Housing and Mortgage Market Review

Omicron is weighing on the Canadian economy

By Ben Rabidoux

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

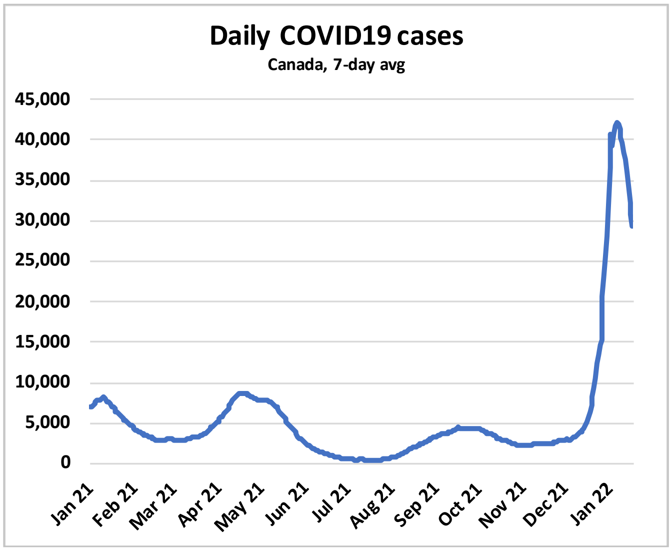
We have partnered with analyst Ben Rabidoux, who each month provides MPC members with a review of the latest housing and economic data and rate trends. He breaks down what the data means and spells out the implications for Canadian consumers—your clients.

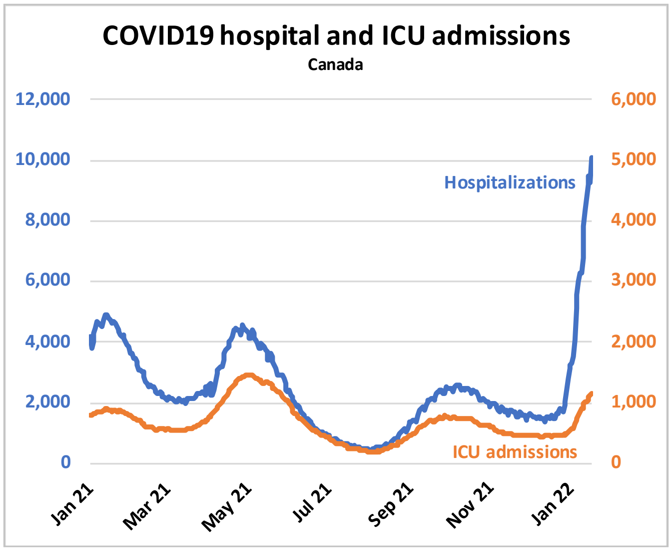
We look forward to arming our members with powerful insight into the housing and mortgage markets and hope you enjoy this latest report.

Omicron is weighing on the Canadian economy

It's hard to get a clear read on trends in new COVID cases, in part due to a shortage of PCR tests in many provinces. New cases are now falling after surging to record highs in recent weeks. There's reason for optimism here: Indicators like positive test rates and viral load in wastewater are on the decline and provide further evidence that cases have likely peaked... at least for now.

The good news is that the normal relationship between hospitalizations and ICU admissions has broken down, suggesting that while Omicron is far more contagious, it's also a less virulent strain. Still, with hospitalizations rising and an ongoing shortage of healthcare workers in most provinces, COVID-related restrictions will remain in place for a while longer, and that will likely weigh modestly on economic growth this quarter.





Interest rate outlook

Markets are looking through the uncertainty around Omicron and are instead focusing on rising inflationary pressures that may force the Bank of Canada to act earlier than previously expected. An unprecedented 56% of Canadian businesses are expecting to raise prices by more than 5% in the next year, a clear sign that more inflationary pressures are on the horizon.

