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Canada Housing Market Outlook: Tough Times Ahead

INTRODUCTION

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The fallout from the COVID-19 pandemic is evident in the Conference Board of Canada's latest survey of consumer confidence, which plummeted in March. The worst effects will be felt in regions that rely disproportionately on the leisure/hospitality, trade and energy industries. British Columbia is most exposed in terms of leisure/hospitality and trade, while the Prairie provinces—which were already dealing with softening demand for energy—are most vulnerable to the collapse in oil prices.

Canada Housing Market Outlook: Tough Times Ahead

BY ABHILASHA SINGH

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Recent Performance: The pre-COVID-19 world

Nearly four years have passed since the first provincial policy intervention was announced to halt the deterioration of affordability in the Golden Horseshoe region.[1] At the national level, the Bank of Canada intervened by raising benchmark rates from 50 basis points to 175 basis points from 2017-2019 while the Office of the Superintendent of Financial Institutions introduced B-20 guidelines for stress-testing, which limited credit availability. The overall impact of these measures on affordability has been mixed.

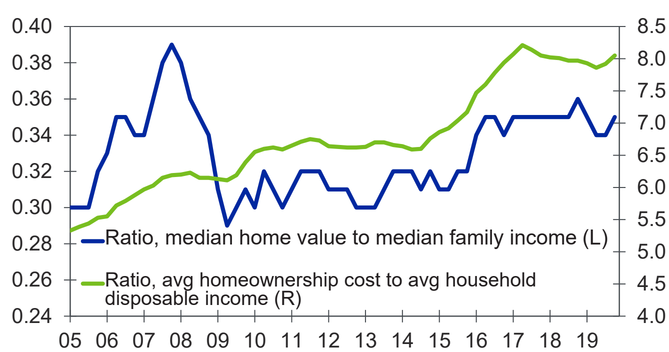
The BoC's housing affordability index—the ratio of average housing costs to disposable income—has stabilized but is still well above its 2015 level. In addition, the ratio of median home values to median family incomes has started to fall after a long period of increase (see Chart 1).

The slowdown in housing that resulted from these policy interventions was most evident in the sales data. After peaking at 550,000 annualized resales in mid-2016, resales have fallen for more than two and half years. However, resales started to recover in early 2019 and surged this year to 546,000 annualized resales in February (see Chart 2).

The recent recovery was likely prompted by a slight decline in mortgage rates. The average five-year mortgage rate tracked by the Canada Mortgage and Housing Corp. fell from 4.6% in early 2019 to 4.1% in February, as the BoC has kept the policy rate steady

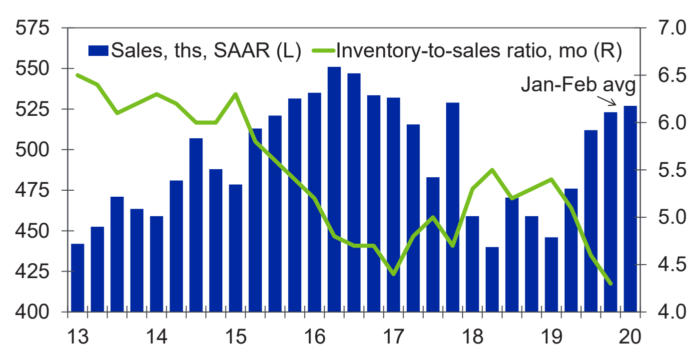
1 The first such measure being a new 3% bracket on property transfers valued above C$2 million in British Columbia, announced in February 2016.

