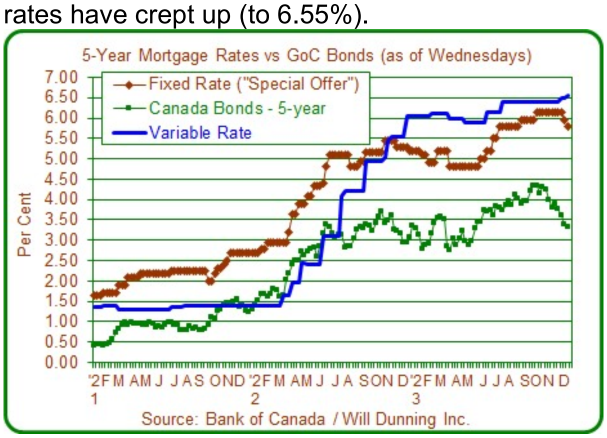
Housing Market Digest

Canada, December 2023

Mortgage Interest Rates

Two years ago, I believed that the neutral mortgage interest rate in Canada was in the area of 2.5% to 2.75%. Considering changes in incomes and home pricing since then, it's probably now about 3%.

My opinion-estimate of the typical rate for 5-year fixed mortgages has recently fallen, to 5.8% (from the prior 6.15%). Lenders have started to respond to the large drop in bond yields that has happened during the past two months. Meanwhile, variable rates have crept up (to 6.55%).

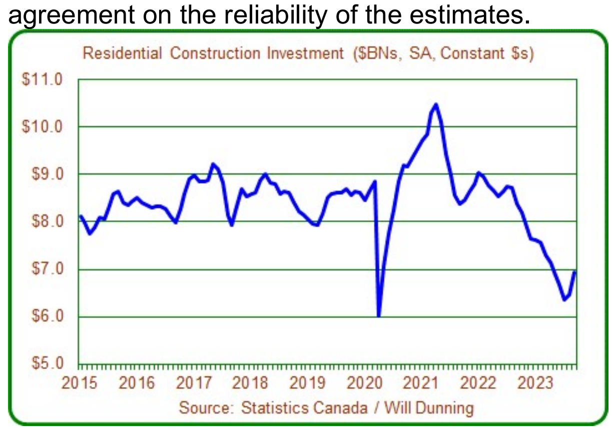


Bond yields are low enough (if they are sustained) to bring 5-year fixed mortgage rates to as low as 5%. That would make the housing market less-awful, and mortgage renewals less-ruinous. But, rates will still be far too high and there is still a risk that Canadians are in for a lot of pain.

Revisiting a multi-part argument that I've been making for a while:

- We aren't yet seeing material economic consequences of current interest rates, only minor softening in some indicators.
- There is one indicator that has shown a very large reduction – work-put-in-place in residential construction, but I don't believe that data (a bit more on that, below).
- Therefore, the reduction in inflation isn't due to interest rates, it is because of the evolving consequences of a number of extraneous events that can't be influenced by interest rates (diseases, war, and natural disasters).
- There was a time when the Bank of Canada said that inflation was transitory (implying that interest rates did not need to be increased). Evolving events show that this earlier stance was the correct one.
- At this time, the major consequence of these interest rates is to cause the inflation rate to be higher than it would otherwise be (due to housing costs).
- I believe that while economic consequences haven't materially begun yet, they will emerge gradually during the coming 1.5-2 years, and in total they will be quite serious.
- The economic outlook for the US is much better, largely due to our larger amount of mortgage debt in Canada and the structure of our debt (renewals will cause a lot of pain).
- To conclude my argument, interest rates in Canada should not have been raised beyond the neutral level, and there is an urgent need to reduce them to neutral as soon as possible.

About the data on residential construction: a few days ago, I had a brief exchange with staff at Statistics Canada. We did not achieve an agreement on the reliability of the estimates.



