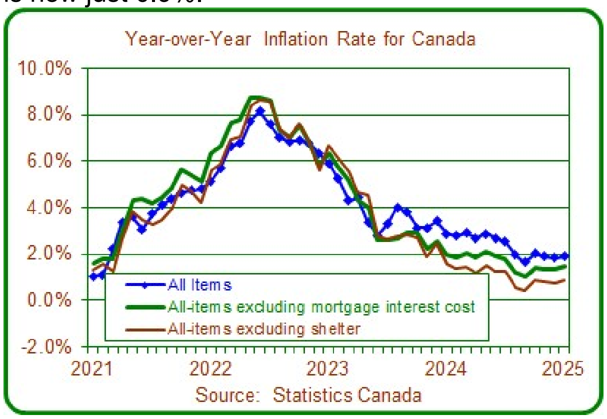
Housing Market Digest

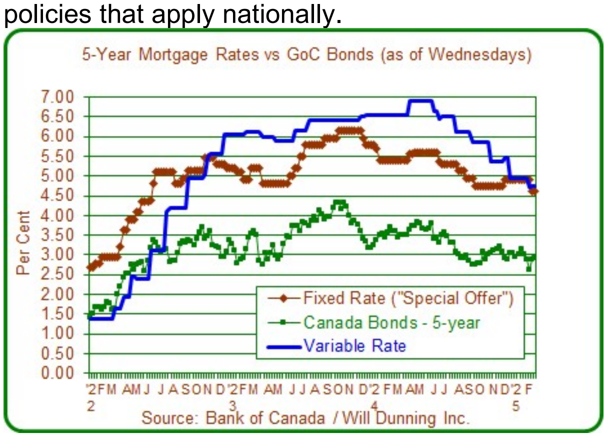
Canada, February 2025

The Impact of Interest Rates on Inflation

Mortgage interest rates continue to raise the reported inflation rate for Canada. Statistics Canada estimates that “mortgage interest costs” have increased by 10.2% during the past year. While this has fallen substantially from the peak (over 30% during the summer of 2023), it is still raising the overall inflation rate: the “all-items: rate is 1.9% as of January, but the rate excluding mortgage costs was 1.5%. Moreover, interest rates are contributing to rapid rent growth: while rents appear to be falling at present, the year-over-year rate estimated by Statistics Canada is still 6.3%. Excluding shelter costs, the inflation rate is now just 0.9%.



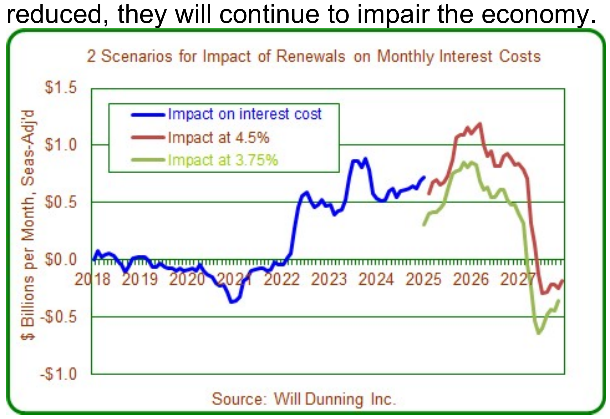
On this basis, I continue to argue that there is room for further substantial reductions in interest rates, including the Bank of Canada’s “policy rate” but also bond yields, which influence mortgage interest rates. To produce healthy housing markets in Ontario and BC, we need mortgage rates in the area of 3%. In lower cost communities, the required rates aren’t as low. This creates a challenge for the Bank of Canada in setting policies that apply nationally.



In producing the estimates for inflation for mortgage costs, Statistics Canada isn’t measuring actual changes in consumers’ costs. The estimates are based on assumptions about how many mortgages are being renewed, and about the changes in costs, and those assumptions might be misleading.

Using Statistics Canada estimates for mortgage “funds advanced” (new mortgages plus renewals), and making some assumptions of my own, I have estimated the volumes of monthly renewals. Starting about the middle of this year, and lasting for about a year and a half, there is going to be a considerably larger volume of renewals.

Renewals will result in an increased inflation rate for mortgage costs, but it’s not clear if Statistics Canada’s estimates will show this. Mortgage renewals have incrementally weighed on finances of Canadians (especially in Ontario and BC), and the rate at which this accrues will become more onerous: this chart shows my (admittedly crude) estimates. While interest rates have been reduced, they will continue to impair the economy.



