

Housing Market Digest

Canada, June 2023

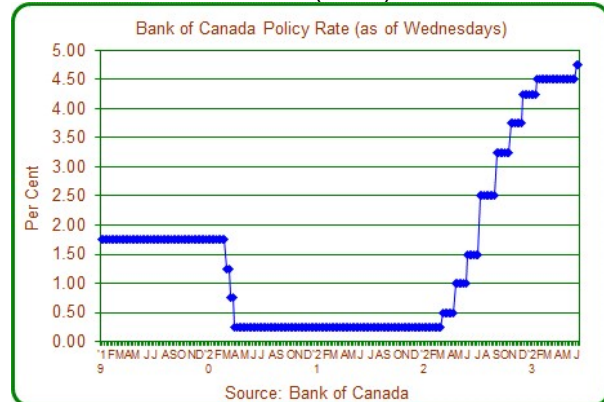
Inflation and Interest Rates

This is an excellent thread. It's long, and well worth the time it takes.

https://twitter.com/Claudia_Sahm/status/1658131328301166593

My take-aways:

- It discusses three drivers of inflation. Only one of them (labour costs) is susceptible to being reduced by interest rates.
- The second driver (supply chain disruptions) cannot be improved by increased interest rates. In fact, in the medium term, by inhibiting investment, interest rates will worsen this issue.
- The third driver (excessive profit-taking) can be affected only very slightly by interest rates.
- Also, I would add a fourth driver that is increasingly emerging as the most important: the effects of interest rates on inflation, directly via mortgage costs and indirectly via pass-through of those costs.
- In other words, I see this thread as supporting my argument that the cost of using interest rates to fix this inflation will be unnecessarily severe.
- The Bank of Canada should reduce its policy rate to the neutral level (2.5%).

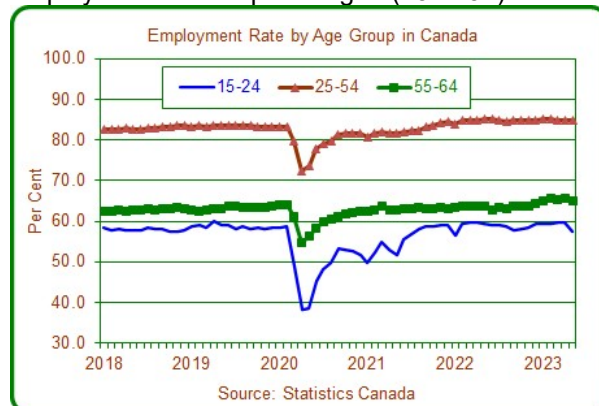


Employment

The data for May is intriguing (and ambiguous). StatsCan estimates that employment fell by 17,300 versus the prior month. Since the estimates assumed another large rise in the adult population (82,500 in just one month!), the estimate of the employment-to-population ratio (the share of the adult population that has jobs) fell.

But, most of the reduction in employment and the emp:pop rate was for people aged 15 to 24 (down by an estimated 77,300, on a seasonally-adjusted

basis). Meanwhile, there was a large (62,200) employment rise for prime aged (25 to 54) adults.



Is this a turning point, the onset of a recession? My guess is probably not, but I am uncertain.

- It might just be statistical noise in the data, the result of using data from a sample survey.
- It's still too soon for higher interest rates to be causing job losses. Notably, the US had another substantial employment rise in May – but, let's keep in mind that Canada is now more interest rate sensitive than the US, so any downturn will occur sooner and more forcefully in Canada.
- The data for May might be correct, and maybe it is true that the student summer employment market is weak this year. If so, this data might be an early indicator of a developing downturn.
- Meanwhile, the estimated emp:pop ratio for the 25-54 age group has varied from month-to-month but it appears to be essentially flat during the past year, and isn't yet showing convincing signs of turning down. The very small reduction that has occurred this year could be the beginning of a downturn, but it might also be random noise in the data.
- And, average weekly hours worked per total adults appears to be more-or-less flat at a healthy level. At this time, I consider this to be the most useful economic indicator.

