TD Economics

Cue the Comeback

Canadian housing markets find their footing after policy-related stumbles

Derek Burleton, Deputy Chief Economist | 416-982-2514
Rishi Sondhi, Economist | 416-983-8806

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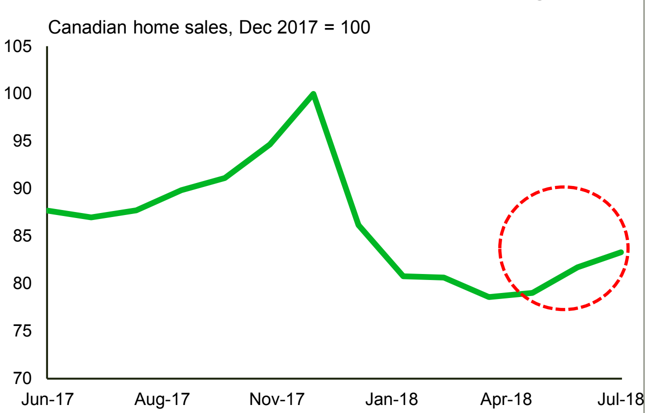
Highlights

- Tighter lending rules, rising borrowing costs and provincial policy actions left Canadian housing markets stumbling out of the gate in 2018. However, our longstanding view was that some traction would be gained after sharp initial adjustments to these factors.
- Recent data has confirmed this view, with activity improving in several jurisdictions since May. Gains have been concentrated in Ontario, with sales in Alberta and New Brunswick also appreciably higher.
- Sales and prices are turning around in Toronto amidst significant pent-up demand. In contrast, Vancouver's market has yet to find a bottom given lingering government policy impacts.
- Healthy economic conditions have buoyed activity in Québec. Meanwhile, demand is picking up in Calgary, driving the provincial sales gain. However, markets in Alberta remain loose by historical standards, leading to subdued price growth. The same holds true for other markets in the Prairies.
- In a change from years past, markets in the Atlantic Provinces have outperformed Canada overall. Newfoundland and Labrador remains the main exception.
- Looking ahead, sales and prices should gain traction across most major markets as the year continues to roll forward, as the effects of the B-20 fade away and economic growth bolsters demand.

Changes to lending rules, provincial policy actions and rising borrowing rates have ensured a tumultuous year for Canadian housing markets. Sales and prices fell sharply in the seven months of 2018, by 17% and 5% year-over-year, respectively. However, our longstanding view has been that Canada's major housing markets would regain traction after the initial sharp knee-jerk policy adjustments, and this is playing out in textbook fashion (Chart 1). Past experience has shown that markets begin to stabilize after about 4-6 months following the implementation of major changes to housing policy. True to form, sales activity and average prices have come off a floor in most major markets since May (Table 1).

Chart 1: Canadian home sales are stabilizing



Source: CREA, TD Economics

But, stabilization should not be interpreted as the start of another strong rally. Unlike past periods when housing policy was imposed, this one is characterized by less accommodative credit and affordability conditions (Charts 2 and 3). As such, pent-up demand from some buyers and healthy income gains will face a stronger headwind this time around, particularly in the face of further gradual interest rate increases by the Bank of Canada. We maintain the view of an ongoing improvement in

