Housing and Mortgage Market Review: **Quarterly Report** - *July 2023*

The Bank of Canada adds to its steepest rate-hike cycle in 30 years

By Ben Rabidoux

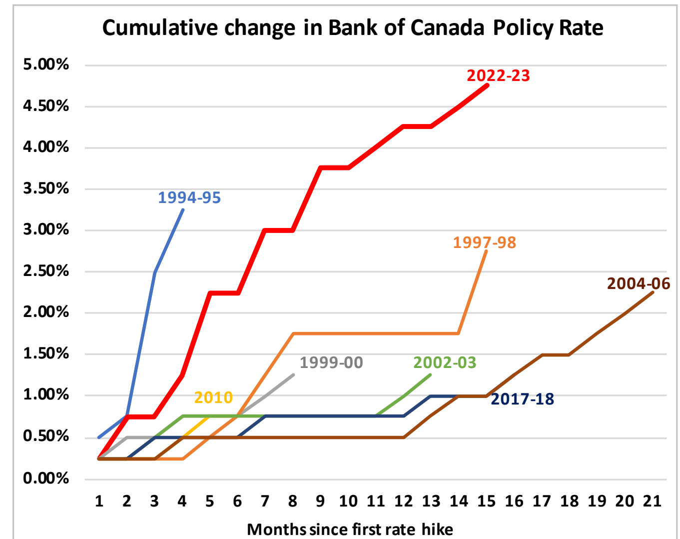
Highlights on what is driving the housing and mortgage market:

- Latest rate hikes from Bank of Canada a very serious challenge to demand over next few months
- Inflation trending in right direction but normalizing much slower than central bank expected and could mean higher rates for longer
- Longer-term view for housing market positive with strong population growth and falling new supply

Housing and Mortgage Market Review

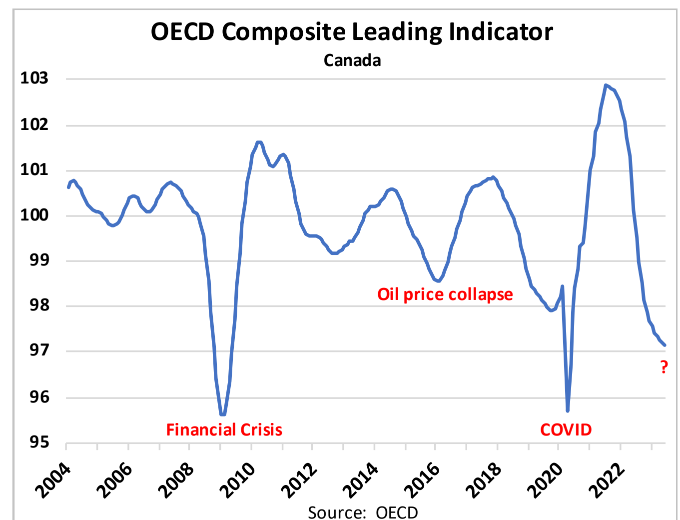
The Bank of Canada adds to its steepest rate-hike cycle in 30 years

The Bank of Canada hiked its policy rate again in July to 5.0%, bringing the cumulative increase off the lows to 4.75 percentage points and adding to what has already become the steepest rate-hike cycle in history.



Stronger than expected economic momentum and persistently high core inflation were cited as the primary reasons for the hike.

One key takeaway is that the Bank now expects inflation to remain above its 2% target rate until the middle of 2025 compared to previous projections of late 2024. The implicit messaging is that higher rates may be necessary for a longer period of time to bring inflation back to target. Markets are taking this to mean no rate cuts until the second half of 2024 if those projections play out.



Of course, that assumes that the economy can achieve a soft landing and avoid a recession over the next 18 months. It's certainly possible, but leading indicators of economic activity continue to deteriorate and are now at levels that historically have signaled an economic downturn on the horizon. And if these indicators prove correct, we will likely see inflationary pressures subside much quicker than expected, which would give the Bank leeway to ease back on rates, likely in early 2024.

As to what's driving these persistent cost pressures, the Bank flagged, among other things, strong population growth and government spending, both of which are directly controlled by the federal government.

It's quite rare for the Bank of Canada to comment on government policy, even implicitly, since it has a mandate to be politically neutral. The central bank and federal government are pulling in opposite directions when it comes to the inflation fight.

The federal government's continued deficit spending into a very strong economy is helping to keep demand running at elevated levels, counteracting some of the tightening policy from the Bank of Canada.

