Economics

THE WEEK AHEAD

July 25-29, 2022

Project cancellations will worsen housing affordability

by **Benjamin Tal** benjamin.tal@cibc.com

For those who are paying attention, the ongoing correction in the Canadian housing market is hardly a surprise. The meteoric ascent in home prices during Covid was simply a result of front-loading activity. The asymmetrical nature of the crisis meant that home buyers received the benefit of a recession via ultra-low interest rates, without the cost of a recession via a broadly-based increase in the unemployment rate. The housing market has never seen such a combination.

While at times it can feel that way, the housing market is not in a free fall. We estimate that close to three-quarters of the 14% decline in the average national home price since the February peak was due to the composition factor, with sales activity shifting from more expensive units (low-rise) to less expensive units (high-rise). This is a similar but much more painful version of the trajectory that we saw in the 2017-18 price adjustment. What's more, the sales-to-new listing ratio, at around 50%, is now where it was for most of the past 15 years — still indicating balanced market conditions.

That reset process is not over. Sales activity will continue to fall alongside the average home price. That price will have to fall by additional 25% to reach pre-Covid levels. And back then, nobody suggested that Toronto or Vancouver were affordable. The point is that the ongoing correction will not solve the housing affordability crisis.

In fact, we might be in the process of making the situation worse. The significant and rapid increase in interest rates, along with surging construction costs and a lack of available labour make projects that only yesterday looked promising, totally uneconomical. Based on information we obtained from Urbanation, out of the 30,000 condo units that were supposed to be launched in 2022 in the GTA, no less than 10,000 have been cancelled or put on hold. And the situation in the purpose-built space is even worse. We are in the midst of a project delay/cancellation wave, with developers choosing to sit on their hands, rather than engaging in a money-losing proposition.

So when the fog clears, the units that were supposed to be built now will not be available — making a tight rental market even tighter. And that's the opposite direction of where we should be heading.

A rental solution must be a big part of any housing affordability policy. We should develop a rental mentality in which you are 35 years old, you are married with two kids, and you are renting — nothing is wrong with you! Simply put, the propensity to rent must rise, and the market should realign to increase the supply of rental units.

For that, developers will need some incentives from municipalities. Expediting the approval process for purpose-built projects can make a significant difference in the final decision. Municipalities can demand in return, increased inclusion ratios. Other ways to promote purpose-built activity are to offer higher intensification rates for purpose-built developments, cut the HST charged on the development, and eliminate or reduce development charges.

The trajectory of the Canadian housing market following the current adjustment is not written in stone. It's largely a function of policy. Purpose-built rental could be the difference between an affordable and an unaffordable housing market in Canada. So far it appears that we are marching in the wrong direction.

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Priority
SAAR = Seasonally Adjusted Annual Rate
Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, July 25	-	-	-	-	-	-	-
Tuesday, July 26	-	-	-	-	-	-	-
Wednesday, July 27	-	-	-	-	-	-	-
Thursday, July 28	-	AUCTION: 30-YR CANADAS $2B	-	-	-	-	-
Thursday, July 28	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	(May)	-	-	-	-
Friday, July 29	8:30 AM	GDP M/M	(May)	(H)	-0.2%	-0.2%	0.3%