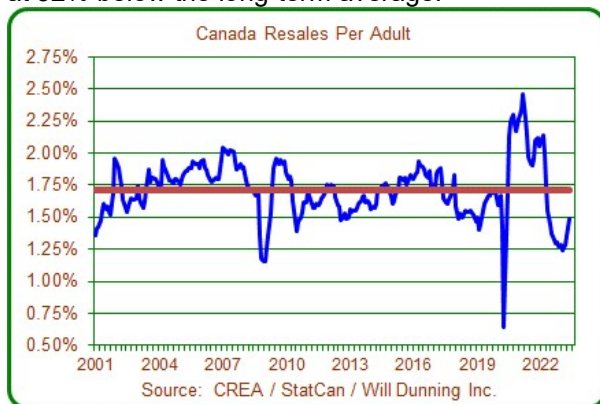


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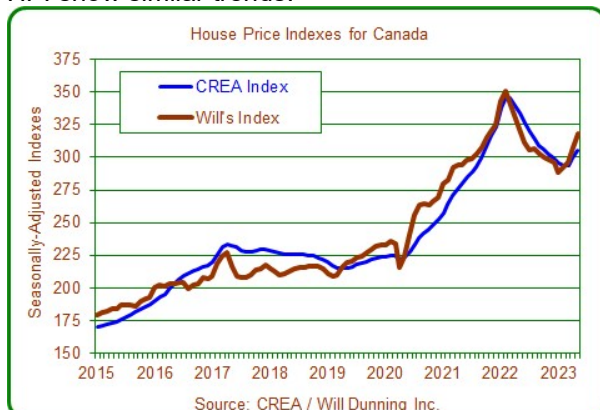
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Resale Market

Sales increased again in May, to an annualized rate of 482,600. On a population-adjusted basis, sales were still weak, at 13% below the long-term average. New listings are even more depressed, at 32% below the long-term average.



The average selling price rose by 2.7% versus April, but is still about 10% below the peak of last February. My alternative price index and CREA's HPI show similar trends.

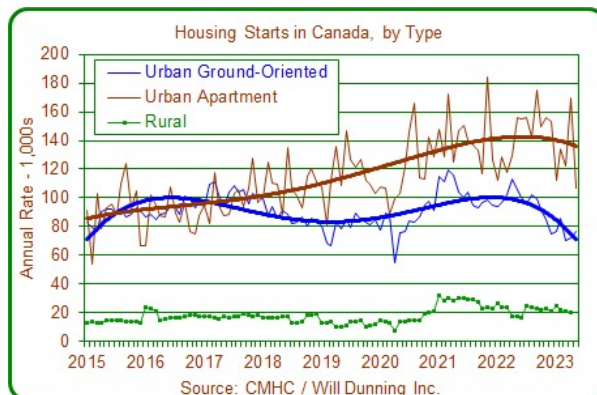


I continue to view these events skeptically, seeing them, for now, as variations in a market that is still damaged by high interest rates, rather than as a return to a bull market.

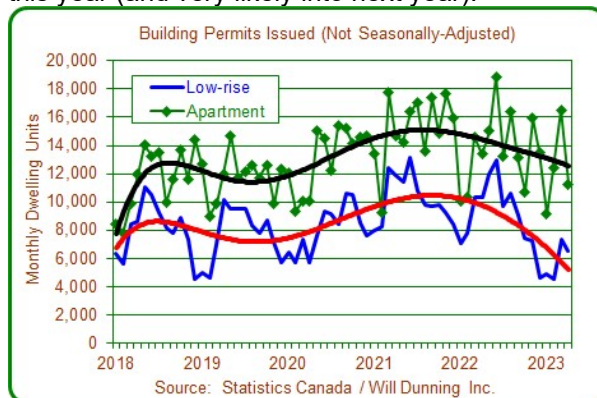
New Construction

Starts dropped in May, to an annualized 202,500, due mainly to a large downward variation for apartments.

Activity is clearly trending downwards. The year-to-date starts rate (226,500) is 13% below the 2022 total (261,849). There has been a very large drop for low-rise (singles, semis, and towns): the year-to-date average is one-third lower than for all of 2022. For apartments, the reduction is smaller, at 13%. Rural starts have fallen by just 3%.



Starts are a lagging indicator. Data on building permits show continuing reductions, which mean that starts will fall further during the remainder of this year (and very likely into next year).



I expect that for all of this year, total starts will be above 200,000, but for next year, they will be below 200,000. Based on population growth, we need more than 300,000 per year. (A year ago, CMHC issued a report that concluded we need about 650,000 per year. I believe they wildly over-estimated the requirements, as I discussed in the July issue of HMD for Canada. I think there was quite useful commentary within that issue, particularly about the impacts of federal policies on housing supply.)

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