ECONOMIC VIEWPOINT

Desjardins Housing Outlook:

Economic Downturn, Delayed Rate Hike Effects Set Up Slow Spring Real Estate Season

By Marc Desormeaux, Principal Economist

Summary

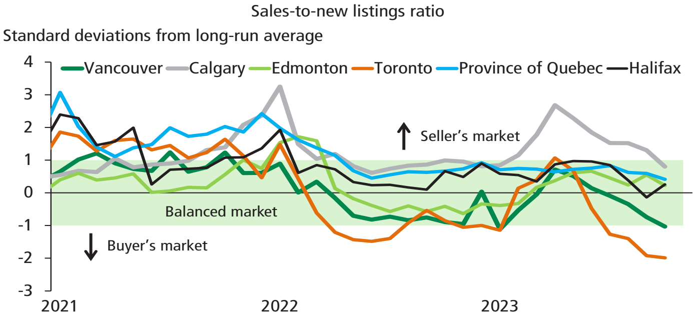
- We now think that most major markets will experience softer sales and prices through the spring months, as weakness has spread significantly since the Bank of Canada resumed hiking interest rates in June. The economic downturn that we expect to materialize as 2024 approaches should also put downward pressure on sales and prices.
- Large cities in Ontario and BC have been hit the hardest and face challenging near-term prospects given the economic weakness we forecast in those provinces.
- Still, we expect 2024 to bring only a mild recession by historical standards. As the Bank cuts rates and an economic recovery takes shape later next year, we should see sales and prices pick up.
- We think homebuilding will moderate significantly next year against a backdrop of still-high rates, elevated input costs and construction sector labour shortages.

OVERVIEW

Higher Borrowing Costs Are Taking a Toll

The second round of Bank of Canada rate hikes may have ended well before November 2023, but its effects certainly haven't. Initially, sales activity in the high-priced Toronto and Vancouver markets bore the brunt of higher borrowing costs. Yet at the time of writing, weakness is spreading more broadly, and national-level home purchases have given back three quarters of the torrid gains experienced between January and June of this year. Listings have also climbed nearly across the board in a sign that homeowners may be struggling with higher mortgage rates. So while supply–demand balances are still tighter in Alberta than in Ontario and BC, all major markets are loosening (graph 1).

GRAPH 1
Supply–Demand Balances Differ by Region, but Large Cities Are Becoming More Buyer-Friendly



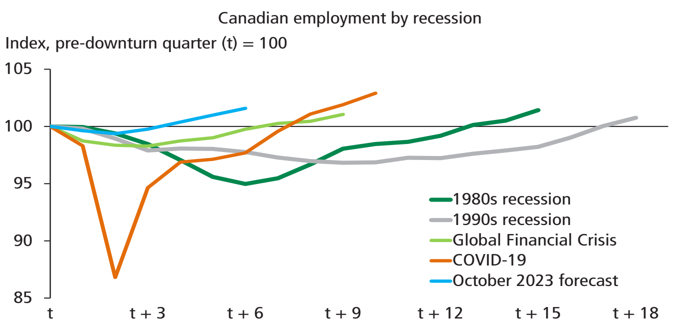
Sources: Canadian Real Estate Association and Desjardins Economic Studies

The plunge in sales and prices since the summer months makes weaker-than-previously-anticipated headline growth rates all but assured in 2024. It also looks like the Bank of Canada's pause this time won't spur a rally as it did earlier this year, resulting in softer sales and prices through next spring. There's a chance that yields begin to move lower early if the Bank begins to signal that rate reductions are imminent. But in general, we think prospective buyers and those renewing may have to wait until cuts begin towards the middle of next year for more relief.

An Economic Downturn Looms

The economic downturn that we expect to materialize as 2024 approaches should also put downward pressure on sales and prices. We still anticipate that more interest-rate-sensitive economies like Ontario and BC will feel those effects most deeply, contributing to more significant increases in those provinces' unemployment rates. That said, we also continue to think that tight labour markets in most of the country should prevent the kinds of job losses normally associated with recessionary periods (graph 2). As an economic recovery gathers steam towards the end of 2024, we should see modest price growth in most jurisdictions.

