Housing Market Digest

Greater Toronto Area, June 2021

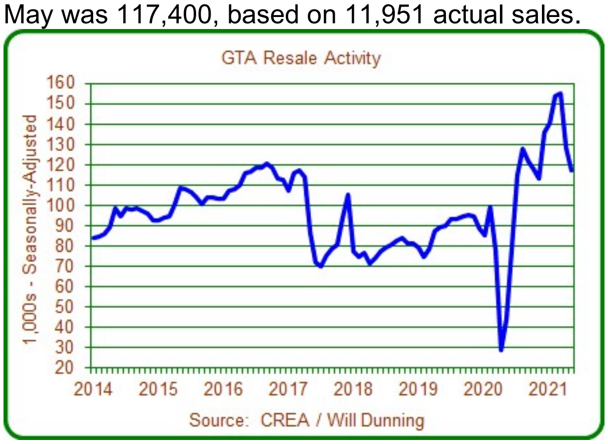
This might sound crazy, but affordability is still a positive factor in the Toronto housing market. The challenges are down payments, the very large amounts of "forced saving" that are built into mortgage payments, and the unreasonable interest rate used in the mortgage stress tests.

Resale Markets

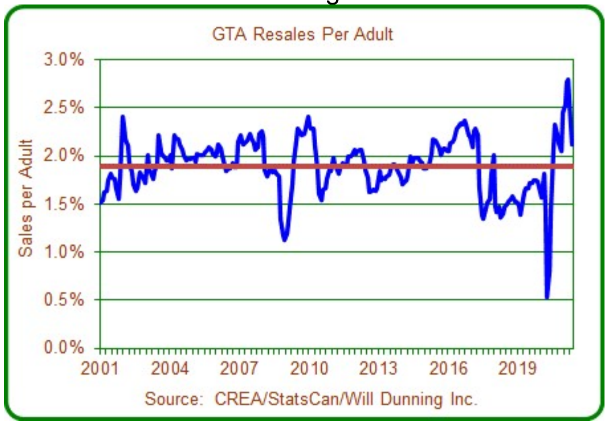
According to the weird way that I calculate housing affordability (the cost of finance is the interest part of the payment and excludes the "forced saving" that results from repayment of principal) affordability was extremely good late last year and early this year for the GTA and across the country. Higher prices and increased interest rates have reduced affordability during the past 3 months. By this measure affordability in May (an index of 103.3) was quite close to the long-term average (104.6). Affordability it is still far better than during 2017 to 2019.

On Twitter, I used a slightly different approach and found that at the end of last year, affordability in the GTA was the best of the past 40 years: https://twitter.com/LooseCannonEcon/status/1401946424418373634

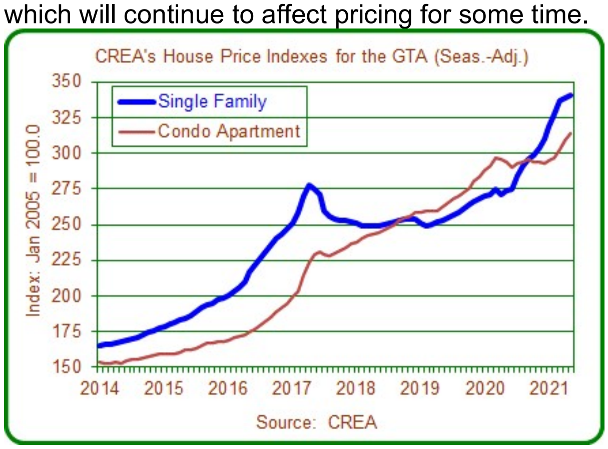
This data goes a long way in explaining the incredible strength seen for home sales seen during the fall and winter, the recent slowing, and the fact that sales during May were still slightly better than average: the annualized sales rate for May was 117,400, based on 11,951 actual sales.



On a population-adjusted basis, the long-term average sales rate is now 105,500. Sales for May were 11% above this average.



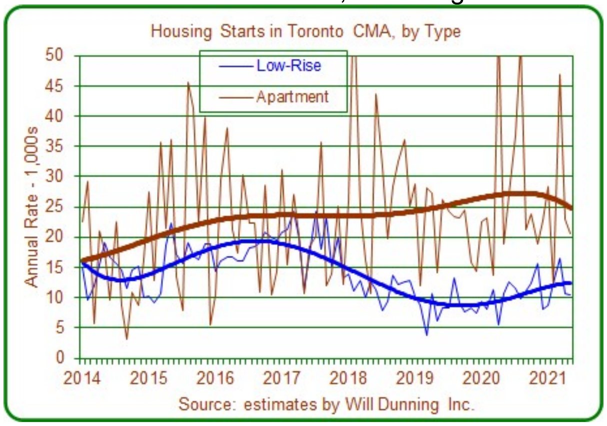
While discussions about prices focus on the still-astronomic year-over-year growth, the recent House Price Index data suggests that growth is decelerating. Based on the affordability calculations, low interest rates have now been more-or-less priced-in within the GTA housing market. On this basis, we might not see much more price growth in the near term. There is a possibility of a partial correction, due to price resistance and the end of the urgency that was seen earlier, when people had to act quickly to take advantage of time-limited pre-approvals at ultra-low interest rates. If this happens it would most likely be a partial retrenchment, not a bloodbath. And, it will still be the case that there is a huge undersupply of housing within the GTA which will continue to affect pricing for some time.



