Housing Market Digest

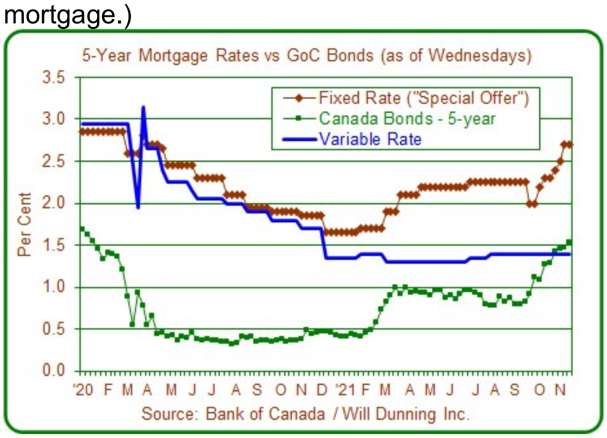
Canada, November 2021

Increased interest rates have created added urgency in the housing market. I don't consider this FOMO – there is a legitimate interest in taking advantage of rates that were pre-approved earlier. That said, buyers need to be careful to not overpay. The spring market will likely be slower.

Interest Rates

Bond yields have increased further, with the 5-year Government of Canada now (as of November 17) above 1.5%. By contrast, during 2015-19, the average yield was 1.32%. Mortgage rates have partly followed. My opinion-estimate of a typical "special offer" rate for 5-year fixed rate mortgages (advertised by major lenders) is now 2.7%. I consider this situation economically neutral.

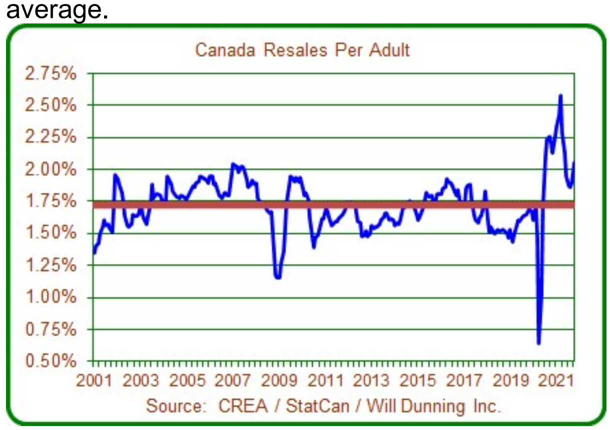
On the other hand, the Bank of Canada's "policy rate" (the overnight rate) is still extremely low, at 0.25%. My opinion-estimate for 5-year variable rates remains at 1.4%. For months, I have believed that the overnight rate should be at least 0.5 point higher. (Disclosure, I have a variable rate mortgage.)



More than a decade ago, I noticed that the economists at the major banks persistently expected bond yields to rise by 1.5-2 points during the coming 1.5-2 years. That expectation was persistently wrong. The expectations of rising rates were interrupted during the Covid period, but once again, sizable increases are expected (averaging about three-quarters of a point from here, during the coming 2 years). We'll see.

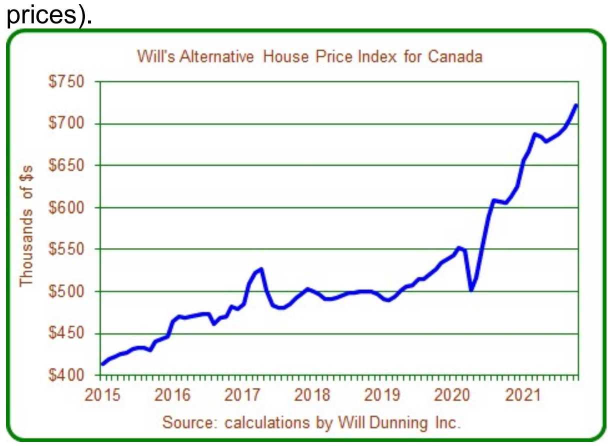
Resale Markets

Sales surged in October, to an annualized rate pf 645,000, as rising rates created urgency to buy, to take advantage of pre-approved rates. On a population-adjusted basis, October sales were 19% above the long-term average (which I estimate as 541,000). Looking at the entire period since the start of 2018, total sales are almost exactly equal to the long-term population-adjusted average.