GRAPH 2
We Should See a Short and Shallow Downturn by Historical Standards

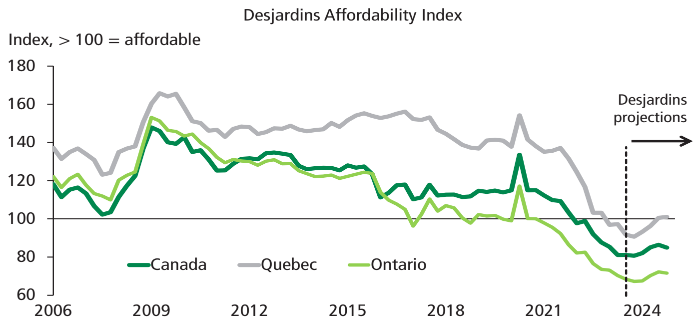


Sources: Statistics Canada and Desjardins Economic Studies

Affordability Concerns Are Ever Present

Despite recent weakness in sales and prices, housing affordability remains stretched. Accordingly, we're continuing to see international and interprovincial migration towards the more affordable centres in Alberta and Atlantic Canada. We've also seen stronger—albeit still easing—demand for cheaper apartment and townhome accommodations. A short and shallow recession will likely mean income losses that are limited relative to past downturns. So with price weakness ahead, the Desjardins Affordability Index points to an overall improvement in affordability from current levels (graph 3). But prices should still stay high relative to the last two decades amid elevated interest rates. Therefore, improvements should be modest, leaving most

GRAPH 3
Affordability Is Unlikely to Return to Pre-Pandemic Levels Next Year



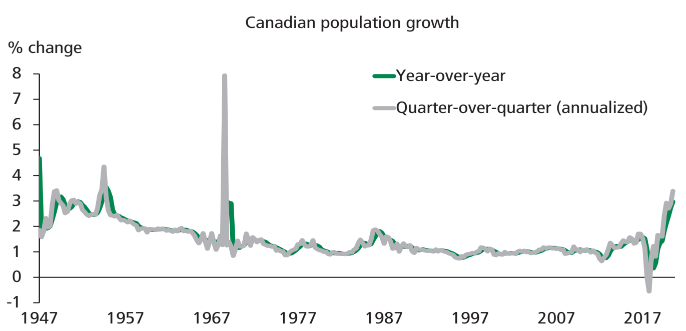
Sources: Statistics Canada, Institut de la Statistique du Québec, Ontario Ministry of Finance, Canadian Real Estate Association and Desjardins Economic Studies

major housing markets in Canada less affordable than before the COVID-19 pandemic began.

Population Growth Is Still Highly Supportive

Decades-high population growth—which accelerated in the last quarter (graph 4)—remains highly supportive of housing demand. This should persist to some degree into the next year, in part because of employers' reliance on temporary labour to fill job vacancies. We think skyrocketing temporary migration could cool next year as employment growth weakens. However, still-elevated job vacancies and the federal government's increased use of temporary labour to meet its permanent resident targets may blunt this effect.

GRAPH 4
Canada's Population Is Skyrocketing



Sources: Statistics Canada and Desjardins Economic Studies

Don't Expect Construction Resilience to Last

While the resilience of housing construction activity has continued to surprise in recent months, we think it's only a matter of time before we see a more significant slowdown. Other than the booming population growth currently underway across much of the country, there aren't many indicators that suggest conditions supportive of homebuilding. Interest rates and building material costs are at decades-high levels. Sentiment in the homebuilding sector is very weak. Labour shortages remain in the construction industry, and the average age of construction workers just keeps climbing. With these trends likely to persist to at least some degree over the next few years and economic activity set to fall back as we approach 2024, we see housing starts declining next year.

