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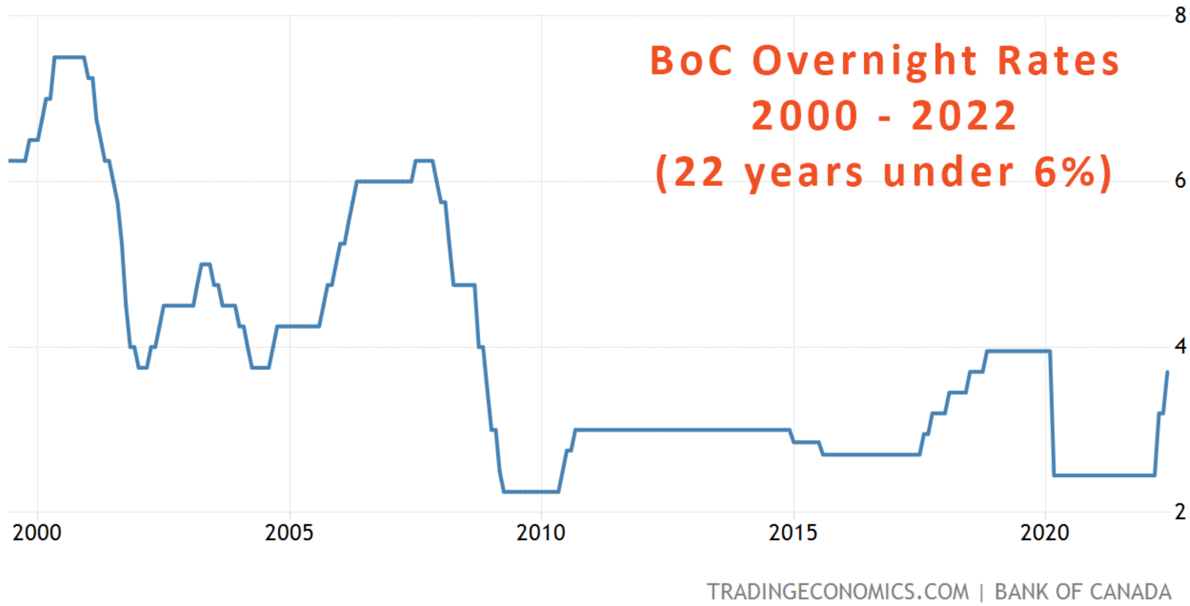
PMA BRETHOUR REALTY GROUP BROKERAGE



July 14, 2022

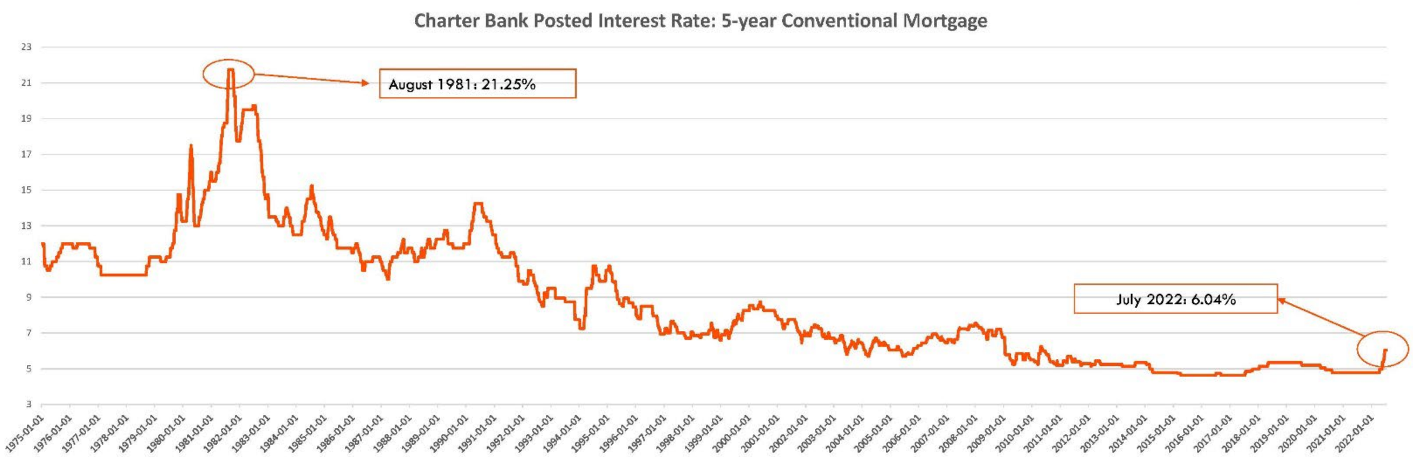
The Bank of Canada (BoC) promised to be aggressive in its fight against inflation, and PMA correctly predicted in our Q1 review that they might go to 100 basis points at their July 13th round. So, let's just say that, at PMA, we are not surprised by this move. Nonetheless, it will be a further shock to the Real Estate Market in the GTA and beyond.

