



**VERMA  
ANALYTICS**

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## OH, CANADA: HOUSING WOES LOOM

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## OVERVIEW

The consensus narrative for the Canadian housing market entering 2026 has been predicated on a cyclical recovery thesis: that the aggressive monetary tightening of 2022 - 2023 has successfully tamed inflation, allowing the Bank of Canada (BoC) to normalize interest rates and subsequently reignite the bull market in real estate (RE). The comprehensive analysis outlined in this research report suggests this view is fundamentally flawed. We are not witnessing the end of a cyclical pause, but rather the onset of a structural deleveraging event.

The Canadian residential real estate market is currently facing a unique confluence of headwinds that are continuing to intensify, rather than dissipating. First, the transmission mechanism of monetary policy has fractured; the BoC's reduction of the overnight rate to 2.25% has failed to reverse the decline in asset prices and sales volume, indicating a market trapped in a liquidity bind where affordability remains mathematically impossible for the marginal buyer. Second, the bond market has decoupled from central bank policy. Rising commodity prices and fiscal uncertainty have re-priced long-term inflation expectations and uncertainty, driving the term premium higher and keeping fixed-rate mortgages elevated despite short-term cuts. Third, the labor market continues to deteriorate beneath the surface, with rising unemployment and a shift in job quality eroding the creditworthiness of the household sector, just as the 2026 mortgage renewal wall hits its apex. Finally, the rental market – a critical support for investor valuation – has rolled over significantly. With rents falling in major urban centers, the potential yield for investors has turned deeply negative, drastically reducing the attractiveness of the asset class.

This report validates the bearish thesis that the Canadian housing market faces a "second leg down" in 2026. We argue that the combination of negative carry for investors, a forced renewal cycle for homeowners, and a stagnant labor market will create a supply-demand imbalance that cannot be cleared at current price levels.

## MONETARY IMPOTENCE: THE FAILURE OF THE "GOOD NEWS" TRANSMISSION

### I. The Decoupling of Rates and Activity

The primary pillar of the 2026 bull thesis for Canadian RE – that lower interest rates will mechanically stimulate demand – has been empirically disproven by the market activity throughout 2025. Historically, a pivot in monetary policy (from tightening to stimulative) has acted as a potent accelerant for housing activity. However, despite the BoC lowering the benchmark interest rate to 2.25% by December of 2025, down from a peak of 4.50% in early 2023, the housing market has thus far failed to respond positively. A YoY decline of 1.8% in the national average sale price was reported in December 2025, as well as a YoY decline of 9.3% in

monthly sales. This divergence is critical. In a healthy market, a 200+ basis point reduction in the overnight rate should have spurred a volume breakout. The fact that volume instead continued to decline alongside falling rates suggests that the market is grappling with a solvency crisis, not merely a lack of liquidity.

This phenomenon described above can be defined as a “Real Estate Liquidity Trap”. When house prices are historically unaffordable relative to household incomes, even after recent corrections, and the qualifying rate (stress test) remains prohibitive, marginal cuts do not create new eligible buyers. They merely offer slight relief to existing variable-rate holders. The “pent-up demand” narrative cited by groups like CREA ignores the reality that demand is constrained by hard credit limits, not just psychological sentiment.

## **II. The Stress Test Anchor**

The Office of the Superintendent of Financial Institutions (OSFI) continues to enforce guideline B-20. Even with the overnight rate down to 2.25%, the 5-year fixed mortgage hovers near 4.50% – 5.0% for uninsured mortgages. This means borrowers must qualify at rates between 6.50% – 7.0%. For the median Canadian household earning roughly \$87,000, qualifying for the average price of ~\$680,000 is mathematically impossible without substantial equity or intergenerational wealth transfer. The rate cuts have lowered the bar, but the bar still remains well out of reach of the labor market’s current income capacity.

## **III. Psychological Shift: From FOMO to FOOP**

Market psychology has shifted fundamentally. During the 2020 - 2022 boom, the dominating emotion was the “Fear of Missing Out” (FOMO). Buyers raced to lock in rates and assets. As we enter 2026, we see a completely different attitude from potential buyers, as the dominating psychology has now shifted to the “Fear of Overpaying” (FOOP). With inventory levels accumulating, for instance active listings in Toronto and Fraser Valley were both up over 10% YoY in December 2025, buyers now perceive time as an asset. They are no longer competing in blind bidding wars, but instead inspecting days-on-market metrics and offering below the asking price. This psychological shift creates a self-fulfilling prophecy where buyers withhold demand in anticipation of lower prices, forcing sellers to cut prices to find liquidity.