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Priority
SAAR = Seasonally Adjusted Annual Rate
Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, July 25	-	AUCTION: 2-YR TREASURIES $45B	-	-	-	-	-
Monday, July 25	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Jun)	(M)	-	-	0.01
Tuesday, July 26	-	AUCTION: 5-YR TREASURIES $46B	-	-	-	-	-
Tuesday, July 26	9:00 AM	HOUSE PRICE INDEX M/M	(May)	(M)	-	1.6%	1.6%
Tuesday, July 26	9:00 AM	S&P CORELOGIC CS Y/Y	(May)	(H)	-	-	21.23%
Tuesday, July 26	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(Jul)	(H)	97.5	96.4	98.7
Tuesday, July 26	10:00 AM	RICHMOND FED MANUF. INDEX	(Jul)	(M)	-	-14.0	-11.0
Tuesday, July 26	10:00 AM	NEW HOME SALES SAAR	(Jun)	(M)	665K	673K	696K
Tuesday, July 26	10:00 AM	NEW HOME SALES M/M	(Jun)	(M)	-4.5%	-3.4%	10.7%
Wednesday, July 27	-	AUCTION: 2-YR FRN $24B	-	-	-	-	-
Wednesday, July 27	7:00 AM	MBA-APPLICATIONS	(Jul 22)	(L)	-	-	-6.3%
Wednesday, July 27	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Jun)	(M)	-$102.5B	-$102.9B	-$104.3B
Wednesday, July 27	8:30 AM	WHOLESALE INVENTORIES M/M	(Jun P)	(L)	-	-	1.8%
Wednesday, July 27	8:30 AM	RETAIL INVENTORIES M/M	(Jun)	(H)	-	-	1.1%
Wednesday, July 27	8:30 AM	DURABLE GOODS ORDERS M/M	(Jun P)	(H)	-0.1%	-0.5%	0.8%
Wednesday, July 27	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Jun P)	(H)	0.4%	0.3%	0.7%
Wednesday, July 27	10:00 AM	PENDING HOME SALES M/M	(Jun)	(M)	-	-	0.7%
Wednesday, July 27	2:00 PM	FOMC RATE DECISION (UPPER BOUND)	(Jul 27)	(H)	2.50%	2.50%	1.75%
Wednesday, July 27	2:00 PM	FOMC RATE DECISION (LOWER BOUND)	(Jul 27)	(H)	2.25%	2.25%	1.50%
Wednesday, July 27	2:30 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, July 28	-	AUCTION: 7-YR TREASURIES $38B	-	-	-	-	-
Thursday, July 28	8:30 AM	INITIAL CLAIMS	(Jul 23)	(M)	-	-	251K
Thursday, July 28	8:30 AM	CONTINUING CLAIMS	(Jul 16)	(L)	-	-	1384K
Thursday, July 28	8:30 AM	GDP (annualized)	(2Q A)	(H)	0.7%	0.5%	-1.6%
Thursday, July 28	8:30 AM	GDP DEFLATOR (annualized)	(2Q A)	(H)	7.3%	7.1%	8.2%
Friday, July 29	8:30 AM	EMPLOYMENT COST INDEX	(Q2)	(M)	-	1.1%	1.4%
Friday, July 29	8:30 AM	PCE DEFLATOR Y/Y	(Jun)	(H)	6.8%	6.6%	6.3%
Friday, July 29	8:30 AM	PCE DEFLATOR Y/Y (core)	(Jun)	(H)	4.8%	4.8%	4.7%
Friday, July 29	8:30 AM	PERSONAL INCOME M/M	(Jun)	(H)	0.6%	0.5%	0.5%
Friday, July 29	8:30 AM	PERSONAL SPENDING M/M	(Jun)	(H)	1.0%	0.8%	0.2%
Friday, July 29	9:45 AM	CHICAGO PMI	(Jul)	(M)	-	56.2	56.0
Friday, July 29	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jul F)	(H)	-	51.1	51.1

Week Ahead's market call

by Katherine Judge and Karyne Charbonneau

In the **US**, it's a busy week, with the Fed expected to conduct a 75bp hike, and signal that the pace of subsequent tightening will be dependent upon incoming data. The impact of previous rate hikes will be on display in the Q2 GDP report, in which residential investment will have subtracted from growth, although we are a little more optimistic than the consensus given the potential for a more modest drag from inventories. The impact of the continued erosion in purchasing power on demand, along with a cooling in interest-sensitive sectors, could justify a slowdown in the pace of rate hikes by the Fed ahead, assuming that inflation expectations are contained.

In **Canada**, a relatively quiet week will see all attention focused on the monthly GDP numbers coming out Friday. Those should show a small decline for May, followed by little growth in the advance estimate for June. That would leave the economy on track for growth of a little under 4% for the second quarter, close to the revised forecast from the Bank of Canada. Though unlikely to attract much attention, the release of the payroll survey on Thursday should give more information on the extent of wage pressures in the economy.

Week Ahead's key Canadian number: Gross domestic product—May

(Friday, 8:30 am)

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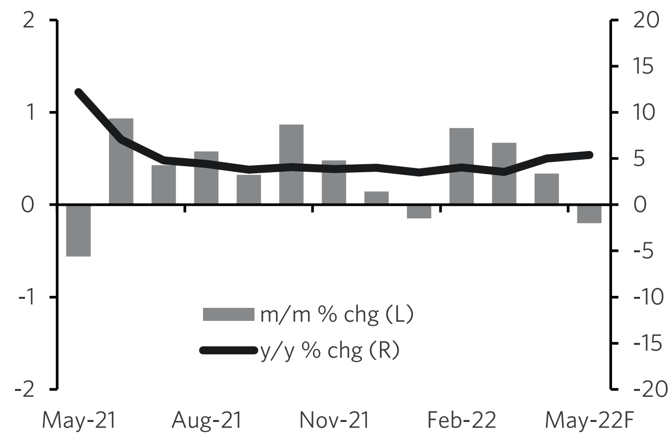
GDP (%)	CIBC	Mkt	Prior
GDP m/m (May)	-0.2	-0.2	0.3

Chart: Canadian GDP at basic prices



Source: Statistics Canada, Haver Analytics, CIBC

After a strong April, Canadians continued to catch up on the consumption of services impacted by the pandemic in May, particularly for restaurants and travel, a trend that should have extended into the start of summer. Retail sales were surprisingly strong in May, but much of the gain in the headline number was due to prices, with volume growth far less impressive. Goods consumption nevertheless remains surprisingly resilient in the face of high inflation, rising rates and strong service demand.

