Economics | Forecast / Outlook Reports

Economic Analysis of Ontario

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central 1 Economics

HIGHLIGHTS

- High borrowing costs, elevated prices remain a drag on Ontario housing sales through 2023
- Annual sales lowest since 2001 as average annual price falls 10 per cent but not a market crash
- Strong population growth, easing financial conditions expected to drive stronger volume and prices in 2024 and 2025
- Housing starts to decline 15 per cent in 2023 on weak resale market and financing costs, adds pressure to longer-term housing shortage
- Rental vacancy rate forecast to fall to 1.5 per cent with rents up 6.0 per cent

Ontario Housing Outlook: 2023-2025

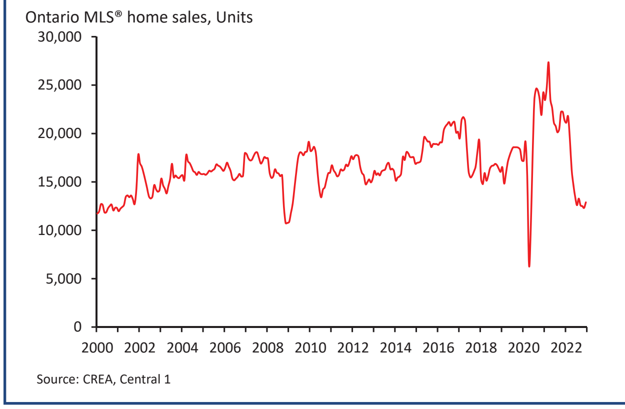
Housing market searches for stability, rebound may not be far off

Ontario's housing market has borne the brunt of the broad national housing market sales downturn. Successive interest rate hikes since early 2021, which has now pushed variable rates up by 425 basis points and soaring prices early in the pandemic, has decimated whatever was left of housing affordability.

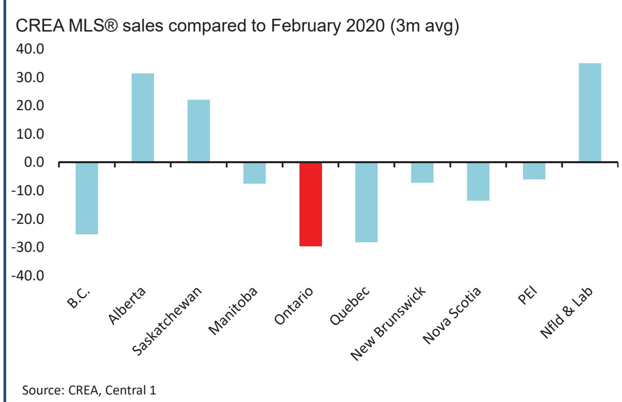
Housing sales have fallen off a cliff with a historic reversal in home sales. Annual 2022 sales fell 32 per cent and December sales sat more than 30 per cent below levels observed just preceding the pandemic and 50 per cent off pandemic highs. Ontario recorded a deeper decline in sales than its provincial peers as elevated household debt and high home values have meant greater sensitivity of the market to interest rate hikes. With variable rates more than tripling over the period, a product that surged in popularity during the pandemic, prospective buyers have seen purchasing power evaporate pushing a swath of buyers to the sidelines.

Home values have followed sales lower as diminished purchasing power triggered sellers to reduce price expectations. The average MLS® price has declined 18 per cent from peak February 2022 to $841k after briefly exceeding the million-dollar mark, while the benchmark value which adjusts for housing attributes fell 16 per cent. Benchmark single-family home prices have led the decline while apartments having trailed during the pandemic price boom and have experienced more modest declines. Broadly, price declines have been deep, with year-over-year reductions exceeding the those observed in the 2008/09 financial crisis period, and in 2018 when prices declined following the introduction of the Non-Resident Speculation Tax (NRST) in the Greater Golden Horseshoe (GGH) area.