Chart 1: Affordability Still High



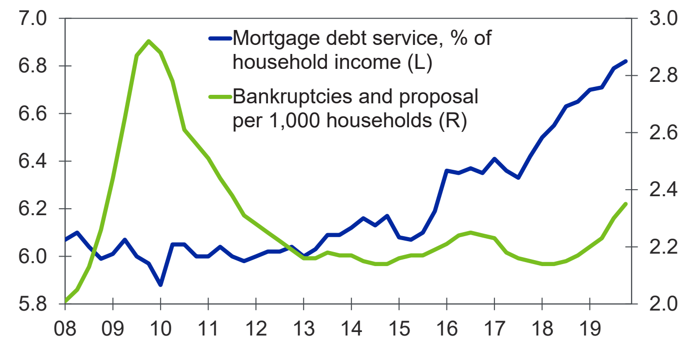
Sources: RPS, Bank of Canada, Statistics Canada, Moody's Analytics

Chart 2: Resale Market on Strong Footing



Sources: CREA, Moody's Analytics

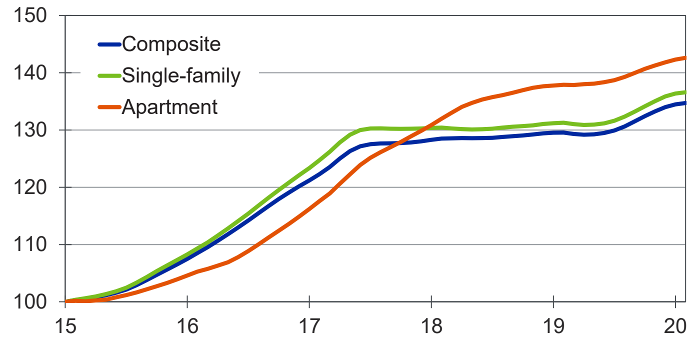
Chart 3: Debt Service Starts to Strain



Sources: OSBC, Statistics Canada, Moody's Analytics

Chart 4: Condos Barely Slowed

RPS house price, Jan 2015=100, SA



Sources: RPS, Moody's Analytics

even as five-year bond rates fell. Nevertheless, the conventional mortgage lending rate is still nearly 50 basis points above its bottom from early 2017, dragging down purchase demand.

The mortgage debt service ratio tracked by Statistics Canada increased from 6.4% of disposable income in mid-2016 to 6.8% in late 2019. Consumer debt performance has also shown some signs of strain. In particular, bankruptcy filings and insolvency proposals have risen (see Chart 3).

The housing market was tightening before March as is evident by the Canadian Real Estate Association's inventory-to-sales ratio—an important measure of balance between sales and the supply listings—which reached a cyclical bottom of 4.1 months of sales in February from an average of more than five months in 2018.

The tightening in the housing market was mainly due to a recovery in demand in early 2019. While supply remained thin nationwide, new listings for existing homes were relatively stable in the first three quarters of last year followed by a tighter than normal fourth quarter.

In the new-home market, residential construction slowed as a result of falling absorption. Annualized housing starts fell from 220,000 in 2017 to 208,000 in 2019. Lower absorption of new homes has also squeezed new-home appreciation. New-home prices have been nearly flat since early 2018.

The combination of falling resales and a looser new-home market contributed to slower house price growth at the national level from 2016 to mid-2019. However, sustained population growth along with decade-high immigration and a decline in mortgage rates supported higher house prices since mid-last year.

In the condominium apartment market, the effect of policy measures has been lagging. Condo apartment prices barely leveled off in early 2019 and had been rising again recently (see Chart 4). A tightening rental market explains the lack of downward adjustment in condo apartment prices. Rental apartment vacancy rates have been trending lower since late 2016.

The median price for condo apartments is significantly lower than the national median for single-family detached homes. It is quite likely that many borrowers who failed to pass the new stress tests to purchase a single-family home may have turned to condo apartments instead.

Regional disparity

All told, the housing market indicators at the national level mask Canada's highly asymmetrical regional housing markets. Vancouver continues to have the lowest affordability in the nation followed by Victoria and Toronto. Though affordability is still a concern for these metro areas, it is no longer deteriorating.

