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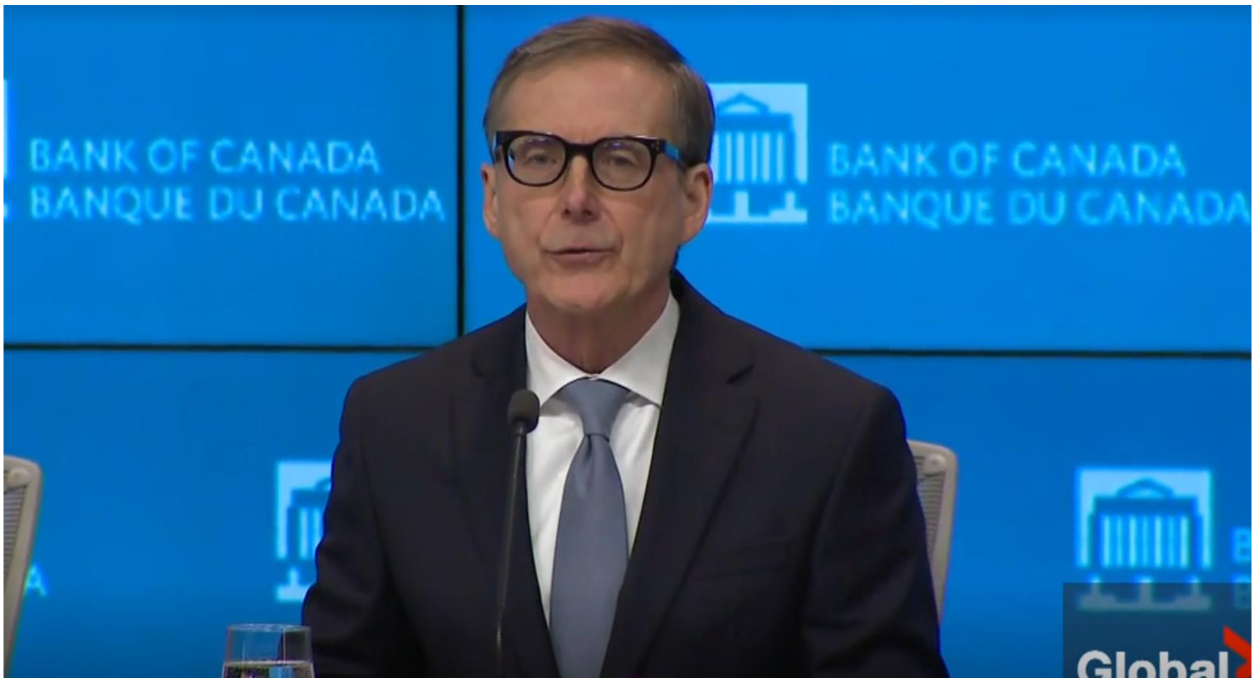
Interest rates – high or low – won't solve housing problems, Macklem says

 Craig Lord || February 1, 2024



Bank of Canada Gov. Tiff Macklem announced it held its benchmark interest rate steady at 5.0 per cent on Wednesday and hinted that its tightening cycle might have peaked. The decision, which marks the fourth consecutive hold from the central bank, was widely expected by economists – Jan 24, 2024

While the Bank of Canada continues to grapple with the high cost of housing in its quest to tamp down inflation, the governor of the central bank is telling lawmakers that monetary policy isn't going to fix affordability issues in the market.

Tiff Macklem spoke to members of Parliament on the finance committee in Ottawa Thursday and broke down how much – and how little – influence the Bank of Canada's benchmark interest rate has on housing affordability.

He said that one of the biggest sources of inflationary pressure right now is in the shelter component of the consumer price index, which factors in the rising costs of rents and mortgages amid higher interest rates.

Macklem noted that annual inflation, which came in at 3.4 per cent in December, would instead be running around 2.4 per cent if shelter prices were stripped out.

But he also noted that shelter inflation has been running hot for many years and what's changed is the "composition" of the price pressure.

During the early years of the COVID-19 pandemic, shelter inflation was up because housing prices were surging. Macklem said rock-bottom interest rates during this time were partly to blame for rising prices, but so was the demand from Canadians to buy homes with more space.

While home prices have declined in most markets and appear relatively stable at the start of 2024, higher interest rates are keeping shelter prices elevated on rent and mortgages.

"You're not going to solve housing (problems) with low interest rates, and you're not going to solve them with high interest rates. We've tried both, and we've had high shelter price inflation," Macklem told MPs.

"The durable solution is to increase the supply. And that includes both the supply of homes and the supply of purpose-built rental."

First-home savings account adding to housing demand: Macklem

The federal government has rolled out a series of policies in recent years to help address housing affordability and add more supply to the Canadian market. These include offering tax breaks to developers to get shovels in the ground on purpose-built rentals and, more recently, putting a cap on international study permits to limit the pressure on rents in cities with post-secondary institutions.

Macklem said that while policies focused on boosting supply will "help fix the situation," efforts to boost demand will be counterproductive.

"Policies that are focused more on demand are simply going to make the situation worse, because prices will just start going up, making houses less affordable," he said.

NDP MP Daniel Blaikie asked Macklem whether policies like the first-home savings account (FSHA) – a proposal from the 2022 federal budget to help Canadians save tax-free for a down payment – would fall under those demand-side measures.

"I think that's reasonable," Macklem said.

More than 500,000 Canadians have so far opened an FHSA, according to Finance Canada, following a gradual rollout from financial institutions last year.

Macklem noted that while he’s not an expert in housing policy, the Bank of Canada would like to see efforts from all levels of government to boost supply in the market. He cited efforts to speed up permitting and reduce uncertainty in the development process as helpful measures.

A week after the central bank held its benchmark interest rate for the fourth consecutive decision, Macklem did not offer a clear timeline for interest rate cuts despite questions from MPs on Wednesday.

He reiterated that the Bank of Canada needs confidence that underlying inflation is cooling before it can look at when to start easing its policy rate after nearly two years of a rapid tightening cycle.

“I hope that comes sooner rather than later,” he said of rate cut discussions. “But we’re going to have to see how inflation evolves.”