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

Bond yields remain stubbornly high despite cooling inflation

Highlights:

- The Bank of Canada now has cover to pause rate hikes after September inflation cooled but borrowers should be prepared for "higher for longer" interest rates
- Mortgage growth has fallen to 20-year lows, but there are signs that things are finally stabilizing
- Back-to-back rate hikes this summer sidelined prospective buyers in Q3

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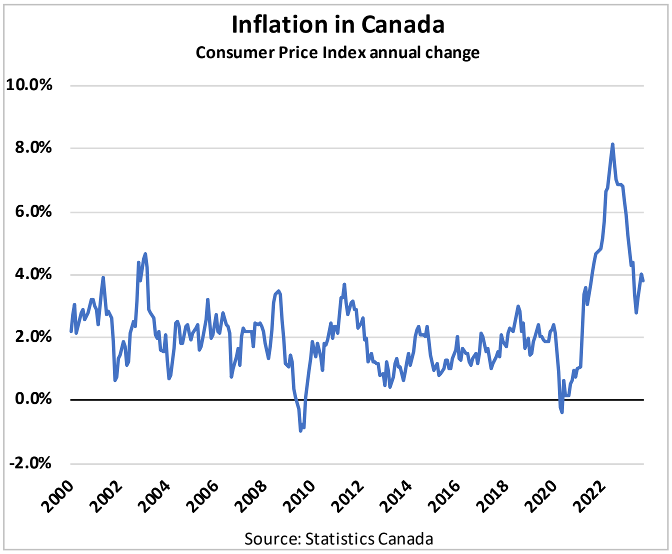
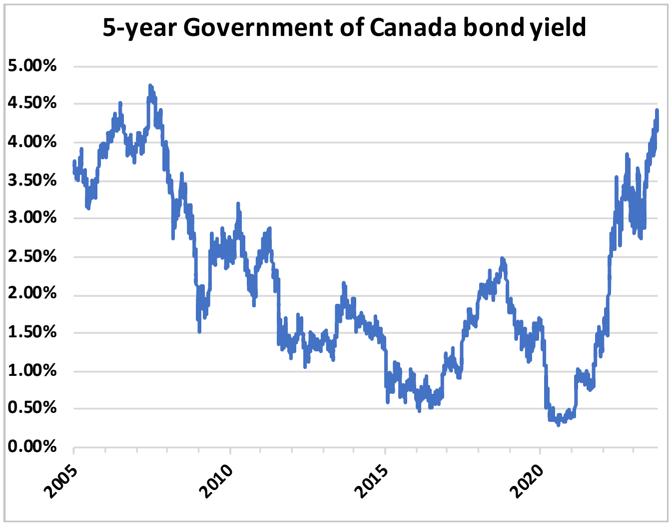
There are some signs that the Bank of Canada is finally winning their fight against the rising cost of living, and they may finally have cover to pause the current rate hike cycle.

Canada's inflation rate unexpectedly cooled to 3.8% in September against expectations of 4.0% reading. More importantly, core inflation—which strips out food and fuel costs and factors much more into the Bank of Canada's decision making—slowed to just 3.2% from 3.6% previously. That's the lowest rate of core inflation since late 2021.

This is good news, but it's not yet being reflected in bond yields, which continue to be dragged higher by rising yields in the United States. Current 5-year yields, which are a major determinant in fixed-rate mortgage pricing, are at 4.35% at the time of writing. They remain just 10bps, or 0.1%, off the recent 15-year highs.

While there's a growing sense that we are nearing the end of the rate-hike cycle in Canada, markets aren't expecting rate cuts until the second half of 2024 and are still expecting the Bank of Canada policy rate to be 4% at the end of 2025. If that proves correct, we may still be looking at 5% mortgage rates two years from now. It's a good idea to be preparing clients for a "higher for longer" interest rate environment.

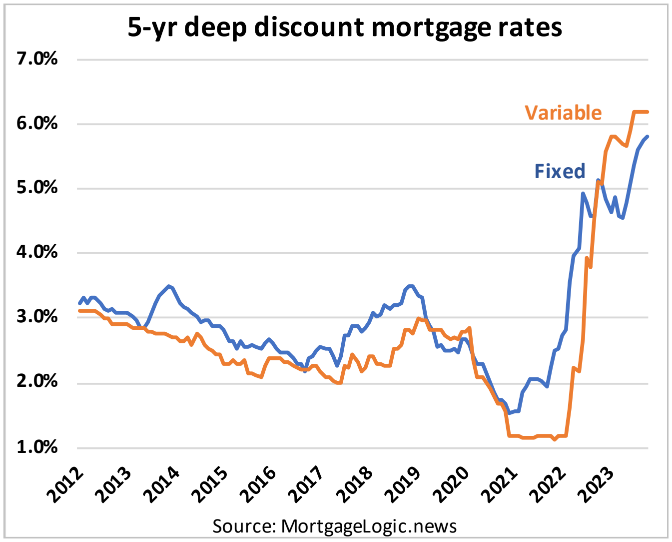




Mortgage demand remains tepid

Deep-discounted fixed mortgage rates continue to drift higher and are now closing in on 6%.