The need for extraordinary monetary stimulus is clearly waning. Canada has recovered all lost jobs and has even added 265,000 new positions since the onset of the pandemic. Hiring intentions among businesses are at record highs and the unemployment rate is already near the lowest level on record:

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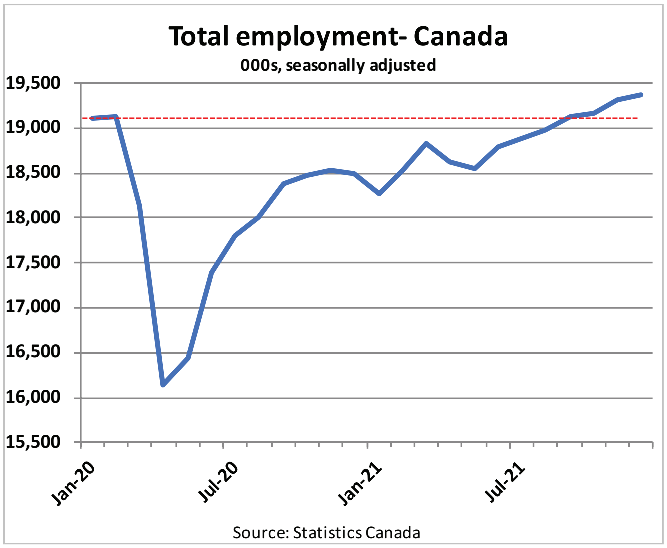
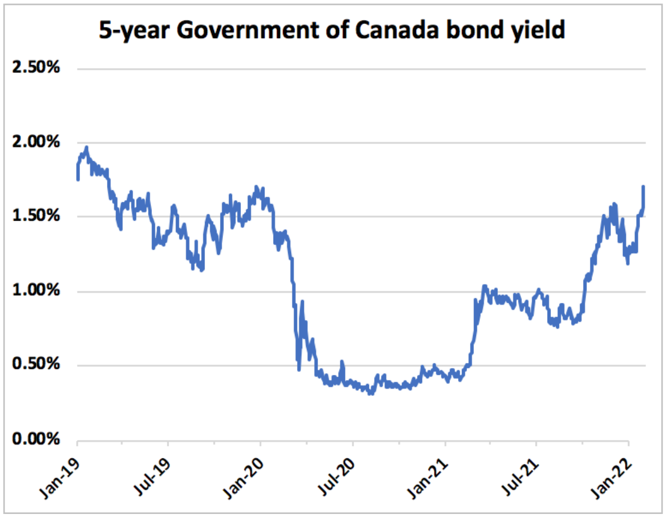


What it means: There is now an implied 80% chance of a 25-bps interest rate hike at the January 26 meeting, and markets are pricing in an additional four to five hikes in 2022. The 5-year Government of Canada bond yield is back to pre-COVID levels, exerting upward pressure on fixed mortgage rates:

At this point, my expectations are for two to three rate hikes in 2022. If we model out six rate hikes this year and flow that through to households, we would see debt service ratios hit record highs by the middle of next year. Given the importance of housing and consumer spending to the Canadian economy in recent years (they have collectively accounted for nearly 85% of real GDP growth over the past five years!), this would act as a sharp brake on economic activity. The Bank of Canada is no doubt aware of this. Combined with the fact that much of the inflation we are seeing is related to factors outside of their control, I believe it means they will move slowly towards normalizing interest rates.



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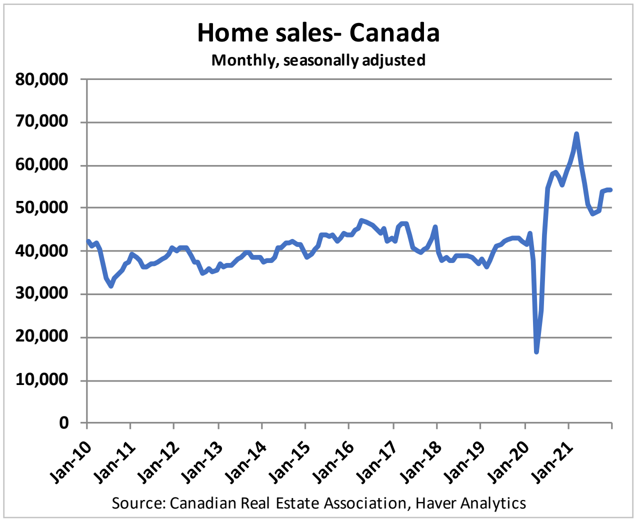
Home Sales