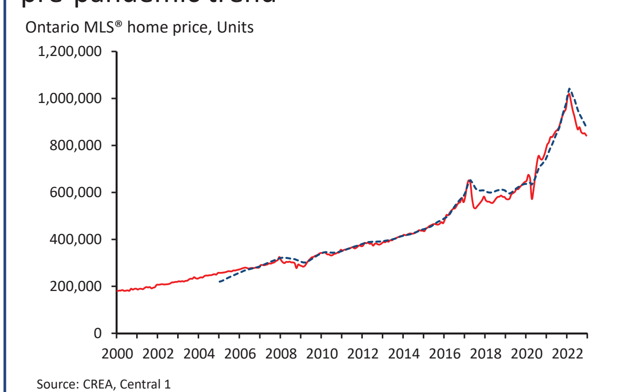
Home sales dive to recessionary levels as interest rates soar



Ontario sales downturn exceeds all provinces



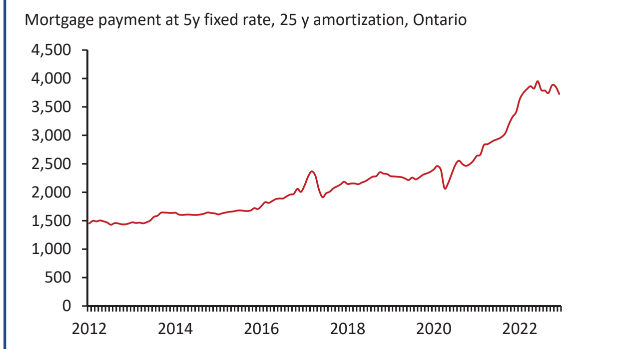
Prices correct sharply but remain 25% above pre-pandemic trend



While the magnitude of decline would normally be considered a crash – and it is for recent buyers – for most owners this is a correction given the robust growth preceding this slide. Despite sharply higher borrowing costs, average price levels have been relatively sticky. Levels are still 25 per cent above pre-pandemic levels, and 35 per cent higher when assessing benchmark values. Even as prices have declined, buyers are navigating much higher potential carrying costs. Based on an average-priced home, monthly payments for prospective buyers are 60 per cent higher, a bridge too far for many. On a full-year basis, the average price rose nearly 7 per cent to $931,950.

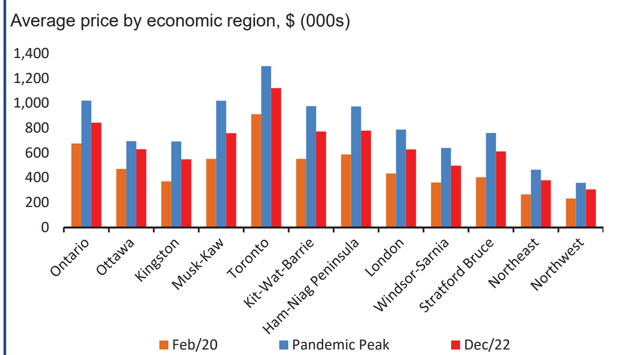
Sticky prices reflect several factors. The pandemic has amplified the importance of housing and space given hybrid and remote work options, rotating income allocation to shelter while spreading gains across the province. Prospective sellers are also loathe to sell into a down market having seen peak prices, and are patiently navigating the current downturn. New listings have generally held near longer-term trends without sign of panic selling. This luxury has been afforded by an economy that has remained resilient with strong employment growth and elevated savings despite higher interest rates, although Ontario's economic recovery has lagged other provinces. This resilience is being tested as higher interest rates impact variable rate holders, and fixed rate holders see their mortgages come due for renewal, albeit offset in part by strong wage growth.

