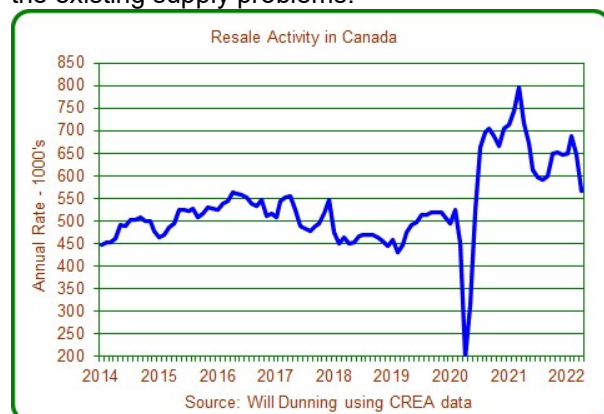


Housing Market Digest

Canada, June 2022

Resale Markets

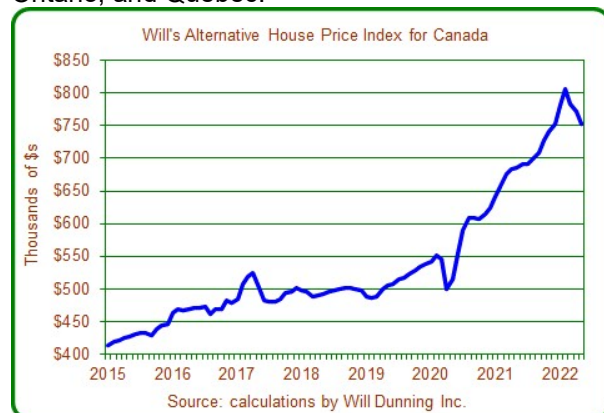
Home sales continue to fall. For May, the annualized sales rate was 511,800. On a population-adjusted basis, this was 7% below the long-term average. We don't have data on sales of new homes. I expect that this is also slowing quite rapidly, which means that next year will bring a reduction in housing starts, and that will worsen the existing supply problems.



As I said in this Twitter thread, the evolving situation in resale markets will make it look like the supply versus demand problem is receding. That will be illusory – while fewer people will be able to buy, the pressures from population growth will continue to build. Meanwhile, this soft phase in the market will make it more difficult to create new supply, adding to future problems:

<https://twitter.com/LooseCannonEcon/status/1531970613719482374>

About pricing – at turning points, indexes can be slow to spot the turns; averages can be distorted by changes in composition. At this time, I'm using an own alternative index (based on a weighted average for the provinces). This data indicates that prices have fallen in the past three months, by a combined 6.7%. The erosion is most visible in BC, Ontario, and Quebec.



Comparing the Costs of Owning and Renting

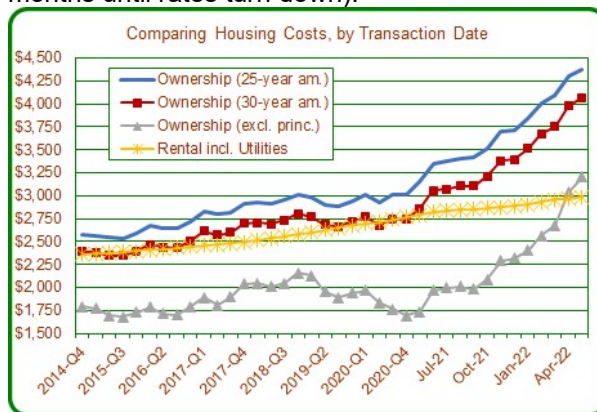
For a while I've been saying that interest rates have overshot. Strictly speaking, I mean that in the context of elevated house prices, interest rates are now dangerously high.

