Housing Market Digest

Canada, March 2022

Long-Covid on My Mind

I've been reading about long-Covid, including this short thread that scans recent research: https://twitter.com/SabiVM/status/1503037242939482112

Our governments should be talking to us, in a lot of detail, about long-Covid.

I also have to wonder if recent policy decisions have given enough consideration to the long-term consequences of Covid.

Magical thinking is not going to end Covid. Provincial premiers making those decisions are committing the biggest mistakes of their entire lives. I despair at the numbers of children (and family members) who will be seriously harmed by those decisions.

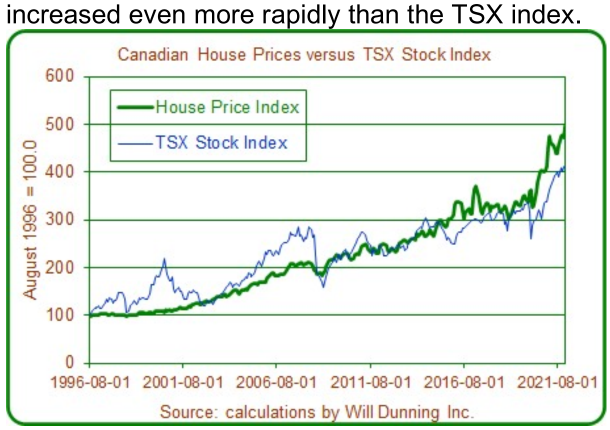
Last week, I bought a big box of N95 masks, because we're going to need them for a long time.

Interest Rates

Since last July, I have been saying that it is time for the BoC to raise its policy rate (the overnight rate) by a half point, for 2 reasons. (1) Measured by the "prime age" (25-54) employment-to-population ratio (see the chart), the Canadian economy had returned to full employment by mid-2021. (2) The extremely low rate has contributed to excessive asset inflation (most notably in housing, but also in financial assets), and that has become a serious risk to the future Canadian economy. That risk continues to escalate. Two weeks ago, the ¼ point rise in the rate was too little, too late. The rate should be immediately increased by at least another half point.

I continue to accept an argument that overall price inflation is (mostly, but not entirely) transitory (due to supply chains). Monetary policy won't have much impact. From that point of view, there isn't an argument to raise the overnight rate. The BoC is not mandated to be concerned about asset price inflation, but during the past year, it should have become increasingly worried about this.

Extremely low short-term rates are contributing to extreme housing price growth, which is being accommodated via excessive amounts of variable rate mortgage borrowing. The longer this goes on, the worse the ultimate damage will be. Repeating a chart I've used previously: house prices and the TSX stock index have tended to move in similar ways. During the past year, both have increased sharply, in large part in response to falling interest rates. Both of these asset prices are now exceptionally high in historic terms, although during the past year, housing values have increased even more rapidly than the TSX index.

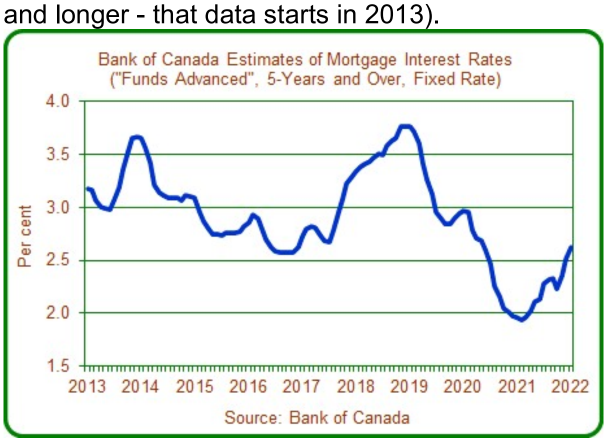


Too-low short-term rates are also forcing mid-term and long-term rates to rise by more than is necessary: the typical rate for five-year fixed-rate mortgages (2.95%) is now above what I consider the neutral range (2.5-2.75%). Variable rates remain too low (my opinion-estimate is now 1.65%).

