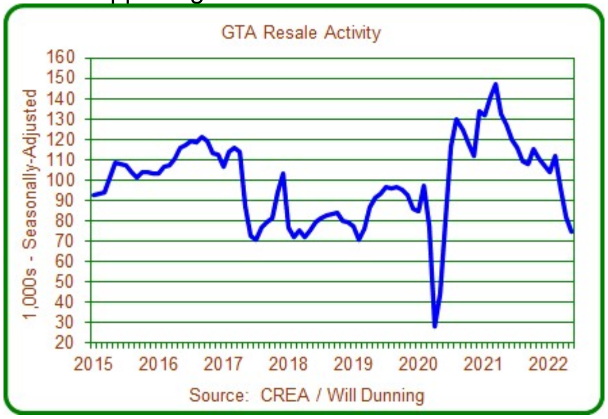
Housing Market Digest

Greater Toronto Area, June 2022

Resale Market

A modernized Rorschach Test: when you look at this chart, what do you see? Is it a moderate slowdown in the GTA housing market? Or, a train wreck happening in slow motion?

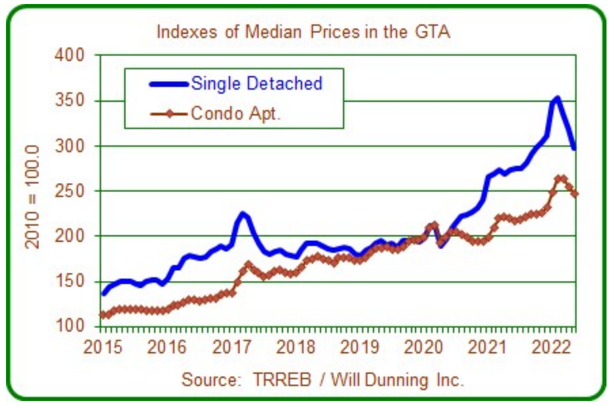


For May, the annualized sales rate was 74,500. On a population-adjusted basis, this is 30% below the long-term average (which is currently 107,000).

For all of Canada. May sales were less-weak, at 7% below the long-term average.

For May, the sales-to-new listings ratio was 46%. The SNLR is now below the threshold for a balanced market, which I calculate as 52%.

During the Covid period, prices have increased much more rapidly for ground-oriented homes than for apartments. In the downturn that is now developing, prices have fallen more rapidly for singles (16% lower versus February) than for apartments (down by 6%). That said, demand-versus-supply indicators are currently weaker for apartments than for singles. I continue to believe that the very large under-construction volume of apartments results in a lot of downside risk.



Are You Old Enough to Remember "The Boom"?

Actually, the recent surge in house prices in the GTA was not the hottest period ever. Starting at mid-1985, the average resale price rose by an average of 25% per year, for 4 years. During the 4 years up to February this year, the average rise was less rapid, at 15% per year.

During "The Boom", reductions in interest rates stimulated increased home buying, which led to higher prices. In pretty much every respect, The Boom contained greater excesses than we are seeing in this period, in terms of speculative buying and also worry (the mantra at the time was "where will your kids live"). There was also a lot of economic optimism and exuberance, which pushed the employment-to-population ratio to the highest level ever – more than 70%. That was a great time to be looking for a job. Many employers found it necessary to provide mortgage assistance to new employees.

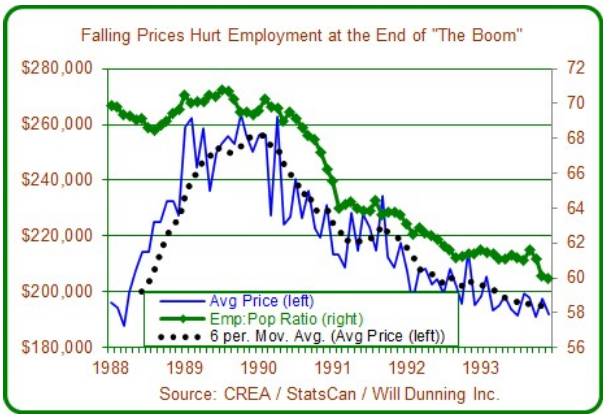
Ultimately, the Bank of Canada became concerned about inflation, and monetary policy was tightened, starting about mid-1988 (which raised variable rates). Bond yields began to rise early in 1990 (raising fixed mortgage rates). Higher mortgage costs caused sales to slow during 1989, and then prices flattened.