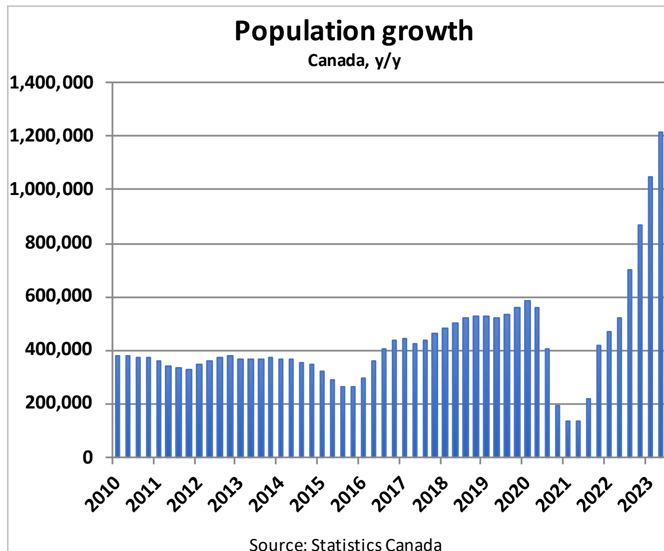
Housing and Mortgage Market Review

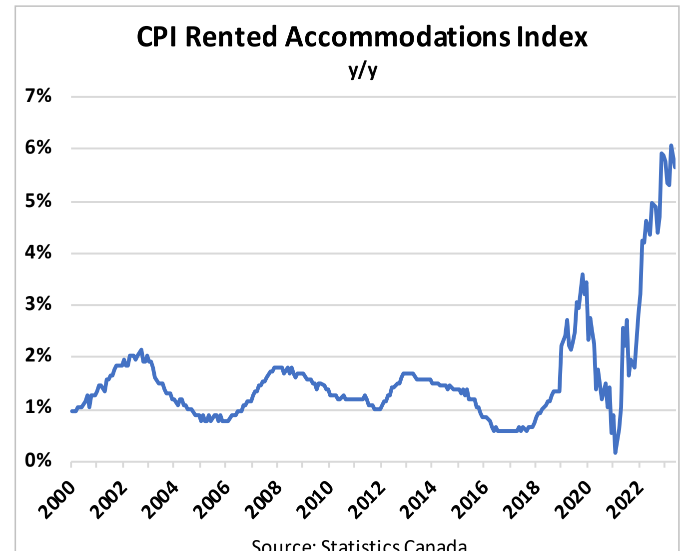
MORTGAGE PROFESSIONALS CANADA

The Bank of Canada adds to its steepest rate-hike cycle in 30 years

Growing population

On the population front, we learned this month that Canada grew by a stunning 1.2 million people in the past year, a 3.1% growth rate that is the highest since the 1950s and is currently running six times the rate in the United States.



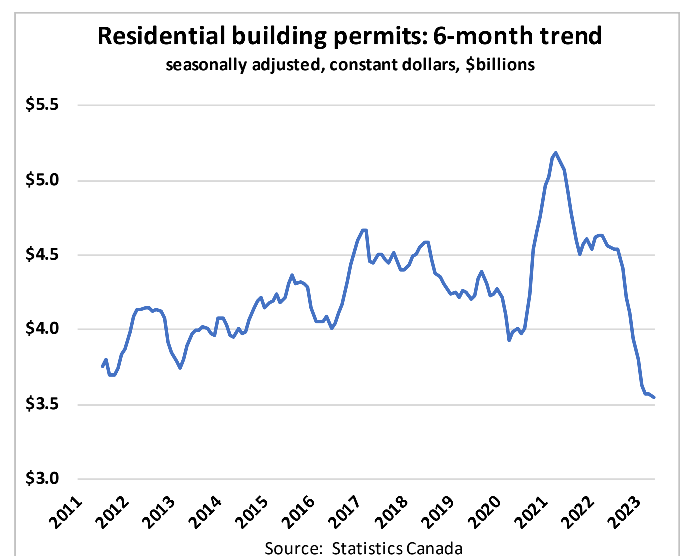


Granted some of these new workers are helping to keep wage pressures lower than they otherwise might be (which means lower inflationary pressures all else equal), but there's more to it. Of those 1.2 million people, over 700,000 were non-permanent residents (temporary workers, international students and asylum seekers). This cohort is made up almost entirely of renters, and it should be no surprise that when we add that many renters in one year, the vacancy rate would hit 20-year lows and rent growth would hit the highest level since the early 1980s. That matters a lot when rents account for 7% of the CPI basket and with that index now running at three times the target rate.