Resale supply remains inadequate. Flows of new listings into local markets are moderate, with the result that the national sales-to-new-listings ratio was 79% in October, far above my estimate that the balanced market threshold is 52%. New listings sell very quickly. CREA calculates that at the end of the month, the available inventory was equivalent to just 1.9 months of sales, far below the long-term average of 5.0 months.

Prices have increased rapidly during the past two months. As of October, there was a 19% year-over year increase for my alternative price index (a constant-weight average of the provincial average prices).



Employment

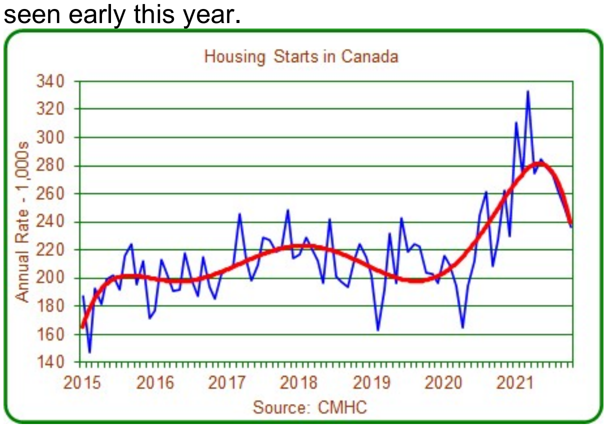
Statistics Canada estimates that employment grew by 32,000 in October, which is a number that we would expect in normal times. Estimated employment is now (slightly) above the February 2020 level.

Measures of economic output indicate that the Canadian economy has not recovered all of the losses, and this is the main reason that the Bank of Canada is keeping its policy rate extremely low. I prefer to look at the economy using data on employment, especially the employment rate (the share of people who have jobs) for the 25-54 "prime working age" (and the prime home buying age). By this measure, we were essentially back to full employment by mid-year, which is partly why I have been arguing that interest rates should be increased (the main part is about asset inflation).

As I commented above, I think that bond yields and fixed mortgage rates are now at neutral levels. Short-term rates remain below neutral. The BoC argues that the neutral level for the overnight rate is currently 1.75% or higher, versus the current 0.25%. Consequently, there are some opinions that there could be substantial rises in short term interest rates next year. Personally, I think the neutral rate might be 1 point higher than the current rate. But, if the BoC has waited too long, then ultimately a larger rise might be necessary.

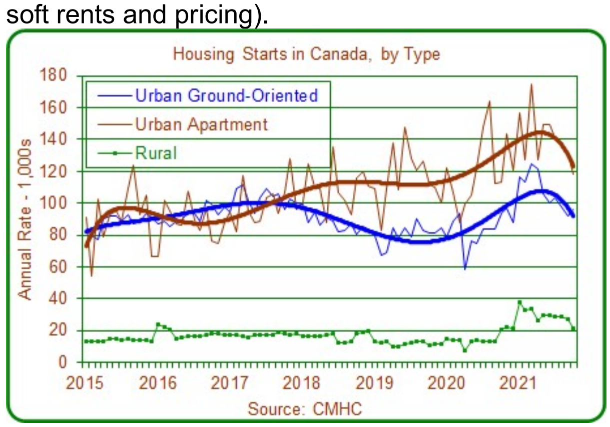
Housing Starts

Housing starts continue to slow. The rate for October (236,600) is still well above the long-term average, but it is substantially lower than the peak seen early this year.



The mix of activity is wrong. We need more family-friendly housing (ground-oriented homes – singles, semis, and towns – plus 2- and 3-bedroom apartments in low-rise and mid-rise forms, with adequate outdoor amenities). Existing shortages are causing intense pressure for family-friendly rentals (resulting in a lot of buying by investors). Further to that, I think that measures to discourage investment buying will be counter-productive: it might make it slightly easier for owner-occupants to buy, but it would correspondingly make conditions worse for tenants.

That said, high volumes of apartment completions in the coming years might result in disappointment for that subset of investors (more vacancies, with soft rents and pricing).



Rental Markets

CMHC conducts its rental market survey in the first half of October. By now, it has completed its compilation of the data. The data and reports might be released in late January. Based on what's happening at the REITs, I'm expecting to see a small reduction in the national vacancy rate (from 3.1% in 2020), and slower rent growth (to as low as 2%, versus 3.7% in 2020). I continue to think that CMHC should be doing this survey quarterly, not just once per year.

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