They didn't say anything that causes me to change my opinion:

- Other data (on construction employment, housing under construction, and starts) show that home builders, construction trades, and renovators are still very busy, working on orders that resulted from the very low interest rates that existed in the past.
- As that work is completed and there is less new business, work-put-in-place will eventually fall from the current peak. I don't have an opinion on when this will begin, but it might be visible in the data (construction employment, housing starts, and under construction) by the second quarter of next year.
- The "residential investment" estimates that are produced might continue to mislead us about what's actually happening.
- I continue to expect that there will be substantial job losses during 2024 and 2025 in construction (and in related industries).
- There will also be job losses due to the impacts of increasing numbers of mortgage renewals.

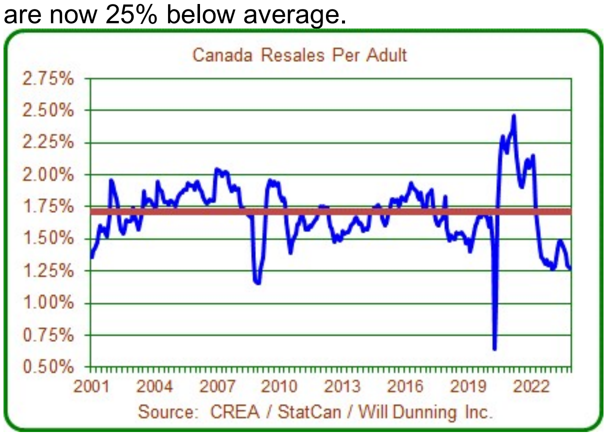
- Therefore, economic consequences of far-above-neutral interest rates are going to gradually emerge during 2024 and 2025.

I see two issues with the estimates produced by Statistics Canada:

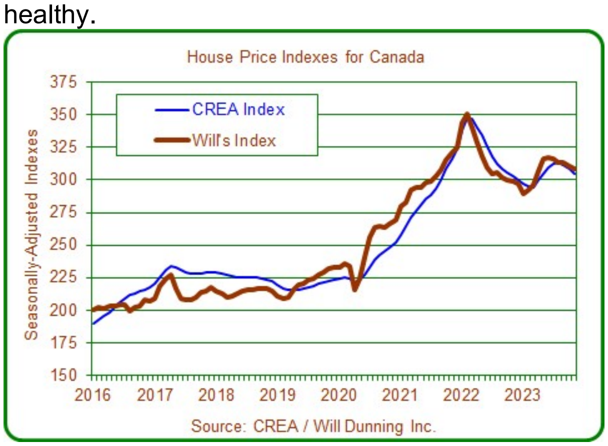
- The main issue is that the estimates of "real" (inflation-adjusted) activity have fallen very sharply, to a level that is currently unbelievable. This is probably due to problems in estimating cost increases.
- A less important issue is that the estimates are too volatile in the very short-term, which is probably caused by problems in distributing construction activity over time.

Resale Market

The sales rate has now fallen for five consecutive months. The annualized rate for November was 420,200. On a population-adjusted basis, sales are now 25% below average.



The sales-to-new-listings ratio (50%) is slightly below the balanced market threshold (52%). Pricing might be softening (a bit). Future price movements will depend a lot on what happens to employment, and at the moment that is still quite healthy.



Housing Starts

While starts were slower in November, the trend remains relatively strong, at 250,000 to 260,000 (although it is far below the level needed to support population growth, and the mix is not what we might hope for). Apartment activity continues to reflect sales and commitments made earlier, whereas low-rise activity is far too low. For next year, I expect total starts below 200,000 units.

Other News

This person is very good at communicating scientific news about Covid: https://twitter.com/lisa_iannattone/status/1733505367466803244

You might be aware of this – a Statistics Canada report on long Covid (in the second paragraph of this document there is a link to a longer version): https://www150.statcan.gc.ca/n1/daily-quotidien/231208/dq231208a-eng.htm?HPA=1

All things considered, this has been a tough year. Let's continue to be good to each other during 2024.

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