Table 1: Housing Market Update									
	Sales, % Change			Average Price, % Change			Market Balance*		
Market	December - April	May - July	July Year-over-Year	December - April	May - July	July Year-over-Year	December	April	July
Ontario	**-25.4**	**13.9**	**4.4**	**-4.4**	**3.8**	**6.6**	**56**	**55**	**60**
Toronto	-35.4	26.1	17.4	-4.0	7.5	4.3	46	46	54
London	-4.8	14.9	-5.4	6.2	1.7	12.0	71	70	76
Ottawa	-14.4	2.2	2.5	-1.3	1.4	3.5	74	70	68
Hamilton	-30.7	-6.6	-19.5	-3.7	2.0	2.8	74	56	60
Kitchener-Waterloo	-17.5	-4.1	-17.9	13.8	1.2	7.7	71	65	65
Alberta	**-25.9**	**5.0**	**-1.1**	**-0.4**	**0.0**	**-2.7**	**58**	**41**	**46**
Calgary	-31.0	7.9	-8.2	2.2	-0.2	1.3	63	39	46
Edmonton	-27.2	0.9	-1.6	4.6	-0.1	-4.0	60	42	44
Atlantic	**-4.3**	**7.2**	**7.5**	**1.3**	**-3.9**	**1.1**	**52**	**53**	**57**
Moncton	-1.6	13.8	13.3	12.7	4.2	4.7	70	70	81
Halifax	-1.4	-3.8	11.6	1.2	-6.1	-2.1	61	63	64
Saint John	-27.0	44.2	19.2	20.5	-2.5	4.4	58	46	59
Quebec	**-1.9**	**0.9**	**-0.3**	**0.8**	**1.8**	**4.0**	**62**	**62**	**62**
Montreal	-3.0	1.0	-2.2	-0.2	4.3	5.4	70	67	70
Quebec City	4.3	-6.0	-5.0	0.7	-3.1	0.4	52	65	49
MB/SK	**-14.3**	**2.8**	**-1.8**	**-1.0**	**0.9**	**0.9**	**48**	**47**	**46**
Regina	-7.7	6.0	-0.7	-3.4	0.2	-5.2	41	43	43
Saskatoon	-18.4	13.3	10.4	-0.1	-2.4	0.4	44	39	42
Winnipeg	-12.2	2.9	-8.2	0.0	0.2	1.1	59	56	56
B.C.	**-31.2**	**-4.6**	**-27.5**	**-5.3**	**3.3**	**0.8**	**64**	**52**	**52**
Vancouver	-34.4	-2.8	-35.3	-4.2	2.2	-0.6	57	43	47
Fraser Valley	-40.7	-8.2	-36.7	-0.5	2.0	6.0	67	49	49

* Market balance is represented by the sales-to-listings ratio, which depicts supply-demand dynamics. A ratio above 60/below 40 is associated with a sellers/buyers market.
Source: CREA, FCIQ, TD Economics

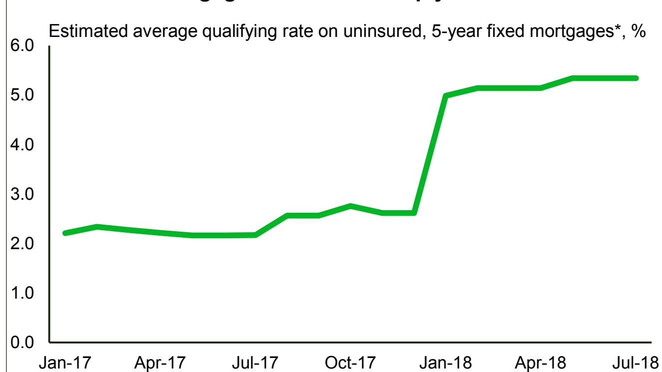
activity over the next few quarters, but the level of sales for the whole of 2018 won't be able to recover what has been lost in most markets. As always, we don't rule out some setbacks along the road to improvement (see TD Economics' updated resale forecasts in Table 2).

Some markets have avoided the wild ride

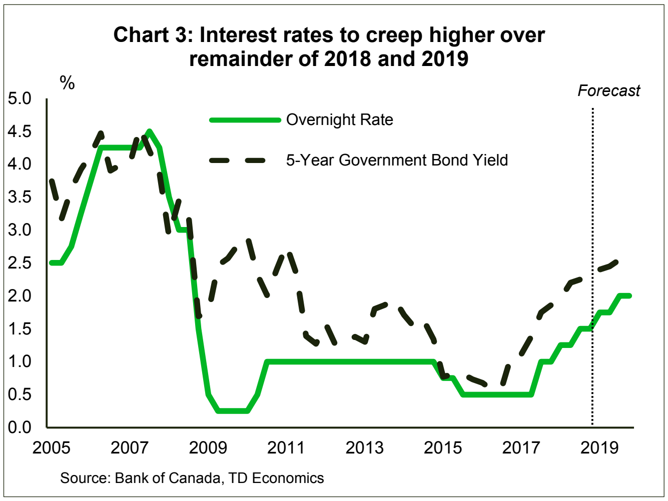
In our prior forecast report, we had anticipated that the impact from the new regulations and higher mortgage rates would be felt broadly across provinces. Within that mix, Québec and most Maritime provinces were expected to hold up better given relatively favourable affordability, still-decent labour market conditions and population dynamics. This view bore out. Sales are down year-to-date across almost all provinces, save for New Brunswick. Québec has held up relatively well, with activity down only modestly. Since May, the improvement in sales has been broadly based, with activity higher in 7 of 10 provinces, with Ontario making a notable contribution to the headline. Furthermore, with new listings generally lagging, demand has begun to outstrip supply over the past two months in several markets, resulting in renewed upward pressure on average prices.