The bottom line is that borrowers are now very much caught in the middle in this tug of war, and it looks like that may remain the case until well into 2024 if nothing changes.

Higher rates are also hurting construction activity. Housing starts fell by 23% in May, the largest decline since the Financial Crisis in 2008. They may continue to fall based on trends in building permits, which tend to lead starts by roughly six months. Here we see that the inflation-adjusted value of new permits has collapsed to the lowest level since at least 2011.

In spite of the challenges from higher rates, it's hard to miss the positive long-term setup for the housing market given strong population growth and falling new supply.



Housing and Mortgage Market Review

The Bank of Canada adds to its steepest rate-hike cycle in 30 years

Mortgage rates hit new highs

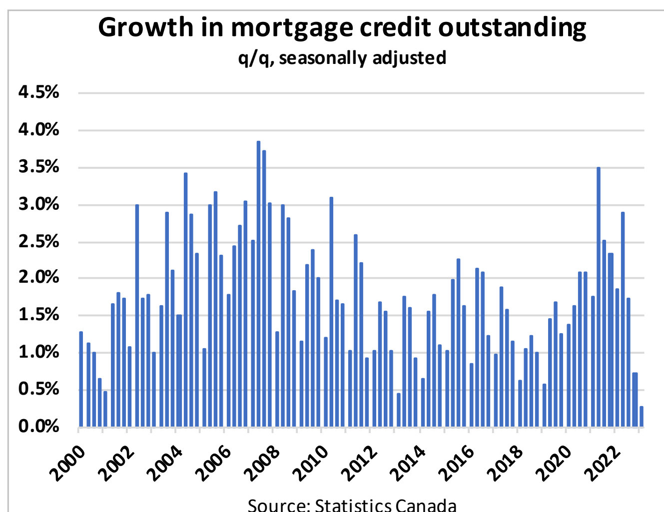
Bond yields followed the Bank of Canada lead and surged over the past month, with the bellwether 5-year yield briefly breaking through 4% for the first time since 2007 earlier this month before pulling back slightly last week.

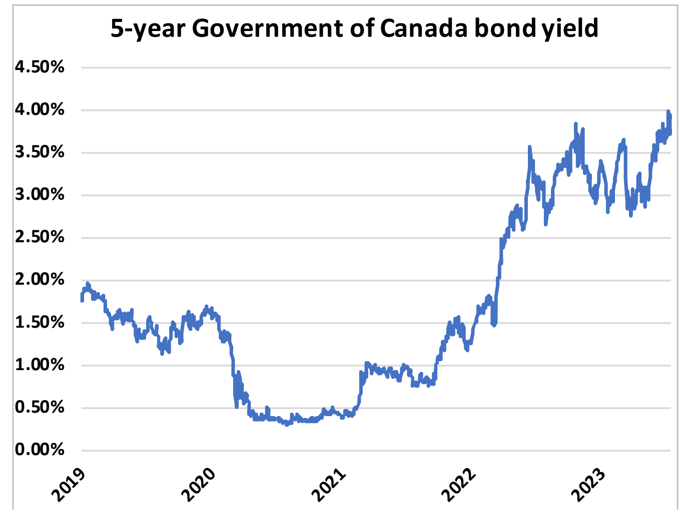
Mortgage rates followed suit, with 5-year fixed rates breaking above the October 2022 highs.

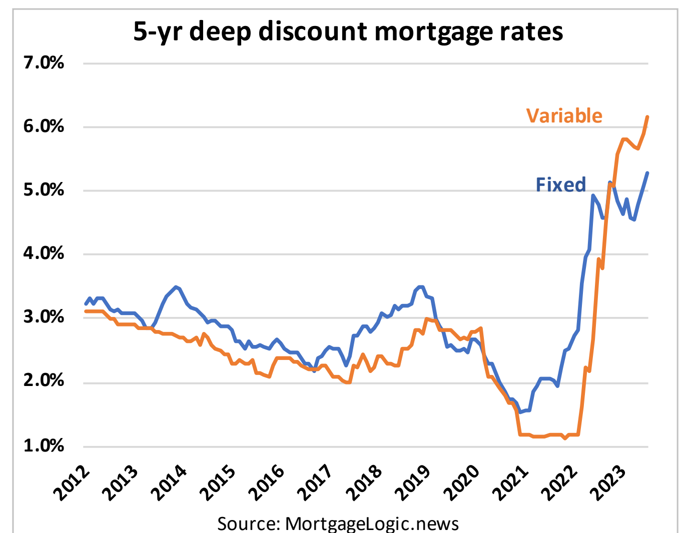
This represents a serious challenge to affordability in the near term. Based on these rates, the monthly payment needed to buy a typical home in Canada has jumped by nearly $400, or 12%, in the past four months alone.