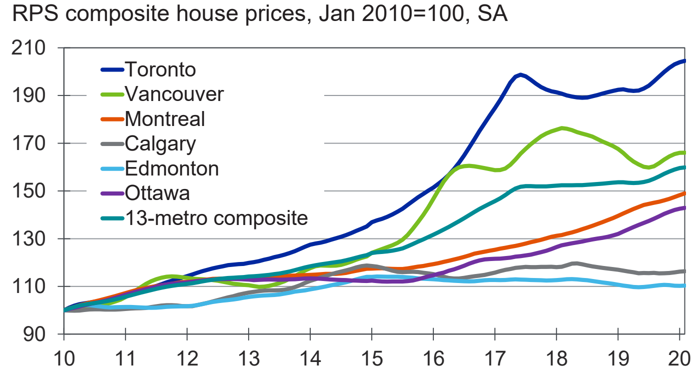
Affordability is deteriorating, but is not a matter of grave concern, in Montreal and Ottawa. Calgary's and Edmonton's housing markets have several issues, including energy sector turmoil and a relatively high unemployment rate, but affordability is not one of them.

Market conditions and house price appreciation are regionally asymmetric as well. Excluding the Prairies together with Newfoundland and Labrador, the number of months of inventory is low in Ontario, Quebec and the Atlantic provinces. However, the measure remains balanced in British Columbia.

Chart 5 shows the asymmetry of RPS transactions-weighted composite indexes for the six largest metro areas and the RPS 13-metro area composite index. Toronto and Vancouver have the two most expensive housing markets in Canada, and the 13-metro area composite index is heavily influenced by them. The indexes for Toronto and Vancouver recorded the largest 10-year price growth despite their policy-induced slowdown in 2017-2018.

Chart 5: Toronto/Vancouver Gain Traction

RPS composite house prices, Jan 2010=100, SA



Sources: RPS, Moody's Analytics

With low unemployment and strong demographic fundamentals, Toronto's housing market was all set to heat up, but all that is now in the rearview mirror.

House prices had been trending upward since spring of last year after flattening for almost two years. According to the Toronto Regional Real Estate Board, the inventory-to-sales ratio fell to 2 months in January, down from 2.7 months a year earlier. Home resales had picked up while new listings remained limited.

Supply is low even in the new-home market. Inventories of newly completed and unsold single-family homes are well below their long-term average despite some pickup (see Chart 6). In addition, there were fewer homes in the construction pipeline last year as builders cut back due to Ontario's Fair Housing Plan.

House prices in Vancouver are still below their year-ago levels but have been rising since last summer and are no longer in correction mode thanks to tightening market conditions. As a result, home sales in Vancouver rebounded in the second half of 2019, while new listings remained flat. Economic fundamentals underpinning housing sales remain strong outside of the Prairies and Newfoundland and Labrador. Resales rose for most of the provinces, though British Columbia's resales lagged the nation last year. According to the British Columbia Real Estate Association, home sales declined by 1.5% despite a strong recovery in the second half of 2019 (see Chart 7).

Of the 13 metro areas in the RPS national transactions-weighted composite index, only Montréal and Ottawa have shown steady appreciation. Market conditions are extremely tight in Montreal due to robust sales activity amid a steady decline of new listings in the resale market.

Appreciation is still slightly negative for the Prairie metro areas other than Winnipeg and in the Atlantic provinces with the exception of Halifax. Home sales barely rose last year in the Prairie provinces while ample supply increased competition among sellers.

CMHC's numbers for apartment structures in 2018 paint a stark regional contrast. Apartment vacancy rates were relatively high in the Prairie metro areas but abnormally low in Ottawa, Toronto, Vancouver and Victoria (see Chart 8).

Some care is needed in interpreting CMHC's figures. Combined vacancy rates for apartments and townhome structures with three or more units were higher for Toronto and Vancouver, indicating that townhomes and smaller apartment buildings are more likely to be vacant. This suggests that the large apartment market is driving rent growth. Conditions remain tight in this part of the rental market and could explain the upward trend in rents.

The fall

The COVID-19 pandemic comes at a terrible time for Canada's economy. Trade and investment were already struggling to make gains as the U.S.-China trade war and Brexit weighed on global demand. The pandemic soured this already-weak outlook almost overnight.