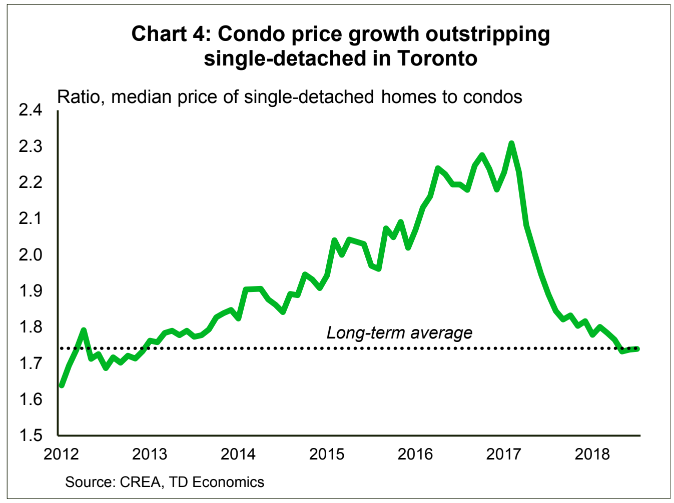
The remainder of this report provides some additional colour around the recent performances and likely near-term prospects of the country's largest urban housing markets.

Chart 2: Qualifying rate on uninsured, 5-year fixed mortgages increases sharply in 2018



* For federally regulated financial institutions
Source: Ratehub, Bank of Canada, TD Economics





Signs of stabilization in Toronto

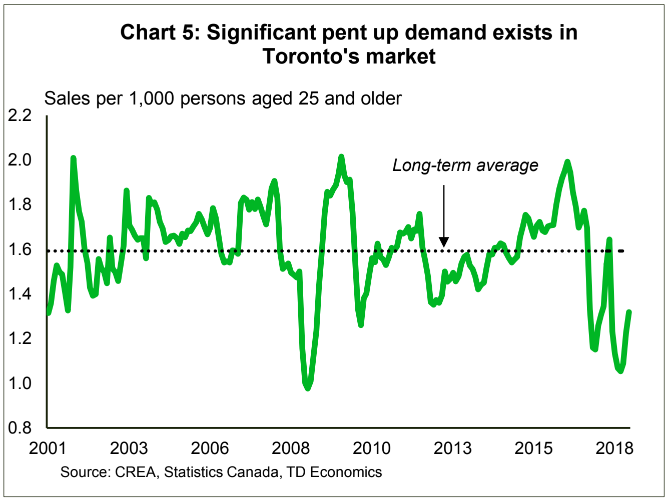
Given stretched affordability conditions and a relatively larger share of uninsured mortgages, markets in the GTA were predictably walloped in the early part of 2018 by the B-20 lending rule changes and rising borrowing rates. Sales fell by 35% from December through April, with weakness especially pronounced for single-detached housing. In comparison, the condo market proved more resilient given its affordability advantage of a lower price point, which made it the only game in town for many buyers. This demand influx was likely compounded by the large millennial cohort that is aging into its household formation years (i.e. when homeownership typically rises). Even with these advantages, condo sales fell in the first four months of this year, though much of the drop can be traced to the pull-forward of demand into 2017, in order to beat the B-20 lending rules. Once this factor is accounted for, sales fell only modestly over the period. Nevertheless, growth in benchmark condo prices slowed to an 8% y/y pace, which is still incredibly strong, but well off 2017's dizzying highs.

