Economics | Current Economic Trends
Economic Commentary
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Rising Wages, Rising Costs: The Mortgage Affordability Challenge in Canada

The Canadian housing market, characterized by high home prices and significant household debt, has increasingly focused attention on mortgage affordability as increasing number of homeowners face significantly higher mortgage renewal rates over the coming two years. As homeowners entering mortgage renewal periods, the financial landscape's evolving interest rates, economic conditions and household earnings play a critical role in determining their financial burden. This note explores whether Canadian wage growth can adequately support the increasing costs associated with mortgage renewals to assess overall financial resilience.

Housing Affordability and Carrying Costs

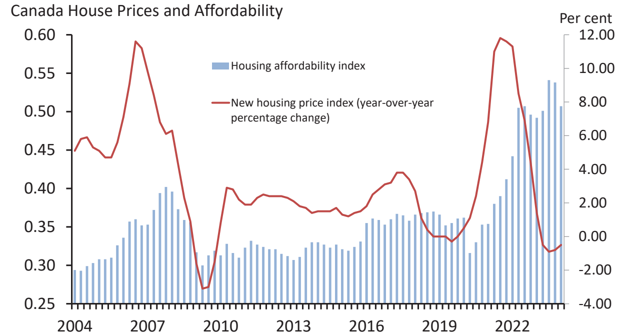
Rising Property Values

The Canadian Real Estate Association (CREA) reported that the national average home price reached $723,000 in December 2023, reflecting a 6.5 percent increase from the previous year. Although the housing market experienced a cooldown in 2024, with the average home price in June at $696,179, this figure remains 53.4 percent higher than pre-pandemic levels in January 2019. In major urban centers such as Toronto and Vancouver, average home prices have exceeded $1 million, intensifying affordability challenges for both prospective homebuyers and current homeowners approaching mortgage renewals.

Mortgage Payments and Affordability

The Bank of Canada's housing affordability index, which measures the share of household disposable income spent on housing-related expenses, highlights the growing challenges in the housing market. As of Q1 2024, the index showed that the average Canadian household spent approximately 50 per cent of its income on housing costs, far exceeding the 30 per cent threshold traditionally considered affordable. Although the index adjusted lower in 2024, it had peaked at nearly 55 per cent in the latter half of 2023. This surge in the index began around Q2 2021, contrasting sharply with the historical average of around 30 per cent since the

Canadian Households Spending 50 per cent of Income on Housing Costs



Source: Bank of Canada latest: 2024Q1

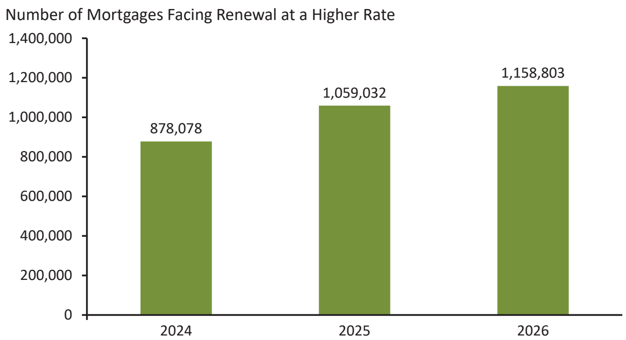
1990s. The situation is even more severe in major urban areas like Toronto and Vancouver. According to RBC's housing affordability measures, over 100 per cent of a median household's income was required to cover the ownership costs of an average home in Vancouver in Q1 2024, even though this was a 4.5 per cent decrease from the previous quarter. Households do not spend all of their incomes on housing, but the index provides a basis for comparison. In Toronto, the aggregate housing affordability index is still at nearly 80 per cent, despite the market slowdown in spring 2024. For those who purchased homes during the peak market years of 2021-2022, particularly those with variable-rate mortgages or facing steep increases in renewal rates, the financial strain is considerable, and for some, it has become unsustainable.

Furthermore, aspiring homeowners have faced increasing difficulties since the pandemic, with the downpayment requirement being a significant hurdle. The minimum downpayment for a starter home, such as a condo apartment, has jumped by 40 per cent since late 2019. By Q1 2024, the minimum downpayment for an average condo priced at $574,500 was $32,500, representing 38 per cent of a typical household's annual pre-tax income. This steep rise from pre-pandemic levels adds to the financial pressure, especially for those younger households who have had limited time to build equity or savings, leaving them more vulnerable to rising costs and economic uncertainties.