Last summer, I wrote a report that compared the costs of owning and renting across Canada. Here is a quick update. (Royal LePage sponsored that report; this update is unsponsored). The report contained a lot more discussion of the concepts and methods. You can find it in the third paragraph here: <https://www.wdunning.com/recent-reports>

The original report used quarterly data. Given how rapidly things are changing the added data (July to May) is monthly.

The important comparison in this chart is the cost of owning (excluding the "forced saving" that occurs through repayment of mortgage principal) versus the cost of renting equivalent properties. Based on the 278 "cases" in this dataset, the cost of owning was far below the cost of renting until the middle of last year. As of 2021-Q2, the "ownership advantage" was \$859 per month. This amply explains why home buying activity had been so robust. That gap created the possibility for prices to rise rapidly. Supply shortages meant that the potential price growth became an actual fact.

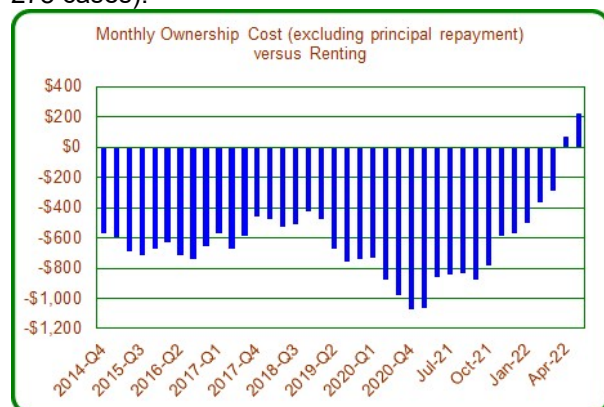
Since then, the ownership advantage has been incrementally reduced. In April, the net cost of owning exceeded rent for the first time in the history of this data, and in May, the average net cost of owning was \$221 higher than the average rent. The stage has been set for a large adjustment, through a combination of price reductions and, hopefully, a substantial downward turn for interest rates (but I expect it will be several months until rates turn down).



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This chart summarizes the data, showing that until very recently, the cost of ownership (excluding principal repayment) was far below the cost of renting equivalent dwellings. As of 2021-Q2, the cost of owning was less than rent for 93% of the “cases” in the dataset (renting cost less than owning for only 20 out of 278 cases). As of this May, the net cost of ownership exceeded renting the same dwelling in 63% of the cases (176 out of 278 cases).



A few years ago, the book *House of Debt* was very popular with the analysts in the federal government who were driving the home-buying suppression policies. It seemed to me that they didn't understand the key message of the book, which I think is... in a modern economy in which there is a large amount of mortgage debt, the most dangerous thing that can happen is for house prices to fall by a substantial amount. By the end of this year, Ottawa will understand this very well.

Interest Rates

“Inflation is always and everywhere a monetary phenomenon” – Milton Friedman.

This is one of the most famous quotations in economics.

I think it needs an asterisk: “ *except when it isn't”.

The cause of inflation this time is that our world is in turmoil – inflation is mostly the result of supply-side problems.

In that case, a monetary solution (attacking the demand side via higher interest rates, and a shift in central bank actions from quantitative easing to quantitative tightening) is a terribly blunt instrument. To solve this inflation with the regular approach of slowing the economy will require a very large economic downturn. Maybe the right

approach is to say – “this is a transitory situation. Admittedly, it has lasted a fairly long time, and we have no idea how much longer it will last. Mostly, what we need to do is to fix supply issues.”

The economy has been a little bit overheated, so a little bit of dampening would be OK, but a major economic downturn would be worse than the disease.

For 13 years, the federal government tried to reduce house price inflation via demand suppression (the Whack-A-Mole game of tightening mortgage regulations), but the problem was mostly on the supply side. Now the Bank of Canada is trying to do the same to overall inflation – applying demand-side measures in an attempt to reduce inflationary pressures that come from the supply side.



Other News

This is sobering (a thread about elite athletes and others who have been sidelined by long Covid): <https://twitter.com/jvipondmd/status/1531676921049690112>

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