What Drives Us

Winter 2022

IN THIS ISSUE

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Mason Michael Dupuis, 8lbs, 6oz.

Happy New Year! Our team has much to celebrate with two recent additions!

Firstly, welcome to Brian Porter, who managed credit strategies for high net worth business owners at RBC's Commercial Banking division. Brian is a proud graduate of the University of Windsor and a dedicated community volunteer currently serving on the Alumni Board of Directors. Born and raised in Windsor, Brian enjoys sports, cooking, gardening, and spending time with his wife and three young sons. A financial markets enthusiast and a lifelong investor, he is excited to work with clients to help them meet their financial goals.

Secondly, join me in welcoming PJ's newest love project, Mason Michael, born Dec 21st, 2021. That is three boys in the Dupuis household for whoever is taking count!

This newsletter edition discusses rising interest rates. The Bank of Canada stated that it is committed to keeping the policy rate on hold at the effective lower bound until the economic slack is absorbed, achieving a sustainable two percent inflation target. However, the length of time that Covid remains a part of our lives will undoubtedly affect our economy and market. Our team will continue to navigate your portfolio through these murky waters, ultimately getting you to your destination.

Stay well,

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TD Wealth Private Investment Advice

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Housing Interest Rate Sensitivity

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Highlights

- The Bank of Canada has been sending a strong signal that short-term interest rates are poised to move higher beginning in the middle-part of 2022. This has contributed to upward pressure in bond yields across the curve in recent months.

- Given the rapid increase in home prices we've seen during the pandemic (and the attendant erosion in affordability), it's logical to wonder whether looming rate hikes will have a larger-than-normal impact on housing demand, and thus prices, moving forward.

- Our analysis of Canadian housing activity showed little evidence of increased interest rate elasticity in the years leading up to the pandemic relative to the long-run trend. Furthermore, stress tests offer ample room for rates to rise before buyers are crowded out.

- It is worth noting that the level of affordability was worse than it is now in late 1980s/early 1990s. Yet home sales managed to hold relatively stable over that period.

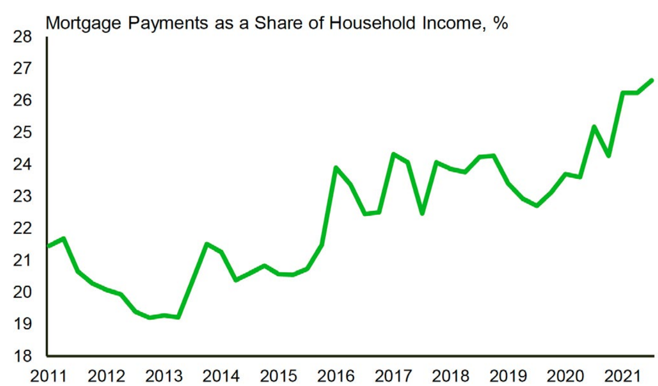
- In addition to affordability levels, the speed of deterioration matters. We calculate that the worsening in affordability during the pandemic has been exceeded only during the Global Financial Crisis. However, unlike back then, the macro backdrop remains supportive, which should help mitigate the impact of rising rates and keep sales well above prepandemic levels moving forward.

In late October, the Bank of Canada engaged in a bout of expectations management, sending a strong message to Canadians that they would do what's necessary to bring inflation under control.

In doing so, it laid bare that higher rates could be in the pipeline. Our own forecast envisions three rate hikes taking place next year followed by three in 2023, bringing the overnight rate to 1.75% from its current 0.25% emergency setting. Of course, yields had been increasing even in advance of the Banks' hawkish message, with the 5-year bond yield on the rise since early September, climbing by about 60 basis points through early December.

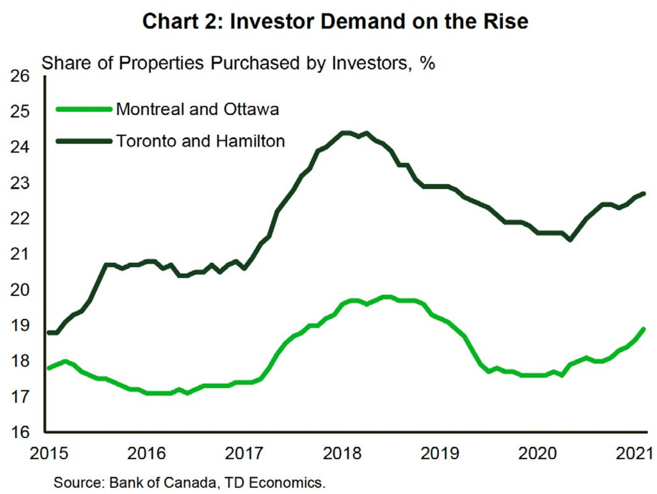
With home prices having reached astronomical levels during the pandemic – thus causing a further steep erosion in affordability from already unfavourable levels (Chart 1) – it becomes logical to wonder whether looming rate hikes will have a larger-thannormal impact on housing demand moving forward. After all, skyrocketing home prices have already made it tough for people to enter the market, and rising interest rates should make it even tougher.