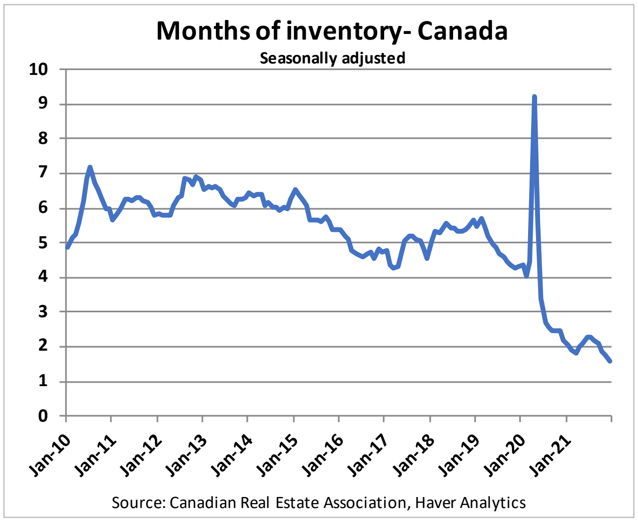
Home sales across Canada rose 0.2% month-over-month in December. Demand remains exceptionally high relative to normal levels over the past decade. There were 667,000 home sales nationally in 2021, which smashed the prior record by over 20%. It was truly an exceptional year for Canadian real estate:

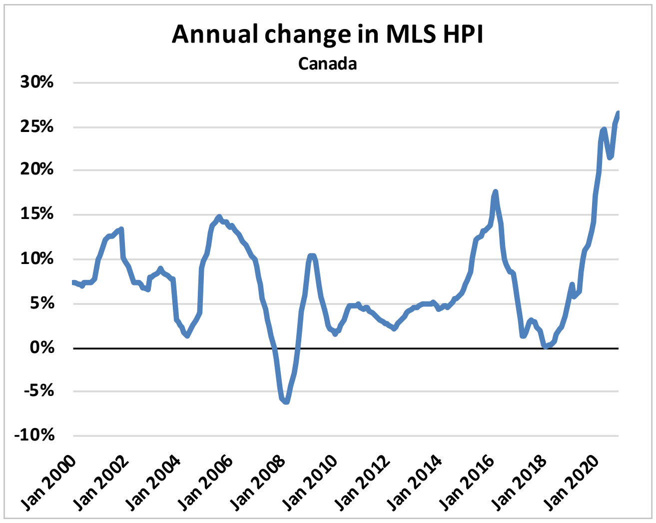


The bigger story remains the chronic shortage of inventory across the country. New listings fell 3.2% in December and remain well below normal levels. With sales up and new listings down, active inventory levels fell to fresh 20-year lows nationally. The number of homes listed for sale has fallen by a stunning 50% since the start of the pandemic.

Putting together declining supply with strong demand, we end up with months of inventory at a record low of just 1.6 in December. A balanced market is generally considered to be five to six months of inventory.

With such a supply-demand imbalance at play, it's perhaps no surprise that house prices continue to hit new records with the MLS House Price Index up an unprecedented 26% in the last year alone:





