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Rate cuts have 'barely' improved housing affordability: RBC economist

Jordan Fleguel || October 8, 2024

A Royal Bank of Canada (RBC) economist says that recent interest rate cuts by Canada's central bank have improved affordability in the country's housing market, but not significantly.

In a report released Tuesday, Robert Hogue said RBC's affordability metrics "inched" lower in markets across the country in the second quarter, but prospective buyers still face historic challenges.

"Buyers continue to struggle to find a home they can afford in the aftermath of massive price escalation and spike in interest rates during the pandemic," the report said.

"Recent declines barely moved RBC's affordability measures off worst-ever levels nationally and in many major markets."

Hogue said that the modest improvement in affordability is expected to grow into more significant relief for homebuyers in the coming months, as the Bank of Canada is expected to continue cutting rates.

The central bank has cut its overnight lending rate by 25 basis points at three consecutive decisions, and officials have signalled a willingness to keep cutting rates as long as inflation continues its downward trend.

The report said that when the central bank made the first rate cut of this cycle in June, it immediately helped more Canadians qualify for a mortgage, but the required income to do so remained much higher than the national average in the second quarter.

"Nationwide, it took an income of $155,000 to carry a mortgage on the $810,200 price tag of an average (benchmark) home in Canada (assuming a 20 per cent down payment, 25-year amortization and 39 per cent gross debt service ratio). That's down from $161,000 at the end of 2023," it said.

"While encouraging, it's still a giant hurdle to clear."

By contrast, the income needed to carry a mortgage on an average Canadian home in 2019 was just $96,000 – 38 per cent lower than in the second quarter of this year.

“That $155,000 in Q2 is almost double what the median household in Canada earned (which we estimate at $87,000). No wonder home resales have generally stayed dormant this year,” Hogue added.

Despite the ongoing barriers to homeownership, the report predicts that costs for buyers and homeowners are expected to fall in the months ahead.

“We expect the Bank of Canada to cut its policy rate by another 125 basis points to three per cent by spring, which will pressure mortgage rates lower,” the report said.

“In our base case scenario, home prices will see small increases, longer-term interest rates will moderately drop, and household income will grow steadily but see diminishing gains until the end of 2025.”

Falling mortgage rates

With mortgage rates poised to move lower, prospective buyers should make sure to thoroughly explore their options, according to RATESDOTCA mortgage and real estate expert Victor Tran.

In an emailed statement to BNNBloomberg.ca, he said the lowest rate isn’t always the best choice.

“The lowest rates available often come with restrictions that could offset the cost benefit of the lower rate. Lowest might not always mean it’s the best option for an individual homeowner’s circumstances,” he said.

“Make sure to read the fine print of the mortgage approval document of the product you’re signing up for and ensure you’ve got a product that matches your expectations of home ownership for the term of the mortgage.”

The federal government’s recent announcement that first-time homebuyers will soon be able to amortize an insured mortgage over 30 years, up from 25 years, is another factor that could improve affordability, but it also comes with risks, Hogue explained.

“The downside, of course, is borrowers would carry their mortgage debt for longer, and pay more in interest (and insurance premiums) over the life of the mortgage. Not reducing the principal as quickly would also raise the sensitivity to interest rate changes in the future,” he said.

“Any large-scale take-up of this new option could potentially heat up prices in some market segments – and ultimately, defeat some of the hoped-for benefits of the measure.”