- The overnight rate now stands at 2.5% (up from 0.25% in last 90 days) and the Bank rate sits at 2.75%. PMA had suggested that the BoC target might be 3.25% by year-end, and this now appears to be possible by their September 7th Governing Council meeting. Expect a further 75 basis points, taking the overnight rate to 3.25% and setting up a possible year-end target of 3.5% to 3.75%. The impact on the overall economy will dictate the aggressiveness of future interest rate hikes.
- Unemployment, resale and new housing sales, and GDP growth are currently adjusting very quickly to the rapid rise in the cost of borrowing and should signal an easing of rate increases by the BoC for year-end.
- The U.S. Federal Reserve set its Bank Rate at 1.75% in June, with its first 75 basis point jump in decades. US officials will announce again at the Federal Reserve meetings on July 26/27. Inflation was just announced to have reached 9.1%, the highest level in 41 years and well ahead of the consensus projection of 8.8%, so expect a similar 75 to 100 basis point adjustment, taking the US bank rate to 2.5% to 2.75%, the same as Canada. This will reinforce the need for the BoC to go higher again in its September 7th announcement to protect the value of the Canadian dollar.
- The Federal Reserve is projecting a 3% Bank rate by year-end "without sparking recession". However, PMA expects that the rate may be closer to 3.4%, given the entrenched level of inflation. Just as supply chain disruption appears to be easing China shut production down again in support of their COVID-Free policy. Supply chain disruption will continue. An end to the Ukraine/Russia conflict would bring great relief to the spiraling cost of food and oil. This should be the lead item on the agenda of world leaders. An end to the Ukraine/Russia war would immediately ease and derail inflation, avoid recession, and create a faster return to world economic stability.

Impact on GTA Real Estate

- The interest rates for 5-year mortgages now stands at around 5% and will jump another 1%. Add on the OSFI stress test, and we will approach 8% “qualifying” rates. Every 1% rise in rates causes about a $500 per month adjustment in carrying costs, so we have added about $1,500 per month to the average mortgage cost since March. Hence, the consumer shock.
- Mortgage rates at 8% are still historically relatively low; we averaged 11 3/4% through much of the ’90s. The difference of course, is that the average house price was $210K, not $1.146M, hence the extreme pressures on affordability.
- Today’s rate moves are a Generational story, and the current generation has never experienced such rapidity of change. As a result, the “shock” effect is immediate and powerful. Uncertainty causes confusion, confusion creates inaction, and the consumer immediately pauses.

MORTGAGE RATES – FROM FREE MONEY TO CHEAP MONEY



CIBC Current Mortgage Rates

Variable Rate		Fixed Rate		
3 Year	5 Year	1 Year	3 Year	5 Year
4.70%	4.35%*	4.74%	5.49%	5.34%*

Source: CIBC Current Discount Rate – July 13, 2022

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The Resale Response

- Resale absorption fell to 6,474 units in June, down from 10,910 in March (-41%), and from 7,232 in April (-11%). PMA expects monthly volume to decline further in July and August to under 6,000 units and remain in this range through September, with a slight recovery to 7,000 units by November.
- Rising listing supply combined with reduced absorption produces downward pressure on prices. Remember, the 10-year average of absorption is 8,500 units per month, and PMA doesn't expect the market won’t reach this level again until the Spring of 2023.
- Prices have corrected by 14% from their peak in February/March. PMA expects further erosion through the summer, stabilizing at the $1.05M mark by October. This will reflect a 23% to 25% correction from the peak. This adjustment will, of course, vary by product, type, and location. Think prices in the fall of 2021...that’s the level of market correction anticipated.

