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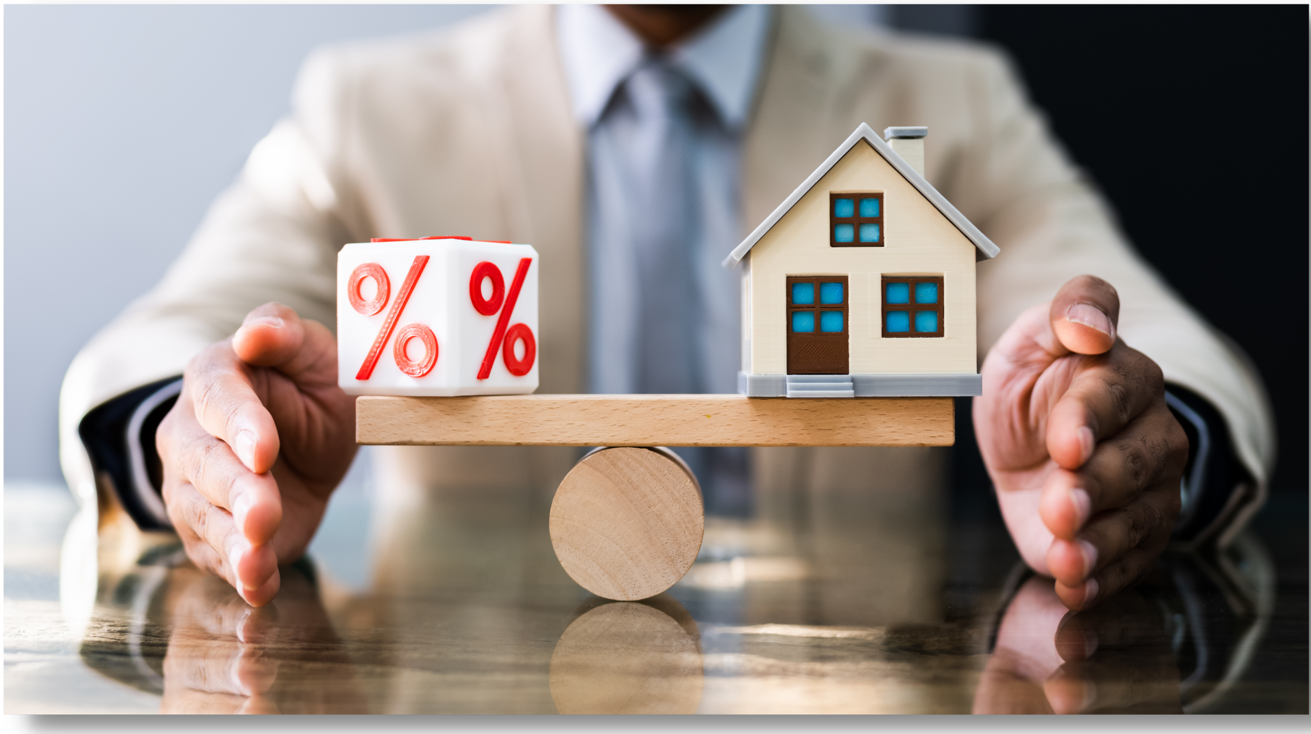
How will Canada's housing market react to higher interest rates?

Source: www.livabl.com By: RYAN GARNER



At the pandemic's outset, the Bank of Canada slashed interest rates in an effort to stimulate the Canadian economy, sparking housing sales across the nation in 2021. But how will rising rates impact the real estate market in the new year? According to a report released earlier this month, CIBC forecasts that rate hikes will result in reduced transactions and a gradual return to more balanced market conditions during 2022.

Nationwide housing sales peaked at roughly 70,000 per month earlier this year before falling to 50,000 to close out 2021 — a significant decline but still 10,000 per month higher than pre-COVID levels.

Examining the correlation between interest rates and sales activity during 2017-18, CIBC found a significant uptick in transactions as buyers looked to get into the market ahead of rising rates. The same pattern is anticipated in the new year.

Recent figures show that most Canadian households were financially unharmed by the pandemic, while rounds of lockdowns and work-from-home measures helped increase savings for those with stable employment.

"It is reasonable to assume that over the coming few quarters, sales activity will average close to 55,000 a month and possibly higher — supported by the increased inflow of new immigrants — before slowing notably in the second half of 2022," said Benjamin Tal, CIBC's deputy chief economist, in the report.

"Overall, we expect sales to fall by 15 per cent in 2022, relative to the elevated level seen in 2021 — an environment that is consistent with a notable deceleration in home price inflation next year."

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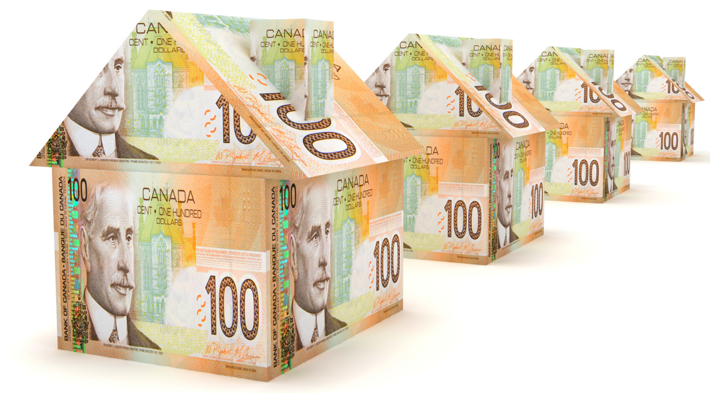
Fattened pocketbooks, combined with manageable mortgage stress tests, motivated buyers to take advantage of the historically low interest rates.

Mortgage application levels have remained high through the autumn and into the winter. That trend is expected to continue in 2022 before gradually softening in the second half of the year.

"Mortgage originations rose by an estimated cumulative 30 per cent in 2020 and 2021, while the average size of a new mortgage rose quickly to reach a record high of $450,000," stated the report. "Overall, we expect mortgages outstanding to rise by 5.5 to six per cent in 2022 — slower than the estimated 8.5 per cent pace seen in 2021."

Reduced supply of single-family homes, as well as decreasing affordability, has left some buyers turning to multi-family options. Condo sales activity surged during the second half of 2021, and rate hikes should bolster it even further.



“Logic suggests that higher rates will channel more activity into the more affordable condo market, resulting in relative price outperformance in that market,” said the report.

CIBC ultimately expects higher interest rates to balance the nation’s housing market following a year marked by volatility.

Meanwhile, monthly immigration numbers have reached their highest levels in more than 70 years, tightening the supply crunch in Canada’s major cities and keeping demand high throughout the new year.

“By late 2022, the housing market will look and feel more like it did in late 2019,” Tal said. “The discussion will shift back to the lack of supply in light of immigration driving increased demand, and to the need to provide a permanent rental solution to Canada’s affordability crisis via increased purpose-built activity.”