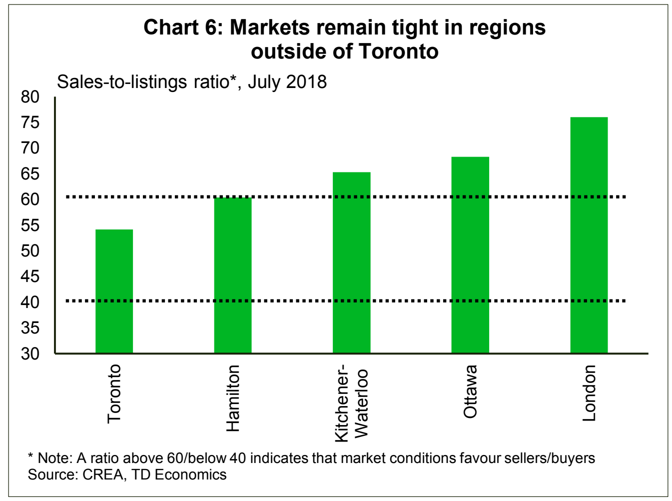
Since May, there has been a distinct turning in the tide within the resale market, for both detached homes and condos. Indeed, aggregate sales increased for three straight months and were 17% higher than their year-ago level in July. Single-detached homes are estimated to have grown by about 20% during May and June, compared to an approximate 10% rise in condos (as of writing, data broken down by different housing types was not available for July). Still, sales remain about one-third below their 2016 high and poor affordability is likely to keep activity well below this prior peak through the end of next year.

One factor that likely contributed to the upswing in demand for detached homes is the fact that strong price growth for condos caused a significant narrowing in the relative price gaps between the two housing types. This improves the economics of owning a detached home, despite the fact that the overall market maintains strained affordability relative to other parts of the country (excluding the Greater Vancouver Area which tops the charts). The price ratio of single-detached units relative to condos is currently back at its historical norm (Chart 4). This offers a window for move-up buyers to jump back in, suggesting price growth for detached homes may outperform that of condos in the near-term, even though the prospect for a sharp price rebound is unlikely.

After falling in the first four months of the year, the average price for all homes subsequently climbed 8% through July - yet another sign of stabilization. Total new listings increased 7% during that time. After flirting with an entry into buyers' territory earlier in the year, the sharp rise in sales combined with a more modest gain in listings has vaulted the sales-to-listings ratio back above 50 – signaling more balanced conditions.

In a turn of fate, the sales-to-population ratio is the lowest it's been in many years (Chart 5), suggesting pent-up demand has returned to Toronto's market. This, coupled with relatively firm economic conditions, should keep sales moving higher. Meanwhile, listings should rise more





convincingly as strengthening demand brings sellers off the sidelines. Together these forces should keep the GTA market more balanced and support stable price growth, with quarterly gains in the 0.5% - 2% range likely through 2019.

Although the GTA market captures most media headlines, there have also been significant developments in markets that lay outside this border. For instance, activity has generally been weak in other major markets in the Greater Golden Horseshoe (GGH). Sales are down 20% and 35% in Kitchener-Waterloo and Hamilton, respectively. Moreover, sales fell in both regions from May to July – bucking the trend seen in most major markets across Canada. However, listings have also plunged in both jurisdictions, leaving them tighter compared to the GTA. This should support positive price growth in these markets going forward.

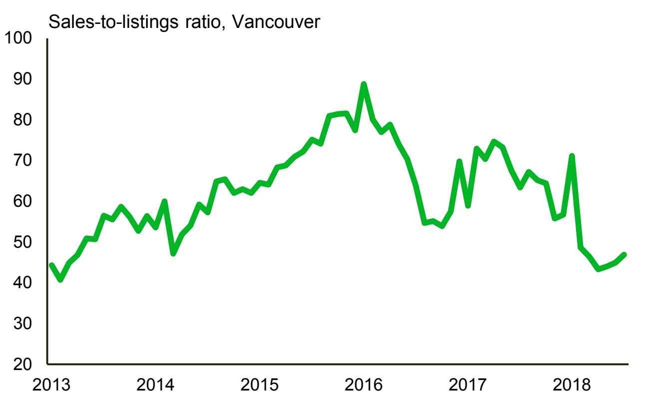
Zooming further out from the GTA, sales increased 15% from May to July in London, supported by a pickup in job and population growth. However, a soft start to the year ensures that activity will decline in 2018 on an annual average basis. Meanwhile, tepid growth in new listings has left London's market drum-tight, resulting in robust price growth. Indeed, prices are on track to grow at a near 10% pace this year, much stronger than the 2% drop forecasted for the province overall. Activity has also grown steadily in Ottawa this year, outside of a massive B-20 induced drop in January. Ottawa's market is also tight, supporting rising valuations, with benchmark prices averaging a robust 8% year-over-year gain so far in 2018.