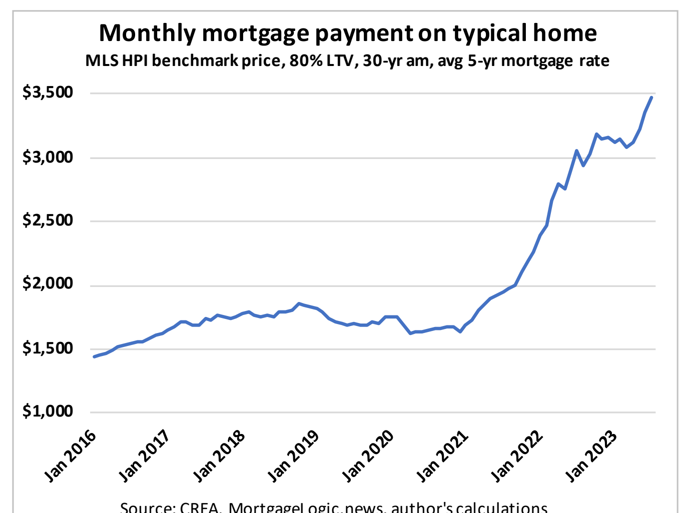
This has weighed on mortgage demand, with outstanding debt posting the weakest quarterly growth rate since 1999 last quarter.

This is a challenging time for the mortgage industry, to be sure, but a longer-term view is helpful here. Strong population growth and a tight rental market ensure that demand for housing will persist in spite of higher rates. What's needed now is some clarity and stability from the Bank of Canada and a bit of time to allow income growth to chip away at the affordability issue.









Housing and Mortgage Market Review

MORTGAGE PROFESSIONALS CANADA

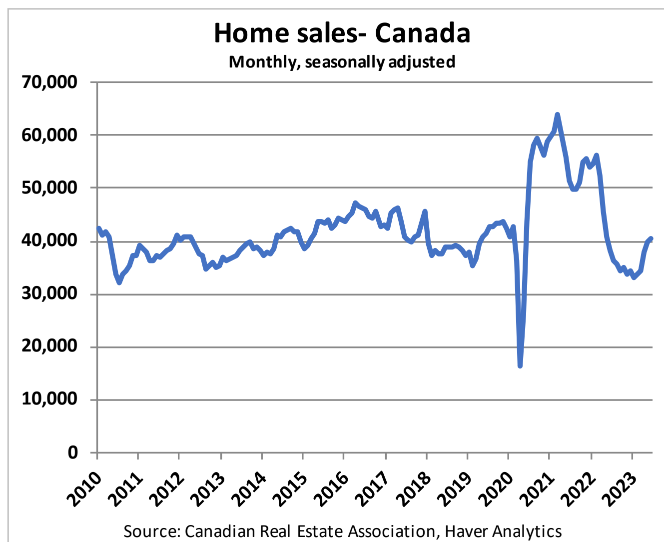
The Bank of Canada adds to its steepest rate-hike cycle in 30 years

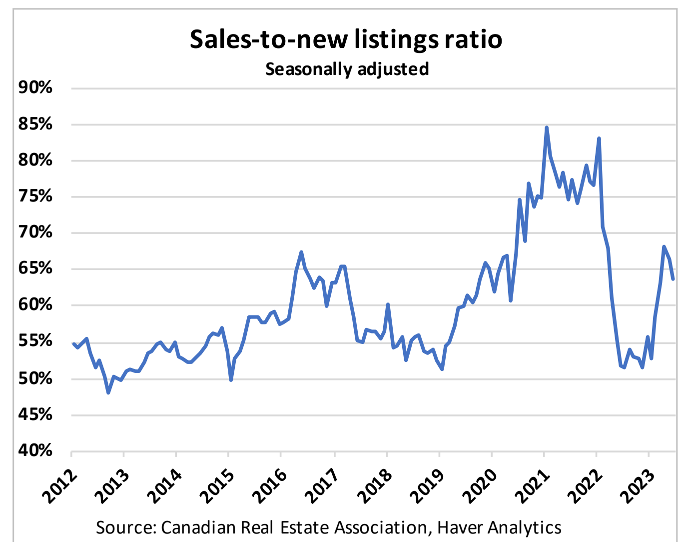
Home sales jump in Q2

Seasonally adjusted home sales jumped 17.2% in the second quarter, including a 1.5% increase in June.