High rates and high house prices are not a good combination for mortgage demand. Annual residential mortgage growth has fallen to just 3.5%, the lowest level since 2001. But there may be some good news. Mortgage originations were up 25% in August compared to the same month last year, according to the Bank of Canada. That marks the second consecutive month of positive year-over-year growth.



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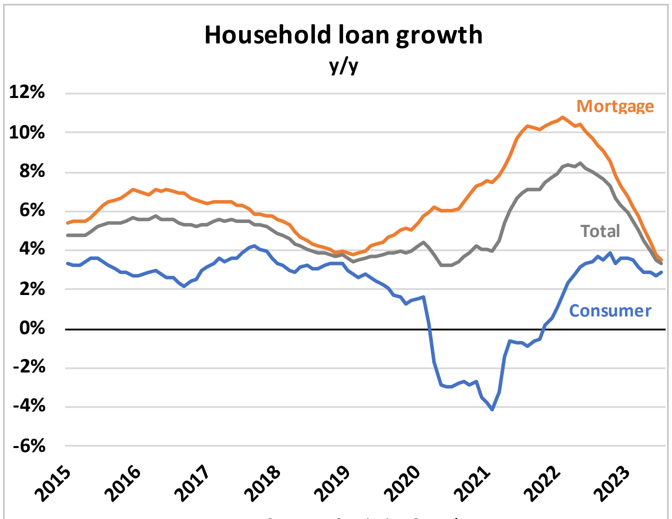
With loan growth at 20-year lows, there are questions around what OSFI aims to accomplish with any further tightening to underwriting. That's particularly true when we look at mortgage delinquencies, which remain anchored at just 0.15%, less than half the long-term average.

Given that interest rates tend to hit the economy with a 12- to 18-month lag, we should expect delinquencies to drift higher in the coming months. But the fact that they remain as low as they are should give policy-makers some comfort.

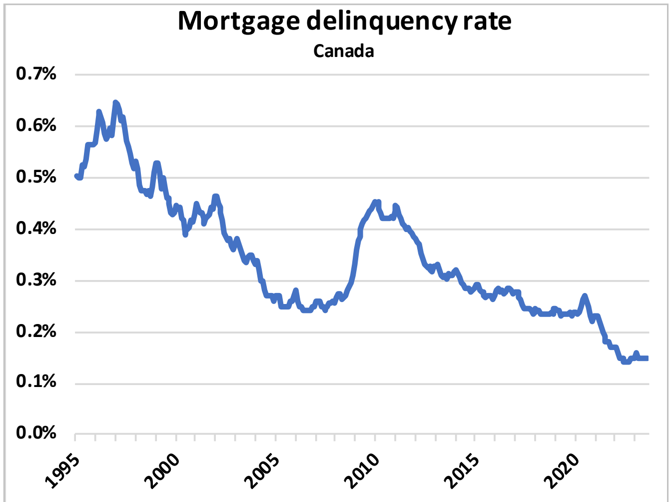


Source: Statistics Canada

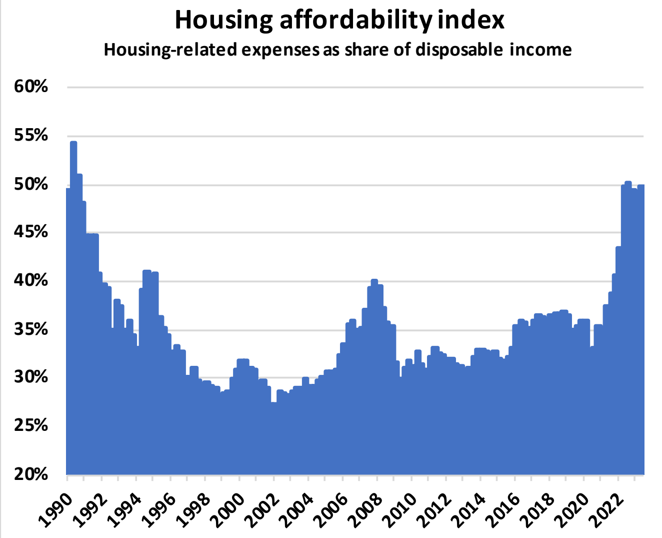
Home sales slip in Q3

Back-to-back rate hikes over the summer took some steam out of Canadian housing demand in Q3 with seasonally adjusted home sales falling 1.6% relative to the second quarter.

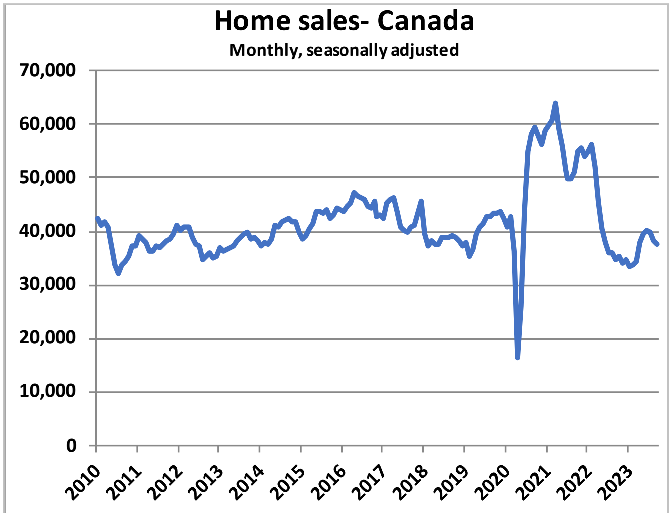
Affordability remains a serious constraint on demand and may remain so for a while. The Bank of Canada's affordability index deteriorated (i.e., increased) slightly in Q3 and is now at levels last seen in the early 1990s.



Source: CBA



Source: Bank of Canada



Source: Canadian Real Estate Association, Haver Analytics

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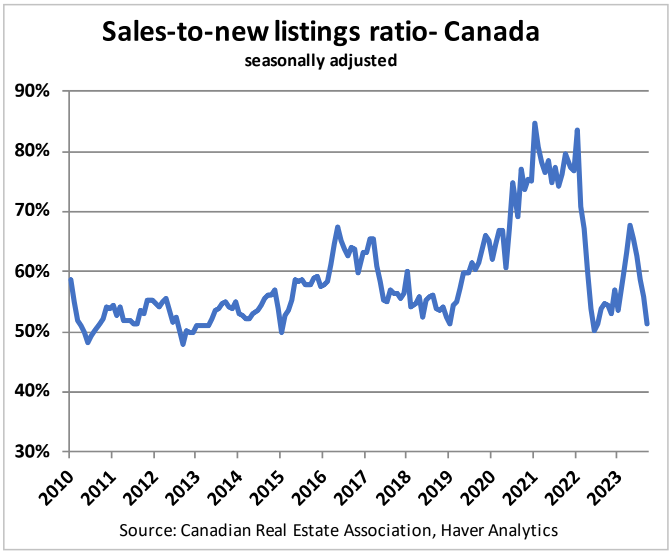
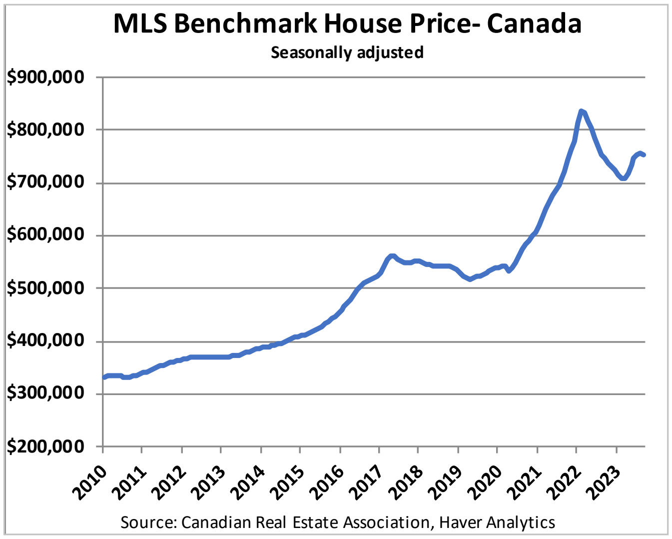
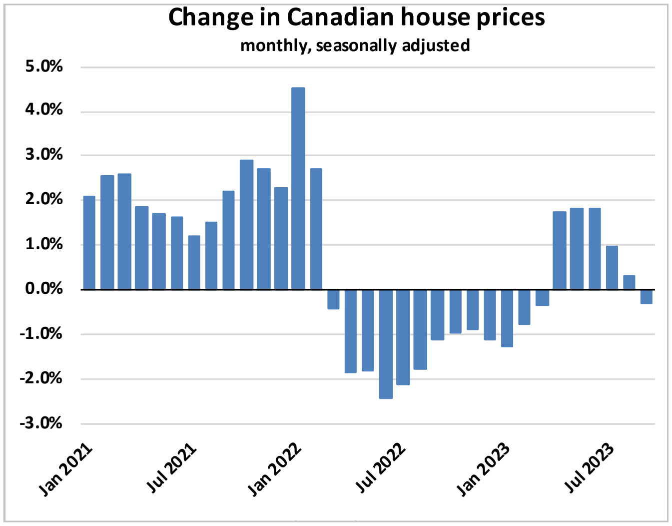
While buyers moved to the sidelines last quarter, the same is not true of sellers. Seasonally adjusted new listings surged 16.3% in Q3. The sales-to-new listings ratio fell sharply and is now hovering close to 50%, well off the recent highs of close to 70% this spring. These levels point to a buyer's market and suggest that prices may grind lower through the fall.