Not there yet in Vancouver

The Greater Vancouver market has the worst affordability conditions in the country, so it's of little surprise that sales were hammered by the B-20 implementation and rising borrowing rates. Like Toronto, sales are down sharply this year for both single-detached and condominium units, with a 40% drop in the former and a 30% drop in the latter through June. Unlike Toronto, there is scant evidence of a pull-forward effect in the GVA, which has made the drop in sales comparatively worse. Also unlike Toronto, activity in Vancouver has yet to find a bottom, as buyers are also contending with an array of provincial policy measures introduced in late-February, including increased tax rates on foreign-bought homes and on expensive properties. In response to these measures, foreign buying has eased in Metro Vancouver from 5% of transactions in February to 2% in June. Additional downward pressure on sales should come from the implementation of a new "speculation tax" this fall, though the government has changed the rules governing the tax in order to make it less impactful. Ultimately, we expect sales to drop for another few months before finding their footing in the latter part of the year and increasing in 2019, supported by rising incomes.

Weaker markets have also kept sellers on the sidelines, with listings down by about 20% year-to-date. Vancouver's market has loosened significantly (Chart 7), despite this reduction in supply, with the sales-to-listings ratio well below its 10-year average in July. Softer conditions have brought average prices lower than where they were at the end of 2017, with much of the drop explained by

Chart 7: Conditions still soft in Vancouver



Source: CREA, TD Economics

moderating price growth for single-detached homes. However, its notable that prices in Vancouver's market have held up much better compared to Toronto, buoyed by still-solid condo price growth. Indeed, although condo sales are much lower on a year-to-date basis in Vancouver's market, sales of higher valued units have outperformed those on the lower end, boosting aggregate condo prices.

Looking ahead, loose markets should keep a lid on overall prices in the near-term, before they rise more convincingly in the latter part of the year in response to increased sales.

Demand has been weak in markets outside of Vancouver, with sales down by about one-third this year. There was a slight improvement in activity in these markets in July, although one month does not make a trend, with provincial policies likely to pressure activity downwards in the near-term.

Fraser Valley's market has been particularly soft, with activity sharply lower across all structure types. This is reflected in the sales-to-listings ratio, which fell from an elevated 67 ratio late last year to 49 in July. Ample supply relative to demand should be a factor weighing on prices in Fraser Valley in the near-term. However, solid price growth in late 2017 and gains earlier this year point to rising prices in 2018 overall. Better affordability has helped Victoria and Kelowna outperform, though activity is still down by about 30% in both regions year-to-date.

Markets outperforming in Québec

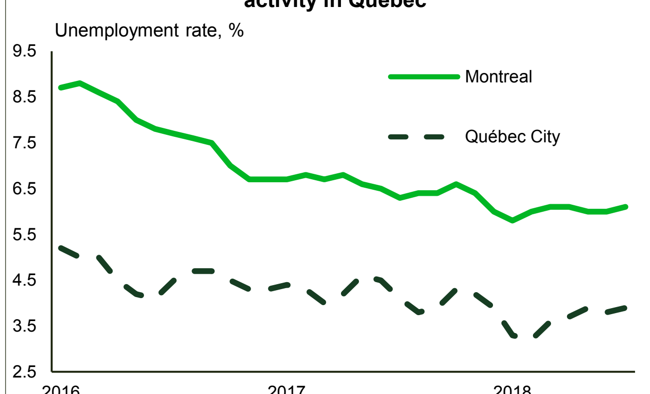
Québec has been a notable outperforming market that has largely defied the large drawdown in sales observed in other parts of the country from B-20 impacts. This is related to relatively strong economic conditions (Chart 8) and lower starting points on home values that have seen sales decline only marginally year-to-date. After dropping from December to April, activity in Montreal edged higher through July. Meanwhile, home prices advanced 4% in Montreal since May, supported by tight market conditions. With the sales-to-listing ratio currently entrenched in seller's territory, prices likely have further room to run. Notably, new home markets are no longer oversupplied in Montreal, thanks to a few lean years of building and rising demand, removing a potential weight on price growth.

After outperforming earlier in the year, markets have softened in Québec City in recent months. In particular, a sharp rise in new listings combined with modest activity has loosened the market considerably – evident with a sales-to-listings ratio well below its long-term average. This suggests that muted price growth is likely in the coming months. However, for the province overall, we expect sales and prices to post some of the fastest growth rates in the country during 2018/2019, led by Montreal and stoked by good affordability and continued job gains.

Demand recovering in Alberta

In Calgary and Edmonton, sales plunged by about 30% between December to April. These housing markets were already on shaky ground due to a build-up of broader

Chart 8: Solid job markets supporting activity in Québec



Source: Statistics Canada, TD Economics

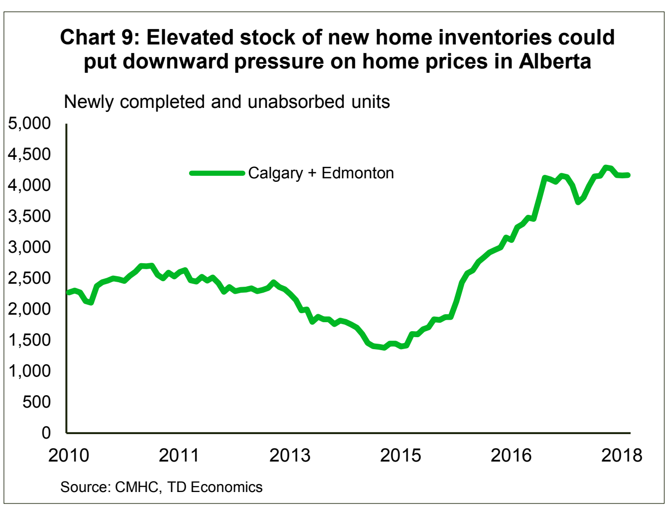
economic slack in prior years, which was compounded by the new B-20 lending rules and higher mortgage rates. However, sales have subsequently improved between May and July. At the same time, sellers have also come back in Calgary and Edmonton. Listings are up modestly year-to-date in both markets.

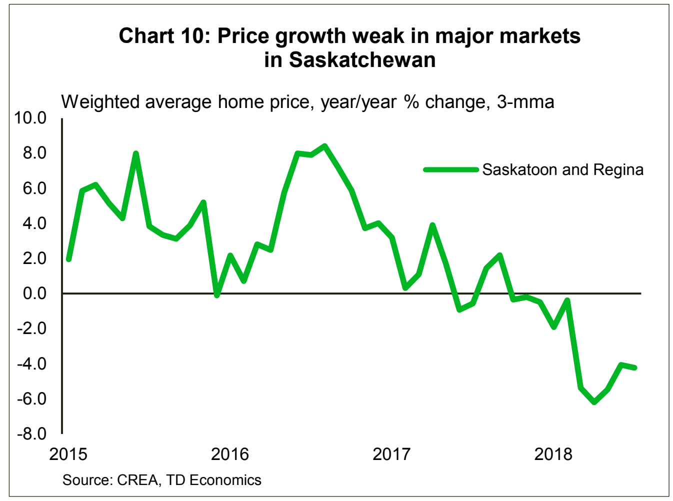
The demand-supply combination has left the sales-to-listings ratios sitting well below long-term averages, which should pressure prices downwards in the near-term and reign in supply. Prices should stabilize in the latter part of 2018 before increasing modestly next year on the back of strengthening demand. However, an abundance of newly built homes available for sale in both markets will limit the upside potential on price growth (Chart 9).

