Housing Market Digest

Canada, June 2021

In Canada, there is a connection between aggressive immigration targets and overheating of housing markets. I'd like to see the federal government discuss the conflict between those two areas of policy and how to resolve it.

"Creeping Incrementalism"

I first encountered this phrase at grad school. It means that a series of small steps, which individually seem minor, can, in combination, have enormous effects (positive or negative).

The label "creeping incrementalism" can very appropriately be applied to federal mortgage policies over the past decade: the multiple changes that have been made are now an enormous barrier to home buying by many thousands of Canadians, who know that they can afford to buy and believe that buying would be in their best long-term interests, but they are prevented from making housing choices by mortgage regulations that are increasingly divorced from reality.

Several thoughts follow.

Firstly, do some people think that the new policy (raising the stress test interest rate to a minimum of 5.25%) is going to be the last change that suppresses home buying? Well, a decade of experience is not encouraging.

Secondly, and as I've argued in several places, this history of increasingly repressive policies is partly responsible for the mess we're in. One of the effects of the new policy will be to worsen the long-term supply problem (thereby creating future pressures for another increment of repression).

On Twitter, I recently saw an interesting discussion, that many buyers are avoiding the stress tests by going to private lenders. They're paying higher interest rates (3-4%, whereas if they could get a conventional or insured mortgage, the interest rate would be in the area of 2%). It seems to me that forcing these outcomes is adding to risks, to them personally and to the broader economy and the financial system.

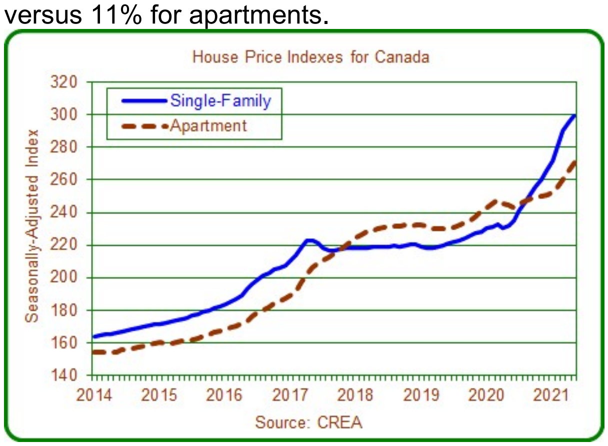
- The higher interest rates mean that they are forced to pay higher percentages of their incomes for their housing.
- I'm wondering if there are risks related to their future mortgage renewals: due to the stress tests, could they end up trapped in the private lending space? When their renewals come up, will funds be available, and at what interest rates?

Resale Markets

Resale activity slowed again in May, to an annualized rate of 673,900. There is less of a sense of urgency in the market (in large part due to the expiry of time-limited guarantees of extremely low interest rates).

On a population-adjusted basis, the long-term (2001 to the present) average is now 541,000. The sales rate in May was 25% above this average. As I commented last month, sales were well below average for some time after the OSFI stress test took effect at the start of 2018. For the entire period since Jan. 2018, total sales are almost exactly equal to the population-adjusted average.

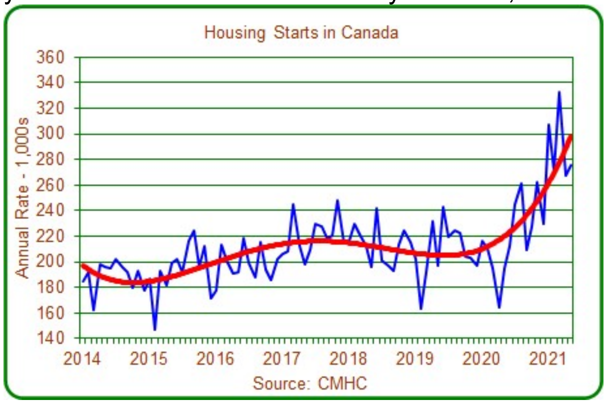
The sales-to-new-listings ratio (75% in May) is far above the balanced threshold of 52%: this is the level at which I would expect prices to rise by 2% per year. Year-over-year price growth remains extraordinary across the country. CREA's House Price Index shows 24% growth during the past year. For single-family homes, the rise is 29%, versus 11% for apartments.



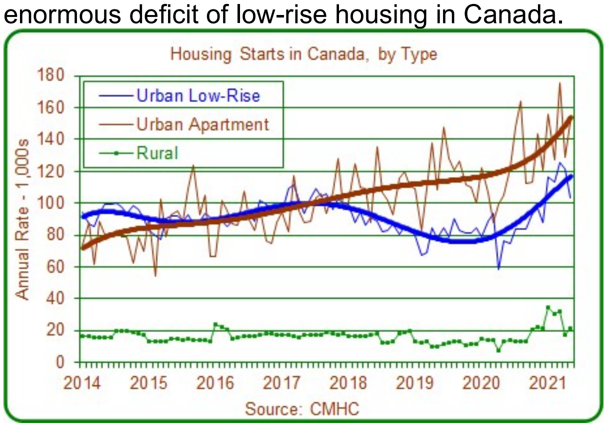
The recent data hints at slower growth. But, to get technical for a moment, the price indexes involve some smoothing, and I suspect that there is a developing slowing of price growth that isn't yet shown in the indexes.

Housing Starts

Starts have increased sharply during the past year. The annualized rate for May was 275,900.



After at least 15 years of under-production, starts of low-rise dwellings are closer to what's needed (at least 130,000 per year). There is still an enormous deficit of low-rise housing in Canada.



Interest Rates

Bond yields have fallen slightly in the past month (the yield for 5-year Government of Canada bonds is currently 0.85%). My opinion-estimate of a typical "special offer" rate for 5-year fixed rate mortgages (advertised by major lenders) is 2.2%. For variable rate mortgages, the rate is 1.3%.

The mortgage stress tests cannot solve the problem of inadequate supply – if anything, they make it worse.

Instead, the Bank of Canada should allow interest rates to normalize. 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.

Other News

In 1990 I wrote a long (173 pages) report – *On the Agenda* – on rental housing in Canada. Some of it has held up reasonably well, including that individual investors rather than large corporations would be the predominant source of new rentals (because decision criteria for individuals makes it easier for them to decide to invest). The key conclusion was that rents will tend to rise faster than incomes, causing on-going growth in the share of renters who have affordability problems. The report can be found at the bottom of the Recent Reports section of wdunning.com, and at the CMHC library, here: https://eppdscrmssa01.blob.core.windows.net/cmhcprodcontainer/sf/project/archive/research/on_the_agenda_the_demographic_challenge_to_rental_housing_policy_in_canada.pdf

There has recently been a larger volume of purpose-built rental construction. This reflects the very high rents that are now attainable and extremely low interest rates.

How to Reach Will Dunning Inc.

Telephone: 416-236-5115
Email: wdunning@sympatico.ca
Web site: www.wdunning.com
Twitter: @LooseCannonEcon

Disclaimer of Liability