After a while, prices began to fall. That was soon followed by a drop in the employment-to-population ratio. This leads me to what I've been thinking about: prices in the GTA (and elsewhere in Canada) have recently started to fall. A key question that will be of interest to the Bank of Canada is… to what extent (and with what timing) will the housing market downturn result in an economic downturn?

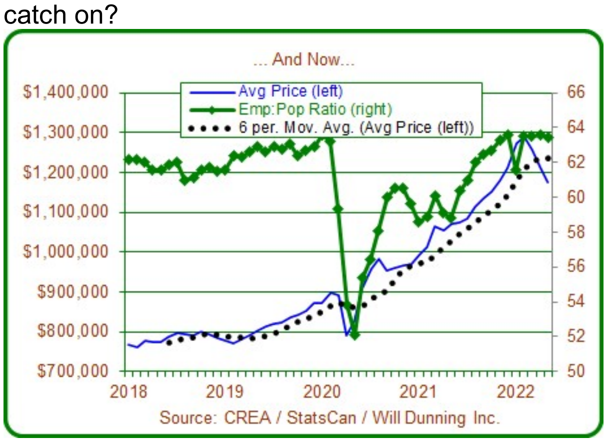
This might be the most complicated chart I have ever published. My reading of it says… when The Boom ended, it took a while for people to start to feel that their wealth was being eroded, but once that realization kicked-in, there was a quite rapid drop in the employment rate (starting in the spring of 1990). Once that began, there was a downward interaction between house prices and the employment situation – they pushed each other lower. In consequence, we experienced a half-decade long period of considerable weakness for both housing and employment.

But, it took a while for economic data to show the changing reality. When, those signals became obvious, around the middle of 1990, the Bank of Canada benchmark rate and bond yields both started to fall. That delay meant that the downward economic momentum continued for a long time afterwards.

The key lesson for today: once a downward interaction becomes established, it is very difficult to turn it around.



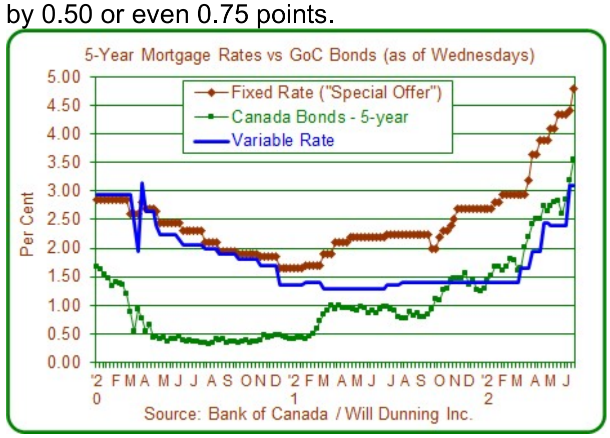
Here's what's developing now in the GTA. At what time will people (and therefore the economy) start to feel the consequences of falling prices? Then, how long will it take for the Bank of Canada to catch on?



Interest Rates

I believe that the neutral mortgage interest rate is in the range of 2.5% to 2.75%. As I've been saying for a while, interest rates have overshot (for a bit more on this, see the discussion about owning versus renting in the Canada edition for May). I think there is a non-trivial risk that the stage has already been set for a downward spiral involving the housing market and the employment situation. Convincing evidence won't become available until later this year. Once the avalanche starts, it will be too late.

There is a widespread belief that in July the Bank of Canada will raise its benchmark Overnight Rate by 0.50 or even 0.75 points.



Other News

It's possible that conditions are now changing rapidly in the rental sector. Each October, CMHC does its annual survey of rental markets across Canada (and then it takes them a really long time to release the results). I've said many times that the survey should be done quarterly.

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