ATLANTIC REGION

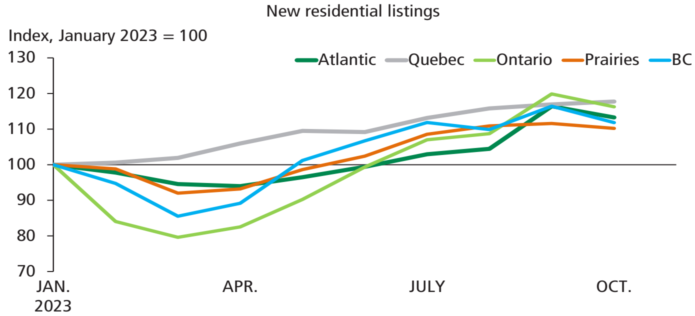
Real estate markets are softening in Atlantic Canada, though generally not as much as we've seen in higher-priced jurisdictions. Home sales and prices proved resilient to both the initial round of aggressive monetary tightening and subsequent rises in June and July. This was supported by relative affordability, as well as population growth that exceeded historical norms much more than it did most elsewhere.

There are now clear signs that homeowners are feeling the pinch. New listings have risen considerably across all four provinces in the region. The climb did not occur as immediately following rate hikes as it did in Ontario and BC (graph 5). However, its persistence nonetheless suggests that many homeowners are struggling under the weight of high borrowing costs and an elevated cost of living. Moreover, many of the recent sales across the region have come in the cheaper apartment and townhome segments. Weakness in the MLS Home Price Index for single-family dwellings suggests demand is moving away from more expensive unit types.

Recent slowing of momentum should continue into the coming months, but we think the Atlantic region will be spared the worst of any forthcoming housing market correction. Despite still-high home prices and interest rates, affordability remains a draw. Low levels of household indebtedness relative to other provinces mean that consumers are less exposed to the drag from a period of prolonged high borrowing costs. And we don't anticipate as significant a deterioration in the economic backdrop in the region as we do elsewhere. Newfoundland and Labrador stands out in this respect, with its economic growth set to pick up next year on the back of rebounding oil output.

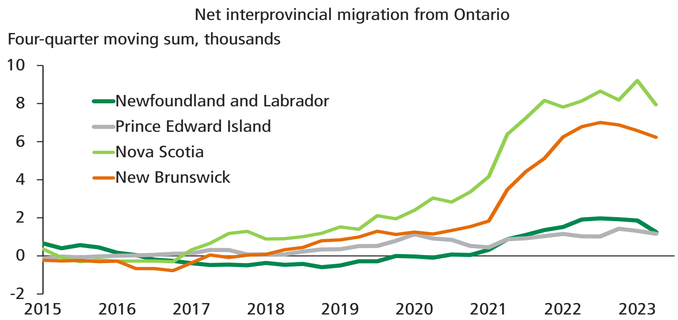
Population growth remains a bit of a wildcard. Notably, net migration from other provinces—especially Ontario—is easing after increased telework drove a surge during the peak pandemic period (graph 6). Our expectation that this trend will continue drives some of the more moderate price rise we have built into the region for the second half of the year.

GRAPH 5
Listings Are up Significantly across the Country



Sources: Canadian Real Estate Association and Desjardins Economic Studies

GRAPH 6
Pandemic-Era Inflows into Atlantic Canada from Other Provinces Look to Have Peaked



Sources: Statistics Canada and Desjardins Economic Studies

QUEBEC

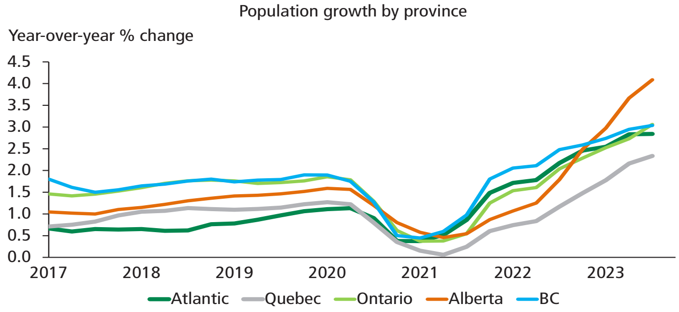
It's been a difficult year so far for Quebec's resale housing market. Home sales weren't hit nearly as hard in Quebec as in other jurisdictions after the Bank of Canada began raising rates. But they didn't experience much of a resurgence when the central bank paused its tightening campaign. Weak population growth relative to the rest of Canada also prevented a more significant recovery this spring (graph 7).