Markets subdued in other Prairie Provinces

Sales are down only 2% year-to-date in Regina, a much better performance than other markets. However, this is partly because, unlike other regions, buyers did not jump into the market in droves to make purchases ahead of B-20 rules taking hold. It would be a stretch to call Regina's housing market performance "good", as activity remains soft amid rising unemployment and mortgage rates. Moreover, price growth has been modest, with the sales-to-listings ratio well below long-term norms.

Sales in Saskatoon are down by 8% year-to-date, despite a notable increase in July. Like Regina, price growth remains soft, with the 3-month trend in prices hitting its lowest level since 2012. On the plus side, employment has trended higher and population growth is firm. These improving fundamentals should help lead activity higher





in Saskatoon in the second half of the year and into 2019, even with market conditions expected to remain on the loose side.

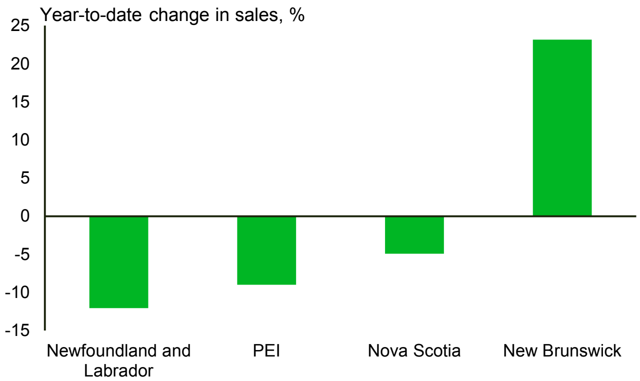
Similar to Regina, Winnipeg did not display front-loaded purchaser behavior to beat out the impact of the B-20 guidelines. But, unlike Regina, there was still an outsized drop in sales to open the year. What's more, the trend remains weak, with activity dropping in 5 of 7 months so far this year. On the supply side of the equation, listings have trended higher after January's big drop, keeping price growth in check. As Winnipeg's market accounts for most of Manitoba, these trends imply that province-wide prices will edge out a gain that will remain below the rate of inflation this year. Meanwhile, sales will likely post their largest decline in many years, on an annual average basis. Fortunately, on-going population gains and job growth should improve activity as 2018 comes to a close.

Atlantic Provinces are resilient

With some exceptions, markets in the Atlantic Region have been resilient this year, helped by relatively firm population growth. Indeed, activity in the Maritimes has outperformed Canada on a year-to-date basis, keeping markets tight. Of course, these aggregate statistics paint a broad picture, with regional dynamics much more nuanced.

Save for a one month spike, Halifax home sales have been soft in 2018. However, because listings have also fallen, the market is relatively tight. This, however, has not prevented prices from sliding 5% from their December 2017 level so far this year. Looking ahead, we do

Chart 11: New Brunswick outperforming other Atlantic markets



Source: CREA, TD Economics

not expect this bout of weakness to last, as labour markets have improved, population growth is accelerating and housing remains affordable, though a glut of unsold newly completed homes on the market could apply some downward price pressure.

PEI sits on the disappointing end of the spectrum, with sales falling by about 1% on average each month this year, leaving the cumulative decline at 9%. Though activity has been on the soft-side, markets have remained tight as listings have also dropped. However, price growth has also been weak this year.

Although sales in PEI are down year-to-date, the level of activity is still historically elevated. Moreover, sales should improve in the second half owing to a strong fundamental backdrop, supporting prices and bringing sellers back into the market. Thus, the overall picture remains healthy.

On the other hand, activity has held up relatively well in New Brunswick, as sales in Saint John have increased solidly since May. However, for the province overall, challenging demographics, slowing job growth and rising borrowing costs will constrain sales and price appreciation going forward.

It's been a buyer's market for much of 2018 in Newfoundland and Labrador as the combination of weak sales and rising listings have loosened markets significantly. Unfortunately, not much relief is in store for Newfoundland and Labrador, with job growth likely to be weak and population trends offering little help to support demand. All told, both sales and home prices are likely to be lower, on average, during 2018/2019.

Bottom Line

After a tumultuous first half of 2018, signs of stabilization are emerging across Canada's housing market with sales, listings and prices all moving higher in recent months. This improved performance has been driven primarily by Ontario and Alberta, with assistance from New Brunswick. Notably, Toronto's market appears to be turning around a very soft start to the year.