Higher rates leads to severe affordability erosion, lower prices a partial offset



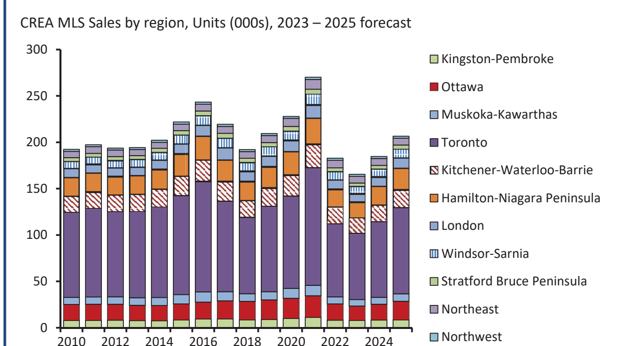
Source: CREA, Central 1 Broker Survey, C1 Calculation

Pandemic surge and retreat observed in all regions



Source: CREA, Central 1 calculations

2023 annual sales lowest since 2001, rebound forecast for 2024 and 2025



Source: CREA, Central 1

Regional patterns consistent with provincial picture, prices still outperform outside Toronto

Regionally, the reversal was shared across the province highlighting the broad impact of higher interest on housing demand and ebbing of the early pandemonium that fanned buyers into Toronto suburbs and into smaller urban communities across the province in search of space and affordability. MLS® sales fell more than 30 per cent in the Economic Regions of Toronto, Hamilton-Niagara-Peninsula and Muskoka-Kawarthas in 2022. Most other regions reported hefty declines of more than 25 per cent. That said, markets outside the Greater Golden Horseshoe region are still more affordable, with permanency of hybrid and remote work options is still supporting demand. Areas such as London, Kitchener-Waterloo-Barrie, and Windsor-Sarnia have experienced robust population growth during the pandemic due to these factors.

Like the provincial picture, annual average prices mask the recent downturn and reflect the 2021 run up and early year strength. Double-digit growth in annual prices were observed outside the Toronto Economic Region and Muskoka-Kawarthas, although growth decelerated sharply from the 20-30 per cent annual gains observed in 2020 and 2021 amidst the exit from the core and severe stress on supply of local housing markets. While prices are off 20 per cent or more in most regions, prices are still 40-50 per cent higher in several economic regions outside of Toronto but remain vastly more affordable than large urban areas. Rotation towards single-family demand during the pandemic partially explains stronger price pressures in smaller markets.

Resale market to stabilize by second half of 2023, sales rebound expected into 2024

The subdued sale flow is anticipated to continue through the first half of 2023 while home values grind down. A low sales handoff to 2023 means MLS® home sales decline 9 per cent this year to the lowest level since 2001 while the average price falls nearly 11 per cent to about $832,700.

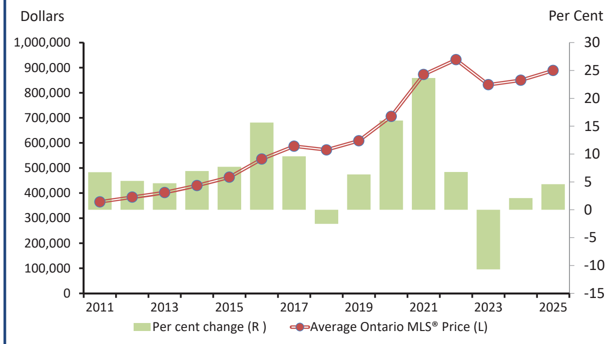
Mortgage rates are expected to remain elevated and a drag on homebuying activity. Our forecast is for the Bank of Canada to hold its policy rate at 4.5 per cent into 2024 as it wrestles down inflation, although this forecast is at odds with market expectations for an earlier cut. The latter would likely need a deeper Canadian economic contraction than our call for a near zero GDP growth in the first half of the year and rapid climbdown in inflation. That said, fixed rate mortgages are expected to ease through 2023 on future rate expectations and declining bond yields.

Moreover, a stall in Ontario's economy is expected to temper buyer exuberance. Ontario GDP is forecast to grow at 0.8 per cent after 3.5 per cent expansion in 2022, while employment growth slows to 0.5 per cent. This is broadly in line with the national forecast. Households are expected to take a more cautious approach to spending as they navigate elevated inflation, higher rates and risks of a recession and job losses. That said, our view remains that the economy will remain relatively sturdy. Prospects remain bright over the coming years owing to high levels of immigration.

