Recent Developments in the Canadian Housing Market Reignite Concerns

The Canadian housing market has been hit by several headwinds in recent years. Not only did the BoC raise key interest rates five times by 25 basis points each time between July 2017 and October 2018, but various levels of government also gradually imposed several restrictive measures.

Against this backdrop, the slowdown in the housing market became quite clear in the spring of 2017. Moreover, the number of existing homes plunged throughout Canada (graph 1). Still, this adjustment was not uniformly felt across the country as British Columbia, Ontario, Alberta and Newfoundland and Labrador saw significantly bigger reductions. The adaptation of the Vancouver and Toronto markets to the restrictions and new financing conditions is clearly at the heart of the struggles in British Columbia and Ontario. As for Alberta and Newfoundland and Labrador, the sluggish sales of existing homes is also the result of weaker economic growth due to the problems in the oil and gas industry. In contrast, some regions never experienced a real slowdown, including Quebec, where the housing market continued along its upward trajectory.

The adjustments also impacted existing home prices. The average price based on real estate transactions plunged roughly 14% between the high of April 2017 and the low of February 2019. This measurement is, nonetheless, misleading. Home prices being much higher in Vancouver and Toronto, the major reduction in transactions in these two markets is such that they contribute less to the national average, thereby causing it to display a downward bias. The average price according to the existing home price index is much more revealing. Moreover, it isn’t affected by the fluctuations within the geographic distribution of home sales. The existing home price index hasn’t really gone down in recent months. Instead, it’s showing a certain stability (graph 2 on page 2). Even so, this stability reveals a changing trend compared to the strong growth noted between 2014 and 2017.

Lastly, new-home construction was also hit by the slowdown, and the number of housing starts has tended to be lower since early 2018 (graph 3 on page 2). The pullback was particularly big in Ontario, especially when it came to condominiums.

After a major slowdown in several regions since early 2017, the Canadian housing market has been showing signs of a recovery in recent months. It must be said that the conditions are favourable, thereby stimulating demand in a number of markets. Even if the situation isn’t raising any red flags in the short term, it still bears keeping a close eye on it while the problem of the housing market overheating could worsen in the coming quarters. Under these circumstances, the risks associated with residential real estate throughout the country remain significant; this could, of course, influence what path the Bank of Canada (BoC) takes with its monetary policy.
Still, the previous graphs show that the housing market recently stabilized. The decline in existing home sales appears to have peaked at the beginning of 2019, and there have even been signs of a rebound lately. The same pattern was also seen in recent months for housing starts. Is this just a break in the downward trend, or is it the start of a real housing market rebound?

Most Regions Are Seeing an Improvement
As graph 4 shows, most regions are benefitting from the recent improvement in the housing market. All of the main cities in Canada are seeing increased real estate transactions from last year. Most of them have also been posting higher prices recently (see Appendix A on page 5 for detailed graphs on each of these regions). Vancouver and Calgary stand out, although their price trend remains low. Still, the situation could turn around soon if sales continue to grow.

Housing market conditions are definitely favourable. The restrictive measures are still in place, but they appear to have mostly been absorbed. In addition, the rise in key interest rates has been replaced by a lengthy status quo. Some mortgage rates even fell recently in response to the drop in yields on the financial markets.

The labour market is also strong. The unemployment rate is hovering around its historical low in Canada and Quebec and is very low in the other provinces. More and more companies are faced with a labour shortage. Under these circumstances, wage growth accelerated recently (graph 5), improving households’ purchasing power in the process.

Housing market demand is also ballooning because of the number of first-time home buyers. The population aged 25 to 34, which usually corresponds to the age range of first-time home buyers, is up sharply in a number of regions (graph 6 on page 3). Ontario and, to a lesser degree, British Columbia saw exceptionally rapid growth. The increase is more moderate in Quebec and Atlantic Canada, but the rate of growth is accelerating. Only in the Prairies is the population aged 25 to 34 declining.
Lastly, despite the introduction of some restrictive measures, foreign buyers still seem to be stimulating demand in certain markets. According to Statistics Canada, the proportion of dwellings belonging to non-resident owners was 4.8% in Vancouver and 3.4% in Toronto. In Montreal, this proportion is lower, but JLR’s data has shown a clear increase in recent years. This implies that some foreign buyers have given up on Vancouver and Toronto, which both impose a 15% tax on foreigners, and are turning to Montreal, which has not yet introduced a similar measure.

