Housing Market Digest

Canada, April 2022

Other News

Many Canadian politicians (and public health officials) are setting policies that we might label a "modified-Swedish approach". Horrible mistakes are being made:
https://twitter.com/RottenInDenmark/status/1507686173002670091

Resale Markets

The sales rate for March (annualized to 659,500) was slower than in February, but was very close to the rates seen during October to January. On a population-adjusted basis, March sales were 20% above the long-term average: as of March, increased interest rates have not materially affected sales.

In times like this, there can be ambiguity about prices. The average selling price in March was lower than in February (by 1.5%), but the year-over-year change remains elevated, at 11%. On the other hand, CREA's house price index tells a different story, rising by 1.0% versus February and by 27% year-over year. Both of these measurements of housing prices have features that create uncertainty: the average price can be distorted by changes in composition (the locations and types of properties sold) whereas price indexes involve some data smoothing, which results in delays in identifying changes.

All things considered, the coming months are likely to be quite different then the recent past, due in large part to a recent severe deterioration of affordability. In the Toronto edition of HMD, I provided more discussion of the mixed set of factors that will influence the near future for housing markets. But, I am not comfortable to produce any specific forecasts for the outlook.

Interest Rates

Inflation is accelerating in Canada: for March, the rate was 6.7%, the highest rate of the past three decades. The Bank of Canada has recently become quite concerned about inflation, and it has now raised its benchmark rate by ¾ of a point since the start of March. There are widespread expectations that there will be a further ½ point rise at the next policy meeting on June 1st.

My opinion-estimate of the typical variable rate has increased by 1.05 point in the past seven weeks, due to the ¾ point rise in base rates, plus mortgage lenders have reduced the discounts (versus prime rates) by 0.3 point. I consider the current rate for variable rate mortgages (2.45%) to be at or above a neutral level. A further rise for the Bank of Canada policy rate would push these rates to above neutral.

In addition, bond yields have increased sharply during the past half year, which has passed through into higher rates for fixed rate mortgages. Six months ago, my opinion-estimate for 5-year fixed rate mortgages was 2.3%; it is now 3.9%: this is far above what I consider a neutral rate (2.5-2.75%) and is the highest rate since mid-2011.

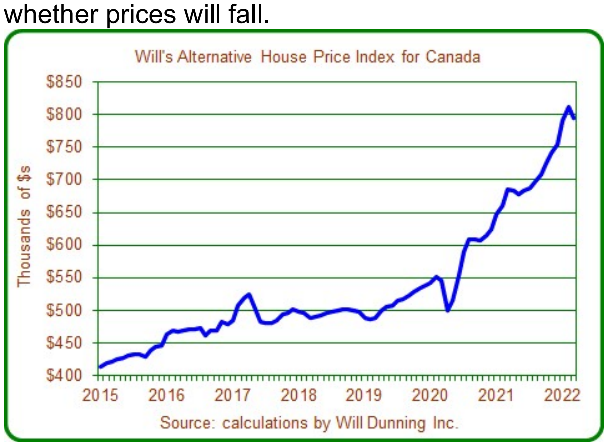
I'm not convinced that this bout of inflation can be cured by interest rates: it is the result of supply and distribution problems caused by the pandemic plus geopolitical turmoil which has contributed to higher costs for oil products and natural gas. There has also been an assist from increased costs for housing, which is in large due to the increased interest rates in combination with higher selling prices.

Higher interest rates might affect the part of inflation that is due to housing costs, but it will do nothing to solve the bigger issues.

The normal way that higher interest rates reduce inflation is that they slow the economy, reducing demand for goods and services. Yes, these higher rates can be expected to slow the economy, but – again – they will not fix the problems that are causing most of the inflation.

The economic slowdown starts in the most interest-sensitive areas of the economy, chiefly housing. We can reasonably expect that housing sales will slow in the coming months, although I don't have an opinion on how substantial that slowing will be.

As of March, the national sales-to-new-listings ratio remains elevated, at 75%, which is still far above the balanced market threshold, which I estimate at 52%. Depending on how sales behave, the ratio will be reduced to some degree in the coming months, and price growth will be affected to some extent. I don't have an opinion on whether prices will fall.



I have been saying since last summer that the BoC needed to immediately raise its policy rate by a half point, which would have blunted the price rises.

I think it would be healthy for prices to reverse the sharp home price rise that has happened since the middle of last year. But, I don't have confidence that policies could be safely engineered to produce exactly that result. We are now in a dangerous situation.

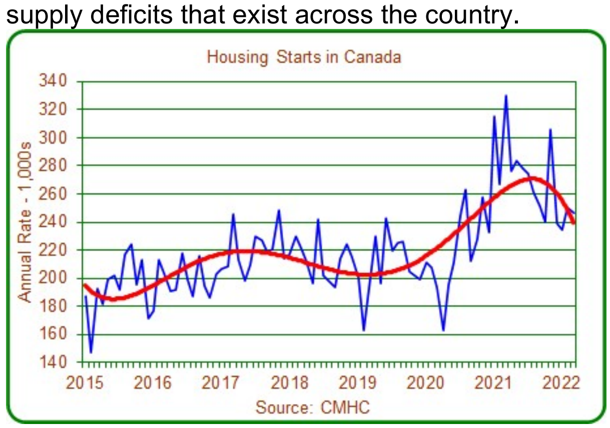
I believe that interest rates (especially for 5-year bonds and fixed rate mortgages) have overshot where they need to be. The Bank of Canada's policy rate is probably where it needs to be, and it should not be raised gain in June. A six month wait-and-see period would be safe. I also expect that a year from now, bond yields and fixed mortgage rates will be lower than they are today.

The Supply Situation

I'm thinking about publishing a report that contains some new estimates of housing supply deficits.

The trend for starts in Canada is now about where it needs to be to meet the incremental needs that result from population growth (about 240,000 per year). But, there is a need for at least 50,000 additional units per year to address the existing supply deficit over a 15 year period, or 75,000 per year for a 10-year period.

To the extent that higher interest rates reduce home sales, the impact won't be just for resales: new (pre-construction) sales would also be reduced, which would result in reduced housing starts later on, and this will ultimately worsen the supply deficits that exist across the country.



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