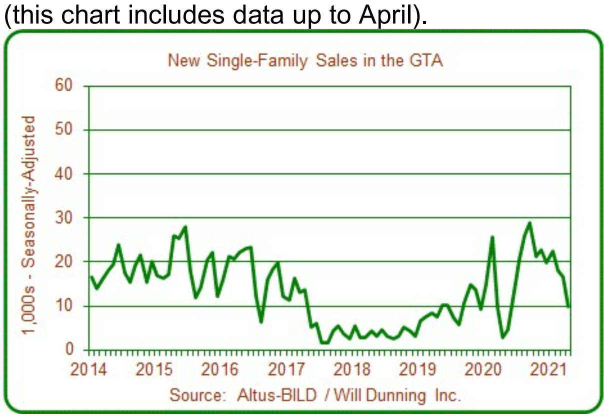
Housing Starts

Housing starts vary from month-to-month. The trend remains below 40,000 (the rate was just

31,000 for May). Apartment starts remain robust. Low-rise starts had been very weak, but the trend has improved slightly. But, at about 12,000, the low-rise trend is still far below what is needed by the growing population and to make in-roads on the huge supply deficit that has accumulated during the past 15-20 years. We need to see a starts rate for low-rises of 30,000 or higher.



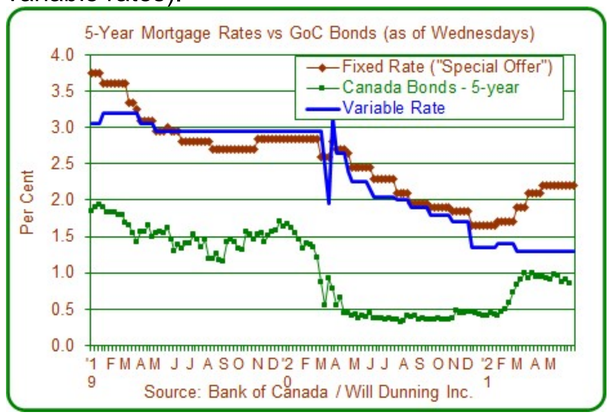
Sales data for new low-rise homes (reported by BILD) had shown encouraging strength during the second half of last year, which has contributed to improved starts. But, recent data hints that sales are slowing (which might be the result of volatility for supplies and costs of construction materials, which makes it difficult for builders to price their offerings). While there is a need for a long period of elevated low-rise construction, it's not clear that the recent improvement for starts will be sustained (this chart includes data up to April).



Interest Rates

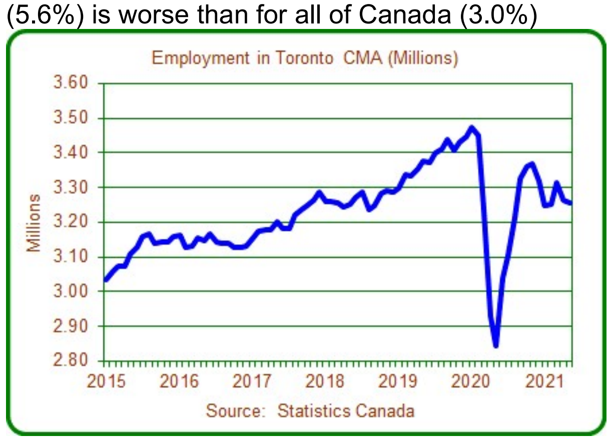
Interest rates have shown little change since March. Yields for 5-year Government of Canada bonds remain just under 1% (currently 0.85%). My opinion-estimate of the typical "special offer" rate for 5-year fixed-rate mortgages (2.2%) is about 1.35 point above the GoC bond yield – this continues to show a competitive lending market. Variable rates remain very low, at a typical 1.3%.

It might be time for the Bank of Canada to let up on the stimulus – a 5-year GoC yield in the area of 1.25% would result in mortgage rates of 2.5-2.75%. The Bank's Policy Rate might be increased by a half point (with a corresponding rise in variable rates).



Employment

Employment remains weakened in the Toronto CMA (as of May, 5.6% lower than in February 2020). The reduction is largely for lower wage jobs, so that the housing effects are for rentals rather than for ownership. The job loss for Toronto (5.6%) is worse than for all of Canada (3.0%)



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