Buyers and sellers will remain at odds in this environment in coming quarters with the latter holding steadfast in price expectations. This persistent affordability gap contributes to low sales volumes through much of the year, although the trend rises in the second half. Home prices are expected to fall further by another 5 per cent, but most of the downturn is likely in the rear-view mirror with a permanent lift in home values from pre-pandemic levels. We expect prices to remain above pre-pandemic levels with affordability partly being restored by higher wages and incomes and declining trend in mortgage rates. New housing construction is a source of downside risk with a record number of units under construction in the province, but the number of completed and vacant new units remains historically low and much of the new product has been pre-sold.

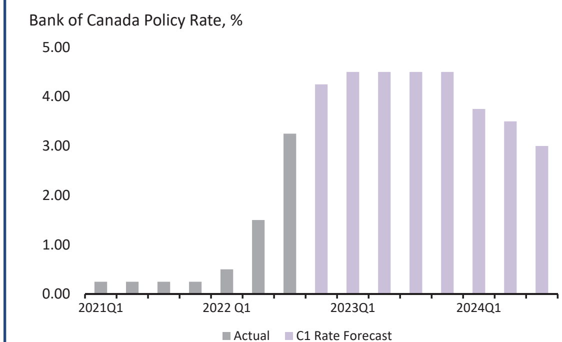
Market conditions are forecast to stabilize by the end of the second quarter with rising sales and steady prices thereafter. Mortgage rates, which drove much of the housing market euphoria on the way down and pain on the way will incentivize more buyers to jump in. In 2024 and 2025, we forecast sales growth of 11 per cent per year and a return to annual price growth. This largely owes to the combination of lower interest rates, robust immigration and pent-up demand in the market. Canada is already welcoming near record levels of newcomers and while homeownership demand hasn't gone away, it has largely rotated to the rental market

11 per cent annual price decline masks larger peak-to-trough pullback, rebound in 2024



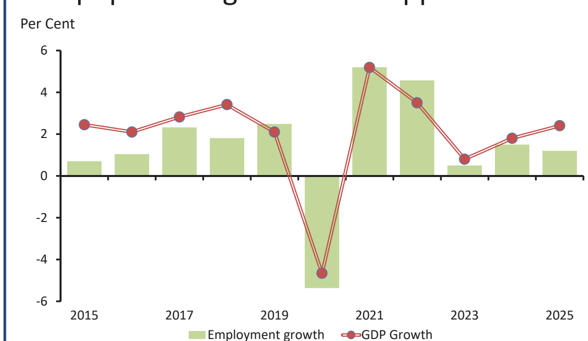
Source: Landcor, Central 1

Policy interest rates forecast to hold steady through 2023 before declining



Source: Bank of Canada, Central 1

Economic slowdown curbs housing activity, but population growth still supportive



Source: Landcor, Central 1

and delayed household formation on the part of young people. This will propel demand higher and contribute to home price growth of 1.5 per cent in 2024 and 5 per cent in 2025. Average prices remain below pandemic peak through the forecast period. Regionally, higher sales and price growth is forecast to be led by Toronto reflecting immigrant preference for larger urban areas and deeper labour markets.

Housing starts to fall 14 per cent

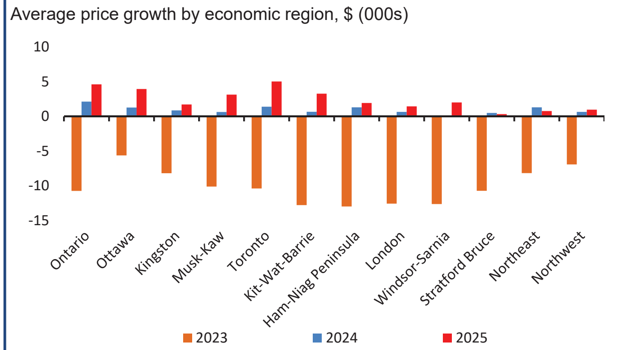
While the housing sales cycle experienced a reckoning last year, new home construction remained robust, highlighting the long lags from housing downturns on building activity. Declining real estate sales and demand impacts single-family construction most quickly, while multi-family townhome and apartment projects take longer to develop and are typically pre-sold. Ontario housing starts edged only modestly lower in 2022 to 96,080 units which was not far off the 2021 record high. Consistent with the MLS® downturn, single-detached housing starts fell 19 per cent as market conditions curbed demand for custom built and spec homes, while multi-family starts rose. The exodus to smaller markets likely also ebbed following the earlier pandemic frenzy.

A scan of larger urban markets highlights the pattern. Markets like Kingston (-52 per cent), London (-40 per cent), and Guelph (-36 per cent) retreated sharply alongside other smaller markets. In contrast, housing starts in the Census Metropolitan Areas of Toronto and Ottawa both recorded growth of 8 per cent.

A slump in housing starts has taken longer than expected to occur but we expect levels to decline this year by 15 per cent to about 82,100 units with much of this decline in the larger urban areas. A less active presale market, challenging financing conditions for both condos and rentals, and fears of an inventory overhang from new supply likely curbs new construction. Higher land acquisition and financing costs could also force some developers into more challenging financial conditions. With strong population growth, this decline will exacerbate housing shortages in the province and accelerate a rebound in housing prices. Lower interest rates and rising demand housing lifts starts in both 2024 and 2025 to near 95,000 units.

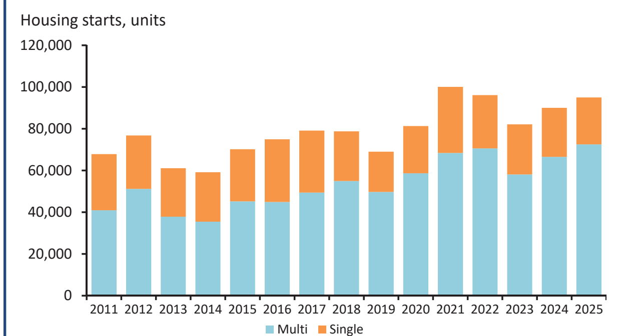
Fewer housing starts in 2023 means the housing sector will continue to lag the rest of the economy. Real residential investment is forecast to decline 8 per cent in 2023 following a similar transaction driven decline in 2022.

Large price reversals in pandemic boom markets, Toronto to see stronger pick up



Source: CREA, Central 1 calculations

Resale downturn, financing costs to temporarily stall housing starts



Source: CMHC, Central 1

Rental market to remain tight

The rental market turned disastrous for existing and prospective tenants last year. After some relief in 2020 and 2021 due to soft population growth and health fears, vacancy rates plunged while rents soared. High mortgage rates curbed buyer demand and soaring population growth put pressure on the rental market.

Highlighted in our recent summary, Ontario's rental market tightened considerably in 2022. The apartment rental vacancy rate in urban areas (10,000+ population) was nearly halved to 1.8 per cent which was the lowest since 2017 and ranked among the tightest markets on record. Average rent jumped 6.3 per cent following a 2.7 per cent gain in 2021. The average rent in the province was $1,555. Rent growth was severe considering the maximum rent increase was limited to 1.2 per cent meaning much of this increase reflected increases in turnover rent. CMHC reported that nationally, turnover rents rose 18 per cent. Current rent growth as estimated by the consumer price index shows a near 7 per cent year-over-year pace. Net additions to rental pool of 15,000 units, was the most on record reflecting two years of elevated starts, but a drop in the bucket when compared to higher demand.