Sales will likely soften given the recent hikes from the Bank of Canada, and we should expect seasonally adjusted sales to tick down by at least 10% through the summer as the market digests higher rates.

The bigger story remains on the supply side. Seasonally adjusted new listings ticked up 2.8% in Q2 but remain at extremely low levels historically. This depressed level of new supply is helping to maintain a tight market balance even in spite of lackluster demand. The sales-to-new listings ratio has pulled back from recent highs but still remains above 60%, a level that signals a very strong market.

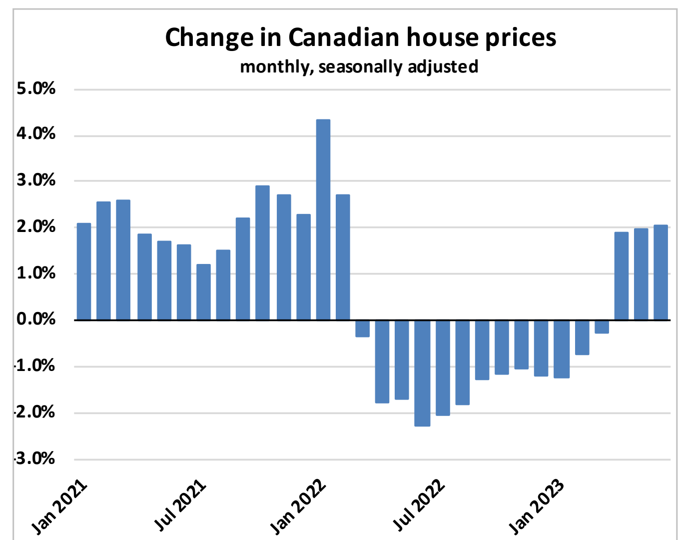




The MLS HPI rose another 2% month-over-month in June, its third consecutive monthly increase. Prices have now risen 6.1% from the lows over the past three months.

First signs of softness in the labour market

The key jobs report for June beat expectations with headline employment jumping by 60,000 vs. the 20,000 expected, and that included a whopping 110,000-person increase in full-time employment.



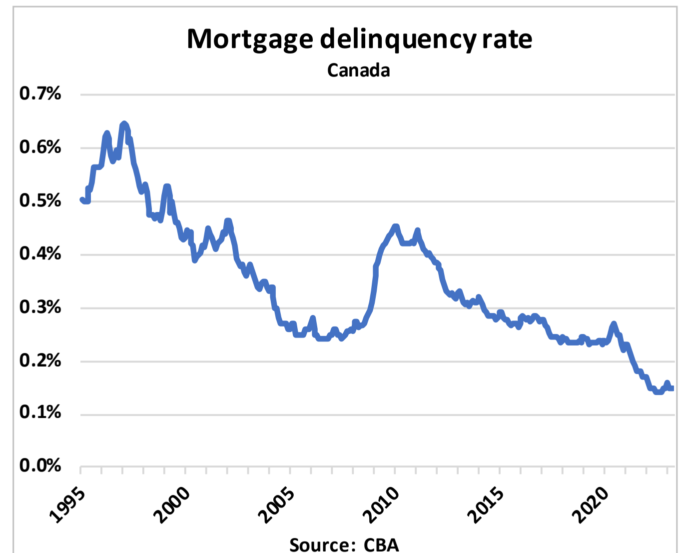
Housing and Mortgage Market Review

MORTGAGE PROFESSIONALS CANADA

The Bank of Canada adds to its steepest rate-hike cycle in 30 years

But digging beneath the surface, things aren't entirely rosy. For starters, massive population growth is now running well ahead of new job creation, which pushed the unemployment rate up 0.2% on the month to hit 5.4% nationally. That's still a very low number historically, but it's now risen by 0.4% over the past three months... the largest non-lockdown related increase since 2019. And prior to that you have to go back to the Financial Crisis to find the last time the unemployment rate ticked up like this.

Strong gains in sectors like healthcare were offset by big losses in interest rate-sensitive sectors like construction, which shed 14,000 jobs in June and has now lost 26,000 in the past three months. It's likely an early sign that higher rates are starting to weigh on the labour market.



Mortgage delinquencies remain near record lows at just 0.15% nationally, but that will likely start to change in coming months. Already, credit card and auto loan delinquencies are at eight-year highs and are rising quickly. These tend to be good leading indicators for arrears in the mortgage space.

Delinquencies will likely drift higher from here and could well double over the next year as higher rates and a likely softening labour market push them back towards the long-term average of closer to 0.35%.

**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.