Canadian Housing Outlook: Another Record Year In the Cards for 2021

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March 3, 2021

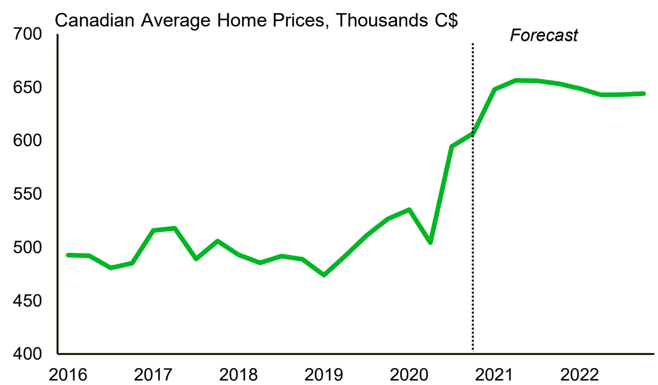
Highlights

- We've upgraded our home sales and prices forecasts relative to December. We now expect the current robust sales pace to hold up in the near-term. However, these levels are likely unsustainable and moderation still appears to be in the cards later this year amid poor affordability in several provinces, an upward grind in interest rates, and a lack of supply.
- Among the factors that will continue to support underlying housing demand are improving job market conditions and still attractive borrowing rates. In addition, a large portion of the population is in their prime homebuying years and households are holding significant excess savings, some of which could flow to the housing market.
- The most notable upgrade to our forecast is on the price side, as ongoing tight supply/demand balances across most markets drive further price gains this year. Next year, we expect to see a tapering off in average home price gains as sales come off the boil, prospective buyers shift to more affordable options and the robust price environment entices some additional supply.
- Affordability pressures should weigh on sales and price growth in Ontario, Quebec, PEI and Nova Scotia. In contrast, the Prairies seem poised to outperform, as affordability is decent by historical standards. Middle-of-the-road performances are expected in B.C. and New Brunswick while weak population growth constrains activity in Newfoundland and Labrador.

The combination of pandemic-related forces, demographic demand and the ultra-low interest rate environment has supercharged the housing market, which has shown few signs of slowing. In our prior forecast released in December, we had expected mounting affordability pressures to cool sales and prices in early 2021. However, data for January indicate that the white-hot momentum has continued in markets across Canada. Additionally, we saw the tightest supply/demand conditions on record in January, with the national sales-to-new-listings ratio climbing to an unprecedented 91%.

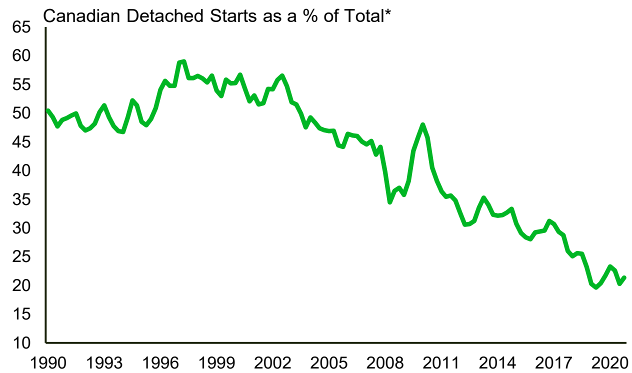
These developments have caused us to re-think our view. While we assume the frenetic levels of sales activity will continue over the next few months, we still believe that the current unsustainable pace will give way to some moderation, particularly in the back half of this year and the early part of 2022. It's important to note that the anticipated cooling in sales will be concealed by what will likely be robust annual average growth rates across provinces in 2021. Moreover, sales are likely to settle next year at around 140k units, which is still a healthy pace of activity.

Chart 1: High Sales Levels, Tight Markets to Keep Prices Elevated Through next Year



Source: CREA, TD Economics.

Chart 2: Detached New Housing Construction Is Making up a Smaller Share of New Housing Supply



*2-quarter moving average.
Source: CMHC, TD Economics. Last observation: 2020Q4.

The more notable forecast adjustment has been made on the price side. We now see home prices recording a second consecutive double-digit gain on an annual average basis in 2021, in sharp contrast to our December forecast that envisaged much more modest growth. Despite the anticipated cooling in demand, the market will likely remain well in seller's territory this year. Our 2022 view assumes a dip in annual price growth, but still leaves average prices ending next year some 13% above their levels in the December projection (Chart 1).

Canadian Sales Outlook: Mind the Gap

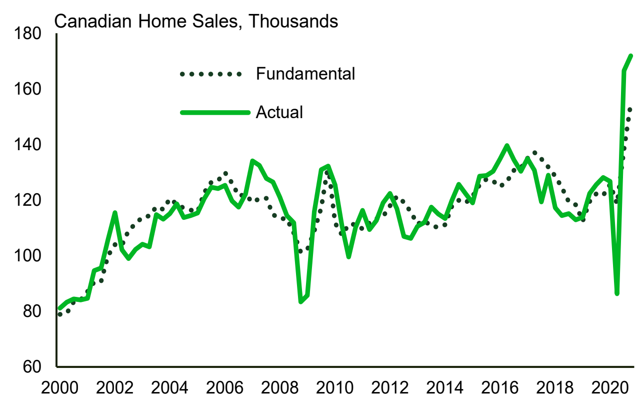
In a recent speech, Bank of Canada Governor Tim Macklem opined that the rapid runup in home prices observed since last June has less to do with speculation and more to a shift in demand towards larger, more expensive units (exacerbated by the pandemic). And, this has come against the backdrop of lagging new supply in these markets for several years (Chart 2).

While we agree that these factors have been playing a prominent role in driving demand, we still estimate that Canadian sales were about 10% above fundamentally supported levels at the end of last year (Chart 3). While massive, this gap is not the largest in history. This is in part because what we deem as "fundamental sales" – or those consistent with current levels of what we believe to be core drivers of housing demand, like household income and mortgage rates – have received significant support from record low rates and econometric analysis suggests that buying behavior has become more sensitive to changes in mortgage rates over time.

Nonetheless, this gap can't be maintained indefinitely, and we expect it to begin to close in the second half of 2021 as borrowing rates move gradually higher in lockstep with Government of Canada (GOC) bond yields. We anticipate 5-Year GOC yields to end the 2021 and 2022 at 1.00% and 1.30%, respectively, up from around 40 bps at the start of this year. And, any backup in rates would come against a backdrop of extremely poor affordability conditions, particularly in Ontario, Quebec, Nova Scotia and PEI (Chart 4).

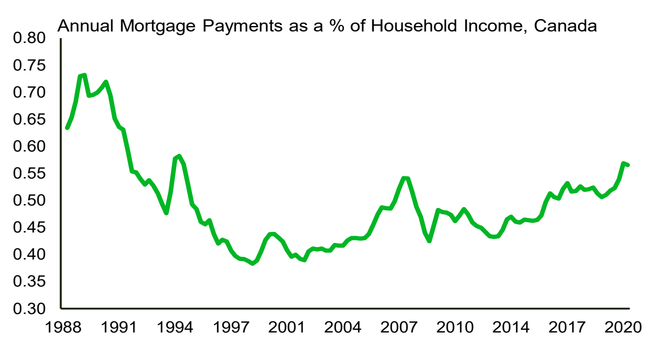
A lack of product on the market could present another near-term headwind for sales. The months' supply of inventory, which is defined as the number of months it would take to exhaust supply against the current sales rate, dropped to a record low 1.9 months across Canada in January. This suggests that the current pace of selling is rapidly depleting available resale supply, highlighting its unsustainability. We anticipate some relief this year, as supply should rise amid a robust price environment and improved mobility stemming from

Chart 3: Home Sales Detached from Fundamental Drivers



Source: CREA, Statistics Canada, CMHC, TD Economics.

Chart 4: Affordability Deteriorating to Levels Last Seen in the Mid-90s



Note: Metric is based on assumed 20% down payment and 5-year fixed mortgage rate.
Source: Statistics Canada, CMHC, CREA, TD Economics.

vaccine rollouts. However, factors like an aging population (which tends to move less) and a falling rate for turning units under construction into completions will likely limit gains.

Although sales are likely trend lower in coming quarters, a steep pullback in activity probably isn't in the cards. For one, while interest rates could move higher, they are likely to remain relatively low, reinforced by a central bank on hold through the next few years. Secondly, an improved economy and on-going job growth are positives for housing demand. In addition, we expect population growth to firm starting in the second half of 2021 as COVID-19 vaccines become more widely distributed globally. This should have immediate positive impacts on the rental market, helping support demand for investor-owned properties. What's more, the sheer demographics of the country are likely to be demand-supportive. The share of Canadians aged 25 – 39 (which is when demand for ownership housing rises the fastest) clocked in at a meaty 21% last year. Finally, the demand for larger detached properties should have near-term staying power as the pandemic rages on.

A big wildcard for the outlook is the extent to which households funnel their pile of savings towards home purchases. We estimate that Canadian households accumulated excess savings of almost $200 billion in 2020. With most of these savings likely attributed to wealthier households who have a higher propensity to spend in areas hardest hit by restrictions during the pandemic, a widely available vaccine would likely boost consumption in these areas. Beyond this, recent surveys suggest that a large share of households plan to redirect savings towards debt repayment and indeed may already have been doing so (see report). However, to the extent that the accumulated balances are used as down payments, near term sales and prices could continue to surprise on the upside.

On the downside, the recent backup in government bond yields highlights the risk of a faster climb in medium-term borrowing rates than the moderate increases currently assumed in our forecast. Moreover, a continuation of unsustainable housing strength could prompt further measures to cool housing activity by federal and/or provincial governments. Given that regulators and governments are unlikely to want to rock the boat during a health crisis, this would appear to be more of a risk facing market activity over the medium term (i.e., late 2021/2022).

Should either (or both) of these risks materialize, it could cause sales to undershoot fundamentals and put more downside pressure on prices than what we are anticipating.

Regional Sales Outlook: Topsy-Turvy

Housing markets in Alberta have lagged since oil prices first collapsed in the second half of 2014. And, despite rising last year, sales were still 8% below their 2015 level. Reflecting this weak activity, prices had also not come back to 2015 levels in 2020.

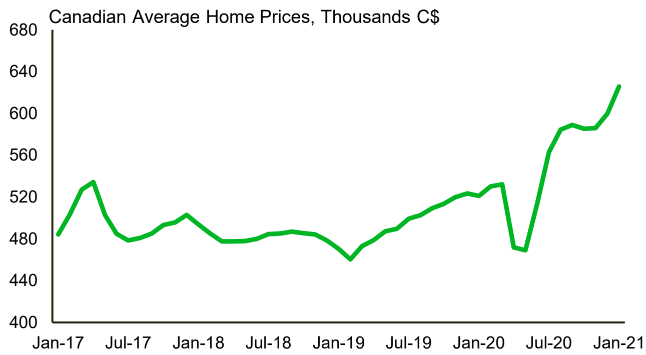
We think that this script will be flipped and expect Alberta to outperform over the next few years (Table 1). For one, sales levels in Alberta are probably not as divorced from fundamentals as they are in other parts of the country. What's more, housing remains affordable, even when measured against recent years when activity lagged.

As for the other oil producing provinces, we believe that there is scope for a comparatively large retracement in activity in Saskatchewan in the back half of the year. Recall that the COVID-19 pandemic was well contained in Saskatchewan during the first wave, resulting in a minor 9% decline in sales during the second quarter. With activity surging thereafter, sales were over 50% above February 2020 levels as of January, compared to over 30% for the country overall. This probably means that steeper declines are in store for Saskatchewan as activity recedes from its current record level, although favourable affordability conditions in the province would work as a buffer and likely result in an outperformance through most of next year. Affordability is also favourable relative to recent trends in Newfoundland and Labrador, however the prospect of still-soft population growth should keep a lid on activity.

In the other Atlantic provinces, affordability challenges will likely restrain activity in Nova Scotia and PEI, leading sales lower in the second half. Meanwhile, activity looks overdone in New Brunswick, with sales-to-population and sales-to-employment ratios 100% above long-run averages in January, compared to over 50% for Canada. As such, there is likely more downside room for sales as activity in New Brunswick normalizes.

We also look for sales to trend down towards fundamentally supported levels in Quebec and Ontario, exacerbated

Chart 5: Tight Markets, Robust Demand and Shifting Preferences Towards Larger, More Expensive Units Driving Explosive Price Growth



Source: CREA, TD Economics.

by elevated affordability pressures in those provinces' largest urban markets. In Ontario for example, our metrics suggest that affordability deteriorated to its worst position since the early 1990s late last year while in Quebec, affordability appears to have been the worst since the run-up to the Global Financial Crisis. Elsewhere, we envision shallower declines in Manitoba and B.C. in the second half, as sales are less divorced from fundamentals and our metrics tell us that affordability is less of a problem in those provinces. However, B.C. has historically been the most sensitive to interest rate changes of any province, making demand vulnerable should rates rise as we expect.

Home Price Outlook: Sky-High

To say that average home price growth was robust last year would be an understatement. Across Canada, prices advanced by over 12% - the strongest gain since 1989 (Chart 5). And, appreciations were recorded in every province. In Ontario, Quebec and PEI, gains topped 15%.

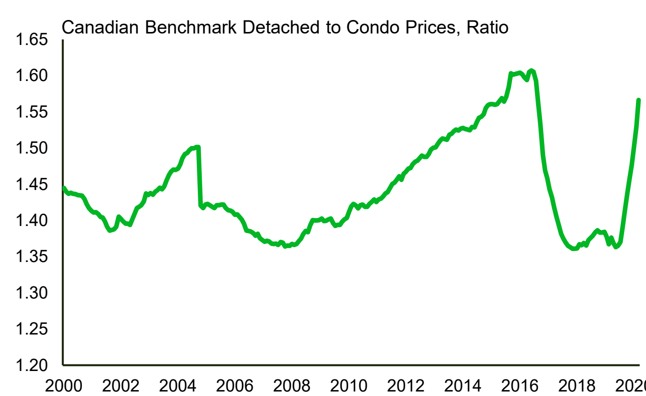
For this year, we expect Canadian home price growth to be even stronger on an annual average basis (Table 1). This is due in part to the solid handoff into this year and continued strength in the early part of 2021. Indeed, Canadian average prices were up nearly 5% m/m in January. However, on a Q4/Q4 basis, prices are likely to record a still outsized but slower gain of around 8%. Supply/demand balances are tight in markets across the country, especially in Quebec and parts of the Atlantic Region. A continuation of historically-tight conditions should support further price gains this year. However, the gradual cooling in sales alongside a modest pickup in listings should moderate the pace of price growth, particularly in the second half of 2021.

As 2020 laid bare, the composition of what is being sold has important implications for average prices. For instance, sales of detached homes grew by 15% in Toronto, versus a 6% decline for condos. With sales of pricier units gobbling up a larger share of the market, average prices jumped by 13%. And, this dynamic was present in major markets across the country. With the pandemic ongoing, we expect demand for detached units to remain to firm in the near-term, supporting average prices.

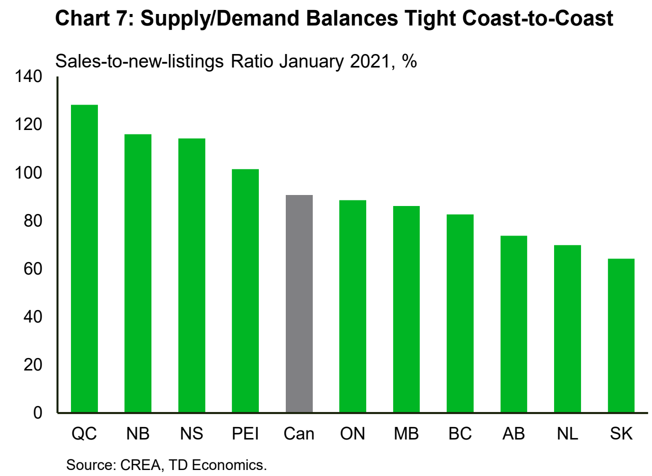
However, our forecast assumes that condo units will capture a larger share of the market this year compared to 2020, and rising sales of these less expensive units should help moderate average price growth. The implication is that activity could improve in urban cores. This could be amplified by the fact that prices have been growing faster in the suburbs during the pandemic, reducing their affordability advantage vis-à-vis larger urban centres like Toronto. Notably, condo sales growth was already solid in key markets like Toronto and Vancouver in January, supported by ample supply. Indeed, year-on-year growth topped 80% in Toronto and was near 50% in Vancouver.

This impact could intensify as the year wears on, as Canada's population count is likely to get progressively larger each quarter. With most of this growth accounted for by immigrants and non-permanent residents, demand for rental units and rents should be supported, thereby improving the attractiveness of investor-owned condo units. A ramp-up in vaccine distribution should also support rental demand

Chart 6: Detached Housing Extremely Expensive Relative to Condos



Source: CREA, TD Economics.



through better job markets for younger workers and more in-class learning at post-secondary institutions.

Condo values have also risen at much more subdued pace in markets across Canada. Benchmark prices even fell 4% in Toronto in the second half 2020, nearly matching the drop seen during the Global Financial Crisis. In January, benchmark condo prices climbed 0.4% m/m in Toronto, although this paled in comparison to the 2.3% monthly gain seen for detached units. The more subdued pace of price growth in condos has improved their affordability relative to other structure types (Chart 6).

Provincial Price Outlook: Growth from Coast-to-Coast

Supply/demand balances are tight across all provinces (Chart 7). In January, the sales-to-new-listings ratio was above the 60% threshold normally associated with a seller's market in every province. And, although we expect sales to trend lower across most markets as 2021 progresses, levels should remain elevated. This will keep markets tight and ensure continued price growth.

Data for January points to strong first quarter price gains in Ontario, Alberta and B.C. After the first quarter, we expect comparatively solid growth through the remainder of the year in Quebec, New Brunswick and Nova Scotia, as these markets were the tightest in Canada even before the pandemic hit and continue to be so. However, affordability challenges should weigh against even faster growth in Quebec and Nova Scotia. Outsized gains are also likely to take place in the Prairies (paced by Alberta) as these markets are not beset by the same affordability issues.

In Ontario, markets deeply entrenched in seller's territory alongside firm demand portend further near-term strength. However, a rotation into condos in Toronto and severely deteriorated affordability will likely sap gains as the year wears on. The latter should also hold true for PEI. In B.C., relatively strong price gains are likely through remainder of this year amid a decent backdrop for affordability. Rounding out the provinces, modest gains are likely in Newfoundland and Labrador this year as population growth remains soft, although this will still mark a change from the declines observed from 2015-2019.

CANADIAN PROVINCIAL HOUSING OUTLOOK												
Provinces	Average Home Prices (% Chg.)						Existing Home Sales (% Chg.)					
	Annual Average			4th Qtr/4th Qtr			Annual Average			4th Qtr/4th Qtr		
	2020	2021F	2022F	2020	2021F	2022F	2020	2021F	2022F	2020	2021F	2022F
Canada	12.2	16.6	-1.3	15.2	7.7	-1.4	12.6	32.4	-18.5	34.4	-1.4	-15.0
British Columbia	10.8	12.1	-1.1	11.0	6.1	-1.2	21.5	49.5	-18.0	46.1	1.5	-14.6
Alberta	1.2	9.0	0.9	5.4	5.5	0.8	3.4	54.9	-13.1	30.8	17.0	-10.7
Saskatchewan	1.9	2.5	0.6	4.1	1.4	0.4	25.1	25.3	-13.7	46.2	0.9	-11.1
Manitoba	4.1	8.0	0.7	8.4	4.1	0.4	14.3	25.8	-16.2	30.9	0.2	-12.9
Ontario	15.2	20.3	-1.9	18.5	11.3	-1.9	8.7	22.4	-18.6	28.9	-5.9	-15.1
Québec	15.5	13.9	-1.4	21.0	5.7	-1.7	16.9	32.9	-22.5	35.8	-2.2	-18.2
New Brunswick	10.0	12.5	-0.7	12.0	6.6	-1.1	13.0	17.4	-18.2	34.4	-8.1	-15.1
Nova Scotia	12.9	15.7	-1.4	18.1	6.0	-1.8	13.6	17.7	-18.9	43.7	-14.0	-15.8
Newfoundland & Labrador	1.3	4.0	-2.1	6.2	-0.8	-2.1	14.7	36.5	-22.5	46.4	-2.3	-17.9
Prince Edward Island	18.0	8.5	-2.2	21.5	-1.1	-2.2	9.7	18.1	-19.1	18.9	-1.5	-15.3

F: Forecast by TD Economics as of March 2021. Annuals are based on sum (for sales) or average (for prices) of quarterly data.

Sources: Statistics Canada, Canada Mortgage and Housing Corporation, CREA, TD Economics.