no much movement in both short and long term rates as the Bank assesses they situation and sees to what extent previous rate hikes are starting to impact the economy. The Bank will also take a close look at the Fed. And it is widely expected that the fed will not go beyond an additional 50 basis point from now.

Beyond that it is very possible that by mid-late 2007 the market will start factoring in a possible rate cut by the Bank. (this might be more so if the Bank ends up raising rates by 75 basis points). We do not view it as a major downward trend in rates but probably some fine-tuning of rates - of say 25-50 basis points (not unlike what the bank did in the past).

Implications: -- shifting now from Var to Fixed will probably be proven a mistake 5 years from now. While variable rate mortgages will not be as attractive as the used to be last year, they will continue to outperform. The likelihood is that we are getting closer and closer to the end of the tightening cycle.