We could see prices and sales deteriorate further in the coming quarters. The uptick in new listings has eased supply–demand tightness, suggesting less upward pressure on prices in the next few months. We're also projecting outright declines in provincial output as we approach 2024 after a contraction in the second quarter. Weak GDP and the accumulated effects of the economic softness earlier this year should weigh on purchasing activity.

Meanwhile residential construction is down nearly 40% since the start of the year, one of the biggest declines in Canada. New project activity is down significantly across single-family homes, condominiums and rental housing, and in both major and mid-sized urban centres. This appears to reflect particularly acute pressure on rental property developers from sharply higher interest rates, as rental apartments accounted for about 60% of total housing starts last year.

We expect new construction and existing home sales activity to increasingly find their footing over the course of the next year. Combined with a joint federal–provincial effort to boost the supply of affordable housing, eventual cuts in interest rates next year should spur a recovery in starts and sales.

GRAPH 7
Quebec Population Growth Lags



Sources: Statistics Canada and Desjardins Economic Studies

ONTARIO

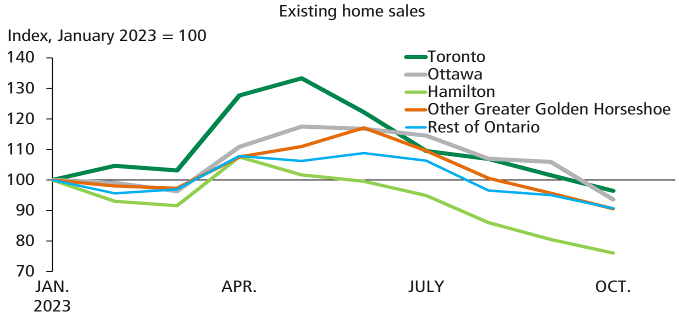
Ontario housing markets have been some of the most obvious victims of the Bank of Canada's second round of interest rate hikes, and that apparent sensitivity to borrowing costs impacts their prospects. Following the initial set of rate increases, Toronto was hit particularly hard. The market in Ontario's largest city may be approaching its peak rate of decline, but sales in adjacent centres are now falling back quickly (graph 8). In nearly all centres, however, listings have picked up dramatically.

Given apparently outsized sensitivity to borrowing costs in Ontario's largest markets, we expect to see a bounce-back in sales activity and prices after rates are eventually cut next spring. However, it might not be immediate. We anticipate that Ontario's economy will experience one of the most significant contractions of any province in the coming quarters, which should weigh on home resale activity. Only towards the end of next year—once multiple rate cuts occur and an economic rebound is well underway—do we see purchasing volumes rising more quickly than in the rest of Canada.

With a few exceptions in some cities, recent weakness appears to have been felt more in the market for single-family homes. However, demand has also cooled more meaningfully for less pricy townhomes and apartments in Toronto than in most other large Canadian cities. If recent post-interest-rate policy change periods are any indication, these segments could be the first to rebound once rates are eventually cut.

While housing starts have proved surprisingly resilient to more downcast building conditions in Ontario so far, that isn't necessarily conducive to improving affordability. Our work highlighted a trend towards multi-unit properties—which account for much of new Ontario construction this year—that are more expensive on a per-square foot basis. Moreover, the so-called "missing middle" remains largely absent from new home construction. In all, while weaker prices and an eventual reduction in interest rates will contribute to some improvements over the next year, sustained housing affordability gains can't come without far stronger homebuilding over time.