# **THE BOND MARKET VIGILANTES: THE TERM PREMIUM THESIS**

## **I. The Mechanisms of the Steeper**

While the BoC controls the front end of the yield curve (the overnight rate), the long end (5-year, 10-year, 30-year bonds) is determined by market participants based on their outlook for

growth, inflation and fiscal stability. We are currently witnessing a “Bear Steepening” of the yield curve, where long-term rates rise (or refuse to fall) even as short-term rates are cut.

As of January 13, 2026, the 5-Year Government of Canada bond yield is trading at approximately 2.94%. Despite the BoC cutting the overnight rate to 2.25% the 5-year yield has remained sticky, refusing to break significantly below the 3.00% handle. This spread represents the term premium – the extra compensation required by investors for holding duration risk.

Maturity	Yield (%)	Monthly Change	Implication for Mortgage Market
Overnight (BoC)	2.25%	Flat (Paused)	Sets Prime Rate for Variable Mortgages.
2-Year Bond	2.57%	-12 bps	Influences short-term fixed/bridge financing.
5-Year Bond	2.94%	Flat / Sticky	The Benchmark for the 5-Year Fixed Mortgage.
10-Year Bond	3.41%	+5 bps	Reflects long-term inflation & fiscal risk.
30-Year Bond	3.85%	+3 bps	Pricing in structural inflation/deficits.

## II. Commodity Prices and Inflation Expectations

When commodity prices rise, as we've seen in dramatic fashion over the last year or so, bond investors anticipate higher future inflation. To protect their real returns, they sell bonds, driving bond prices down and yields up. This “inflation premium” is preventing the 5-year bond yield from falling in tandem with the BoC rate. Consequently, banks cannot lower their 5-year fixed mortgage rates aggressively because their funding costs (swaps based on bond yields) remain elevated.

- **Copper:** Prices were supported in October 2025 by supply concerns and production disruptions. Copper is notoriously known as “Dr. Copper” for its ability to diagnose the health of the global industrial economy. The significant rise in copper prices, with copper now trading at an all-time high above USD\$6/lb, signals cost-push inflation for the manufacturing and construction sectors.
- **Gold:** Gold is often seen as a measuring stick for inflation, with a rising gold price indicating a lower purchasing power for the dollar. The meteoric rise in gold price since 2023 indicates a need for market participants to hedge against persistent inflation expectations.
- **Silver:** While also a precious metal with many of the inflation-hedging properties of gold, silver also has significant industrial uses, such as in electronics, EVs, and even AI

datacenters. Silver rose nearly 150% in 2025, once again signalling significant cost-push inflation for certain sectors.

- **Energy:** While oil prices have seen volatility, the structural floor provided by OPEC+ and geopolitical risk keep energy input costs elevated relative to the deflationary expectations needed to crash bond yields.



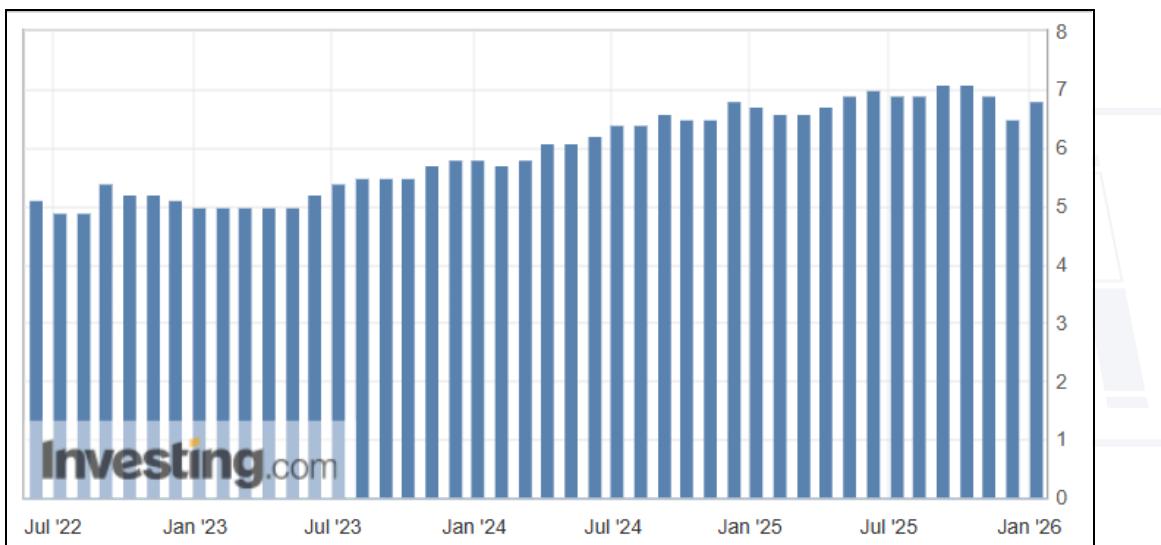
### III. Fiscal Dominance

With the Canadian federal government maintaining significant deficits to support the economy and social programs, the supply of government bonds is high and continues to grow. Investors require a higher yield to absorb this supply, especially when the U.S. Treasury (the global benchmark) is also seeing yield pressure from its own fiscal expansion.