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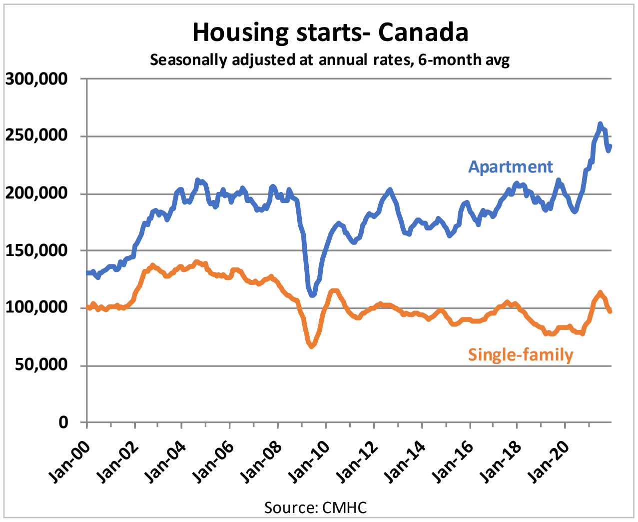
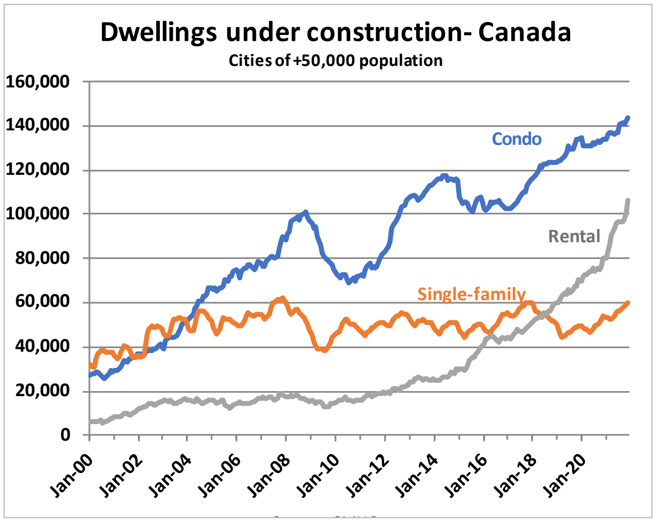
What's desperately needed to help balance the market is an increase in new single-family housing construction. Canada has seen a record number of housing starts over the past year, which on the surface bodes well for future supply. However, the increase has primarily been in the apartment segment, particularly rental apartment starts. There are now 250,000 condo and rental apartment units under construction compared to just 60,000 single-family homes.

Single-family starts have not increased over the past decade in spite of a massive increase in demand.





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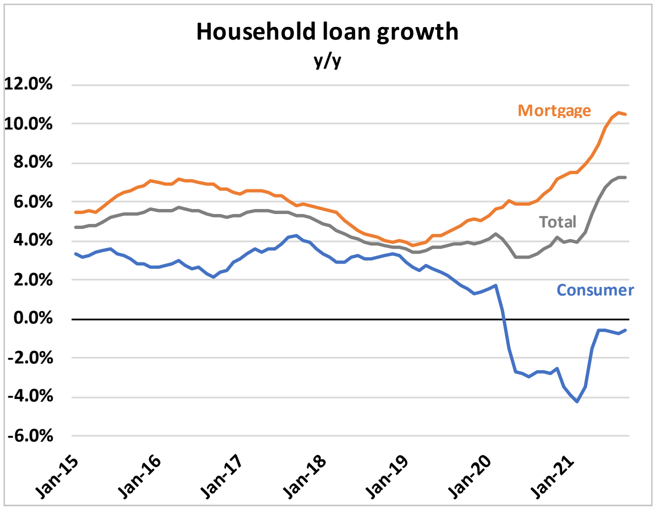
Mortgage market

Mortgage credit growth is currently running at over 10% year-over-year, the highest level since 2008. While there's a good news story here in that consumers are simultaneously paying off higher interest consumer debt, it's still the sort of dynamic that concerns regulators and policymakers, particularly in the context of record house price growth.



What it means: Expect policymakers to tighten mortgage underwriting rules before the spring selling season kicks off. Recent remarks from the Office of the Superintendent of Financial Institutions (OSFI), the Canada Mortgage and Housing Corporation (CMHC), and the Bank of Canada point to concerns around the role that investors may be having in causing excess demand and price volatility. I expect rule changes would be targeted at this group and may include higher down payment requirements or a limit on the share of the down payment that can be financed by borrowing against existing properties.

**Any forecasts/projects 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.