Impact of Higher Interest Rates

Interest rate increases—the fastest and largest in over four decades—have significantly impacted mortgage payments. According to records from C1 Economics' broker rate survey, the 5-year variable mortgage rate reached a historic low of 1.14 per cent in November 2021, with the 5-year closed mortgage rate dipping to 1.57 per cent in February 2021. Similarly, the 3-year variable mortgage rate held steady at 2.35 per cent from April 2020 until November 2021. However, by November 2023, the highest weekly effective household interest rate had surged to 6.96 per cent, as reported by the Bank of Canada, with the estimated variable mortgage rate peaking at 6.31 per cent by April 2024. While many homeowners secured record-low mortgage rates during the past three to five years, approximately 2.2 million mortgages are either up for renewal in 2024 or will come up for renewal within the next year, based on data from the Canada Mortgage and Housing Corporation (CMHC). This accounts for over 45 per cent of all outstanding mortgages in Canada. While the renewal payment can be higher for those who had to renew in 2024 as interest rate cuts only started in July, Bank of Canada noted that the average increase in mortgage payment for 2025/26 is closer to 20 per cent to 25 per cent upon renewal.

Homeowners Facing Mortgage Renewals at Higher Rates



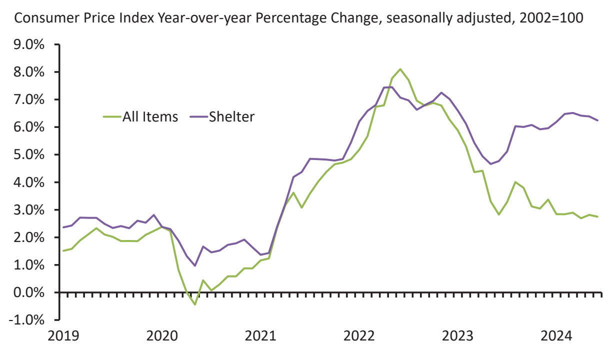
Source: CMHC, Statistics Canada

According to CMHC, the average monthly mortgage payment in Canada was $1,312 in Q4 2019. Homeowners renewing their mortgages in 2024 and 2025 can expect an estimated increase of $300 to $400 on average in their monthly payments compared with the previous term. This increase is substantial, especially considering that average earnings have to keep pace with inflation and housing costs.

Rising Housing Related Costs

In addition to higher mortgage payments, Canadian homeowners are facing rising housing related costs. Strata fees, which cover the cost of maintaining common areas and shared amenities in condominium buildings, have risen substantially. According to a survey by Condos.ca, average monthly strata fees in Toronto increased by 5 per cent annually over the past five years, reaching an average of $0.65 per square foot in 2023. According to Canadian Underwriter, home insurance rates saw a notable increase in Q1 2024, recorded a 10.9 per cent growth year-over-year. B.C. led the growth with 18.3 per cent yearly increase while the rest of the provinces seeing around 10 per cent growth except Quebec. This trend is part of a broader pattern of hardening insurance markets, where insurers adjust premiums to reflect higher claims costs and increased risk factors, such as climate-related damages. Property taxes have also seen considerable increases. Data from the Canadian Taxpayers Federation shows that property tax rates in major cities have risen by an average of 3 per cent per year over the past decade. Statistics Canada reports that electricity prices increased by an average of 4.4 per cent annually from 2018 to 2023. Similarly, natural gas prices rose by an average of 5.1 per cent annually over the same period. The cumulative effect of these increases adds significant strain to household budgets already stretched by rising mortgage payments.

Housing Related Costs on the Rise



Source: Statistics Canada, Central 1 latest: Jun2024

The Canadian Consumer Price Index (CPI) uses a variant of these approaches that measures the change in the cost of owning (rather than buying) a home by tracking the ongoing costs of homeownership, including replacement cost, mortgage interest cost, property taxes, homeowners' home and mortgage insurance, homeowners' maintenance and repairs and other owned accommodation expenses, while excluding the principal mortgage payment and capital gains.