Among metro areas, Toronto recorded a steep decline in the vacancy rate from 4.6 per cent to 1.6 per cent, with the region being a key beneficiary of rebounding immigration. Meanwhile, Ottawa's vacancy fell to 2.1 per cent from 3.4 per cent, while regions like Kingston (1.2 per cent) and London (1.7 per cent) also saw declines and remained amongst the tightest markets. Rent growth was robust with urban area rents up 6.3 per cent in aggregate. This included a 6.5 per cent increase in Toronto, 7.5 per cent in Thunder Bay, and 7.2 per cent in Kitchener-Waterloo-Barrie. Broad population growth and intra provincial flows of population has driven these increases.

Renters will continue to experience challenging conditions as potential homebuyers wait patiently for homeownership to regain some semblance of affordability keeping them in rental units for longer, while competition for shelter will remain fierce due to high levels of immigration. Policy efforts will continue to promote rental construction, but market conditions and elevated interest rates could curb the pace of construction. The provincial rental vacancy rate is forecast to decline further to 1.5 per cent this year and the lowest since 1990. Increased construction and rotation to homeownership loosens vacancy rates slightly but we expect a sub 2 per cent rate into 2025. Rent growth is in part held back by limits to provincial allowable increases while many renters will look to stay in their units to avoid more substantial increases, but growth averages in the 5-6 per cent range per year.

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Ontario Housing Summary Table

	2019	2020	2021	2022	2023	2024	2025
MLS Sales	209,467	227,862	270,094	182,854	165,830	184,700	206,600
% ch.	9.0	8.8	18.5	-32.3	-9.3	11.4	11.9
MLS Price	608,406	705,789	872,657	931,953	832,076	849,678	888,822
% ch.	6.4	16.0	23.6	6.8	-10.7	2.1	4.6
MLS New Listings	331,508	320,397	346,477	344,900	348,000	357,000	375,000
% ch.	-0.2	-3.4	8.1	-0.5	0.9	2.6	5.0
Sales-to-New Listings Ratio	63.2	71.1	78.0	53.0	47.7	51.7	55.1
Housing Starts - Total	68,985	81,305	100,089	96,080	82,100	90,000	95,000
% ch.	-12.4	17.9	23.1	-4.0	-14.6	9.6	5.6
Housing Starts - Singles	19,287	22,682	31,701	25,494	24000	23500	22500
% ch.	-18.9	17.6	39.8	-19.6	-5.9	-2.1	-4.3
Housing Starts - Multi	49,698	58,623	68,388	70,586	58,100	66,500	72,500
% ch.	-9.6	18.0	16.7	3.2	-17.7	14.5	9.0
Row and Apartment Vacancy (%)	2.0	3.2	3.4	1.8	1.5	1.7	1.9
2-bedroom apartment rent growth (%)	5.8	4.9	2.7	6.3	6.0	5.0	5.0

Source: CREA, CMHC, Central 1 calculations and forecast

Forecasts

Forecasts

MLS® Sales, Units by Economic Region

	2019	2020	2021	2022	2023	2024	2025
Ottawa	21,182	21,693	23,243	17,488	15,500	17,000	20,000
Kingston-Pembroke	8,870	9,985	11,246	8,169	7,900	8,300	8,500
Muskoka-Kawarthas	8,831	10,656	11,223	7,624	7,000	7,500	8,000
Toronto	92,053	99,590	126,788	78,792	71,500	81,500	93,000
Kitchener-Waterloo-Barrie	19,748	22,557	25,269	18,087	16,500	18,000	19,000
Hamilton-Niagara Peninsula	22,639	25,023	27,988	19,154	17,180	20,000	23,000
London	11,669	12,253	14,069	10,014	8,800	10,000	11,500
Windsor-Sarnia	10,080	10,254	12,024	9,108	8,100	8,800	9,500
Stratford Bruce Peninsula	4,557	5,112	5,382	3,984	3,500	3,900	4,500
Northeast	7,635	8,657	10,448	8,175	7,300	7,500	7,400
Northwest	2,203	2,082	2,414	2,259	2,100	2,200	2,200
Ontario	209,467	227,862	270,094	182,854	165,830	184,700	206,600