Canada's economy is suffering from twin shocks. The unemployment rate is rising after the pandemic forced widespread business closures. Collapsing oil prices due to the global recession is devastating the energy sector. Weakness in commodity prices and global demand will strike a heavy blow to Canadian exports. The previously flat outlook for real exports has downshifted.

With supply chains fracturing, liquidity drying up, and the corporate-earnings outlook dimming, more declines in stock prices appear on the horizon. The sharp drop in stocks, combined with oil's plunge, increased uncertainty, and weakening global demand spells significant trouble for nonresidential investment in equipment and machinery. Personal spending will be severely restrained as long as stay-at-home orders and other restrictions on economic activity remain in place.

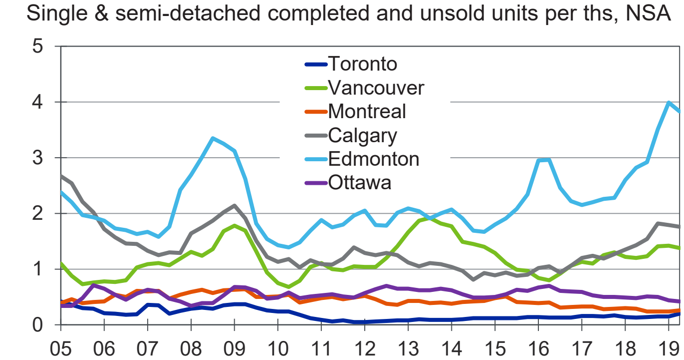
While investment and exports will experience a series of setbacks in 2020, a similar drop in imports provides a positive contribution to the GDP accounting. The depreciation of the Canadian dollar following the decline in oil will also diminish Canadians' appetite for imports.

Summing up all of the components, baseline GDP is expected to contract by an annualized 15% in the second quarter while the unemployment rate peaks at 10%.

All provincial economies will contract substantially this year. The outbreak's negative effect will be felt acutely in western Canada, which is already suffering from the U.S.-China trade war, while incomes in the Prairie provinces will take another hit as commodity prices sink.

Chart 6: Construction Not a Problem

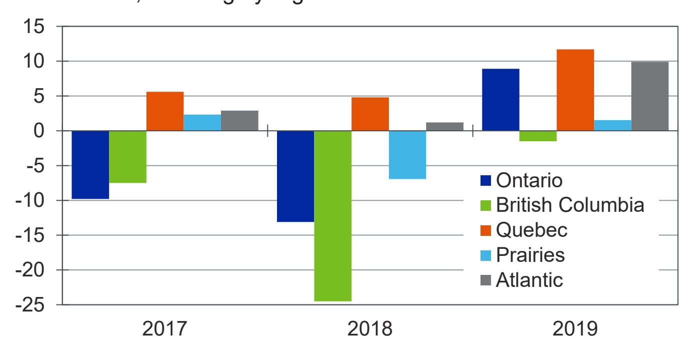
Single & semi-detached completed and unsold units per ths, NSA



Sources: CMHC, Statistics Canada, Moody's Analytics

Chart 7: British Columbia Not There Yet

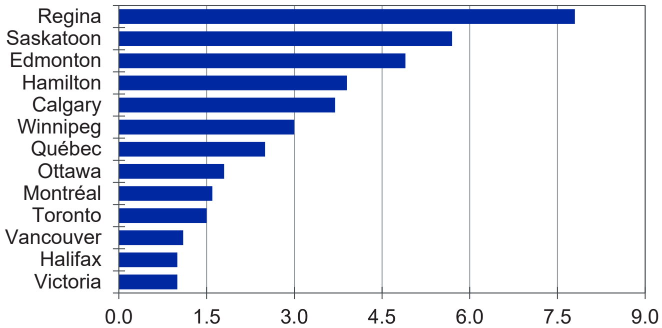
Home sales, % change yr ago



Source: Moody's Analytics

Chart 8: The Big Areas Are Rent-Tight

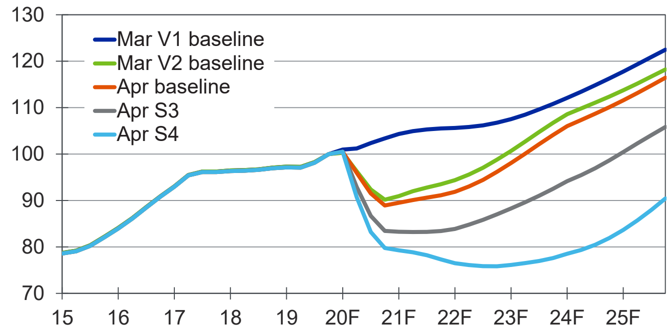
Vacancy rate, %, apartment structures with 6+ units, 2019Q4