Chart 1: Swift Deterioration in Affordability During the Pandemic



Source: CREA, Statistics Canada, TD Economics. Last observation: Q3-2021.

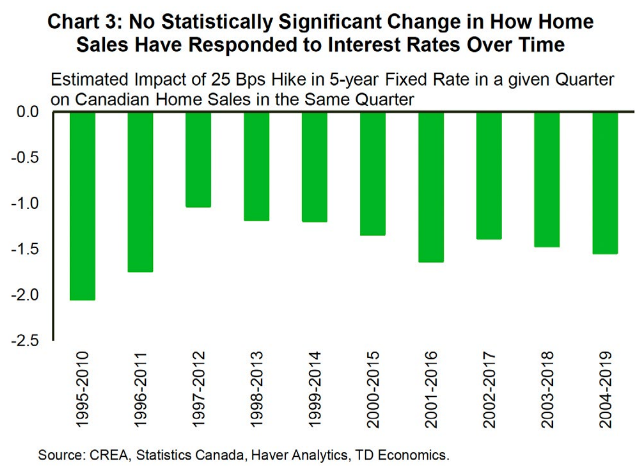
Our own view is that higher interest rates will exert a drag on demand, as they change the affordability calculus for potential owners and investors, while also reducing cash flows for the latter group. The potential impact on overall demand from investors shouldn't be overlooked, as they have formed a rising share of activity this year (Chart 2)



Only time will tell, but we are not convinced that higher rates will be enough to prevent another year of elevated sales activity and home price increases in 2022. There is a commonly held perception that higher prices equate to increased interest rate sensitivity. Yet our modelling work showed little evidence that this was the case during the several years of eroding affordability and rising yields prior to the pandemic. In addition, interest rates are not the only factor in the demand equation. Indeed, other key factors that drive demand, including savings and demographics, remain important offsets to rising borrowing costs.

Stable Negative Relationship Between Rates and Sales

Prior to the pandemic, the negative relationship between interest rates and Canadian housing demand had been quite stable over time. Rolling regressions undertaken from 1995 through 2019 using equations relating home sales to fundamentals such as income, supply, prices, and interest rates confirm this. (Chart 3)[1]



They also suggest that a 25 bps increase in the 5-year fixed mortgage rate in a given quarter has historically yielded around a 1.5% drop in home sales in the same quarter, all else equal.

For the unabridged version of this report, please email: Boraba.Sordachanh@td.com

BDWM IN THE COMMUNITY

Pay it Forward

To show appreciation for your continued business, we have donated to the John McGivney Children's Centre (JMCC), purchasing much-needed equipment for their physiotherapy programs. We're proud to support their services on your behalf.

A Timely Reminder

The RRSP Deadline for 2021 is Fast Approaching.

Happy New Year! To start the year off right, we wanted to take this opportunity to review the tax benefits offered by Registered Retirement Savings Plans (RRSPs). Quick Facts about RRSPs:

- Contributions are deductible against your income for Canadian income tax purposes, subject to your contribution limit, and are not taxed until you withdraw them as needed during retirement (ideally at a lower tax rate).
- Taxable withdrawals can be made at any time, not just during retirement.
- The annual contribution room is 18% of the previous year's earned income up to a maximum contribution limit, subject to pension adjustments.
- Your contribution limit for 2021 can be found on your Canada Revenue Agency Notice of Assessment for 2020.
- The deadline for 2021 contributions is 11:59 p.m., March 1, 2022.
- Contributions made in the first 60 days of a year can be used for the current year's or the previous year's tax filing.

Maximum Annual RRSP Contribution Limits.

Year	Contribution Limit
2015	$24,930
2016	$25,370
2017	$26,010
2018	$26,230
2019	$26,500
2020	$27,230
2021	$27,830
2022	$29,210

We see the value in understanding your journey.

Please contact us with any question or concerns you may have about how RRSPs can fit into your overall wealth strategy.