CIBC ASSET MANAGEMENT

Market Spotlight—May 2024

Canada's population growth, the economy and our housing market

Here's how Canada's housing affordability crisis could impact your real estate goals

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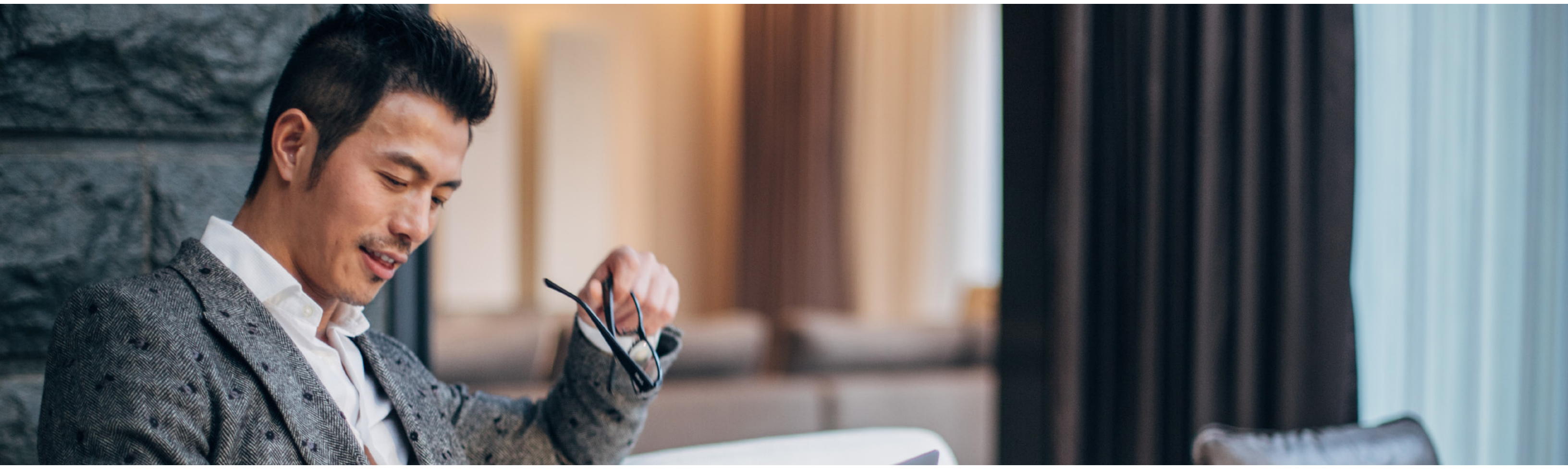

A perfect storm of demand outweighing supply, higher interest rates and stagnant household income have led to Canada's housing affordability crisis.

Housing affordability is top of mind for many Canadians and the effects are visible as a lack of supply, pitted against rising demand, has driven the cost of homes up 6.3% annually over the last 20 years. Meanwhile, household income increased approximately 1%, over the same time horizon. The bar to achieve home ownership continues to rise and those fortunate to own, have been negatively impacted by rising interest rates, as mortgage payments have skyrocketed and there is less disposable income.

What is the outlook for housing prices?

As Canadians, we are highly tethered to the housing market. The ratio of homeownership costs to income in Canada is north of 60% and over 100% in Vancouver. We are seeing apartment sizes shrink, room sharing, and line ups outside of shelters.

In the 2024 federal budget, "Fairness for every generation", the government stated its desire to restore home affordability. Top initiatives include more than doubling new homes built to 3.87M by 2031 and aligning immigration with housing by reducing temporary residents by 600,000 over three years. Other initiatives include a vacant land tax, unlocking public land for homes, accelerating capital cost allowance and funding. While a doubling of supply is an audacious goal it may be challenging to accomplish due to high construction costs, lack of labour availability and permitting time constraints.

Net/net if the measures to restore housing affordability are executed, we could potentially expect to see a cooling in price appreciation. This should in turn reduce the financial burden to buy or rent a home and increase availability. In regard to timing, we believe it will take time for measures to have a notable impact on market dynamics and affordable housing, albeit the plan does mark a renewed focus to tackle this issue.

How is the Canadian housing crisis impacting real estate investors?

Like Canadians, the real estate sector has been negatively impacted by rising interest rates as well as the supply and demand imbalance in the market. As of May 17, 2024, most public real estate stock prices sit well below their net asset values. On a one-year basis the TSX Capped REIT Index return was -8% versus the TSX Index's 10% gain. Although the multi-family was a brighter spot, given tight rental market dynamics, the announcement of these potentially market cooling initiatives in the 2024 federal budget, leaves us less positive on investing in this sub-sector in comparison to other real estate verticals such as Industrials or retail.

How population growth impacts the Canadian economy—and you

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Canada's population grew by 3.2% year-on-year in the last quarter of 2023—the highest increase in our population in 66 years. The driver of this growth in the past five quarters was an increase in non-permanent residents, which added 805,000 people to our total population.

The correlation between economic and population growth

Generally speaking, a growing population promotes economic growth. A positive growth outlook is good for corporate earnings, and good corporate earnings are good for equity performance and, by extension, your equity portfolio.

A growing population can also help alleviate inflationary pressures. As newcomers integrate into the workforce, they add supply to a tight labour market and slow the rate of wage increases. And indeed, in 2023 the labour force grew by 621,000 individuals, 463,000 of which were work permit holders. This increase in the labour force resulted in an increase in the unemployment rate which went from 5.1% in March 2023 to 6.1% in March 2024.

However, in spite of this increase in unemployment wages have yet to lose momentum. Average hourly wages have been growing at or above 5% since December 2023 and most wage growth measures are accelerating in Q1 2024.

A plausible reason why the positive supply shock from population growth has yet to put a break on wage inflation may be that newcomers are also consumers. In 2023, for each addition to the workforce there was approximately two additional consumers. Given the poor performance of labour productivity in the past several quarters, more demand for goods and services could be providing a further boost to labour demand. This makes it difficult for wage inflation to slowdown, which could delay interest rate cuts by the Bank of Canada.

Population growth and housing

The hasty growth in population has also aggravated pressures on the Canadian housing market where there was already an imbalance in supply and demand. If you're a buyer, this means purchasing a home that may be overvalued. If you're a renter, it means paying more for a residence that's harder to find. The rental market is currently posting the lowest vacancy rate in the last 22 years and rent inflation has almost doubled since mid-2022 to 8.5% in March 2024, the highest rate observed since 1983.

In the long term, population growth is positive. It increases potential economic growth and can reshape the demography and have a positive impact on the fiscal balance. But in the short term, it could mean higher for longer interest rates and continued housing market challenges.

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We provide our clients with our research insights and expertise on industry issues and themes that matter most to them.

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