MLS® Sales change, per cent, by Economic Region

	2019	2020	2021	2022	2023	2024	2025
Ottawa	5.9	2.4	7.1	-24.8	-11.4	9.7	17.6
Kingston-Pembroke	4.9	12.6	12.6	-27.4	-3.3	5.1	2.4
Muskoka-Kawarthas	8.1	20.7	5.3	-32.1	-8.2	7.1	6.7
Toronto	11.9	8.2	27.3	-37.9	-9.3	14.0	14.1
Kitchener-Waterloo-Barrie	8.9	14.2	12.0	-28.4	-8.8	9.1	5.6
Hamilton-Niagara Peninsula	11.2	10.5	11.8	-31.6	-10.3	16.4	15.0
London	4.6	5.0	14.8	-28.8	-12.1	13.6	15.0
Windsor-Sarnia	4.5	1.7	17.3	-24.3	-11.1	8.6	8.0
Stratford Bruce Peninsula	0.6	12.2	5.3	-26.0	-12.1	11.4	15.4
Northeast	5.9	13.4	20.7	-21.8	-10.7	2.7	-1.3
Northwest	0.0	-5.5	15.9	-6.4	-7.0	4.8	0.0
Ontario	9.0	8.8	18.5	-32.3	-9.3	11.4	11.9

Forecasts

MLS Average Price, Dollars, by Economic Region

	2019	2020	2021	2022	2023	2024	2025
Ottawa	420,338	504,195	617,486	664,337	627,000	635,000	660,000
Kingston-Pembroke	354,240	423,779	567,223	631,672	580,000	585,000	595,000
Muskoka-Kawarthas	523,426	651,725	814,811	884,327	795,000	800,000	825,000
Toronto	828,498	940,970	1,109,433	1,204,954	1,080,000	1,095,000	1,150,000
Kitchener-Waterloo-Barrie	520,305	610,496	784,312	871,180	760,000	765,000	790,000
Hamilton-Niagara Peninsula	532,921	630,428	796,360	884,734	770,000	780,000	795,000
London	408,367	489,027	636,454	714,714	625,000	629,000	638,000
Windsor-Sarnia	319,505	389,996	512,615	572,155	500,000	500,000	510,000
Stratford Bruce Peninsula	384,602	457,993	613,921	677,584	605,000	608,000	610,000
Northeast	249,100	297,268	373,546	419,213	385,000	390,000	393,000
Northwest	239,256	262,028	301,764	333,051	310,000	312,000	315,000
Ontario	608,406	705,789	872,657	931,953	832,076	849,678	888,822

MLS Average Price Change, per cent, by Economic Region

	2019	2020	2021	2022	2023	2024	2025
Ottawa	8.5	19.9	22.5	7.6	-5.6	1.3	3.9
Kingston-Pembroke	7.3	19.6	33.8	11.4	-8.2	0.9	1.7
Muskoka-Kawarthas	7.3	24.5	25.0	8.5	-10.1	0.6	3.1
Toronto	3.9	13.6	17.9	8.6	-10.4	1.4	5.0
Kitchener-Waterloo-Barrie	6.3	17.3	28.5	11.1	-12.8	0.7	3.3
Hamilton-Niagara Peninsula	6.6	18.3	26.3	11.1	-13.0	1.3	1.9
London	10.9	19.8	30.1	12.3	-12.6	0.6	1.4
Windsor-Sarnia	12.1	22.1	31.4	11.6	-12.6	0.0	2.0
Stratford Bruce Peninsula	10.4	19.1	34.0	10.4	-10.7	0.5	0.3
Northeast	1.9	19.3	25.7	12.2	-8.2	1.3	0.8
Northwest	2.7	9.5	15.2	10.4	-6.9	0.6	1.0
Ontario	6.4	16.0	23.6	6.8	-10.7	2.1	4.6