I fear that some of the recent borrowing might not be unsustainable. I have long believed that most home-buyers are careful and don't make mistakes, but the flip side is that I have also believed that a very small minority of buyers do make mistakes. During the past year, we have entered an environment in which more people will make mistakes. The number of bad purchases (and bad mortgage choices) is most likely escalating and becoming a serious risk to those people and to the broader economy. Again, the longer this goes on, the greater the risks become.

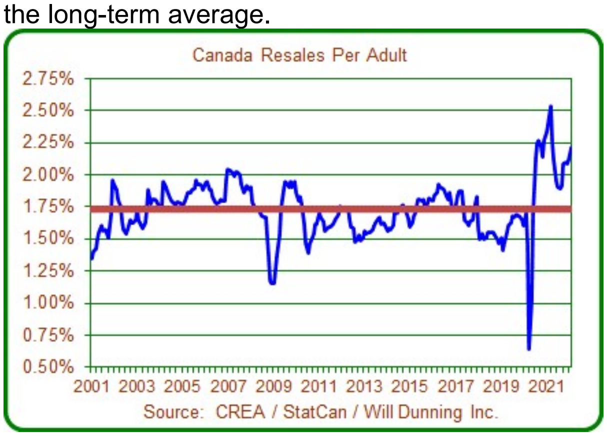
Final point, I still think the ridiculous interest rate (5.25%) used in the stress tests is unduly harming Canadians, as it prevents people from making housing choices that are in their best interests.

So, the overnight rate should be increased by another one-half point and <u>the qualifying rate used in the stress tests should be reduced to 3.76%</u> (which is the highest rate for new mortgages reported by the BoC in the history of its published data for fixed-rate mortgages with terms of 5 years and longer - that data starts in 2013).

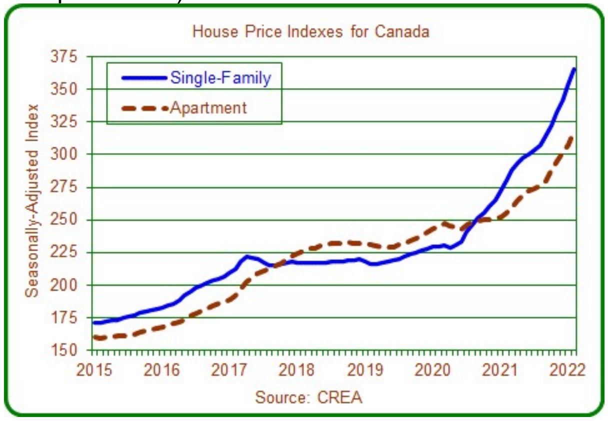


Housing Activity

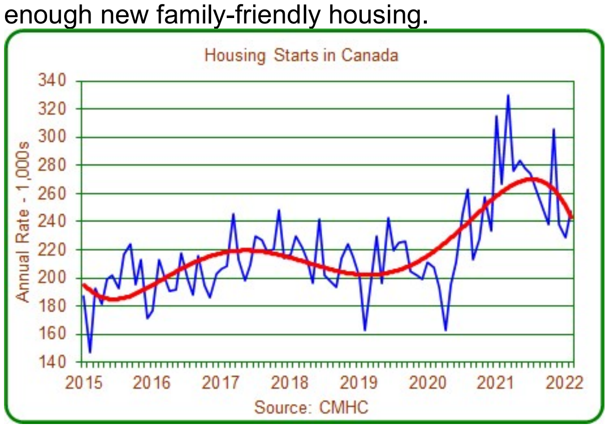
Resale activity picked up in February (as more supply entered local markets). On a population-adjusted basis, February sales were 28% above the long-term average.



CREA's benchmark price index is up by 29% from a year ago (30% for single-family homes and 24% for apartments).



Housing starts are still above average in historic terms, but they remain far lower than is needed (in the area of 300,000) to meet the needs of our growing population and to reduce the shortages that exist across the country. As stated before, the mix is wrong, with too many apartments and not enough new family-friendly housing.



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