Sources: CMHC, Moody's Analytics

Chart 9: House Prices Will Tumble

RPS house price, by forecast vintage, 2019Q4=100



Sources: RPS, Moody's Analytics

Policymakers' response

The BoC and all parts of the government are rapidly ramping up their responses to the twin health and economic crises. The BoC reduced its key interest rate by 100 basis points in March, bringing the overnight target down to 25 basis points to cushion the economy against the impact of the COVID-19 outbreak.

As a result of recent rate cuts, the OSFI has suspended a change to its mortgage stress test that could have lowered the benchmark used to determine the minimum qualifying rate for borrowers with down payments of more than 20%.

The BoC also announced a series of extraordinary measures intended to stabilize the economy, including (1) expanded term repo facilities, (2) government bond buybacks and switches, (3) purchases of Canada mortgage bonds and bankers' acceptances, (4) purchases of provincial money market instruments, (5) yield curve control through the purchase of government debt of all maturities on the secondary market to the tune of C$5 billion per week until the "economic recovery is well underway," and (6) a Commercial Paper Purchase Program.

In addition, Canada's largest banks and many other lenders have announced that borrowers struggling because of the COVID-19 crisis will be able to defer their mortgage payments for up to six months.

Finally, the Moody's Analytics baseline forecast also incorporates the approximately C$100 billion fiscal stimulus package proposed by Prime Minister Justin Trudeau. A massive and mounting monetary and fiscal policy response will help many households navigate the storm.

Housing's last hurrah

After some challenging years, Canada's housing market was on stronger footing at the start of this year. However, the housing market fell apart in March and will experience a steep and severe decline in volume in 2020 along with the rest of the economy. Temporary disruptions to travel schedules and supply chains as well as the collapse in oil prices will result in lighter consumer spending as well as lower incomes. Table 1 provides the Moody's Analytics current macroeconomic and house price forecasts for Canada.

The COVID-19 pandemic along with the collapse in oil prices will create a perfect storm this year for both home sales and residential construction. The outlook for residential construction is contractionary because of the weak new-home market and slower household formations. Housing starts are forecast to decline to 145,000 annualized units by the end of 2020, compared with 210,000 in early 2020.

Not even lower interest rates will be enough to save the housing market. The unemployment rate is expected to hover around 8% in the second half of 2020—almost 2% higher than its prerecession level. This will be a dominant factor in determining the decline of house prices. As a result, Moody's Analytics expects Canadian house prices to suffer

Table 1: Canada Housing Market, History and Baseline Forecast

	Most recent	2018	2019	2020	2021	2022	2023	2024	2025
Detached single-family house price index, % change*	3.19	1.45	1.5	-2.57	-3.27	4.38	7.49	6.56	5.01
Condo apartment price index, % change*	2.87	9.15	3.05	-2.82	-3.34	3.43	6.22	5.46	4.1
Composite house price index, % change*	3.15	1.5	1.57	-3.94	-4.13	3.91	7.7	6.86	5.51
Real per capita disposable income, % change	2.79	2.03	2.65	0.48	0.89	2.59	2.54	1.97	1.83
Unemployment rate, %	5.7	5.83	5.67	8.55	8.27	7.06	6.42	6.4	6.51
Avg mortgage rate, 5-yr, %	4.09	4.36	4.25	3.38	3.36	4	4.71	5.47	5.82
Housing starts, ths	201.29	214.16	208.28	168.44	143.25	175.01	181.16	160.54	150.12
% change	-7.7	-2.92	-2.75	-19.13	-14.95	22.17	3.52	-11.39	-6.49
Ratio, median dwelling price/median family income	8.05	7.99	7.94	7.84	7.59	7.59	7.8	8.02	8.15
Ratio, outstanding mortgage debt/disp. income	1.16	1.16	1.15	1.17	1.11	1.05	1.01	0.99	0.98

*Q4, yr/yr

Sources: RPS, Statistics Canada, CMHC, Moody's Analytics a peak-to-trough decline of about 10% (see Chart 9). As the outlook begins to improve in early 2021, house prices are expected to rebound.

Housing affordability is still a big issue in Vancouver and Toronto, but the COVID-19 pandemic and economic turmoil will draw more attention near term. The pandemic will lead to even further widening in economic inequality, including housing.

No region is immune from the historically sharp downturn that has taken hold (see Table 2). Still, the Prairie provinces are the most vulnerable as they were already dealing with soft market conditions and have been hit by the double whammy of COVID-19 and the oil price collapse. The share of first mortgages in arrears is much higher for the Prairie and Atlantic provinces than for Canada as a whole (see Chart 10). The collapse in oil prices will only deepen and prolong the economic hardships for the oil-producing provinces. The impact on Calgary's and Edmonton's housing markets will last longer than the rest of the nation's; house prices will barely rebound in 2021.

Risks

The spread of COVID-19 has led to an unprecedented global pandemic as well as an economic shock. Economies around the globe

Table 2: Canada Subnational Forecast, Composite House Price Index, % change

	Most recent (19Q4, y/y)	2018	2019	2020	2021	2022	2023	2024	2025
Canada	3.09	2.19	1.48	-2.79	-3.68	3.92	7.07	6.19	4.66
Alberta	-0.94	-0.30	-1.60	-7.79	-7.67	5.93	14.19	13.11	7.75
Calgary, census metropolitan area	-1.54	0.74	-2.16	-8.34	-8.81	4.50	12.84	11.98	6.85
Edmonton, census metropolitan area	-0.79	-0.31	-1.90	-6.98	-6.52	7.37	15.56	14.25	8.67
British Columbia	-1.59	5.24	-3.57	-4.24	-5.96	-1.84	2.60	6.10	7.43
Abbotsford, census metropolitan area	2.09	8.58	0.50	-5.00	-7.32	-2.88	1.76	5.44	6.92
Kelowna, census metropolitan area	1.79	4.82	-1.13	-1.36	-3.63	-0.83	2.91	6.09	7.29
Vancouver, census metropolitan area	-3.17	4.12	-5.94	-4.29	-6.19	-2.13	2.33	5.87	7.24
Victoria, census metropolitan area	-1.14	6.82	-1.02	-5.15	-5.26	-0.25	4.38	7.76	8.85
Manitoba	1.99	0.94	1.78	-5.77	-2.49	7.66	9.20	7.32	5.99
Winnipeg, census metropolitan area	1.73	1.22	1.53	-5.82	-2.49	7.66	9.20	7.32	5.99
New Brunswick	1.29	3.31	1.88	-1.80	-0.65	2.76	4.10	3.51	2.78
Moncton, census metropolitan area	-4.17	5.68	-1.01	-1.29	-0.44	1.86	3.14	2.61	1.94
Saint John, census metropolitan area	-1.89	0.72	1.45	-6.97	-0.90	3.86	5.27	4.62	3.83
Newfoundland and Labrador	-1.95	-3.68	-4.37	-4.26	1.46	8.78	8.60	6.09	4.36
St. John's, census metropolitan area	-1.63	-1.76	-4.52	-4.05	1.46	8.78	8.60	6.09	4.36
Nova Scotia	2.69	1.29	2.38	-1.14	0.70	4.03	5.23	4.63	3.88
Halifax, census metropolitan area	2.90	1.67	2.33	-0.99	0.70	4.03	5.23	4.63	3.88
Ontario	5.75	1.05	3.84	-1.11	-3.82	4.17	7.06	4.80	2.60
Barrie, census metropolitan area	4.47	-1.15	2.17	-1.30	-3.27	4.44	7.09	4.67	2.37
Brantford, census metropolitan area	8.80	5.71	5.33	0.86	-2.81	4.66	7.31	4.98	2.79
Greater Sudbury, census metropolitan area	4.37	2.77	1.98	-4.11	-4.45	7.00	11.28	8.64	5.50
Guelph, census metropolitan area	6.36	5.18	5.87	0.53	-2.13	4.63	6.96	4.48	2.21
Hamilton, census metropolitan area	5.66	2.35	3.21	0.39	-2.71	4.53	7.11	4.75	2.55
Kingston, census metropolitan area	6.36	8.85	8.59	-2.30	-2.27	6.82	9.73	7.11	4.53
Kitchener, census metropolitan area	6.09	6.53	4.80	-1.81	-4.24	4.25	7.32	5.09	2.87
London, census metropolitan area	8.52	11.81	10.58	-2.39	-4.87	3.98	7.33	5.27	3.17
Oshawa, census metropolitan area	1.48	-3.27	0.94	-2.47	-4.45	3.21	6.07	3.94	1.91
Ottawa-Gatineau, census metropolitan area	7.92	4.79	6.25	-1.14	-2.12	6.81	9.72	7.08	4.49
Peterborough, census metropolitan area	4.03	11.65	6.14	-2.15	-3.02	5.10	7.85	5.42	3.11
St. Catharines-Niagara, census metropolitan area	6.47	9.18	5.69	-0.62	-3.38	4.34	7.19	5.03	2.96
Thunder Bay, census metropolitan area	3.70	0.94	2.05	-4.24	-0.81	10.10	13.54	10.76	7.87
Toronto, census metropolitan area	5.28	-1.75	2.77	-0.96	-4.50	3.07	5.90	3.76	1.71
Windsor, census metropolitan area	9.36	11.78	10.49	-0.70	-3.24	5.47	8.57	6.28	4.00
Prince Edward Island	7.37	10.61	3.34	0.09	-5.85	-1.30	1.59	2.00	1.81
Québec	5.55	4.05	5.74	-0.31	0.87	3.42	3.93	4.15	4.51
Montréal, census metropolitan area	6.48	5.22	6.96	-0.53	0.26	2.91	3.50	3.79	4.22
Québec, census metropolitan area	2.69	1.19	2.35	-0.08	2.61	5.06	5.31	5.28	5.43
Saguenay, census metropolitan area	4.26	-0.96	0.17	0.57	2.01	4.99	5.62	5.78	6.05
Sherbrooke, census metropolitan area	8.74	3.52	6.79	2.81	2.12	3.82	4.06	4.13	4.40
Trois-Rivières, census metropolitan area	1.71	2.16	2.67	1.69	3.48	5.01	5.12	5.07	5.24
Saskatchewan	-0.01	-1.02	-1.28	-6.29	-1.88	10.69	12.85	8.66	4.81
Regina, census metropolitan area	0.05	-0.56	-2.23	-5.49	-2.63	9.09	11.28	7.47	4.02
Saskatoon, census metropolitan area	-0.06	-0.69	-0.72	-6.32	-1.27	12.00	14.12	9.62	5.44

Note: Italicized metro areas are part of the RPS 13-metro area composite index.

Sources: RPS, Moody's Analytics

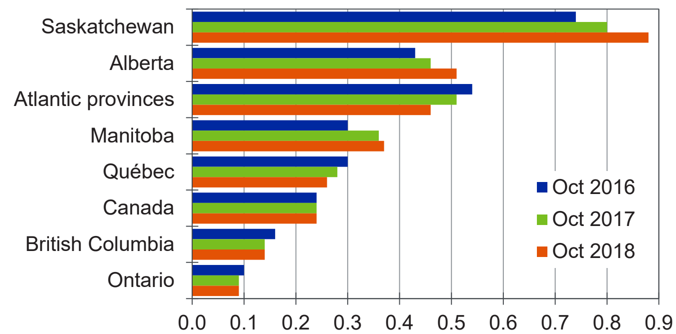
are shutting down, and the sudden halt to business is resulting in serious economic and financial damage.

