Housing and Mortgage Market Review

All Eyes on the Bank of Canada

By Ben Rabidoux

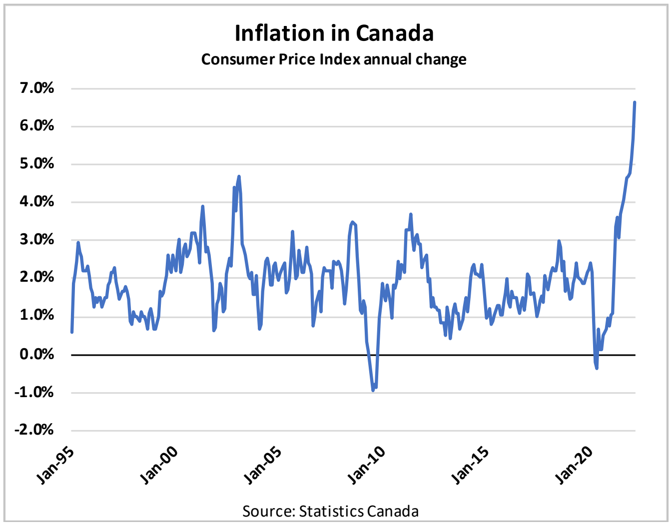
Mortgage Professionals Canada is pleased to share the April issue of our monthly report on key market findings and analysis to help support Canada's mortgage broker channel.

We have partnered with analyst Ben Rabidoux, who each month provides MPC members with a review of the latest housing and economic data and rate trends. He breaks down what the data means and spells out the implications for Canadian consumers—your clients.

We look forward to arming our members with powerful insight into the housing and mortgage markets and hope you enjoy this latest report.

All Eyes on the Bank of Canada

The big story again this month is the relentless rise in Canadian interest rates. The Bank of Canada hiked the overnight interest rate by 50 basis points (bps) this month and they may not be done yet.



Two issues dominate the Bank of Canada's thinking right now and help explain why it has an inclination to hike further: Inflation and inflation expectations.

On the inflation front, headline CPI spiked to 6.7% year-over-year in March...the highest rate since 1991.

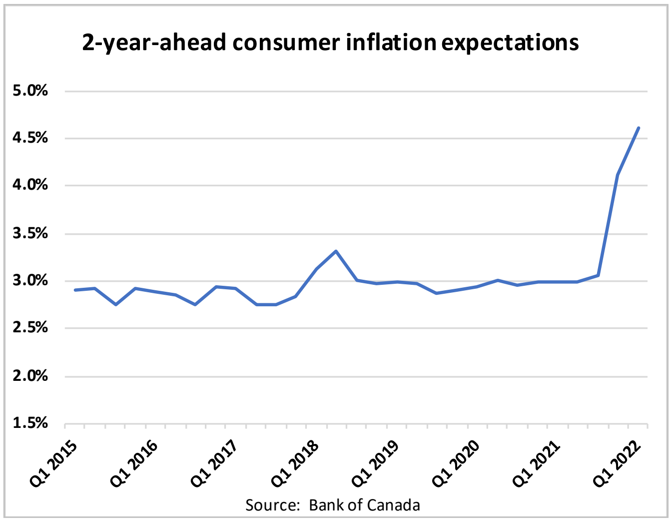
But what's more concerning is that inflation is still accelerating and can no longer be viewed as a transitory issue related primarily to energy and supply chains.

The core consumer price index, which excludes food and energy, has jumped by 1% in the past two months alone. That's the strongest two-month increase since at least 1992. So much for being transitory!

The other concern for the Bank of Canada is that inflation expectations are beginning to rise. The reason this is such a concern is that when people and businesses expect inflation to remain high, they naturally want to go out and spend their money on goods and services today. For example, a business that needs raw materials may be inclined to stock up on those materials before prices rise further.

When that happens across an economy, it means demand runs stronger than it otherwise would, which can push prices higher and in turn create a self-feeding dynamic of higher inflation expectations and higher prices.

In that context, this has to be the most concerning chart for the Bank right now:



What it means: We can expect the Bank of Canada to continue hiking rates until both inflation AND expectations of future inflation come back in line with their 1-3% target. At this point, barring a significant shock to the economy, it looks like another four to six rate hikes by mid-2023 are likely.

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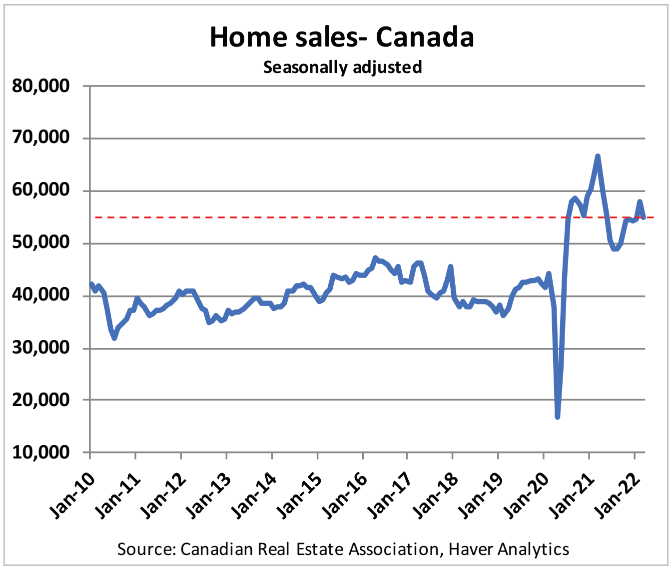
Home sales under pressure as rates take a bite out of affordability

Seasonally adjusted home sales slipped 5.4% month-over-month nationally in March.

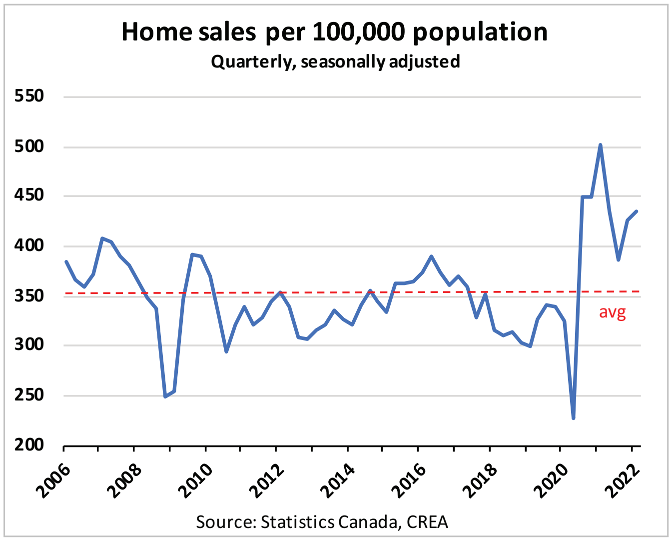


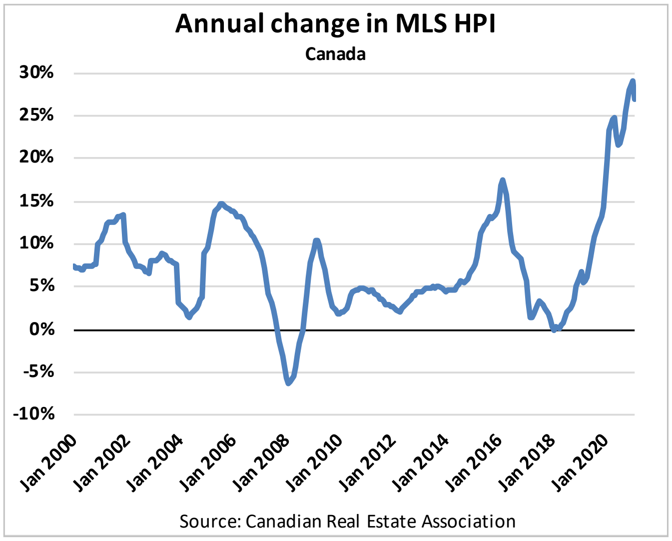
There may be more downside to come. Consider that on a population-adjusted basis, home sales are still nearly 25% above long-term norms. In other words, even with very strong population growth, the level of home sales is well above what demographics would warrant.

What it means: This suggests that some demand has been pulled forward over the past two years. We were already set to see a bit of a slowdown in sales even before the steep run-up in interest rates. Now it looks likely that we're facing a more pronounced slowdown in the coming months.

The good news is that the market is still very tight with just 1.8 months of inventory nationally. Inventory is finally beginning to build again after falling steadily over the past 3 years, but it will take a while to balance the market even with a slowdown in sales.

On the pricing front, the MLS House Price Index rose 26.9% year-over-year in March:





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Zooming in a little, we find that seasonally adjusted house prices rose “just” 1.0% on a monthly basis in March.

What it means: That’s the lowest monthly reading since July 2021, and it suggests that price gains may finally be slowing. That’s welcome news for regulators and policy-makers who have been keen to rein in this runaway market.

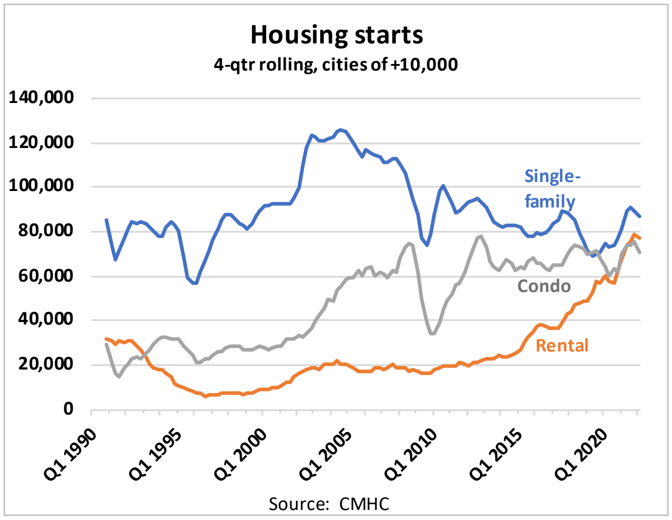
Long-term supply/demand dynamics look good