June seasonally adjusted shelter costs in Canadian CPI are now 27.3 per cent higher than January 2019 level. Among the cost categories, mortgage interest costs led the growth in home related costs at 52.8 per cent higher than pre-pandemic level in January 2019, while home and mortgage insurance costs ranked the second at 43.1 per cent this June.

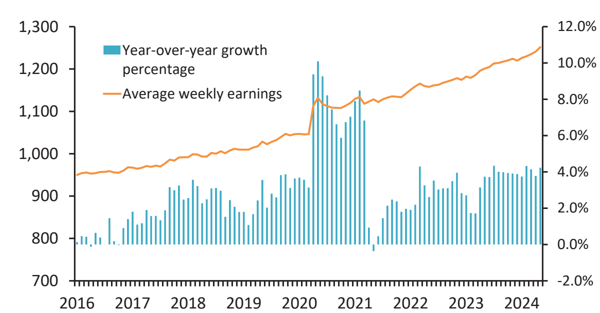
Wage Growth Trends

During the pandemic, Canada's average wages increased sharply due to composition effects as job losses among lower-income workers and lower wage sectors of the economy skewed average values. Much of this composition effect has reversed but wages remain substantial, reflecting tight labour markets.

During the pandemic after the initial surge, wage growth was relatively moderate, with nominal average weekly earnings increasing by around 1-2 per cent on year-over-year basis according to Survey of Employment, Payrolls and Hours (SEPH). However, as the economy recovered and labor market conditions tightened, wage growth accelerated, reaching at over 4 per cent in March 2022. Since then, wage growth has remained elevated, with the average weekly earnings increasing by about 3-4 per cent annually except early 2023 due to base year effect. The sharp rise post-pandemic is partly due to increased labor demand as businesses reopened and production ramped up, as well as workers negotiating higher wages to counteract the loss in purchasing power caused by rising inflation. By May 2024, average weekly earnings ($1251.8) were 19.6 per cent higher than in December 2019, outpacing the 17.0 per cent rise in consumer prices during the same period.

Canadians Seeing Strong Nominal Wage Growth

Employment and average weekly earnings, seasonally adjusted, CAD$



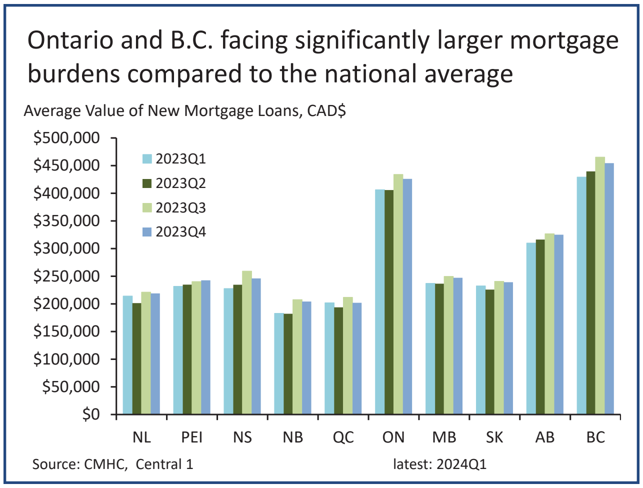
Source: Statistics Canada, Central 1 latest: May2024

In terms of real wages (wages adjusted for inflation), the situation is more nuanced. While nominal wage growth has been strong, inflation has eroded some of these gains, meaning that the purchasing power of workers has not increased as significantly as nominal figures might suggest.

If average earnings before tax could grow at the current annual rate of 4.0 per cent, resulting in a 1.5 per cent real wage increase (assuming inflation remains around 2.5 per cent), this wage growth would only add around $150 per month for two working individuals in a household a year from now on average. Therefore, payroll earning's growth alone may not be sufficient to cover the anticipated rise in mortgage payments ($300 to $400) if the couple needs to renew their mortgage in 2025/26. Taking on multiple jobs or part-time work has been a common strategy, allowing individuals to boost their earnings. By the end of 2023, the number of multiple jobholders in Canada has surpassed the pre-pandemic level and the growth was largely concentrated in the age group of 25-44 years old. Renting out a portion of their primary residence, such as a basement suite or spare room also helps ease the financial burden of mortgage payments.

