MARKET UPDATE: January 26th, 2022:

Hello Again! Happy New Year!
I hope you and your family are all doing well and for many of you…excited to have the kids back at school! Hopefully everyone is managing to stay safe.
This update will be longer than usual. SORRY! The big talk this month is inflation and increasing interest rates. So I'm going to go into a bit more detail than usual about that, as we are now at that crucial point where rates have to go back up.

The Bank of Canada (BoC) met yesterday for their first interest rate decision of 2022, and they decided not to change rates again this month. And those who owe money on a variable rate mortgage or HELOC let out a HUGE collective sigh!!
The Bond Market and many economists had believed that the BoC would be forced to increase rates this week to show the world they were serious about combatting inflation. And basically every article in the papers and internet were implying that it was a foregone conclusion that rates would be going up yesterday.

Fortunately (in my opinion) the BoC doesn't just do what the Market and many economists think it should do! Raising rates in a lockdown to combat inflation is a bit risky in my opinion. It is also risky raising rates before the US Central Bank does….and the USA chose NOT to raise rates this week either! Doing that would send our dollar soaring and could risk slowing down the economy.

The Reality is that from an economic perspective, it didn't really matter whether they raised rates at this meeting or the next one.
The optics of raising rates when 100,000 Canadians have lost their jobs during this Omicron wave would have seemed a tad bit cruel. (Not to mention the piling on of suffering for the many businesses bleeding money daily still…almost 2 years after the start of the pandemic). So the BoC decided not to move this month, but instead signalled to the market that they will be raising rates at the next meeting. So it isn't like they are not going to raise rates! They are just pushing it back a month from the "masses" predictions.

So the Prime Rate remains unchanged at 2.45% (unless you are with TD…their Prime is 2.60%)….at least for another month.

The BoC acknowledged the inflation issue. But they said that as supply shortages diminish, they expect inflation to decline reasonably quickly to about 3% by the end of this year.
They also said that they don't expect the economic impact from this Omicron wave to be as severe as the previous waves we've experienced.

SO WHEN ARE RATES GOING UP AND HOW MUCH AND HOW FAST??!!
Well that is the million dollar question! I wish I knew the answer!
I am certainly not a macro-economics expert (though I do have a number of books about the subject

from my university days that are collecting dust in my basement….and I acknowledge that those books might not have ever been opened!! 😊)
But based on some of the answers I'm seeing in the press, it seems apparent to me that no one knows the answer. It also seems apparent that those who speak the loudest and most aggressively are the ones getting the attention and the press. And the Bond Market appears to be following their lead.
BUT I DON'T AGREE WITH THOSE LOUD VOICES…
So that is why I'm speaking out here….As loudly as possible…

So let's go over what we know…..

-Rates were dropped by 1.5% in March of 2020 when the pandemic broke out. It seems likely the BoC would want to eventually get back to this level (in the least).

-The issue that many economists and the bond market clearly keep forgetting is that currently the biggest driver of our high inflation is caused by issues at ports and supply chain disruptions. Higher rates won't truly fix that! Sure, there are other factors driving inflation up as well. But even if the BoC hiked rates to the moon, the ports would still be a mess and we'd still have inflation issues. So it isn't like raising rates soon and fast is going to fully fix this inflation issue. And really…Is inflation going to 100% because we wait another month to raise rates?? Heck no.

-Tiff Macklem, the Bank of Canada Governor said, "The challenge here is to bring inflation back to target -without choking off the recovery."
That's right people….We are still in a recovery! No point spending more money than I can count to try to keep the economy afloat for the last 22.5 months, only to ruin it all by raising rates too quickly.

-For perspective, the BoC has averaged SIX 0.25% hikes in its typical "raising rates" cycle. That doesn't mean it is always 6 hikes and always 1.5%, but that is the average.

-In June of 2020 (which was the very end of his term as BoC governor), former BoC Governor Stephen Poloz acknowledged that our record-high household and government indebtedness will magnify the impact of future hikes and likely reduce the total number needed to bring inflation back under wraps.

I don't think he could have predicted inflation would be as bad as it is now, but he knew there would be lots of inflation worries as we came out of the pandemic. But that does show that the BoC might not have to increase rates so high to have a huge impact on slowing inflation.

-It took the BoC a decade to get rates up 1.25% after the US Financial Collapse in 2008.
That event was not nearly as detrimental to Canada as the pandemic and lockdowns have been.

