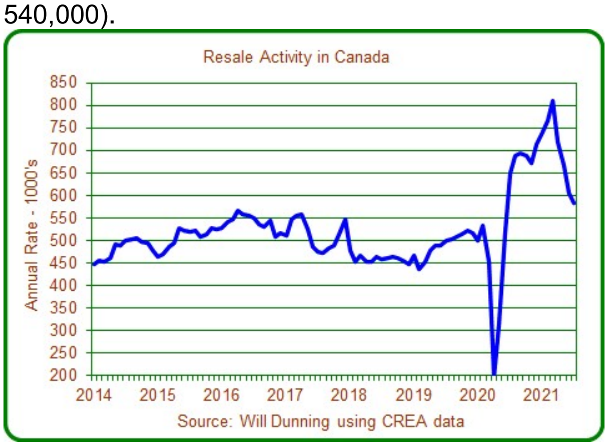
Housing Market Digest

Canada, August 2021

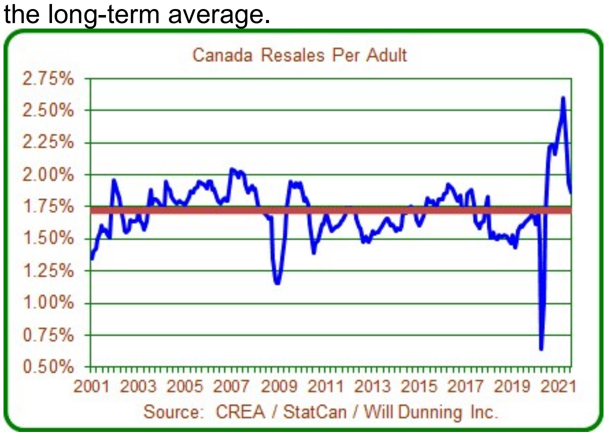
I have just realized that it's incorrect to call the mortgage stress tests "demand suppression" policies: demand suppression would <u>reduce the number of households</u>. That's not what the stress tests do: they affect the <u>allocation of housing demand between tenures</u>, forcing people who are very good candidates for ownership to stay in rentals for longer than they should.
So, when I say that the stress tests need to be less onerous, I'm not saying that demand needs to be increased. I'm saying that <u>the federal government needs to reduce how much it distorts the choice</u> between owning and renting - for the demand (the households) that already exists.
This might seem like semantics, but it matters: the policies aren't fixing the housing market problem, they are just altering the nature of the problem (and harming the long-term interests of hundreds of thousands of Canadians along the way). Plus, the stress tests are "supply suppression" policies: by reducing pre-construction sales of new homes, the stress tests have worsened the supply shortages that exist in most of our major cities. I had more to say about this on Twitter: <u>https://twitter.com/LooseCannonEcon/status/1395810375434752008</u>

Resale Markets

The sales rate has now slowed for four consecutive months. For July, the annualized rate was 584,200. This is still 8% above the long-term population-adjusted average (which I estimate as 540,000).

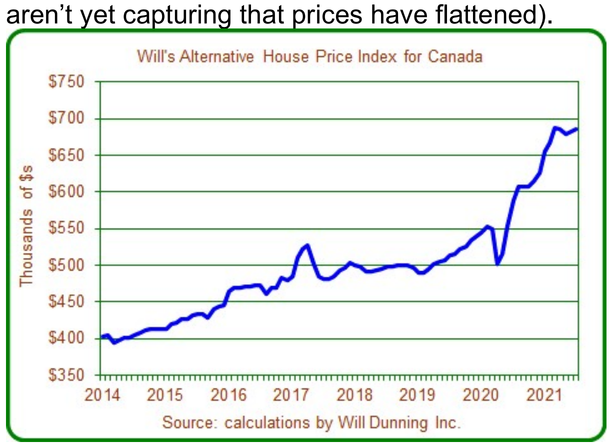


As I have commented previously, the surplus sales that have occurred during the past year have more-or-less offset the shortfalls that occurred during 2018 and 2019 (in the wake of the stress tests). On a population-adjusted basis, total sales since the start of 2018 are almost exactly equal to the long-term average.



The flow of new listings into housing markets has also slowed sharply. In consequence, the sales-to-new-listings ratio ("SNLR") is quite high (74% in July, versus the balanced market threshold of 52%). CREA data also shows that inventories of active listings are extremely low.

The slowdown of sales can, I think, be largely attributed to a combination of price resistance and lack of supply. Therefore, despite the elevated SNLR, prices appear to be flat since March (last month I discussed that available price indexes are lagging behind the changes in price trends, and aren't yet capturing that prices have flattened).