## LABOR MARKET DETERIORATION

### I. The Rising Unemployment Rate

The most critical metric for the housing market is the unemployment rate, which rose to 6.8% in December 2025, up from 6.5% the previous month. The unemployment rate has been on a steady trajectory higher since Q2 2022, despite the central bank's efforts to stimulate the economy by lowering rates. The trend in unemployment since 2022 can be seen in the chart below.



## II. Demographic Pivot

The federal government's pivot on immigration policy and "right-sizing" of non-permanent resident (NPR) targets has led to a massive tapering in population growth. This reduction in net migration acts as a deflationary force in the rental market.

Specifically, the sharp reduction in international student visas – with new arrivals projected to fall by roughly 50% in 2026 (150,000 students) – removes a primary source of demand for entry-level rentals and investor-owned condos. The reduction of this demographic cohort creates a vacancy shock, directly applying downward pressure on rent prices.

## THE 2026 RENEWAL WALL: A SOLVENCY EVENT

The year 2026 represents the peak maturity for mortgages originated during the frenzy of 2021, a period characterized by historically low rates and peak valuations. The dramatic increase in debt-service-costs upon renewal of these mortgages likely poses the risk of a credit event taking place this year.

### I. The Mathematics of Payment Shock

The Bank of Canada and commercial banks alike have been warning of a potential solvency event in the Canadian residential real estate market, and the data is now confirming the severity and likelihood. Approximately 60% of mortgage holders renewing in 2026 will see their payments increase compared to their current contracts.

- **The 2021 Cohort:** Borrowers who locked in 5-year fixed rates in 2021 typically secured rates between 1.50% and 2.00%.

- **The 2026 Reality:** Upon renewal in 2026, these borrowers face a 5-year fixed rate environment of roughly 4.50% to 5.00% (assuming rates remain sticky as analyzed above).
- **The Calculation:** The 300 basis point shock translates to a massive increase in monthly debt service. For example, a standard \$500,000 mortgage could see a monthly payment increase of approximately \$600 to \$800.

## II. The Variable-Rate Fixed-Payment (VRFP) Trap

A specific and dangerous subset of the market involves Variable-Rate Fixed-Payment (VRFP) mortgages, primarily originated by major banks like TD, CIBC, and BMO. These products allowed borrowers to keep their monthly payments static even as rates rose in 2022 - 2024, resulting in negative amortization – where the payment didn't even cover the interest.

- **The Reset:** When mortgages renew in 2026, they must reset to their original amortization schedule. The borrower must not only pay the higher interest rate but also catch up on the principal that wasn't paid.
- **The Impact:** The Bank of Canada estimates that some of the borrowers in this category could face payment increases of up to 40%. This is not simply a budgeting inconvenience for a household that can be solved by "cancelling Disney+", this presents a potential solvency crisis.

## III. Rising Delinquencies: The Canary in the Coal Mine

Credit Bureau data is already flashing red. Equifax Canada reported in late 2025 that 1.45 million consumers missed a credit payment. More alarmingly, mortgage delinquency rates in Ontario and British Columbia have soared – up 135.2% and 62.2% respectively YoY.

- **The Hierarchy of Payments:** In credit risk analysis, we know that borrowers prioritize their mortgage above all else. They will default on other forms of credit first, such as credit cards, lines of credit and auto payments. The fact that mortgage delinquencies are now rising in dramatic fashion in the most expensive provinces indicates that households have exhausted their unsecured credit buffers. They are now tapping out.
- **Power of Sale Potential:** We expect a significant increase in Power of Sale listings (foreclosures) in 2026 as lenders move to recover capital from insolvent borrowers who cannot refinance due to falling equity values.

## THE INVESTOR EXODUS: CAP RATES AND CASH FLOW

A critical, often underappreciated driver of the Canadian housing market – specifically in the condo segment – is the small-scale investor. Investors own a significant portion of the condo stock in major metropolitans like Vancouver and Toronto. This segment is facing a perfect storm that could compel liquidation in 2026.