GRAPH 8
The Post-Rate Hike Housing Market Weakness Extends beyond Toronto



Sources: Canadian Real Estate Association and Desjardins Economic Studies

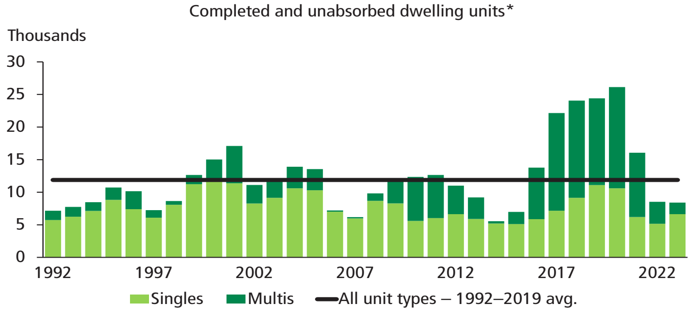
PRAIRIE PROVINCES

Despite pronounced weakness in October 2023, Alberta's major housing markets have some of the strongest outlooks of any city over the next year. The province also has some of the best economic and labour market prospects in Canada, with support from the staple oil and gas industry, renewable energy and manufacturing. Moreover, Calgary and Edmonton maintain significant affordability advantages over other large Canadian cities, and that continues to help attract significant numbers of young people from other provinces. That is complementing admissions of non-permanent residents and permanent resident immigrants, of which a larger share tends to settle in Alberta when economic prospects are good. Strikingly, very strong demand over the last two years has helped to erode the supply overhang accrued in Calgary after the last pre-pandemic oil price correction (graph 9). That said, housing supply may get a shorter-run boost if high rates continue to prompt some homeowners to list their properties for sale. Factors such as high interest rates and construction industry labour shortages will restrain homebuilding in the next couple of years, but Alberta's largest cities are less constrained by land availability than Toronto and Vancouver are.

We think Saskatchewan's housing prospects look good relative to the rest of the country as well. As in the case of Alberta, we expect rising commodity output and relatively little vulnerability to interest rates to drive better-than-average economic growth. The province's largest cities are more affordable than those in most other jurisdictions. And despite a slow start for employment growth in 2023, a tight job vacancy rate limits the odds of employment losses as the effects of sharply higher interest rates are increasingly felt in the coming months.

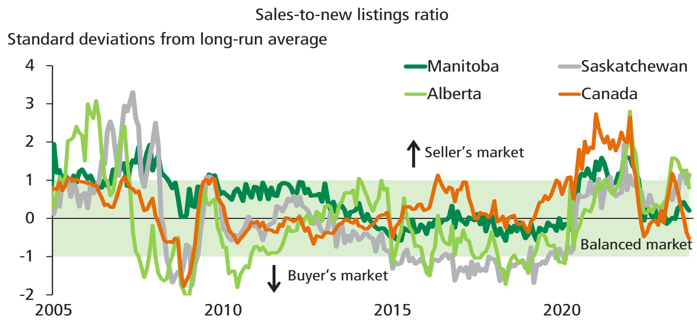
Manitoba's residential real estate industry has been feeling the effects of higher interest rates, but we still foresee relatively balanced market conditions going forward. Indeed, that has been the case during the most recent market adjustment and for much of the past 20-plus years (graph 10). The province's broad industrial base should prevent a significant deterioration of the economic backdrop and labour market, and by extension of home purchasing activity.

GRAPH 9
Calgary's Longstanding Housing Supply Overhang Is Being Absorbed



* 2023 figure based on year-to-date growth rates
Sources: Canada Mortgage and Housing Corporation and Desjardins Economic Studies

GRAPH 10
Manitoba Housing Markets Have Been Balanced for Much of the Past Two Decades



Sources: Canadian Real Estate Association and Desjardins Economic Studies

BRITISH COLUMBIA

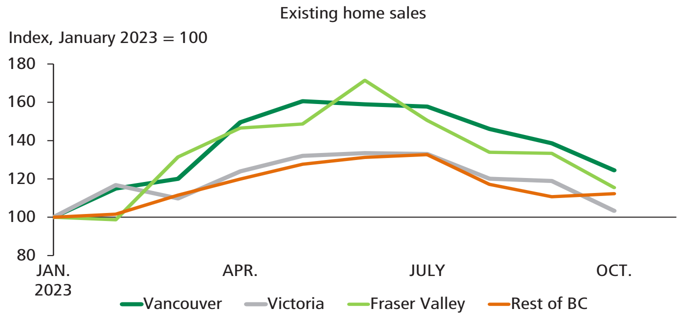
Our outlook for BC's housing market is influenced by many of the factors present in Ontario. Home sales were initially hit harder in Vancouver than most elsewhere following the resumption of interest rate hikes in June. Weakness now appears to be spreading beyond the province's highest-priced market (graph 11). New listings have picked up more meaningfully than at the national level, suggesting that households in the highly indebted province are feeling the pain of higher rates more acutely than almost anywhere else. Purchasing activity could rebound once rates come back down, but softer-than-average near-term economic prospects will likely hold back a stronger resurgence until the end of 2024.