On the pricing front, the seasonally adjusted MLS House Price Index ended the quarter up 1.0%, but all the heavy lifting was done in July and August. September saw a slight 0.3% decline in pricing. The index remains 10% below the all-time highs set in February 2022.

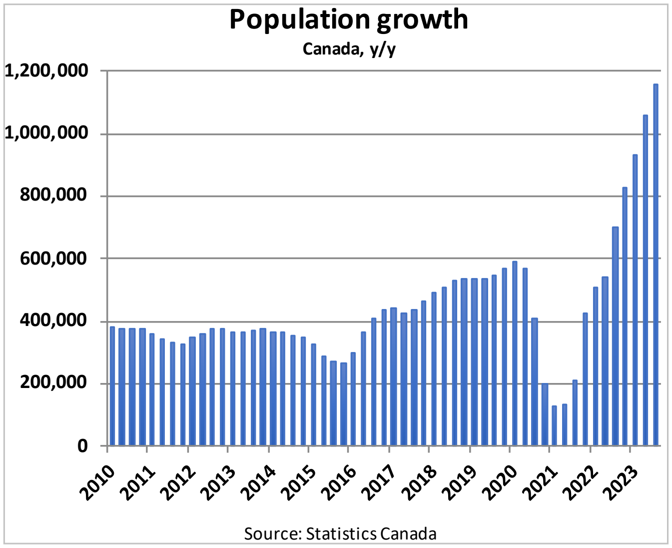






Long-term fundamentals still look solid

Canada's population surged by 358,000 in the third quarter, a record by a wide margin. That brought total growth over the past year to an unprecedented 1.15 million people.



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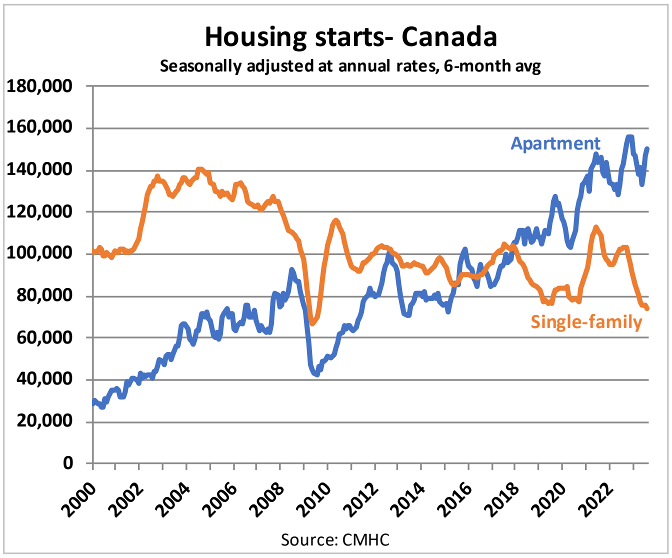
The concern now is that high interest rates are weighing on developer activity. We can see that in the recent decline in single-family housing starts, which have only partially been offset by rising apartment starts. Canada needs to build a lot more homes over the longer term if it hopes to accommodate population growth at these levels, and that means that the fundamentals of supply and demand remain very favourable looking beyond the next year or so.



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