

Could there be a drop in residential real estate values in Canada?



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The mortgage loan crisis has led to a market collapse south of the border. In Canada, the residential sector is still doing very well. But will this trend continue throughout 2008?

The vitality of the residential sector has outstripped the most optimistic prognoses from last year. While a certain slowdown was expected following the exceptional growth seen in recent years, that slowdown never materialized.

More than 500,000 homes were sold in 2007 in Canada, a previously unheard of result. Prices increased by more than 10%, driven by the overheated real estate market in Western Canada. While the Prairie provinces stood out with price increases of over 20%, Québec and Ontario also did well with increases of 7.3% and 7.6%, respectively. In Ontario, sales shot up after two slow years so that real estate price increases accelerated. The real estate market remained strong from coast to coast in Canada in 2007, in stark contrast to what was happening in the United States.

In Québec, more than 80,000 properties were sold using a real estate agent, shattering the record established the previous year. High demand created upward pressure on prices, which reached an average of \$208,240 last year. Increases even exceeded 10% in some areas such as Québec City (+11.0%), Trois-Rivières (+12.2%) and Saguenay (+14.0%). In the Greater Montréal area, prices last year increased between 5% and 10%. The average price for a single-family home is \$350,000 on the Island of Montréal and more than \$200,000 in the outlying areas. Overall, the resale market in Québec did not slow down last year and there are no signs of a downturn.

WHAT'S BEHIND THIS MARKET STRENGTH

While a certain slowdown is expected in 2008, a collapse here would be virtually impossible. How is it that we can escape the fate of the U.S.? First of all, contrary to what's happening in the United States, housing demand remains solid here since it was never artificially pumped up through an abundant supply of risky loans. Such products are very marginal here,

representing less than 5% of new mortgage loans (compared to 22% in the United States in 2006). In addition, recourse to mortgage loan insurance in Canada constitutes an additional protection in case of default. So the risk of a mortgage loan crisis in Canada is virtually nil.

Here, the residential sector also benefits from the strength of the labour market. Unemployment rates in Québec and Canada are as low as they were 33 years ago. While increasing difficulties in the U.S. economy and their repercussions on this side of the border could have a negative influence, the labour market will continue to support housing demand in Canada.

PRICES WON'T GO DOWN, BUT THEY WON'T INCREASE MUCH EITHER

One thing is certain: the residential sector is in a much better position in Canada. Demand remains strong and the low supply situation has persisted, encouraging price increases that exceed inflation. A certain slowdown is still expected this year since the cost of buying a home is less and less affordable.

At the end of 2007, in fact, the Desjardins affordability index, which reflects the financial ability of households to purchase a property, dropped close to its lowest point, reached in 1990. Price increases in recent years as well as the increase in mortgage interest that happened last year are the main causes of this situation. However, the relatively healthy condition of the real estate market, which is steadily settling into a more balanced position, will give way to a gradual decrease in demand for housing in the country. Consequently, price increases will tend not to be so strong this year, i.e. 6.5% in Canada and 3.5% in Québec. However, there is no cause for concern that prices may drop, since, unlike the situation in the United States, the market in Canada is far from offering a surplus. **D**