The baseline outlook has quickly turned more pessimistic. The risks to the baseline forecast are weighted decidedly to the downside because of the numerous unknowns related to COVID-19, including the outbreak's timeline, the extent to which the economic shock could trigger a credit crisis, and whether policymakers can implement the appropriate stimulus to mitigate the fallout.

The trajectory of the housing market in the short run will closely track that of the spread of the coronavirus. Slight changes in the assumptions for the outbreak's timing and severity imply significantly different results for the second quarter and beyond. Shutdown for even a few more months entails more severe labor market dislocations, bankruptcies, worsening credit performance, and a slower recovery. For example, the downside S3 scenario assumes that the economy does not reopen until July, just one additional month. In the long run, the housing market will depend on several factors, including consumer preferences for homeownership and the ability for families to save for a down payment. Both factors could change radically in the aftermath of the pandemic putting Canada's housing market at risk.

Chart 10: Prairies in Trouble

Share of first mortgages in arrears, %, by province



Sources: CBA, Moody's Analytics

About the Author

Abhilasha Singh is an economist at Moody's Analytics, where she leads model development, validation, and forecasting for global subnational economies. She is responsible for coverage of emerging markets as well as U.S. and metropolitan area economies. She is also a regular contributor to Economic View. Abhilasha completed her PhD in economics at the University of Houston, where she taught microeconomics. She holds a master's degree in finance from Pune University in India.

About RPS Real Property Solutions

RPS Real Property Solutions is a leading Canadian provider of outsourced appraisal management, mortgage-related services, and real estate business intelligence to financial institutions, real estate professionals, and consumers. The company's expertise in network management and real estate valuation, together with its innovative technologies and services, has established RPS as the trusted source for residential real estate valuation services.

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About the RPS – Moody's Analytics House Price Forecasts

The RPS – Moody's Analytics House Price Forecasts are based on fully specified regional econometric models that account for both housing supply-demand dynamics and long-term influences on house prices such as unemployment and changes in mortgage rates. Updated monthly and providing a 10-year forward-time horizon, the forecasts are available for the nation overall, its 10 provinces and for 33 metropolitan areas, and cover three property style categories, comprising single-family detached, condominium apartments and aggregate, in a number of scenarios: a baseline house price scenario, reflecting the most likely outcome, and six alternative scenarios.

About Moody's Analytics

Moody's Analytics provides financial intelligence and analytical tools supporting our clients' growth, efficiency and risk management objectives. The combination of our unparalleled expertise in risk, expansive information resources, and innovative application of technology helps today's business leaders confidently navigate an evolving marketplace. We are recognized for our industry-leading solutions, comprising research, data, software and professional services, assembled to deliver a seamless customer experience. Thousands of organizations worldwide have made us their trusted partner because of our uncompromising commitment to quality, client service, and integrity.

Concise and timely economic research by Moody's Analytics supports firms and policymakers in strategic planning, product and sales forecasting, credit risk and sensitivity management, and investment research. Our economic research publications provide in-depth analysis of the global economy, including the U.S. and all of its state and metropolitan areas, all European countries and their subnational areas, Asia, and the Americas. We track and forecast economic growth and cover specialized topics such as labor markets, housing, consumer spending and credit, output and income, mortgage activity, demographics, central bank behavior, and prices. We also provide real-time monitoring of macroeconomic indicators and analysis on timely topics such as monetary policy and sovereign risk. Our clients include multinational corporations, governments at all levels, central banks, financial regulators, retailers, mutual funds, financial institutions, utilities, residential and commercial real estate firms, insurance companies, and professional investors.

Moody's Analytics added the economic forecasting firm Economy.com to its portfolio in 2005. This unit is based in West Chester PA, a suburb of Philadelphia, with offices in London, Prague and Sydney. More information is available at www.economy.com.

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