The highly localized nature of housing market dynamics means that not all are moving in the same direction. Key markets are softer in parts of the Prairies and the Maritimes. Markets also remain weak in B.C., where Vancouver has yet to find a bottom amidst lingering government policy impacts and rising mortgage rates. Fortunately, sales and prices should gain traction as the year continues to roll forward within major markets, as the effects of the B-20 fade away and economic growth bolsters demand.

We would characterize the risks around the near-term resale forecast as being roughly balanced. Past rebounds following policy changes have followed more distinct V-shaped patterns than we have embedded in our near-term forecast. As such, our view over the remainder of 2018 could be on the cautious side. On the downside, the economic environment remains risk filled, with trade tensions arguably the most pressing near-term risk to regional job markets. In addition, interest rate sensitivity is high relative to past cycles, so this may prove more meaningful in crimping demand than we currently have built into the forecast.

Table 2: Housing Forecasts								
	Existing Home Sales				Existing Home Prices			
	Units (000's)	Year-over-Year %			Dollars (000's)	Year-over-Year %		
	2017	2017	2018	2019	2017	2017	2018	2019
Canada	**516.3**	**-4.5**	**-10.0**	**7.6**	**506.0**	**3.9**	**-4.2**	**4.3**
B.C.	**85.3**	**-7.5**	**-23.3**	**7.2**	**704.6**	**3.4**	**1.2**	**2.6**
Vancouver	28.6	-10.5	-29.1	10.3	1,022.2	2.9	0.5	5.0
Fraser Valley	15.4	-7.2	-30.5	3.2	696.2	5.2	5.3	-0.1
Alberta	**57.8**	**4.3**	**-6.2**	**7.7**	**395.9**	**0.2**	**-2.2**	**-0.5**
Calgary	23.2	6.0	-13.2	12.0	463.4	0.3	-0.5	0.2
Edmonton	20.5	0.5	-2.8	8.2	377.5	0.5	-1.7	-1.2
Saskatchewan	**11.7**	**-2.5**	**-3.1**	**8.9**	**292.6**	**-2.1**	**-1.8**	**1.2**
Regina	3.4	-4.0	-2.5	7.3	314.0	-0.3	-5.0	-0.6
Saskatoon	5.0	-4.5	-0.6	12.5	335.8	-2.1	-1.9	2.0
Manitoba	**14.5**	**-0.8**	**-3.5**	**4.5**	**285.7**	**3.4**	**1.9**	**3.4**
Winnipeg	12.9	-0.9	-3.6	4.6	293.8	3.8	2.4	3.1
Ontario	**201.6**	**-9.6**	**-16.1**	**8.3**	**578.3**	**8.9**	**-2.2**	**5.0**
Toronto	83.2	-18.1	-18.6	9.8	807.6	11.5	-4.1	5.1
Hamilton	11.5	-9.7	-24.6	8.0	561.2	12.1	-1.7	4.2
Kitchener-Waterloo	6.3	1.4	-16.8	6.7	452.7	17.8	5.7	4.2
Ottawa	19.2	10.8	1.5	9.2	391.3	4.6	4.2	3.5
London	10.5	8.3	-16.4	11.7	327.5	17.3	9.1	5.1
Quebec	**91.5**	**5.7**	**5.5**	**5.0**	**292.9**	**4.4**	**5.0**	**4.5**
Montreal	48.8	7.5	5.7	4.0	365.1	5.6	5.3	4.8
Quebec City	7.4	2.2	4.1	2.8	266.7	0.6	3.6	5.5
Atlantic	**25.8**	**3.9**	**1.7**	**2.9**	**210.0**	**2.3**	**4.5**	**3.7**
Moncton	3.2	9.2	5.3	2.3	168.6	3.0	8.0	6.0
Saint John	1.9	8.0	-8.6	1.6	172.5	3.5	7.6	4.3
Halifax	6.2	6.7	6.8	3.0	293.1	1.6	2.2	1.9

Source: CREA, FCIQ, TD Economics, Forecast by TD Economics as of August 2018, Note: Historical annual levels are sum (for sales) and average (for prices) of quarterly figures