- Listing supply continued to soar in June to over 16,000 net listings for sale, 2.3 times higher than the February level of 6,985. PMA expects listing supply to continue on an upward trend through the summer, topping out at around 20,000 units. A shift to a BUYERS market is underway.
- Condo price adjustments have been much softer than detached housing. The irrational exuberance of Q1 was felt more directly in the lower density product. Detached prices have already adjusted 19% downward from the spring peak while condo prices have adjusted by 8%. Listing supply of condos soared in June to nearly 1/3 of overall listings at 5,210 units. This will put further downward pressure on condo pricing, but not nearly to the level of detached and townhome products. Expect condo prices to adjust in this 8% to 10% range from the peak in February/March.

Source: TREB

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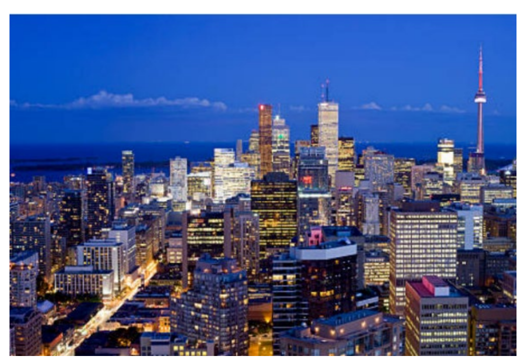
The New Home Response

New Home prices will never adjust as quickly as resale; they always ratchet down slowly in a correction . The Development Industry and the consumer have one thing in common: in the summer of 2022, both hit the PAUSE button simultaneously.



- The inflationary cost of labour and materials is pushing up against the downward pressure on revenue, causing the industry to take a deep breath. The consumer is doing the same in response to the shock of a rate change. When the market numbers are released in late July, watch for our Q2 Review with a detailed analysis of both the Resale and New Home markets.
- The current scene is witnessing price and incentive adjustments in both the low-rise and high-rise markets to stimulate sales. This has and will continue to produce modest results until new product is released in the fall with significant design and price adjustments from the peak of Q1.

- The current production plate is so full that most builders are focused on delivering what's been sold and meeting construction/closing schedules while confronting hard-to-control costs. As noted, uncertainty begets inaction, and the consumer reacts by pulling back to the sidelines waiting for a signal to re-enter the market. As the BoC knows, much of the consumer reaction is psychological – perception drives reality.
- If consumers believe the BoC has derailed and controlled inflation, they will return to the market. The fundamentals remain unchanged: supply is very tight, immigration remains very buoyant, and the GTA remains a strong economic engine and a fabulous place to live/work/play.

So, the question is, when will we see a market return to more normal absorption levels? PMA thinks we are in the middle of a short, sharp correction, leading to stability in late fall and spring 2023 that will feel more normal. The low-density market will take on a more challenging route to recovery than high density.

The Signal

The BoC will ride this inflation fight hard until it sees signs of change: unemployment rising and new job creation subsiding; the first evidence of that occurred in June. Also, house prices are correcting and supply pressures are subsiding; we have already seen this happen in the resale market. Resale is 95% of the housing stock, and new housing is the other 5%. The latter will take longer to adjust, but it will adjust. Watch for new product and pricing adjustments by the fall.

The SIGNAL might come from OSFI; with the BoC suggesting an easing of inflation by year-end and a target of adjustment back to its 2% range into 2024, the need for the stress test disappears. OSFI did an excellent job protecting the consumer from these current rate increases, but as rates peak and eventually subside in 2023, the stress test is simply piling on, it's no longer needed. A removal or adjustment to the stress test will be the SIGNAL that it's time to re-enter the market, so watch for increasing pressure to adjust or remove the stress test by the fall.

Coming mid-August is PMA's comprehensive look at Q2, so watch for our review.

Look Forward! Live Positive!

Please click the image below to watch Andy's video presentation of the above material