Delinquencies and Financial Fragility

In provinces with higher housing prices, such as Ontario and British Columbia (B.C.), homeowners face significantly larger mortgage burdens compared to the national average. By the end of 2023, the average value of new mortgage loans in these provinces exceeded $400,000, with Toronto and Vancouver Census Metropolitan Areas (CMAs) surpassing $500,000. Despite these substantial loan amounts, the average individual incomes according to Statistics Canada in Ontario ($68,900 for core aged group in 2022) and B.C. ($68,700 for core aged group in 2022) are only slightly above the national average of $57,100. In contrast, Alberta, which had the highest average income ($71,300 for core aged group) in 2022, showed a lower average new mortgage loan value of just over $300,000. Additionally, both Ontario and B.C. had debt-to-disposable income ratios over 200.0 by Q1 2024. The significant difference in mortgage sizes, coupled with relatively modest income increases, highlights the financial pressures in high-cost housing markets. Homeowners in these regions are more vulnerable to economic downturns and rising interest rates, which can exacerbate their financial stress and limit their ability to manage mortgage payments effectively.



According to CMHC, there has been an increase in overdue payments for auto loans, credit cards, lines of credit, and home equity lines of credit (HELOCs). This indicates that a growing number of credit consumers are struggling with debt payments. Typically, increases in mortgage arrears are preceded by delinquencies in other credit products, as homeowners prioritize mortgage payments. Some mortgage borrowers are resorting to additional debt or maximizing their revolving credit (like credit cards or lines of credit) to make monthly payments. The national mortgage delinquency rate remained below 0.20 per cent by the end of 2024, 0.10 per cent below the level in Q4 2019. However, this rate has been rising since the end of 2022 led by defaults of larger sized mortgages and is expected to continue increasing.

Impact on Consumer Spending and Savings

Canadian homeowners often prioritize mortgage payments over other debts and non-essential expenses. In times of financial stress, they typically reduce savings, cut back on consumption, or incur additional debt. According to TD Economics, spending cuts differ based on the timing of mortgage renewals. Homeowners renewing in 2021 reduced spending by 0.9 per cent year-over-year, those in 2022 by 1.4 per cent, and the most significant cuts occurred in 2023 at 2.4 per cent. As of September 2023, those expecting renewal in 2024 had already cut spending by 0.5 per cent, indicating likely further reductions. Overall, mortgage holders reduced spending by about 1 per cent compared to non-mortgage holders, amounting to a $6 billion decrease in spending across the economy. This reduction could further dampen the retail business, potentially leading to further economic slowdown. Food and beverage retailers in Canada have experienced a decline in seasonally adjusted sales, measured at constant 2017 prices, falling below pre-pandemic levels. This decline reflected a reduction in consumer spending, as households cut back on non-essential purchases, including dining and groceries, to manage tighter budgets and rising costs.

In the last quarter of 2023, the average household savings rate in Canada stabilized at 6.2 per cent, down from a peak of 11 per cent during the pandemic. However, this figure masks significant disparities across income levels. Higher-income households reported a net savings rate of 12.6 per cent, while lower-income households often had to dip into their savings monthly. Rising costs, particularly for housing and essential goods, outpaced income gains for lower-income families. Additionally, financial support from family became crucial for some Canadians to manage living expenses and reduce debt.

These trends are likely to persist in 2024, with reduced savings and consumption typically marking the onset of financial stress. If financial challenges continue or worsen, particularly during mortgage renewals, consumers may resort to selling assets to maintain their mortgage payments. Prolonged financial strain could deplete resources, leading to missed mortgage payments and an increased risk of default.

Despite a tight labor market giving workers some leverage in wage negotiations, the broader issue of wage growth lagging behind rising living costs remains a critical concern. As a result, many Canadians are increasingly financially fragile, with limited capacity to absorb further economic shocks especially as labor markets loosen and economic growth cools. This situation is exacerbated as more homeowners facing mortgage renewals at higher interest rates, significantly increasing their financial burdens. However, there may be some relief ahead. The Bank of Canada recently cut its policy rate for the second consecutive meeting in July, reducing the target for the overnight rate by 0.25 percent, with the possibility of further cuts. For a mortgage balance of $300,000 with a 25-year amortization period, each 0.25 percent reduction in the interest rate could lower monthly payments by approximately $45. This potential for further rate cuts might offer some breathing room for those with upcoming mortgage renewals or variable-rate mortgages.

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