## I. The Collapse of the Cash Flow Model

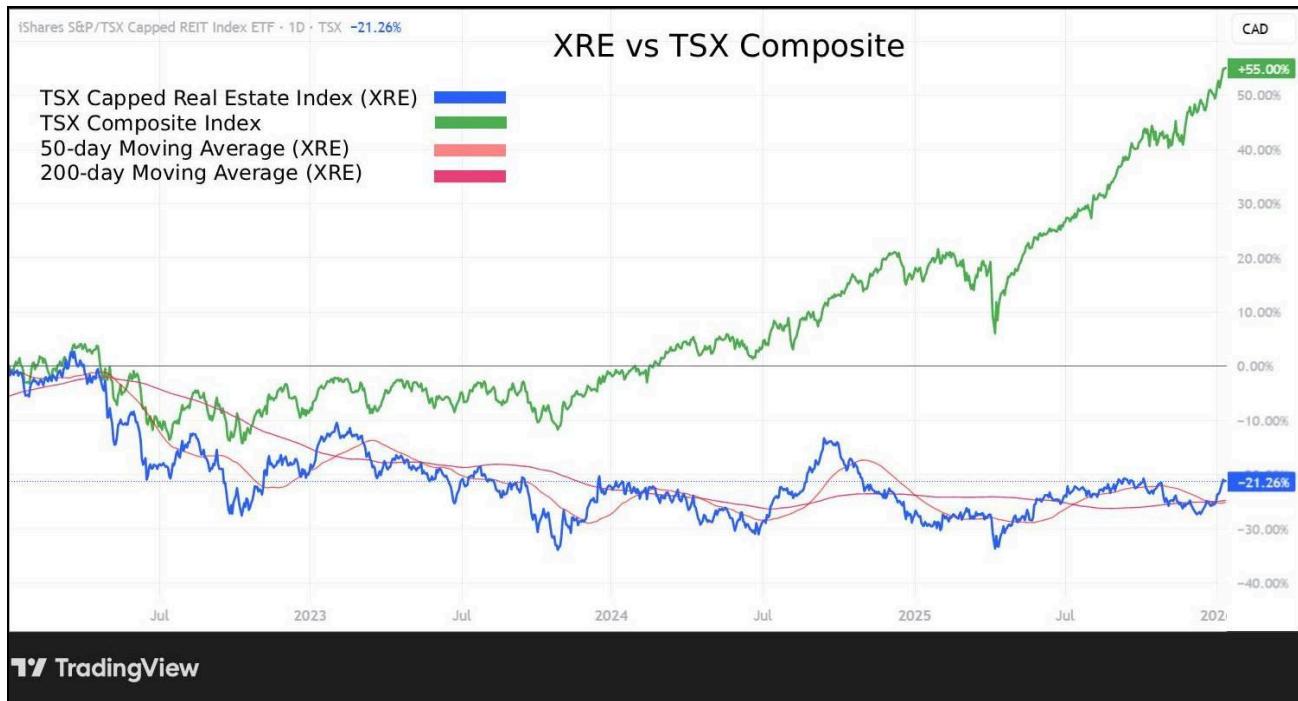
For the past decade, some Canadian RE investors accepted neutral or slightly negative cash flow, banking on capital appreciation instead. In 2026, this investment thesis is entirely broken.

- **Cap Rate:** With the risk-free rate (5-Year GoC bond) yielding ~3.00%, residential cap rates of 3.5% - 4.0% offer virtually no risk premium for the illiquidity and management headaches of real estate. Smart capital is rotating into fixed income or other asset classes.
- **The Rental Reversal:** Contrary to the narrative of perpetual rent growth, the rental market is softening. In December 2025, the average asking rent in Canada *fell* 2.3% YoY. The declines were most severe in investor-heavy markets:
  - Vancouver: -7.9% YoY
  - Toronto: -5.1% YoY
  - Calgary: -5.0% YoY
- **The Investor Squeeze:** Recent data reveals the extent of this crisis – approximately 81% of Toronto condo investors are now cash-flow negative. With average monthly losses reaching roughly \$600, the attractiveness of holding these assets has collapsed. An investor holding a Toronto condo is now facing a potential “double-whammy”: their mortgage payment upon renewal could jump by as much as 30 - 40%, while their rental income is dropping. This is an unsustainable situation for the “mom and pop” investor.

## TECHNICAL ANALYSIS

### I. TSX Capped Real Estate Index (XRE) Analysis

- **Relative Strength:** Since 2022, there has been an evident divergence between the performance of XRE and the overall TSX – the TSX has delivered a 55% price return since January 1, 2022, benefiting from strong financials and energy, while XRE is down -21.26% over that same period. This divergence is a classic bearish signal; capital is rotting out of real estate exposure.
- **Moving Averages:** The “Death Cross”, when the 50-day moving average crosses below the 200-day, has recently been observed in XRE and other REIT charts.



## II. Physical Market Technicals

- **Volume/Price:** A trend that is currently observable in the market is low/falling sales volume while prices also slide. When volume dries up but prices continue to drift lower, it indicates a lack of bid support in the market.
- **The SNLR Signal:** The national Sales-to-New-Listings Ratio is hovering near 52%. A sustained break below 50% would technically confirm a buyer's market. Given the inventory glut in major centers, this technical breakdown appears imminent in 2026.

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