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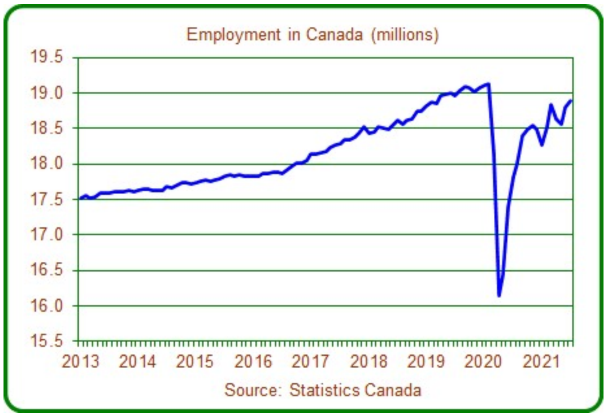
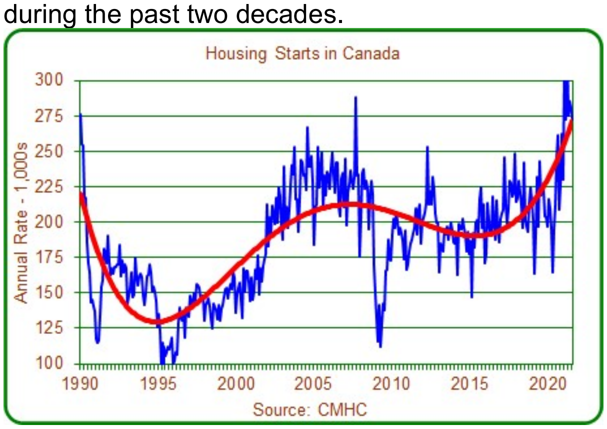
Employment

The employment situation remains in flux, with continued very large month-to-month changes. As of July, the estimated level of employment is 246,000 (1.3%) lower than in February last year. The shortfall is still greatest for young adults (down by 2.5% for those under 25 years old). For the "prime working age" (25 to 54), the shortfall is now 1.0%.

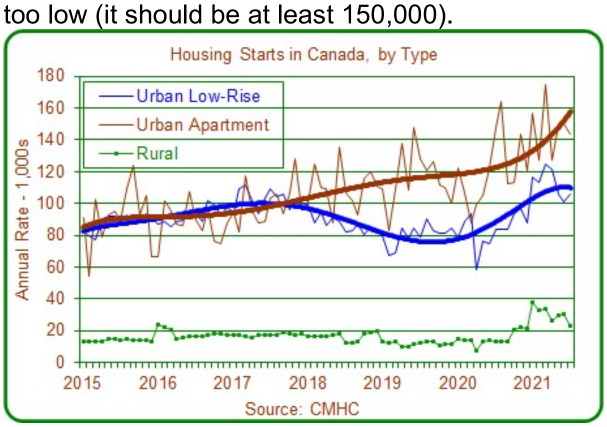


Housing Starts

Construction of new homes has increased very strongly, and is now at the highest level seen in the last three decades. In total terms, this will reduce the supply deficit that has developed during the past two decades.

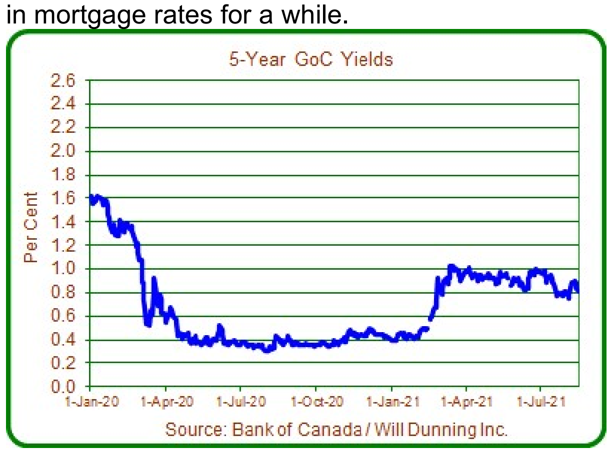


CMHC should change the way it reports the details. It comments on "singles" versus "multiples". But, what matters is the division between "low-rise" versus "apartments". For a few years, I've been recalculating the data on that basis, and it leads to some important conclusions. At this moment, the main point is that we are still under-producing low-rises: while there was an encouraging jump, activity has retreated once again, and urban low-rise construction remains far too low (it should be at least 150,000).



Interest Rates

Bond yields (and mortgage interest rates) have shown only minor variations during the past five months. The yield for 5-year Government of Canada bonds remains in the area of 0.8-0.9%. My opinion-estimate of a typical "special offer" rate for 5-year fixed rate mortgages (advertised by major lenders) is 2.25%. For variable rate mortgages, the rate is now 1.40%. The spread between 5-year bonds and fixed rate mortgages (about 1.4 points) continues to show a competitive market. I don't expect any significant movements in mortgage rates for a while.



That said, for several months, I've argued that the Bank of Canada should allow interest rates to rise slightly. A 1.25% yield for 5-year Government of Canada bonds would result in mortgage rates at 2.5-2.75%. A half point rise in the Bank of Canada Overnight rate would also be appropriate. Interest rates at something approaching a cyclically-normal level would depressurize housing markets in a healthy way. Interest rates could then stay at those levels for a prolonged period. Delaying the increases until the economy has tightened could very well result in larger rises, which would have negative economic consequences down the road.

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