BC's economy appears to be entering 2024 with less economic momentum than Ontario's. Employment growth and retail sales have lagged the national average so far this year. Households out west also had less savings to draw on last year, and preliminary data for 2023 indicate a similar pattern.

Construction activity has held up well so far in BC in contrast to most other provinces, but should increasingly fall back over the coming quarters amid still-high interest rates and material costs, construction sector labour shortages and a softening economic backdrop.

That said, BC brings more housing market momentum into the next few months than Ontario does. Sales activity rallied more meaningfully earlier this year in Vancouver than it did in Toronto, and listings have not picked up as significantly.

GRAPH 11
Housing Weakness Has Also Spread beyond the Biggest Market in BC



Sources: Canadian Real Estate Association and Desjardins Economic Studies

FORECAST TABLES

TABLE 1
Canada: Major Housing Indicators by Province

ANNUAL AVERAGE IN % (UNLESS OTHERWISE INDICATED)	2019	2020	2021	2022	2023f	2024f
Existing home sales – Canada	**6.5**	**12.6**	**20.5**	**-25.1**	**-11.8**	**-5.0**
Newfoundland and Labrador	9.6	14.6	45.6	-7.2	-15.9	0.2
Prince Edward Island	-6.9	9.7	14.8	-18.1	-8.0	-10.0
Nova Scotia	10.9	13.2	14.2	-21.7	-17.9	3.1
New Brunswick	12.5	13.7	22.4	-20.5	-13.9	2.3
Quebec	11.4	16.4	-2.4	-20.4	-12.9	-1.7
Ontario	9.0	8.8	18.5	-31.7	-13.5	-10.9
Manitoba	8.5	14.3	17.1	-20.1	-9.2	5.1
Saskatchewan	1.5	24.6	24.0	-11.7	-3.3	3.2
Alberta	-0.1	4.3	53.6	-1.9	-9.8	1.7
British Columbia	-1.5	21.5	32.9	-35.4	-9.2	-8.6
Average home resale price – Canada	**2.5**	**12.9**	**21.2**	**2.4**	**-2.9**	**2.5**
Newfoundland and Labrador	-3.3	3.1	9.9	6.7	0.0	0.6
Prince Edward Island	12.2	18.8	20.6	13.8	-0.6	0.8
Nova Scotia	7.9	13.7	23.1	14.9	3.6	5.7
New Brunswick	2.9	10.5	26.0	17.6	3.6	6.7
Quebec	5.2	16.4	16.4	10.3	0.3	0.0
Ontario	6.4	16.0	23.5	6.7	-5.0	2.2
Manitoba	-0.1	4.4	9.8	7.9	-2.9	2.2
Saskatchewan	-0.4	2.5	6.9	0.6	-0.1	2.4
Alberta	-2.7	1.2	9.2	5.3	1.0	4.2
British Columbia	-1.4	11.6	18.5	7.5	-1.4	3.0
Housing starts (thousands) – Canada	**208.7**	**217.8**	**271.2**	**263.3**	**241.5**	**222.8**
Newfoundland and Labrador	0.9	0.8	1.0	1.4	1.1	1.2
Prince Edward Island	1.5	1.2	1.3	1.3	0.8	0.8
Nova Scotia	4.7	4.9	6.0	5.7	5.6	4.9
New Brunswick	2.9	3.5	3.8	4.7	4.4	3.9
Quebec	48.0	54.1	67.8	57.1	40.3	39.0
Ontario	69.0	81.3	99.6	96.1	93.3	82.0
Manitoba	6.9	7.3	8.0	8.1	7.1	6.5
Saskatchewan	2.4	3.1	4.2	4.2	4.4	4.5
Alberta	27.3	24.0	31.9	36.5	36.6	38.0
British Columbia	44.9	37.7	47.6	46.7	47.7	42.0

f: forecast
Sources: Canada Mortgage and Housing Corporation, Canadian Real Estate Association and Desjardins Economic Studies