-As mentioned above, we had many economists calling for increases yesterday. It has been the top story in the news for the last couple of weeks. For example, Scotiabank's Economists said they expected five

0.25% increases and one 0.50% increase this year….Or to be exact..0.25% increase yesterday, 0.25% in March, 0.50% in April and then 3 more quarter percent increases in the 2nd half of 2022.
And then Scotia predicts there would be even more increases on top of that in 2023!! So that would be an increase of 1.75% in 2022. And 0.50%-1% more in 2023. That would mean the Prime Rate would be 0.75%-1.25% HIGHER than where we were at the start of the pandemic. The last time our Prime Rate was at 5% or higher was March of 2008. A lot has changed in the last 14 years….For example, the average home price in Toronto at that time…about $379,000. Today…$1,163,000. Sounds like a good way to kill the housing market and the economy to me!

I guess anything is possible…But to me, that prediction is extremely aggressive….to put it as nicely as I can.
It is so extreme and scary it certainly gets you to read the news article!! Do they honestly believe what they are saying?? Or maybe they are trying to force the BoC's hand?? ***Guess who stands to benefit most from raising interest rates?? THE CANADIAN BANKS!*** *So of course they want to see the BoC raise rates sooner rather than later, and to do so many many times! I'm just not sure if we should be trusting an opinion that is a tad bit biased. But again….these are the economists that are being quoted in the news.*

SURE…they could be correct in their prediction. But there are many who don't see their prediction as very likely to materialize. You just haven't been reading much from those economists. It doesn't make for "sexy" headlines. I think that this fact has helped the bond market to align more with the LOUD economist's thinking as opposed to those that believe rates will be increased at a more measured pace.

-ONE THING that does not get mentioned very often (or at all) in the press….did you know the Bond Market has priced in RATE DROPS by the BoC in both 2024 and 2025?!?!? So that says to me that investors think the BoC will be raising rates quickly and will over-shoot and be forced to turn around and lower rates again. That would definitely be a good possibility if they followed the Scotia prediction!
I apparently have more confidence in the BoC than the Market does! I think they might get this right if they raise rates slowly and not as high….so they won't have to lower rates aggressively in 2024 and 2025 to save the economy they crippled.

SOOOOOO…with all that being said….what does this all mean?? When are rates going to go up and how fast and how far??

From where I sit, it seems pretty darn likely the BoC will have to start raising rates at their next meeting in March. The BoC essentially said just that in their meeting yesterday. So barring another variant moving us back to lockdown, we should expect rates to jump 0.25% at the next meeting in early March.

The US Central Bank also signalled they expected they would be increasing rates at their next meeting in March. So it appears we'd be increasing rates at the same time as the USA.

But after that, things become a lot less clear. We still have many Economists calling for a ton of increases (I notice in the press today that those economists seem quite angry that the BoC didn't do what they expected yesterday….almost taking it personally that the BoC didn't follow their suggestions!!).

But you have other economists (e.g. CIBC's Deputy Chief Economist Benjamin Tal, etc…) who believe a more measured approach is the way to approach this. Tal points out that if rates are increased too quickly, we risk ruining the economy. And if that happens, then the BoC will be forced to lower rates again. ('Overshooting' as it is called…when rates are increased too quickly… generally leads to recession).

They also risk ruining the housing market with 6 or 7 rate increases this year. 4 increases in 2022 probably won't ruin it…that's the hope anyway!! And they certainly don't want to ruin our housing market. Housing has been such a huge chunk of the economy over the last 10 years. If they ruined it, it would surely drive us back into a recession.

SO AGAIN…ANYTHING CAN HAPPEN. We are still in a pandemic after all! And what the BoC does will also depend on how quickly the USA raises its rates.

But I'm going to align my prediction with CIBC's Benjamin Tal…someone who speaks calmly and without ego.
So that means four 0.25% increases in 2022. And 2 or 3 more in 2023. So that means Prime is 1.5%-1.75% higher by the end of 2023. With Prime at 2.45% today, that means Prime is up to 3.95% or 4.20% by the end of 2023.

Could I be wrong! Of course! But even the best economists are correct less often than weathermen, so the odds are I will be wrong!!
😊

My hope is that by going with a more measured approach it will soften the blow and allow us to climb out of this mess as a nation as unscathed as possible.

