

Better Dwelling – October 26, 2023

Canada Can't Double Housing Output. It Can't Even Stop It From Dropping: BMO

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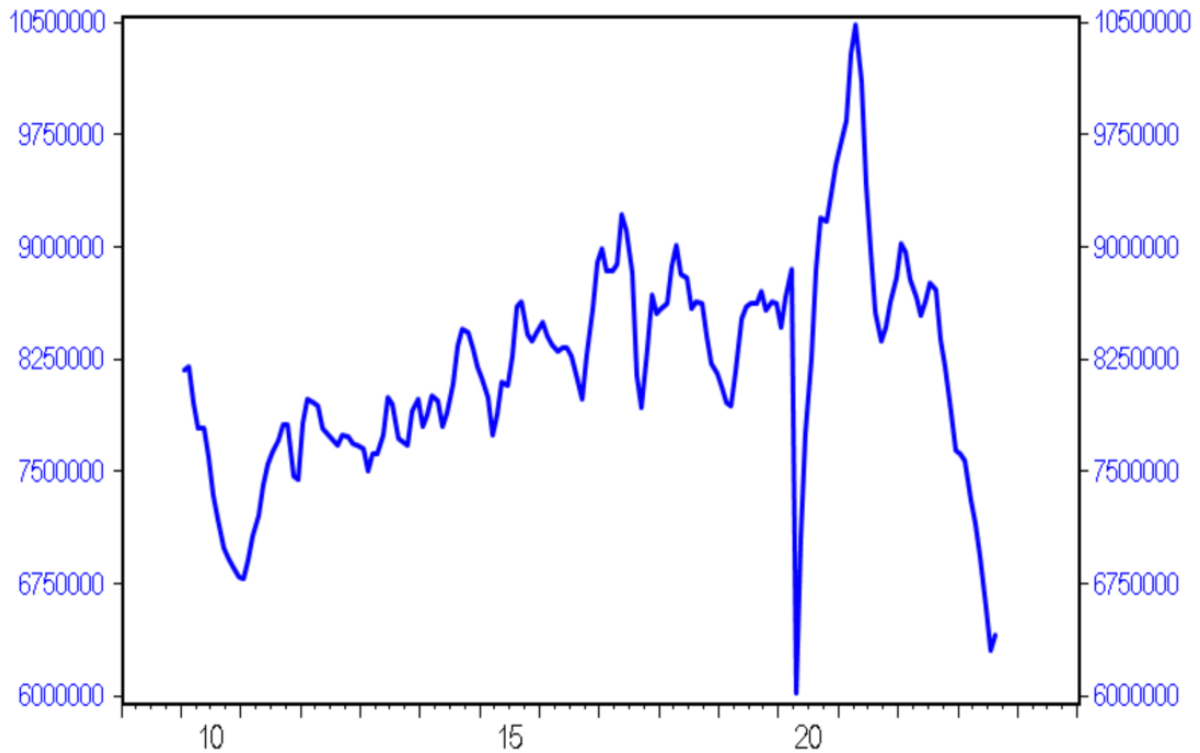
If photos of policymakers in construction vests were new homes, Canada's housing supply would be booming. Unfortunately, that's not the case. BMO Capital Markets is warning investors that residential construction investment is plummeting. The drop may indicate the slowdown in new homes could drop even further in the near-future. The bank quips, perhaps the government should try stopping the decline in new home construction before promising to double it. Ouch.

Canadians Are Investing Less Towards Building New Homes

Canadian investors are putting a lot less money into building more housing. Real (inflation adjusted) residential construction spending rose 1.6% in August. That sounds great, but it was the first increase in 12-months, and remains 27% below last year. The bank notes this is the worst annual decline since 2011.

Canada: Construction Investment: Residential

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Source: Statistics Canada

BMO Senior Economist Sal Guartieri puts this into context. “The level is a little higher than during the darkest days of the pandemic,” he said. Not exactly a good sign for future homebuilding.

It’s not exactly a broad builder issue either, according to the bank. They highlight that non-residential construction has maintained its spending level from last year.

“Labour shortages, expensive materials and high credit costs aren’t helping, nor are rising resale listings of late,” says Guartieri.

Fewer New Homes Are Starting Construction Despite Promises

Other indicators show the bank is onto something here. The seasonally adjusted annual rate (SAAR) of new homes started was just 270k units in September. That's significantly higher than pre-pandemic volumes, but still 9% lower than last year. Compared to the peak observed in March 2021, the volume remains 16% lower. Since promises of more homes, there's been a pullback in the existing number of starts.

Canada Is Doubling Down On Its Real Estate Inefficiencies

Such sharp declines are likely to surprise many tracking the booming population. However, the low rate boom transferred a large share of homebuying from end-users to investors. Many of these investors are cash flow negative and speculating that appreciation would make up the loss.

When prices stopped rising, investors could no longer continue to support driving demand. Since the gap between what investors were paying and what end-users can pay is so large, there's now a lack of demand. That's why it's so important to tackle healthy demand early, otherwise governments are likely to try and re-stimulate investor demand rather than user-demand.

BMO appears to be more confident governments are embracing the investor-driven model. "Recent moves by the federal government to lower borrowing costs for developers and reduce sales taxes on the construction of rental units are helpful first steps," explains Guartieri.

Adding, "But the hoped-for building boom could be delayed until the Bank of Canada chops interest rates." This isn't the first time economists at BMO have highlighted flaws in the plan to increase housing output. One economist flat out called Ontario's plan to build 1.5 million homes impossible. It's easy to say, let's build more! It's not so easy to compete with global supply chains without raising the cost of housing. The latter might be the point, though.