Housing Market Digest

Canada, February 2024

Sentiment Among Home Builders

About 3 years ago, the Canadian Home Builders Association started a quarterly survey of its membership. While there isn't a long data history for comparisons, it is clear that builders are now highly pessimistic about current conditions and the outlook.
https://www.chba.ca/hmi

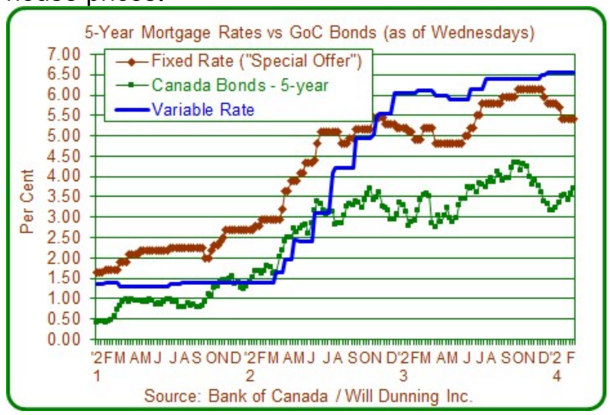
The section of "special questions" is especially important, including responses on levels of concern about the future for their firm as well as the share of respondents who report that they are experiencing difficulties closing past sales.

Note that the data shows the percentages of builders who make responses. So, while 26% say that some buyers have defaulted, there is no indication of how many defaults have occurred. It might be hundreds (which would be important to the people affected, but not a serious issue in the broad view) or it might be thousands (which would be more salient).

One of the consequences of current interest rates might be that they cause the capacity of the home building industry to shrink, which will blunt the future recovery of construction.

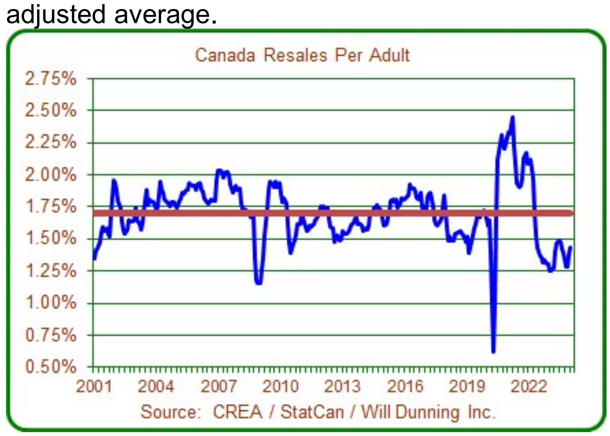
Mortgage Interest Rates

Bond yields have climbed during the past month, but my opinion-estimate of typical mortgage interest rates hasn't moved. Today (Feb 16), there is a close-to-normal spread between the yield for 5-year Government of Canada bonds (about 3.75%) and 5-year fixed rate mortgages (about 5.4% for uninsured loans). Anticipating short-term movements in mortgage rates is a hazardous task. But, I am comfortable to say this: the neutral mortgage rate today (considering prices and incomes) is in the area of 3%. Until actual rates get closer to that we are going to continue to see weak sales for resales and new homes. Three major potential consequences of current rates are: (1) a downturn for housing starts during the coming year, and a worsening of the housing shortages that exist in Canada. (2) There will be a continuing gradual accrual of people who renew mortgages at much higher costs, which will result in a gradual impairment of the broader economy that will last for a long time (since most of the renewals these days are being done with 5-year fixed rate mortgages). (3) There is a risk of a downward interaction involving job losses and house prices.



Resale Market

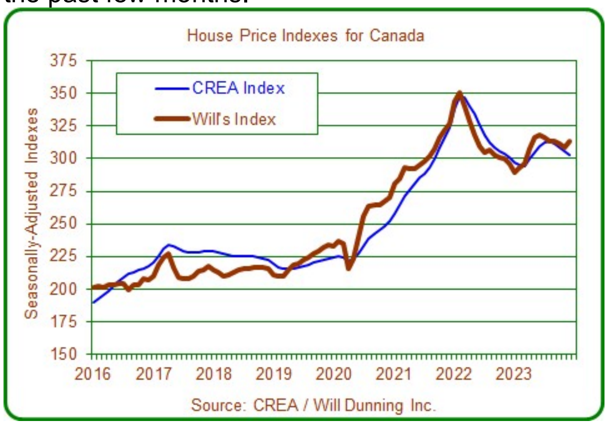
The sales rate rose again in January, to an annualized rate of 472,800. Sales were much stronger than a year ago (401,700), but that was the weakest month in the current cycle. While the sales rate has increased for three consecutive months, it is still weak in historic terms, with the January rate 16% below the long-term population-adjusted average.