SOOOOO….WHAT ABOUT MORTGAGE RATES?!?!
Because of the bold predictions from influential people (e.g. Scotia economists, etc…), we have seen fixed Mortgage Rates continue to climb in anticipation of the BoC raising rates this month and many more times after that this year.
For Purchases with less than 20% Down Payment, we are seeing 5 year fixed rates around 2.74%-2.99%...depending on the lender. That is about 0.70%-1% higher than it was 3 months ago!
5 year variable rates for purchases with less than 20% down payment are around 1.30% (Prime less 1.15%). This is only about 0.15% higher than a few months ago.

For Purchases with 20% Down Payment, the 5 year fixed rate is up to 2.89-3.24%...depending on the lender. That is up 0.60%-0.95% in the last 3 months. The 5 year variable option is now at 1.45% (prime less 1%). That is an increase of only about 0.10% over the last 3 months.

Most likely this trend of fixed rates increasing will continue as we move forward, as rates are going to be increased by the BoC soon. Though we might see a bit of a lull for a month as the market had already priced in an increase yesterday which didn't materialize.

IN GTA REAL ESTATE NEWS:

TORONTO, ONTARIO, January 6, 2022 – A record 121,712 sales were reported through TRREB's MLS® System in 2021 – up 7.7 per cent from the previous 2016 high of 113,040 and up 28 per cent compared to 2020. Record demand last year was up against a constrained supply of listings, with new listings up by 6.2 per cent – a lesser annual rate than sales. The result was extremely tight market conditions and an all-time high average selling price of $1,095,475 – an increase of 17.8 per cent compared to the previous 2020 record of $929,636.

"Despite continuing waves of COVID-19, demand for ownership housing sustained a record pace in 2021. Growth in many sectors of the economy supported job creation, especially in positions supporting above-average earnings. Added to this was the fact that borrowing costs remained extremely low. These factors supported not only a continuation in demand for ground-oriented homes, but also a resurgence in the condo segment as well," said TRREB President Kevin Crigger.

One sales trend that stood out in 2021 compared to 2020 was the resurgence in demand for homes within the City of Toronto. Overall sales in the "416" area code were up by a substantially greater annual rate (+36.8 per cent) compared to sales growth for the surrounding Greater Toronto Area (GTA) suburbs combined (+23.6 per cent). The marked recovery in the condominium apartment segment was a key driver of this trend.

"Tight market conditions prevailed throughout the GTA and broader Greater Golden Horseshoe in 2021, with a lack of inventory noted across all home types. The result was intense competition between buyers, pushing selling prices up by double digits year-over-year. Looking forward, the only sustainable way to moderate price growth will be to bring on more supply. History has shown that demand-side policies, such as additional taxation on principal residences, foreign buyers, and small-scale investors, have not been sustainable long-term solutions to housing affordability or supply constraints," said TRREB Chief Market Analyst Jason Mercer.

In December, GTA REALTORS® reported 6,031 sales – a strong result historically, but still down by more than 1,000 transactions (-15.7 per cent) compared to the record of 7,154 set in December 2020. Over the same period, new listings were down by 11.9 per cent to 5,174. The MLS® Home Price Index Composite *benchmark was up by 31.1 per cent year-over-year in December. The average selling price was up by 24.2 per cent annually to $1,157,849.*

"On February 3, TRREB will release its latest Market Outlook and Year in Review report. The report will include survey results and research that will help us navigate 2022 and beyond. The findings will highlight the latest consumer polling on home buying intentions; joint research with the Toronto Region Board of Trade on the future of employment and work; plus an outlook for home sales, listings and pricing over the next year. This will be a must-read report for Members, consumers, housing market watchers, researchers and policymakers," said TRREB CEO John DiMichele.

Here is a sneak peak of what you'll see in that Market Outlook and Year in Review report….WE NEED MORE LISTINGS!
The mass exodus of Toronto has ended and the people are returning. But we still don't have enough listings for the demand in the 416 or 905. So prices continue to climb.

Residential Vacancies are also way down in the 416 in 2021 after climbing quickly during the early stages of the pandemic. Purpose-built rental apartment buildings in the Greater Toronto Area reported a vacancy rate of 3.0% at the end of Q3-2021. They were at 6.4% in Q1 of 2021. I'm sure they will be much lower than that when the numbers come out for Q4. This is going to force Rental Rates up, which will only intrigue investors even more (and make it harder and more expensive for renters!).

There is no quick fix to this unfortunately. Higher mortgage rates might deter some but demand still greatly outstrips supply. So this issue isn't going to change anytime soon.

That is it for this month. The next BOC Meeting is on March 2nd, so I will be in touch after that.
Be well! Stay safe! And have a great month!

Take care,

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