However, the GDP numbers should show a small decline in May and very little growth in June. The economy is still held back by supply chain disruptions, notably in motor vehicles, and a sharp pullback in real estate affecting all related industries, including construction. A fall in mining and oil and gas extraction in May should also weigh on growth in that month. There should, however, be some offset from an increase in wholesale trade. Following a decline in May, advance data suggests manufacturing shipments fell further in June.

Forecast implications — Demand for services, particularly those that had been restricted by the pandemic, should remain strong in May and June, but the economy will be held back by supply chain issues and the sharp pullback in the housing market. We still expect growth in the second quarter to be a little under 4%, close to the revised forecast from the Bank of Canada. A resurgence of the pandemic with the new Omicron subvariant, while unlikely to bring a wave of restrictions, might add a degree of cautiousness to service demand from Canadians later this summer.

Week Ahead's key US number: Real GDP—Q2 (Advance)

(Thursday, 8:30 am)

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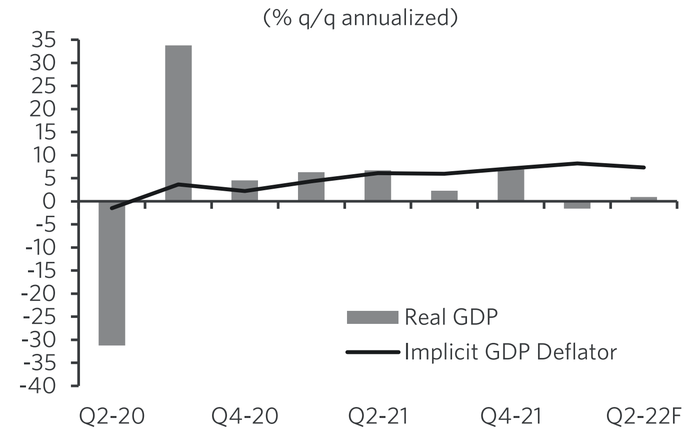
GDP (%)	CIBC	Mkt	Prior
GDP q/q annualized	0.7	0.5	-1.6
GDP deflator	7.3	7.1	8.2

Chart: US GDP



Source: BEA, Haver Analytics, CIBC

GDP forecasts were downgraded over the second quarter as the consumption outlook deteriorated and continued supply constraints in the market for vehicles thwarted unit sales. Moreover, the retreat in home sales and housing starts suggest that residential investment will have been a drag on growth. While there are nascent signs of supply chain issues abating, inventories look to have stifled growth again in the second quarter. Business investment won't provide much of an offset, as spending on non-residential structures fell into May, while imports of capital goods floundered. That will leave the consumption of services and export growth as the main drivers of an expected 0.7% annualized advance in GDP growth.

Forecast implications — With prices continuing to squeeze incomes, spending in discretionary areas of the economy is likely to moderate ahead, while the cooling in the housing market will also continue to limit growth. However, a rebuilding of inventories as supply chain issues ease, combined with continued demand for services that were out of reach during the pandemic, should prevent a contraction in growth ahead.

Market impact — We're slightly more optimistic than the consensus, which could boost bond yields and the USD.

Other US Releases: Advance trade in goods—June

(Wednesday, 8:30 am)

With export prices outpacing import prices again in June as industrial product prices continued to rise, the advance trade deficit in goods likely narrowed to $102.5bn. However, the narrowing will have been limited by the climb in prices for inbound petroleum products, and continued demand for restocking inventories. Although export volumes just attained pre-pandemic levels in recent months, future growth prospects have been dampened by the global slowdown in growth that is underway.

Durable goods orders—June

(Wednesday, 8:30 am)

Higher prices will have amplified growth in durable goods orders in June, but that won't prevent a likely 0.1% drop in total orders on weakness in the transportation group. Excluding transportation, order growth likely slowed to 0.4% in nominal terms, possibly reflecting a cooling in core capital goods orders, as capacity utilization has started to ease in the industrial sector, and the orders sub-index in the ISM manufacturing survey has trended down lately.

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