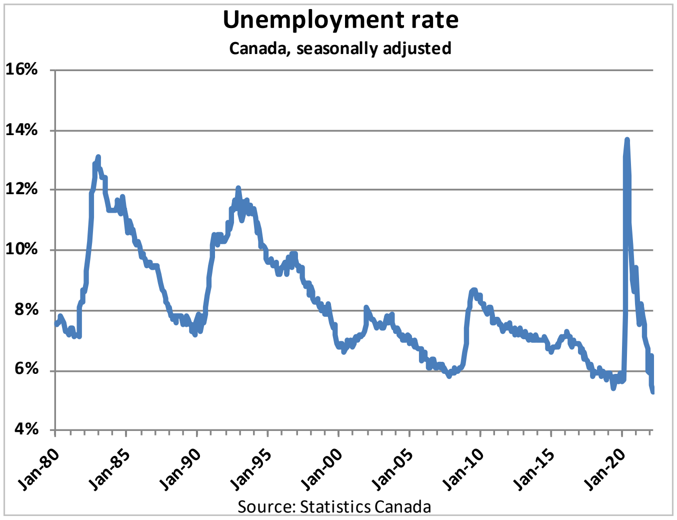
In the near term, housing dynamics will likely be determined by the speed and magnitude of interest rate hikes. But over the longer term, factors like productivity/wage growth, population growth and new supply matter more. On that front, the long-term dynamics still look positive.

For starters, population growth remains robust, driven by immigration that hit the highest level on record last quarter.

On the supply side, housing starts remain relatively high overall, but really that’s a story of rising rental and condo starts while single-family (including row/semis/towns) are still below levels seen in the early 2000s.

Finally, Canada’s economy remains in good shape overall. The unemployment rate just hit the lowest level on record in March at just 5.4%.





Housing and Mortgage Market Review

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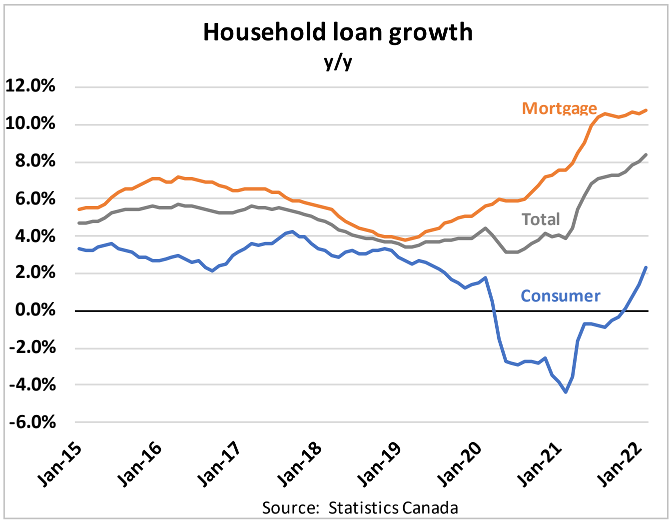
Mortgage market update: Big push into variable rates continues

Households continue to pile on debt, with total credit growth now running at 8.4% year-over-year, the highest since 2009:



Mortgage credit growth is currently running at 14-year highs, which is probably not sitting well with policy-makers……particularly as we are now firmly into a rate-hike cycle. It wouldn't be at all surprising if the Office of the Superintendent of Financial Institutions (OSFI) were to tighten financing conditions on second property purchases via higher minimum down payments, unless credit growth begins to slow soon.

Variable rate mortgages are currently priced nearly 150bps below 5-year fixed, and that is incentivizing borrowers to opt increasingly for floating rate mortgages. These now account for 55% of new originations and nearly 30% of all mortgage debt outstanding, up sharply from 18% in early 2020.

What it means: While this saves consumers on interest costs, it does leave some of them vulnerable to moves in prime lending rates, which are driven by the Bank of Canada overnight rate.

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The key takeaways:

In summary

- Home sales are slowing and will likely slow further as the impacts of rising rates continue to weigh on demand.
- Housing markets in most metros are still firmly in seller's territory, but things are changing. Inventory is finally building again after several years of declines but it will take a while to get back to balance.
- Price gains are moderating and we may see outright declines later this year.
- Long-term fundamentals, particularly population growth, still look solid, particularly as it relates to single-family housing in major metros.
- Mortgage credit growth is still running very hot, and we may yet see regulators tamp down on demand.

**Any forecasts contained in this report are accurate as of the date indicated.*

Ben Rabidoux is the founder of Edge Realty Analytics (www.edgeanalytics.ca), which equips top real estate and mortgage professionals with timely research and insightful marketing infographics to help them stand apart from the competition and stay engaged with their clients and prospects.

He is also the founder and president of North Cove Advisors, a market research firm serving institutional and high net worth clients since 2013 that is consistently ranked top 5 for Canadian economic coverage by Brendan Wood International.

He is a frequent guest and contributor in major media outlets, including Bloomberg, The Wall Street Journal, Reuters, The Globe and Mail, The Toronto Star, Macleans, and many others.