Resale Markets

Resale activity slowed in December and again in January (to an annualized rate of 493,400). The impacts of prior drops in interest rates have now largely ended. On a population-adjusted basis, sales in January were 16% below the long-term average. The recent softening for sales is quite widespread across the country.

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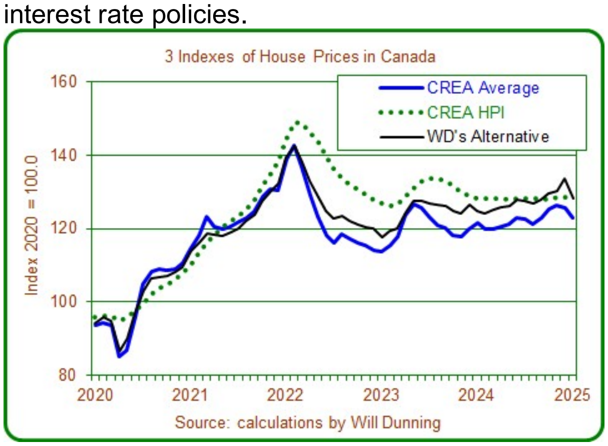
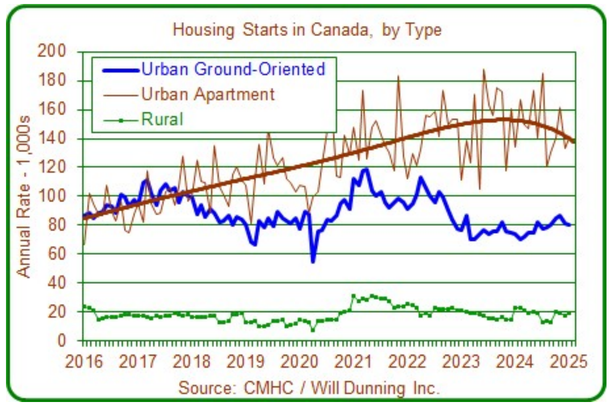
The flow of new listings into local markets increased, causing the sales-to-new-listings ratio to drop to 49.3% in January, which is now slightly below the balanced market threshold of 52%. Over the past 12 months, the average SNLR has been slightly above average, at 54% - we should expect this will result in moderate price growth. The available price indicators for Canada remain ambiguous. Nationally, they certainly don't show any substantive movement in either direction, but that is largely because pricing is flat in Ontario and BC. Elsewhere, the interest rate reductions that happened last summer stimulated some price growth. Once again, this creates a challenge for the Bank of Canada in deciding on national interest rate policies.



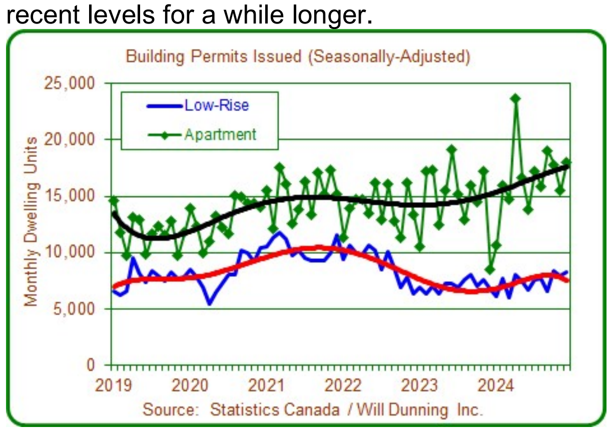
New Construction

Housing starts have been roughly flat during the past year, at rates below the peak seen during 2021 and 2022. But, they are still fairly high in historic terms. Yet, they aren't high enough to meaningfully address the existing shortage (which I have estimated is in the area of 1.25 million dwelling units).

Low-rise starts remain quite weak. For apartments, starts have slowed, but remain at quite high levels. Initially, this is surprising, But, as I discussed in my review of the Toronto rental market, I attribute this to rapid rent growth during the past decade, which may be creating unrealistic expectations about sustainable rent levels. While it is very difficult to make forward-looking statements at this time, I expect that low-rise housing will remain considerably more pressurized than high-rises.



Data on building permits continues to hint that nationally the level of starts will be sustained at recent levels for a while longer.



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