I attribute the recent improvement mainly to a drop in the 5-year fixed mortgage rate (compared to late November, the typical special offer rate is down by three-quarters of a point). Non-trivial changes in interest rates, whether up or down, can cause short-lived increases in the sales rate: increased rates cause small numbers of buyers to accelerate their decisions (to take advantage of time-limited rate locks), while rate reductions cause some consumers to jump. In order for sales to improve on a sustained basis, rates will have to be considerably lower (below 4%). During the past two months most (two-thirds) of the rise in sales occurred in Ontario, which is highly interest-rate sensitive, and the where the weather was quite favourable for home-shopping.

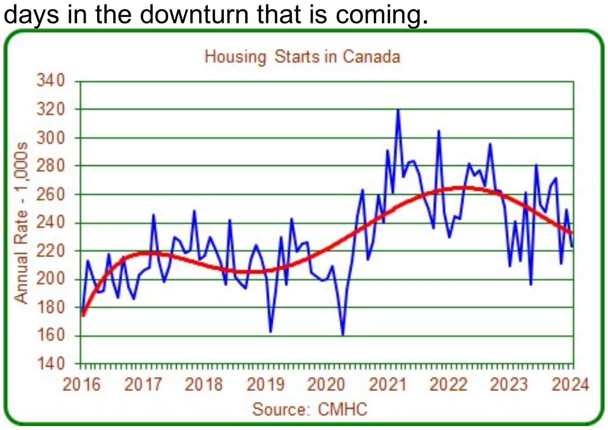
Listings remain constrained (for both flows of new listings into the market and for active listings), and therefore the sales-to-listings ratios remain above the balanced market thresholds: the new listings ratio was 59% in January, versus the balanced market threshold of 52%.

CREA's House Price Index has fallen for five consecutive months, by a total of 5%. I'm not entirely convinced. My alternative index suggests that price changes have not been material during the past few months.

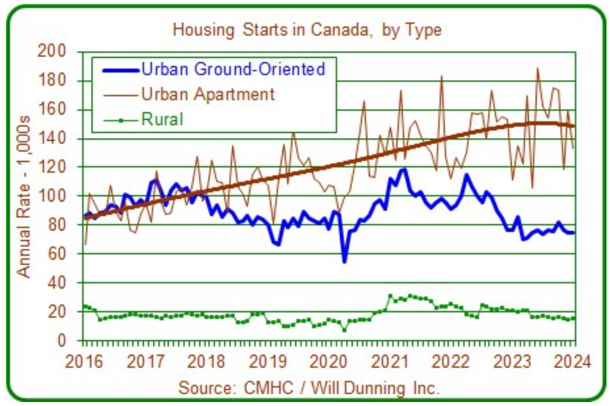


Housing Starts

Starts fell in January (to a rate of 223,600), and the trend continues to slow – but this is still early days in the downturn that is coming.



Low-rise activity remains weak. For apartments, the data is volatile and the trend is uncertain. In all likelihood, that part of the cycle is now passing its peak and the trend will fall gradually this year (although as I said last month, the timing of that is uncertain). I continue to expect that for this year, total housing starts will be below 200,000 units, and I expect that weakness to continue into 2025 (I am much more bearish on the housing outlook than most other economists).



Statistics Canada continues to generate estimates of investment in residential construction that I find highly unbelievable. The most recent datapoint (December) indicates that "real" (inflation-adjusted) activity is 13% lower than in 2019. But, employment in residential construction is now 15% higher than in 2019, suggesting that on-site construction activity remains very strong. Data on numbers of dwellings under construction points to the same conclusion. A downturn may develop during this year, but it hasn't started yet. When it begins the slowing will be quite gradual, lasting into next year.

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