All these factors paint a very positive picture of housing market demand. Therefore, there is reason to believe that the recent upward trend will continue over the coming months in most markets. This is obviously very good news for the growth of Canada’s economy. However, this has reignited the concerns associated with an overheated housing market and excessively high household debt.

**Affordability Could Deteriorate Once Again**

Platueauing home prices in most areas of the country in recent quarters have certainly helped to keep stable the Canadian market affordability (graph 7), but the adjustments of recent quarters were too modest to lead to any real improvement. As a result, most metropolitan areas are still considered unaffordable (graph 8). With prices starting to climb again in most areas, the fear is that affordability will once again deteriorate in the coming quarters.

As such, housing market conditions are now favourable to price increases in several regions across the country (graph 9). The number of transactions in relation to new listings is up, while the number of months of inventory (i.e., the number of months required for all listings to sell based on the monthly transaction rate) is down. Despite the recent tightening, the conditions are

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No Need to Panic... but Authorities Need to Be Careful

In spite of the return of a positive trend in the housing market, there is no need to worry much about it, at least not in the near future. The Vancouver and Toronto markets still have a long way to go before they recover the ground lost during the recent slowdown and revisit worrying levels. As for Ottawa, Montreal and Halifax, even if there never was a real slowdown, prices are still very much below Vancouver’s and Toronto’s prices, a sign of some leeway despite the upward trend. However, if the uptrend were to last, it is possible that, in the coming quarters, the entire Canadian housing market could hit—or even surpass—the peaks recorded before the slowdown. Therefore, authorities need to stay alert.

Against this backdrop, the risks associated with the housing market are considerable. On the one hand, the increase in home prices implies that Canadians are still going further and further into debt to buy their new homes. This could drive household debt in Canada to new heights. For now, stable key interest rates are saving the day, but for how long if they were to begin climbing again? This weakens household financial position, which could lead to slower spending and, as a result, affect economic growth should interest rates rise significantly.

On the other hand, if the Canadian economy were to slow down, this could lead to a housing market correction. The relative weight of residential investment within the Canadian economy has increased markedly in recent years. Under these circumstances, a sudden housing market adjustment would exacerbate the struggles faced by Canada’s real GDP.

All this is a major challenge for Canadian monetary authorities. As such, it’s difficult to envision interest rates coming down in the same way other central banks have lowered theirs at the risk of stimulating the housing market even more. All signs indicate that staying the course may be the best compromise in the current situation. That being said, we can’t exclude the possibility that the BoC will go ahead eventually and reduce its key interest rates too if the fear of international turmoil spreading were to increase in the country.

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Appendix A
Existing Properties for Each Region

GRAPH A1
Greater Vancouver

GRAPH A2
Calgary

GRAPH A3
Winnipeg

GRAPH A4
Greater Toronto

GRAPH A5
Ottawa

GRAPH A6
Greater Montreal

Sources: Canadian Real Estate Association and Desjardins, Economic Studies

NOTE: The average price based on transactions must be used for this region, as the average price index is unavailable.

Sources: Canadian Real Estate Association and Desjardins, Economic Studies
Appendix B
Housing Market Balance for Each Region

**GRAPH B1**
Greater Vancouver

**GRAPH B2**
Calgary

**GRAPH B3**
Winnipeg

**GRAPH B4**
Greater Toronto

* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies
**GRAPH B5**
Ottawa

Sales-to-new listings ratio
Long-term trend of the sales-to-new listings ratio*

* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

**GRAPH B7**
Quebec City

Sales-to-new listings ratio
Long-term trend of the sales-to-new listings ratio*

* 10-year moving average.
Sources: Quebec Professional Association of Real Estate Brokers and Desjardins, Economic Studies

**GRAPH B6**
Greater Montreal

Sales-to-new listings ratio
Long-term trend of the sales-to-new listings ratio*

* 10-year moving average.
Sources: Quebec Professional Association of Real Estate Brokers and Desjardins, Economic Studies

**GRAPH B8**
Halifax

Sales-to-new listings ratio
Long-term trend of the sales-to-new listings ratio*

* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies