

Canada's housing market downturn: will it restore affordability?

TABE

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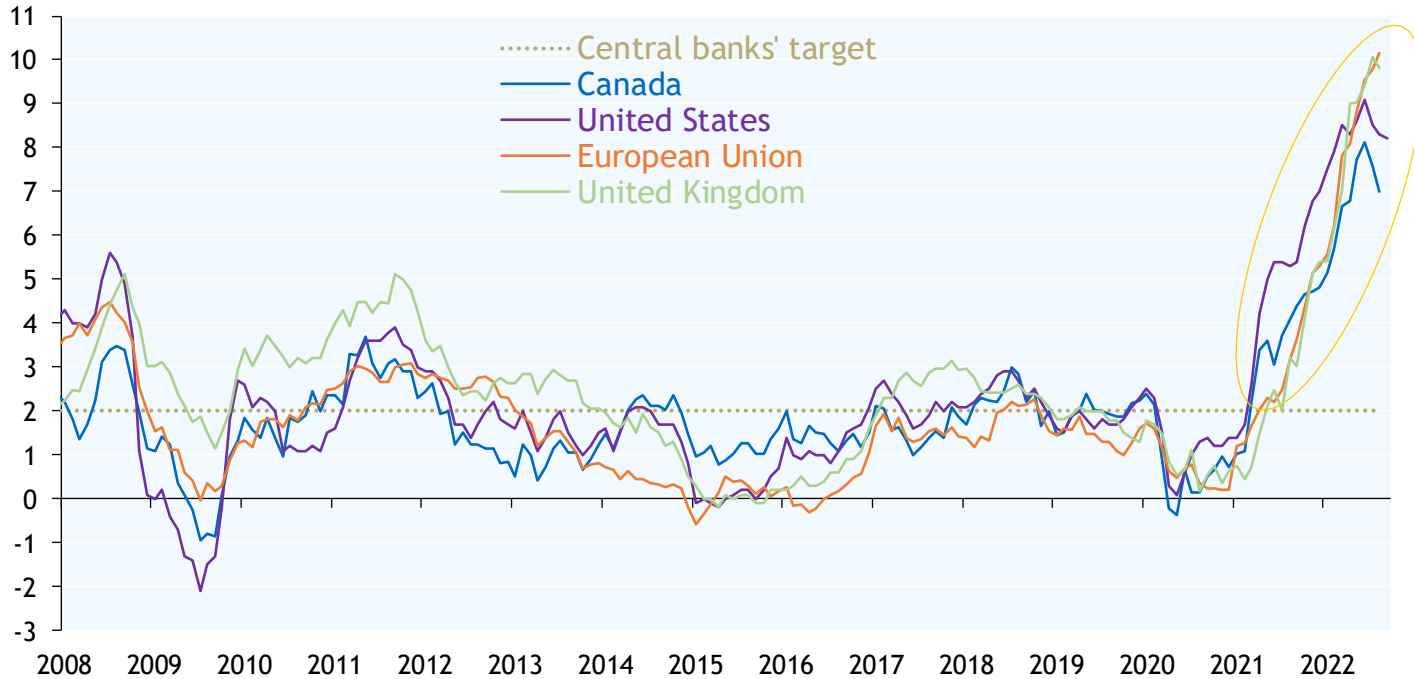
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Inflation still near a four-decade high

Inflation

Consumer price index, annual % change



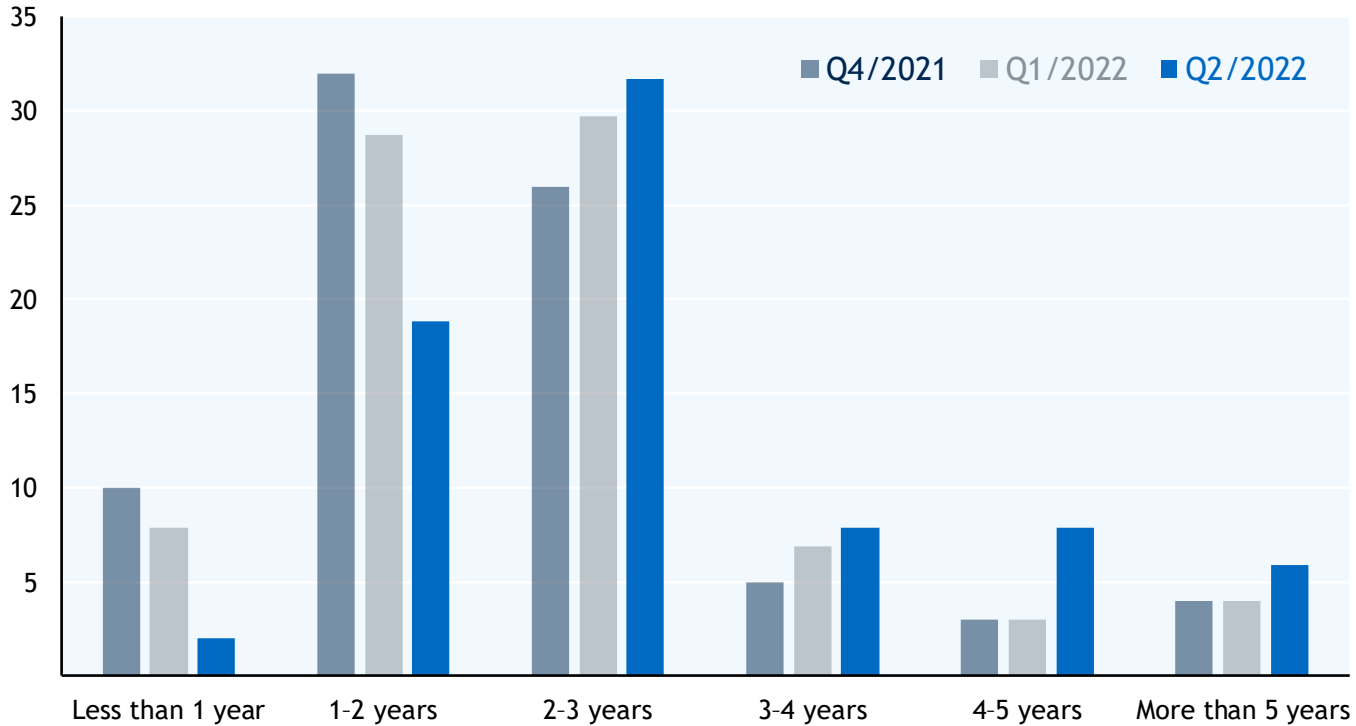
Source: Statistics Canada, Bureau of Labor Statistics, Office for National Statistics, Statistical Office of the European Communities, RBC Economics

Headline down slightly since cyclical peaks of 8.1% in Canada and 9.1% in the US

Central bank credibility is at stake

Business inflation expectations: Canada

% of businesses responding to "how long for you expect inflation to remain substantially above 2%?"



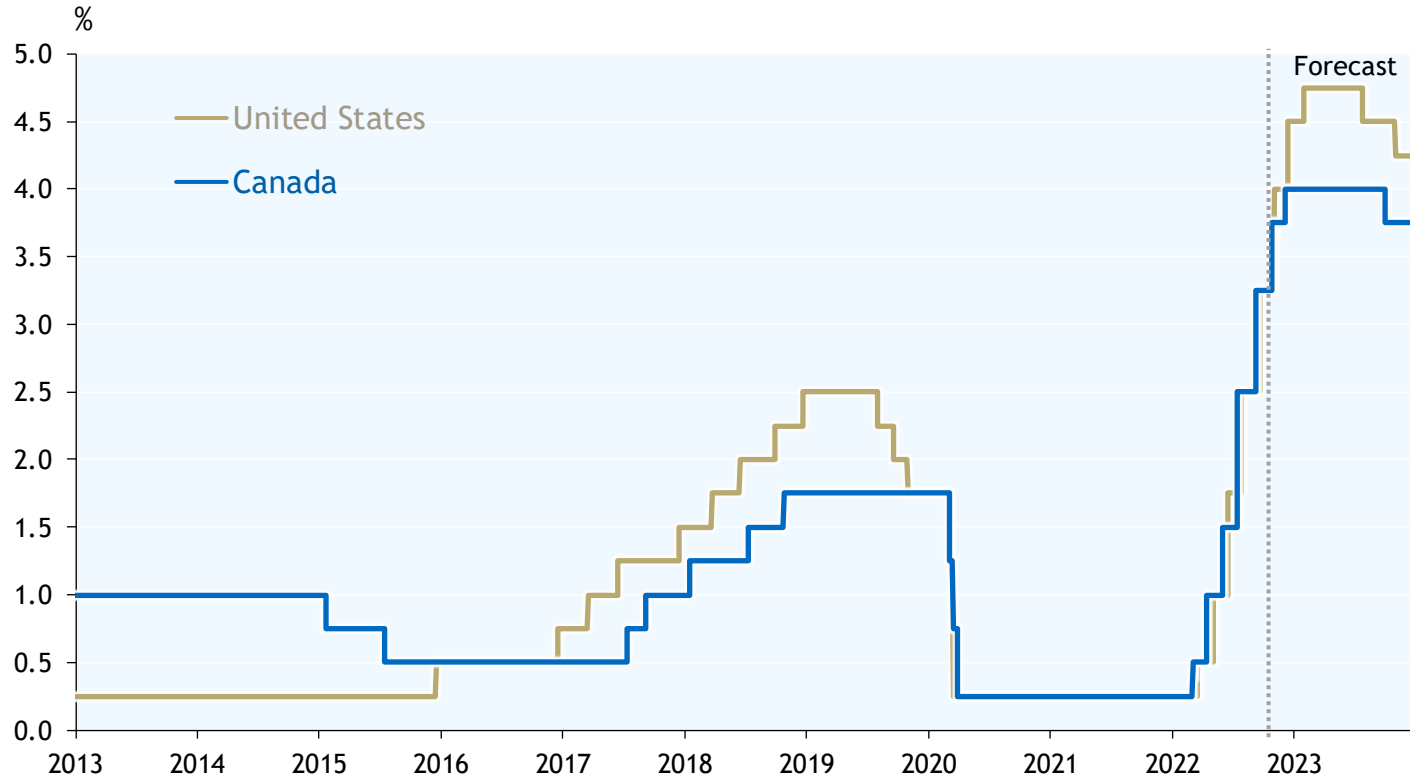
Source: Bank of Canada BOS Survey, RBC Economics

Inflation expectations have drifted higher



'Forceful' action is required

Policy interest rates: Canada and United States



Source: Bank of Canada, Federal Reserve, RBC Economics

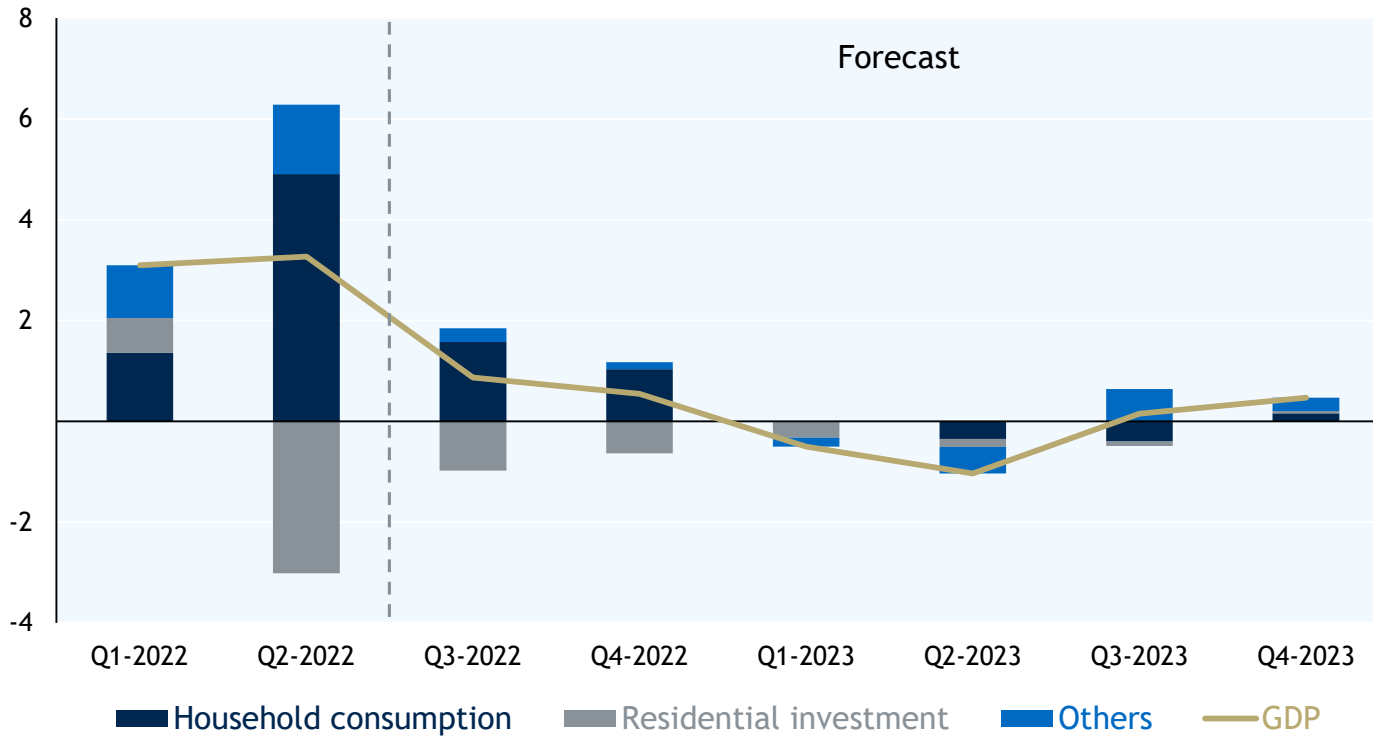
Bank of Canada, federal reserve to hike policy rates to 4% and 4.75%, respectively



This will cause a slight contraction...

Real GDP growth by major components: Canada

% contribution to quarter over quarter annualized GDP growth



Source: Statistics Canada, RBC Economics

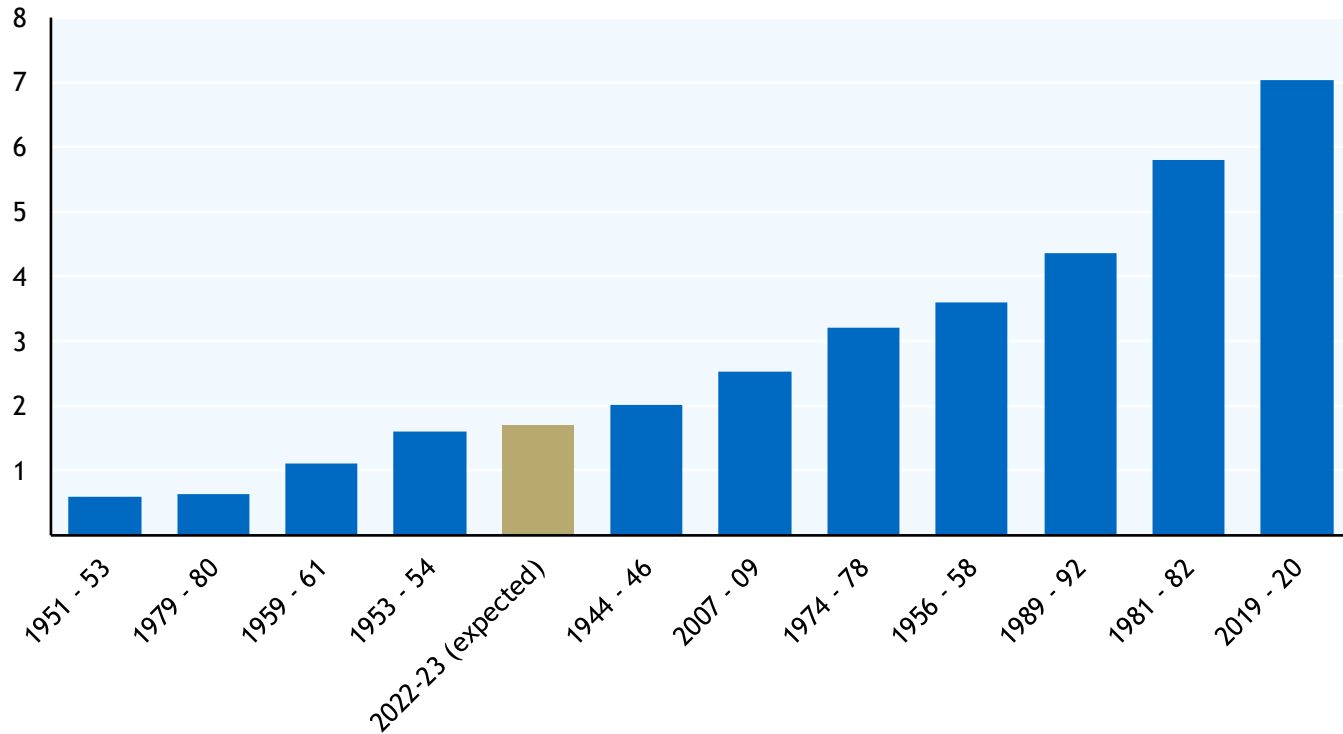
Interest-sensitive sectors to take a hit next year



...and rise in unemployment

Unemployment rate increases during Canadian recessions

Percentage-point increase from pre-shock level



Source: Statistics Canada, RBC Economics Research

Unemployment rate expected to climb 1.7 percentage points in Canada

March was the housing market's turning point

Home resales: Canada

Thousand units, seasonally adjusted and annualized



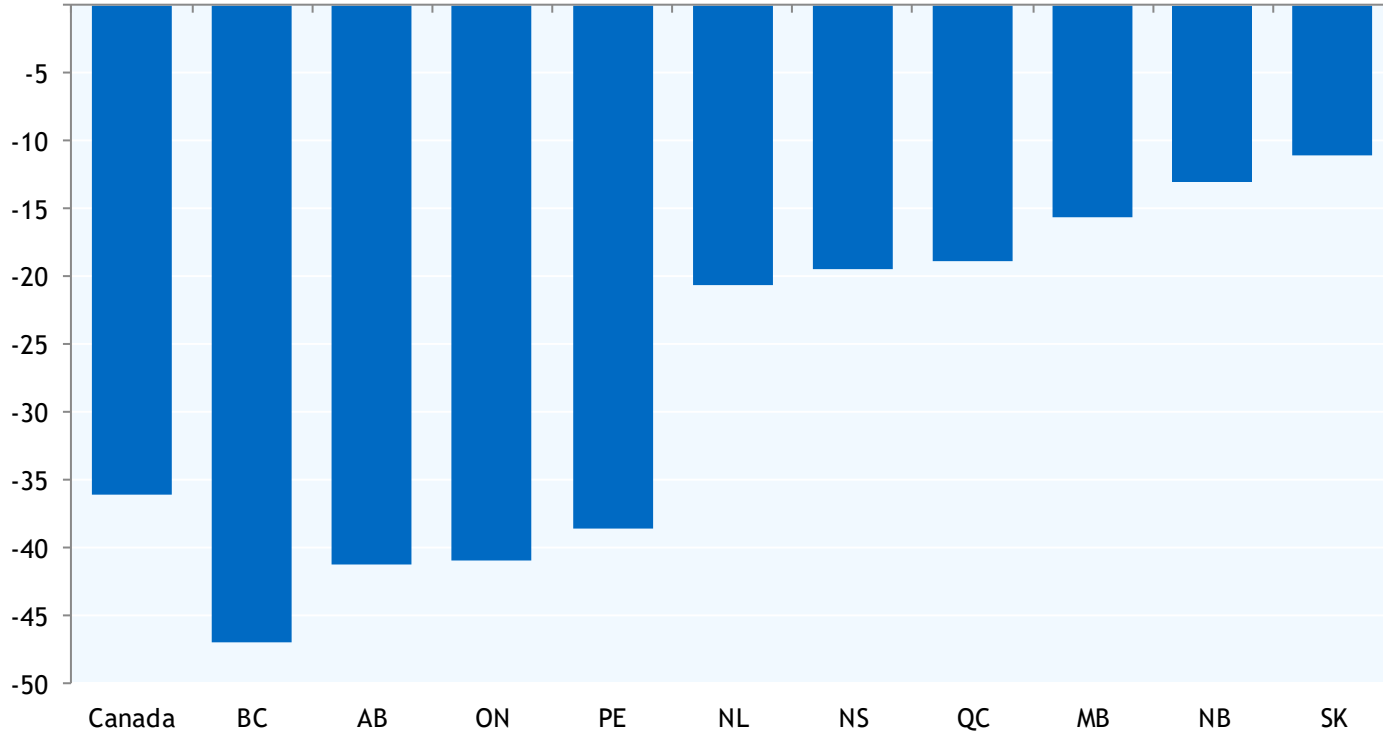
Source: Canadian Real Estate Association, RBC Economics

Coincided with the Bank of Canada's first hike

Downturn is widespread...

Home resales by province

% change between February and September 2022



Source: Canadian Real Estate Association, RBC Economics

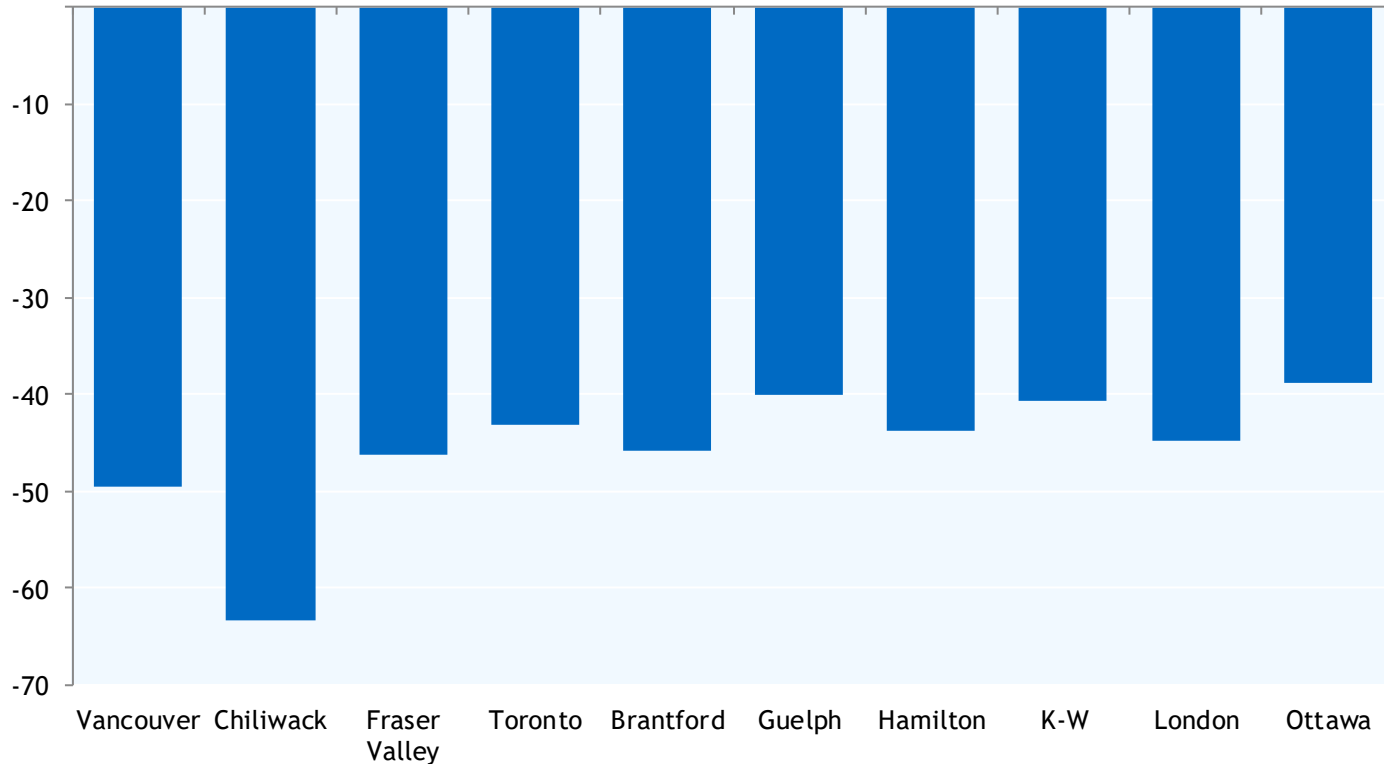
Canada's priciest markets among those that cooled the most this year



...though deeper in BC and Ontario

Home resales in selected BC and Ontario markets

% change between February and September 2022

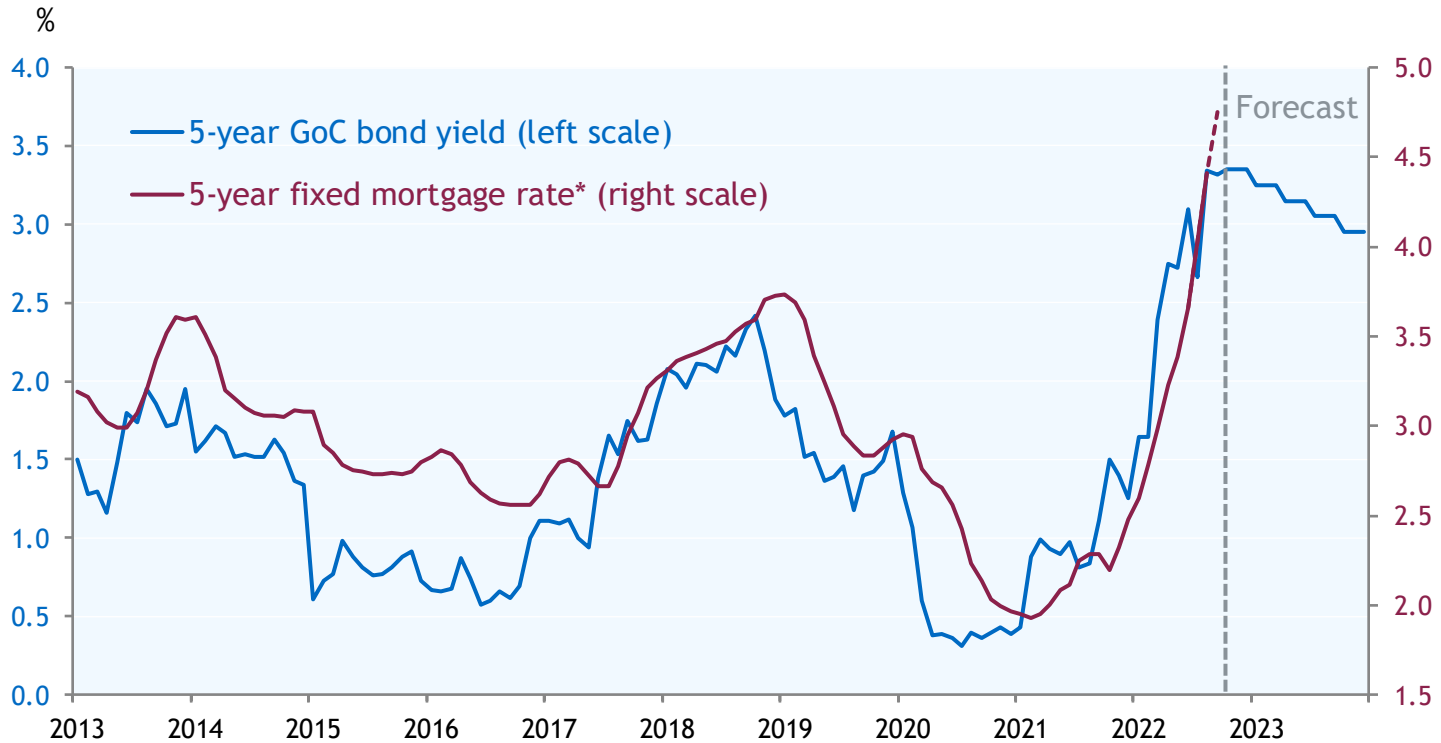


Source: Canadian Real Estate Association, RBC Economics

Activity is down considerably in both major and smaller markets

Higher rates for both fixed...

Fixed mortgage rates vs bond yields: Canada



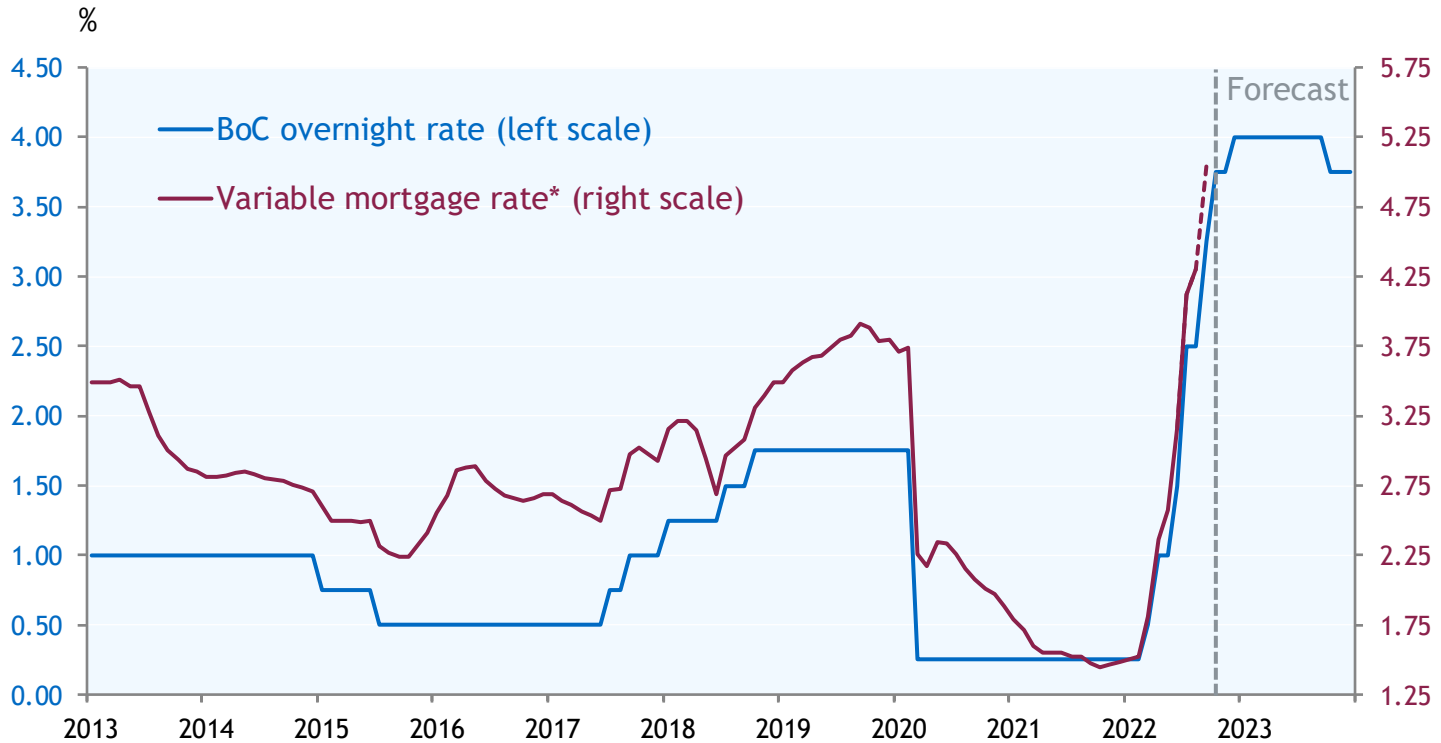
Source: Bank of Canada, RBC Economics * Weighted-average rate on funds advanced by chartered banks.

Fixed rates likely close to peaking



...and variable-rate mortgages

Variable mortgage rates vs policy rate: Canada



Source: Bank of Canada, RBC Economics * Weighted-average rate on funds advanced by chartered banks.

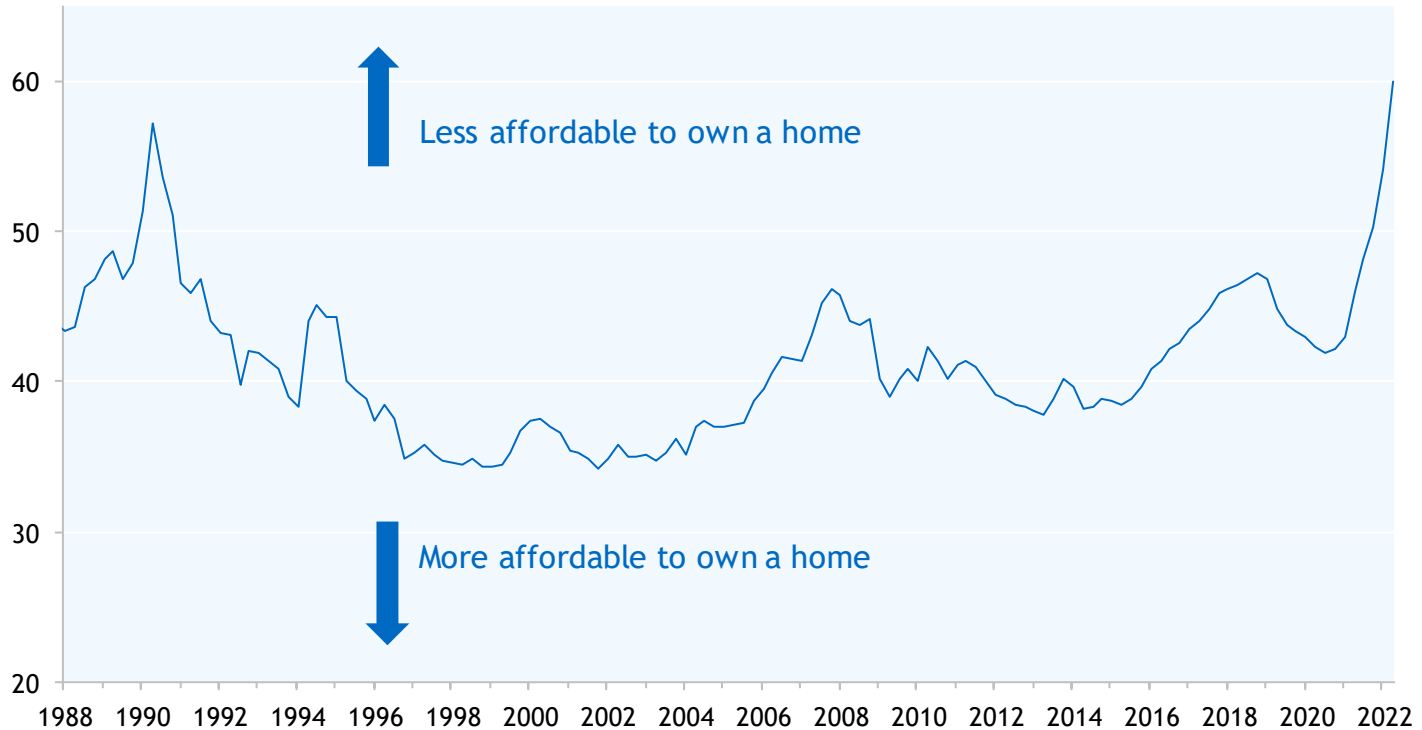
Variable rates aren't done rising yet



Worsening affordability holding back buyers

Housing affordability: Canada

Ownership costs of an average home as % of median household income



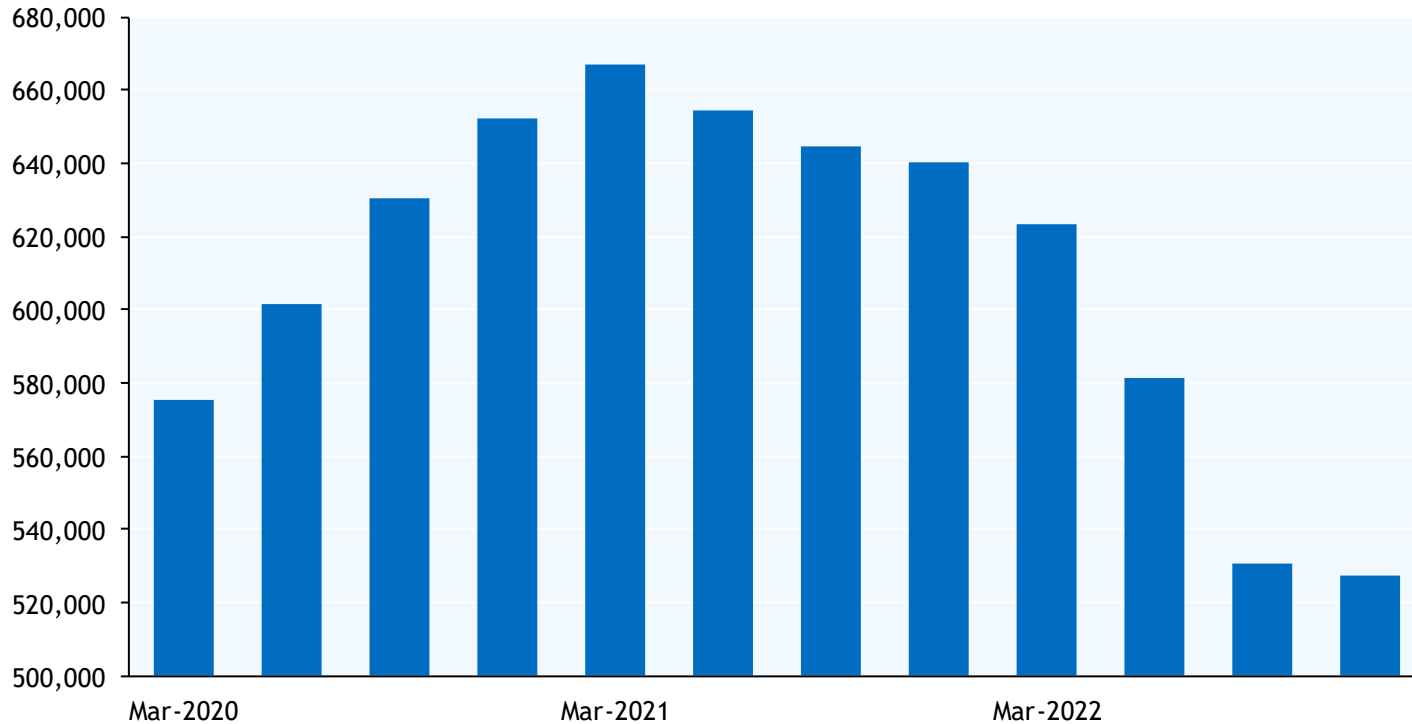
Source: RPS, Statistics Canada, Bank of Canada, RBC Economics

Earlier price gains and spiking interest rates seriously inflate ownership costs

Rising rates shrinking buyers' budget...

Maximum home purchasing budget*: Canada

For a median-income household, in \$



* Based on 20% down payment, 25 years amortization, 35% GDS ratio, 5-yr fixed mortgage rate
Source: Statistics Canada, Bank of Canada, RBC Economics

Many buyers are also entirely shut out of the market by loftier qualifying rates

...and sellers losing their grip on the market...

Sales-to-new listings ratio: Canada

Seasonally adjusted



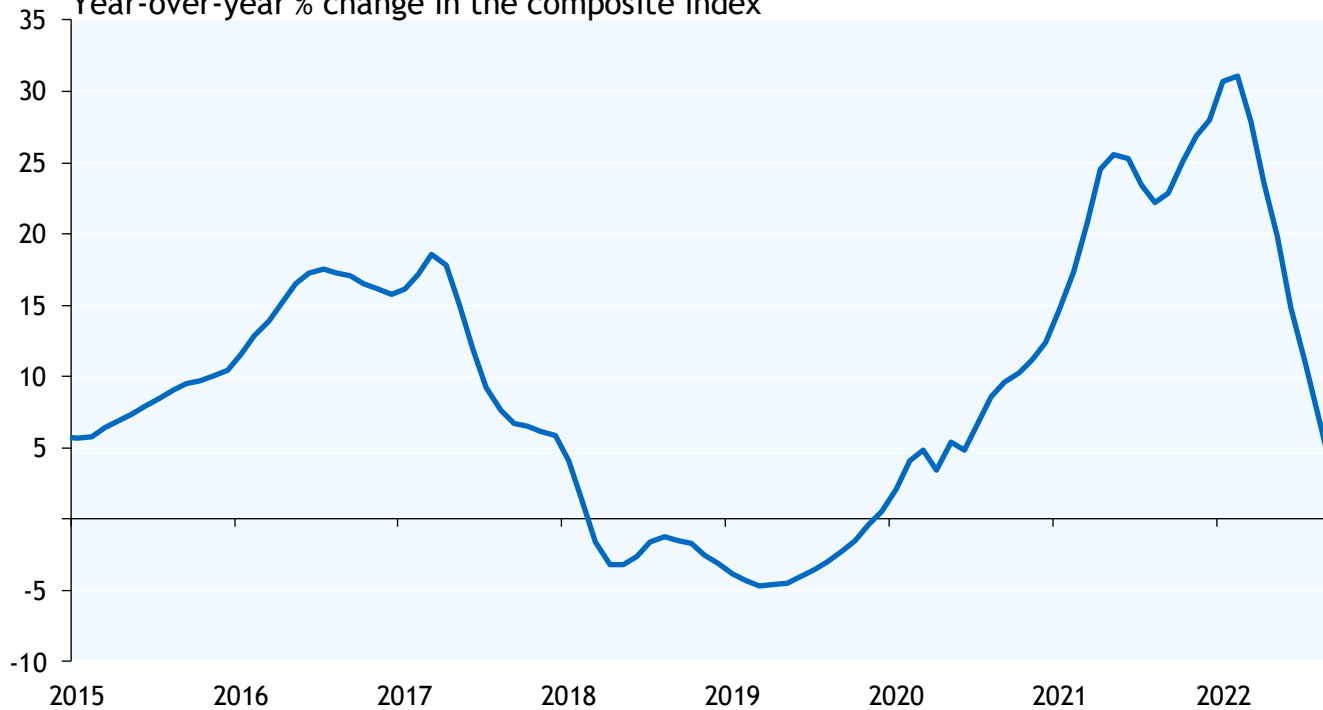
Source: Canadian Real Estate Association, RBC Economics

Exceptionally tight demand-supply conditions have eased significantly

...are now reversing earlier price gains

MLS Home Price Index: Canada

Year-over-year % change in the composite index



Source: Canadian Real Estate Association, RBC Economics

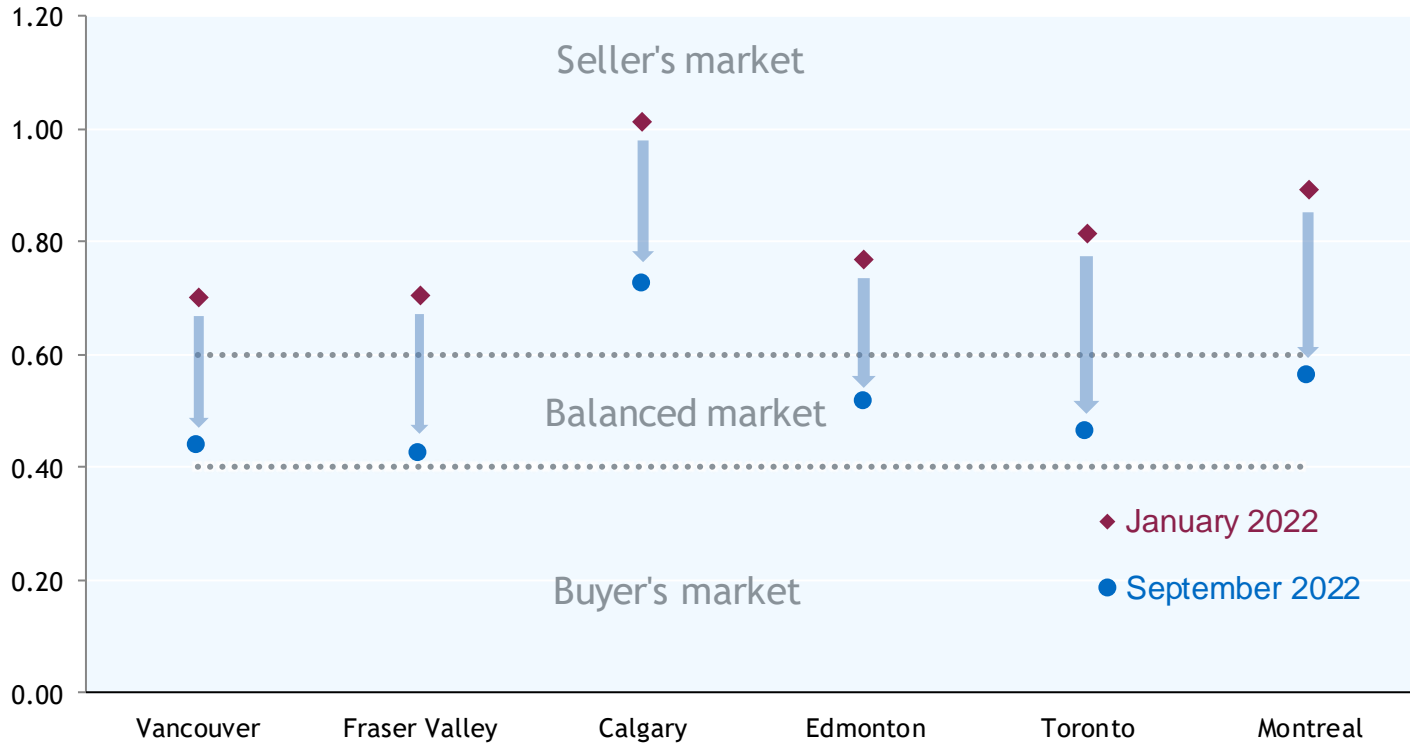
National index fell m/m in past seven months led by declines in Ontario and BC



Markets have rebalanced across the country

Sales-to-new listings ratio

Seasonally adjusted



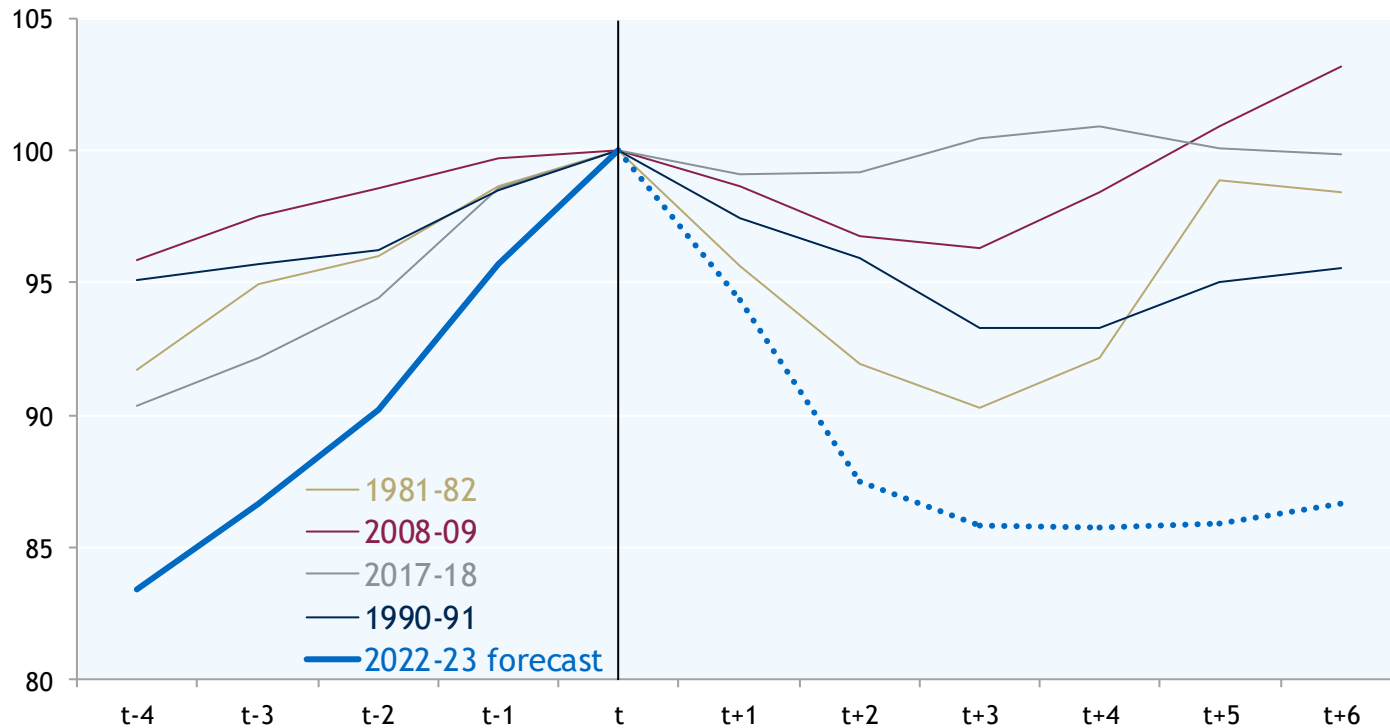
Source: REBGV, FVREB, CREB, RAE, TRREB, QPAREB, RBC Economics

A few pockets of tightness left in the Prairies, Quebec and Atlantic Canada

Material housing market correction unfolding

Home price downturns: Canada

RPS/Royal LePage aggregate Home Price Index for Canada, cyclical peak = 100, quarterly



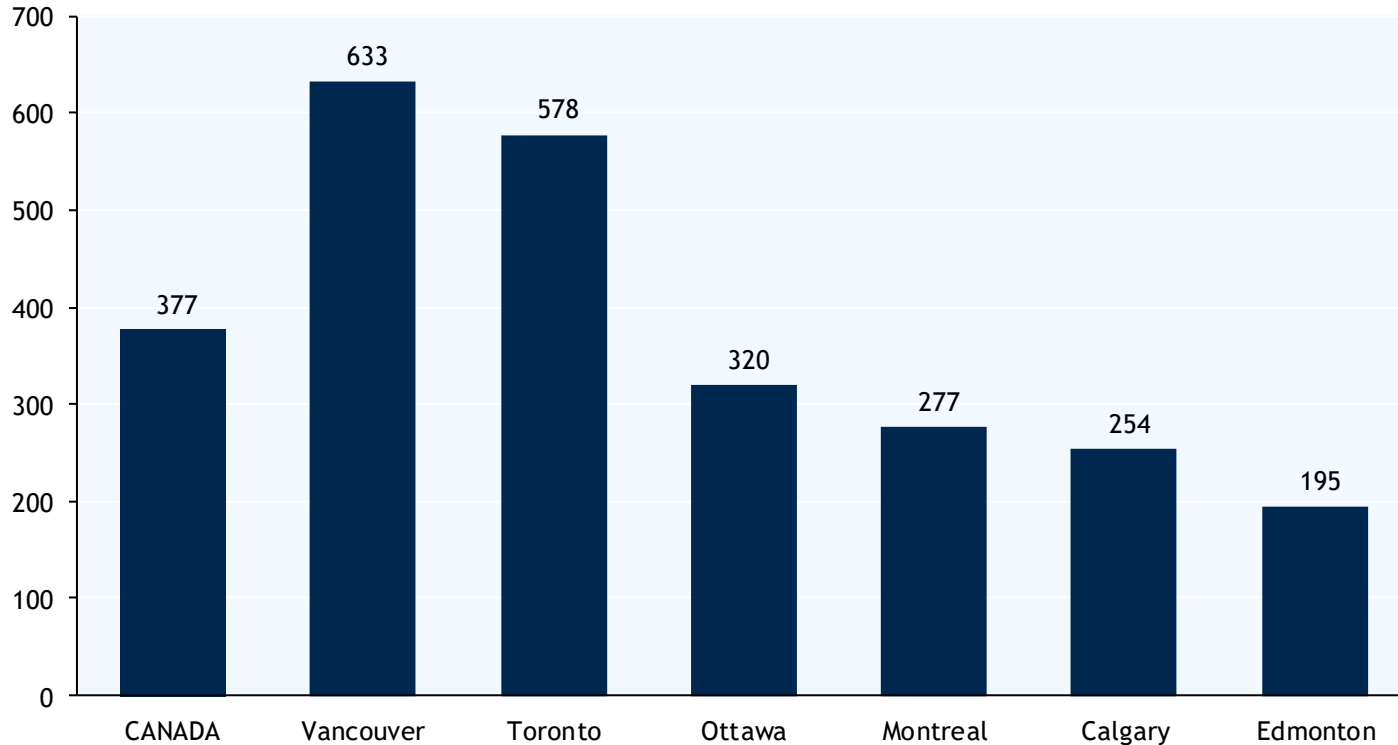
Source: RPS, Royal LePage, RBC Economics

14% peak-to-trough price decline projected nationwide; more so in Ontario and BC

Vancouver, Toronto most rate-sensitive

Impact on mortgage payments of a 1 ppt rise in rates

\$ increase per month, based on the market value of a typical home at Q2 2022



Source: RPS, Bank of Canada, Statistics Canada, RBC Economics

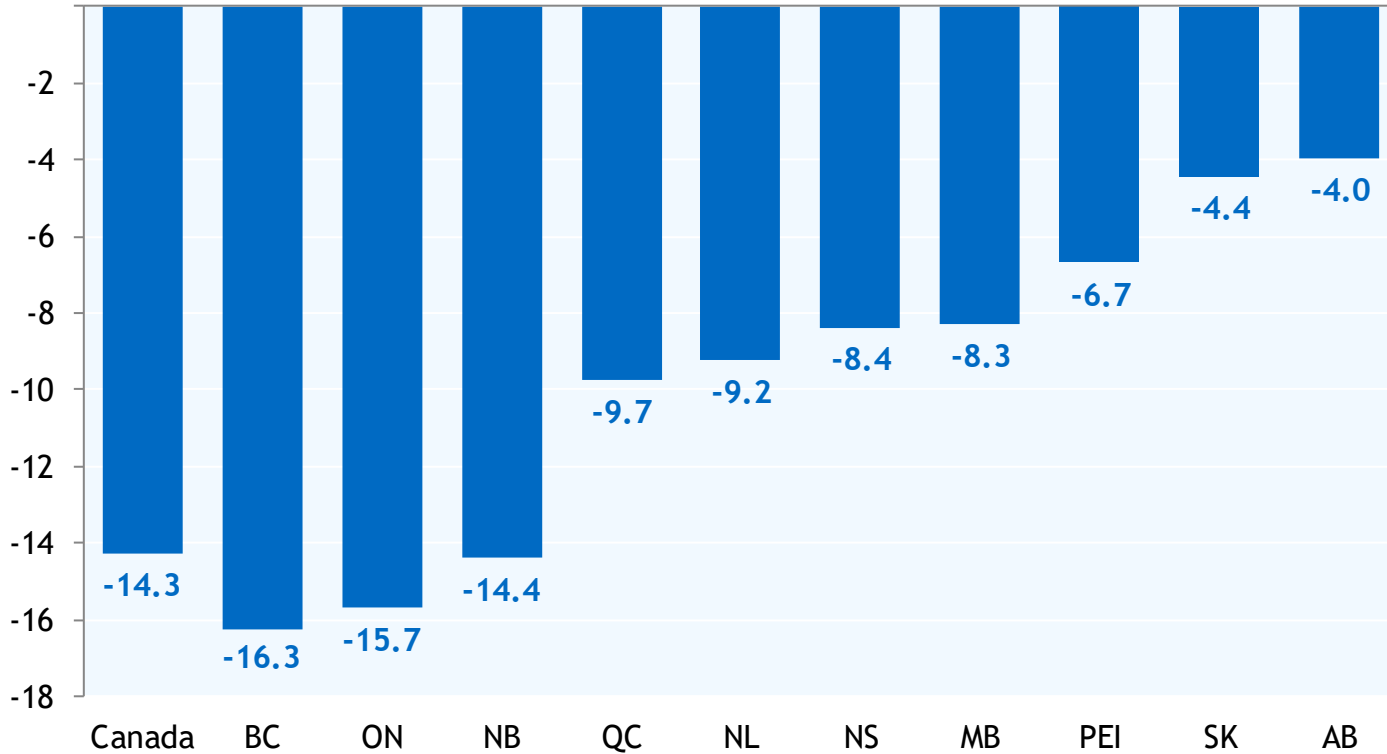
Buyers in expensive markets face bigger mortgage payment shock



BC, Ontario leading the price decline

Home price forecast by province

Projected quarterly peak-to-trough decline in the aggregate RPS Home Price Index



Source: RPS, RBC Economics

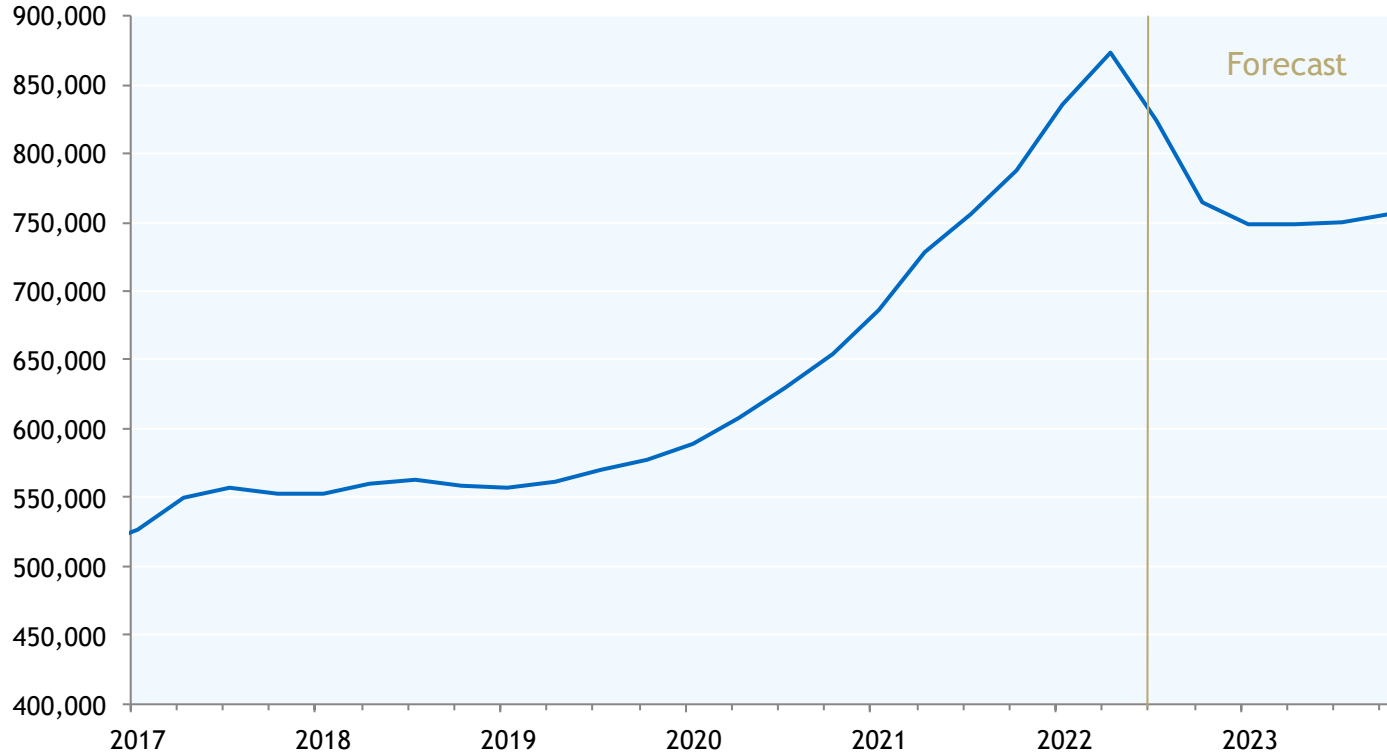
Expecting the bottom for prices to be around spring 2023 in most cases



Rolling back the clock to mid-2021

Home price forecast: Canada

RPS aggregate home price benchmark, \$



Source: RPS, RBC Economics

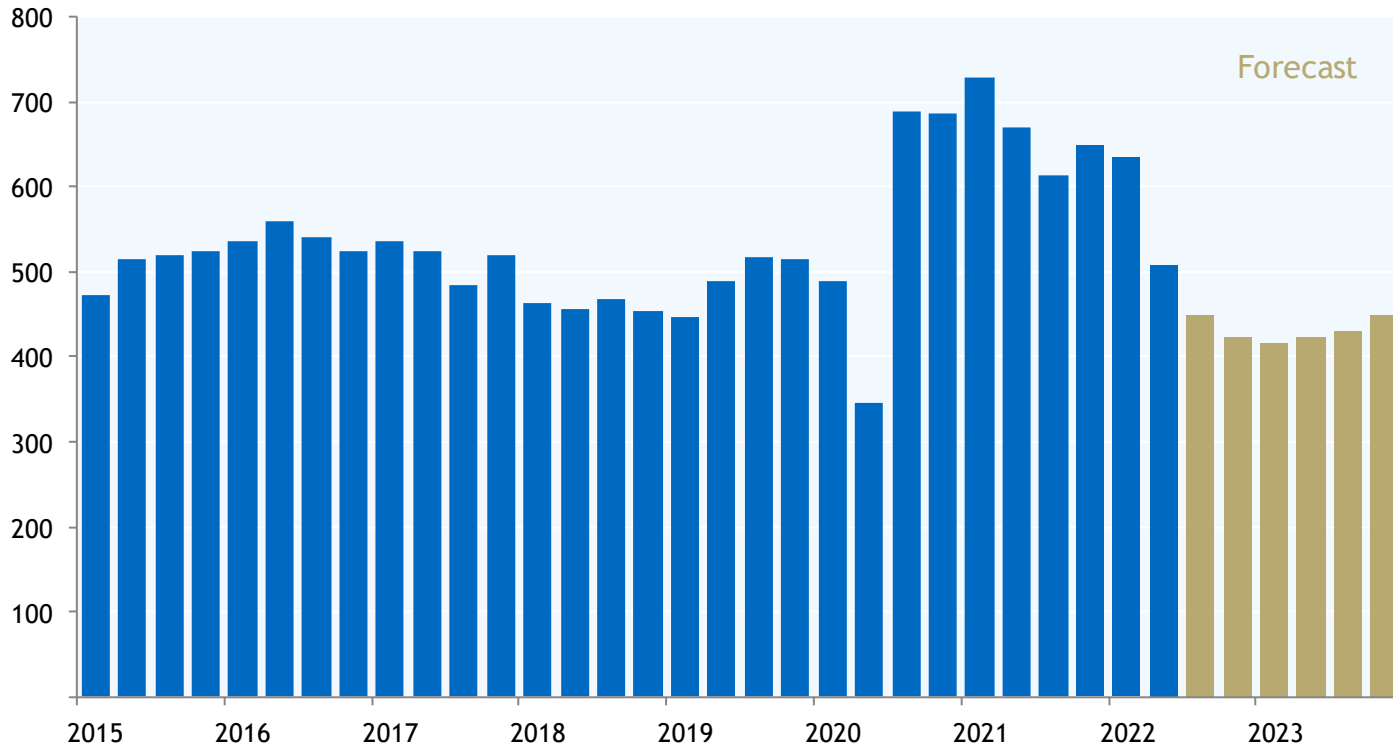
Expecting the correction to only partially reverse gains during the pandemic



Correction expected to extend into 2023

Home resales: Canada

Thousands of units, seasonally adjusted and annualized



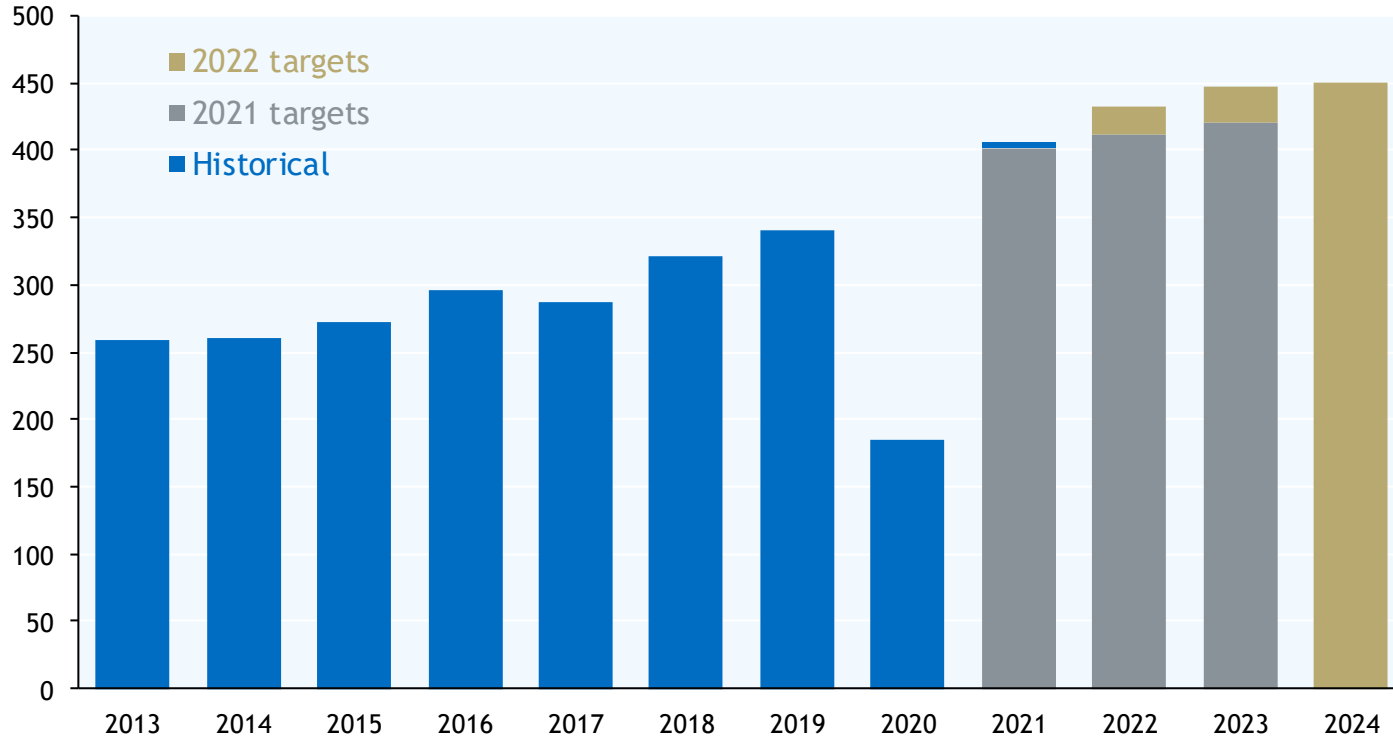
Source: Canadian Real Estate Association, RBC Economics

Nationwide, activity projected to drop 24% in 2022 and 15% in 2023

Still, housing market is unlikely to collapse

Immigration: Canada

New permanent residents in Canada, in thousands



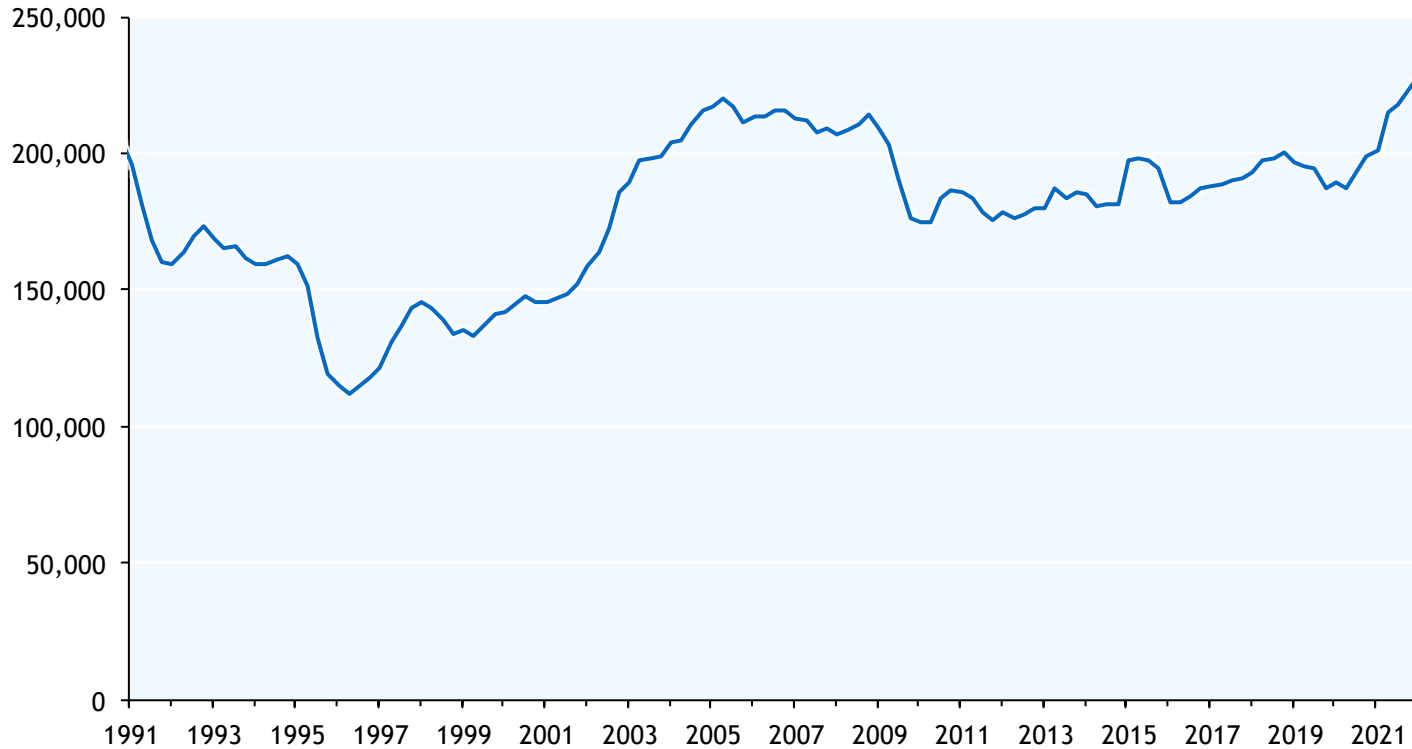
Source: Statistics Canada, IRCC, RBC Economics

Main contributor to a projected rise of 730,000 households by 2024 (240k per year)

New supply is lagging

Housing completions: Canada

All housing types, trailing four-quarter total



Source: CMHC, RBC Economics

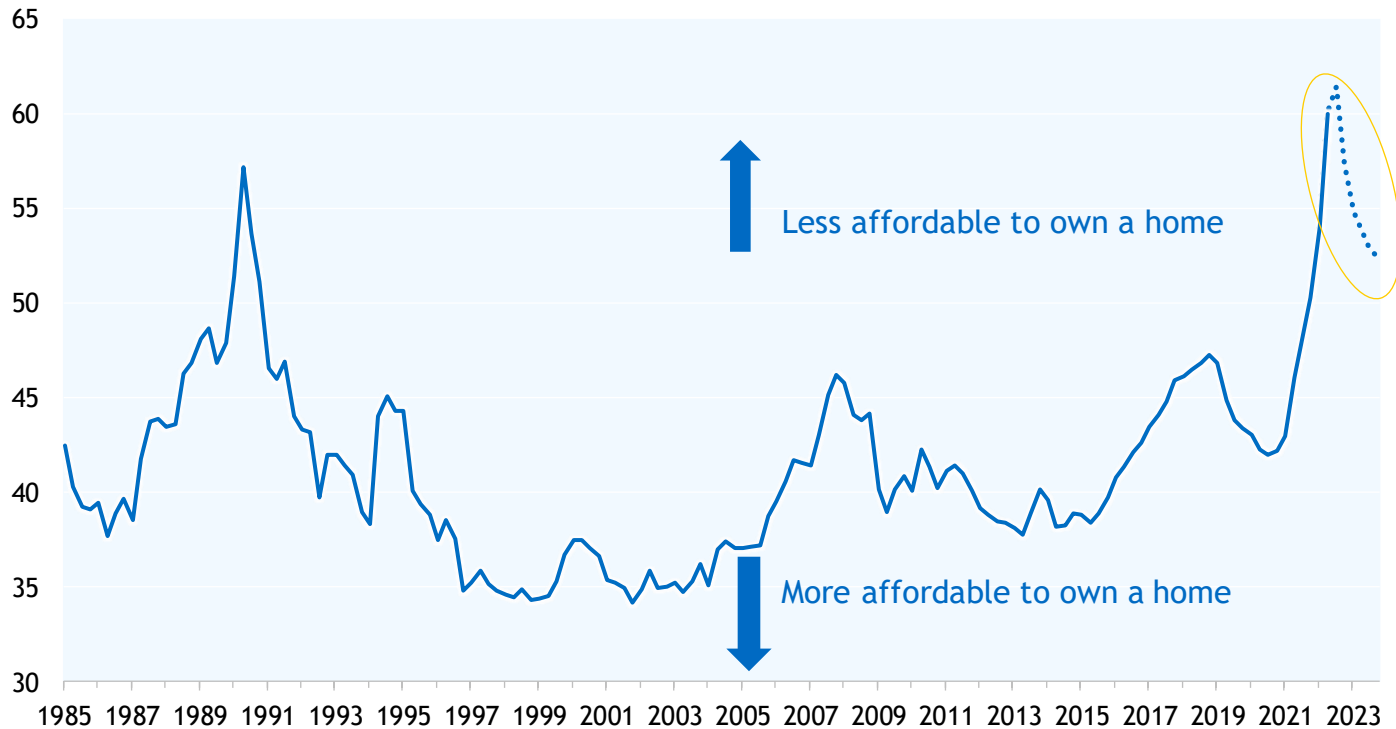
Completions averaged 200k in the last five years; must increase to meet demand



Lower prices will help affordability

RBC's aggregate housing affordability measure: Canada

Ownership costs as % of household income, composite of all housing categories



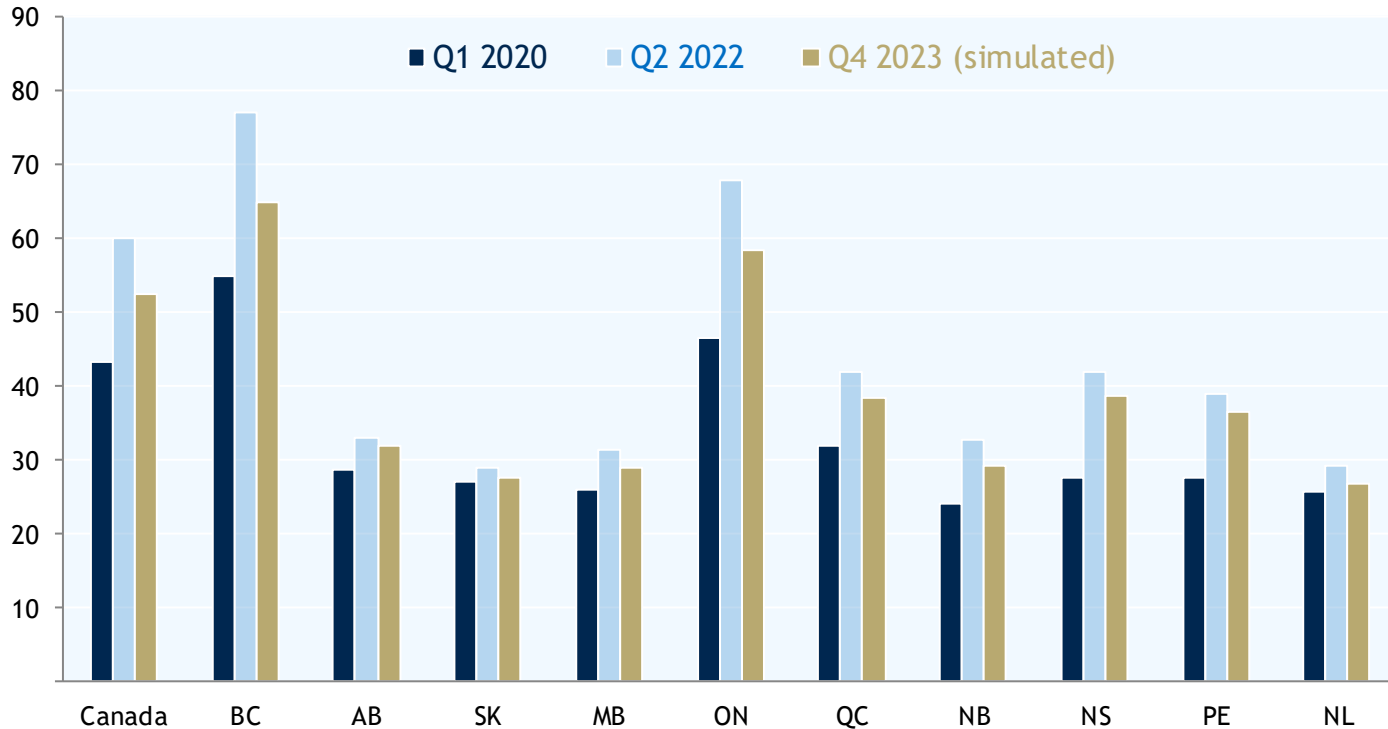
Source: RPS, Statistics Canada, Bank of Canada, RBC Economics

But will unlikely restore affordability to pre-pandemic levels

No quick fix

RBC's aggregate housing affordability measure

Ownership costs as % of household income, composite of all housing categories



Source: RPS, Statistics Canada, Bank of Canada, RBC Economics

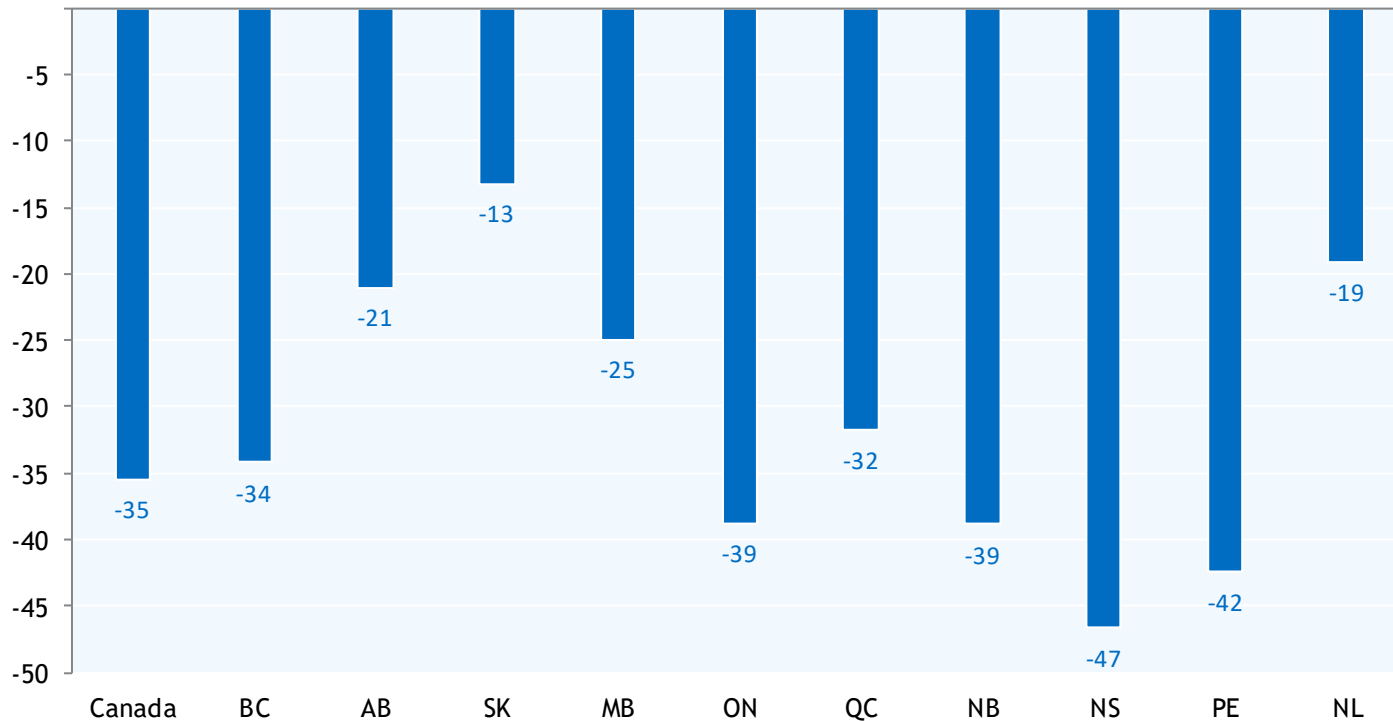
Fully reversing pandemic deterioration would likely to take years in most cases



Tall order

Price drop needed to restore affordability to Q1/2020 levels

By Q4 2023, assuming moderate household income growth and expected interest rate path



Source: RPS, Statistics Canada, Bank of Canada, RBC Economics

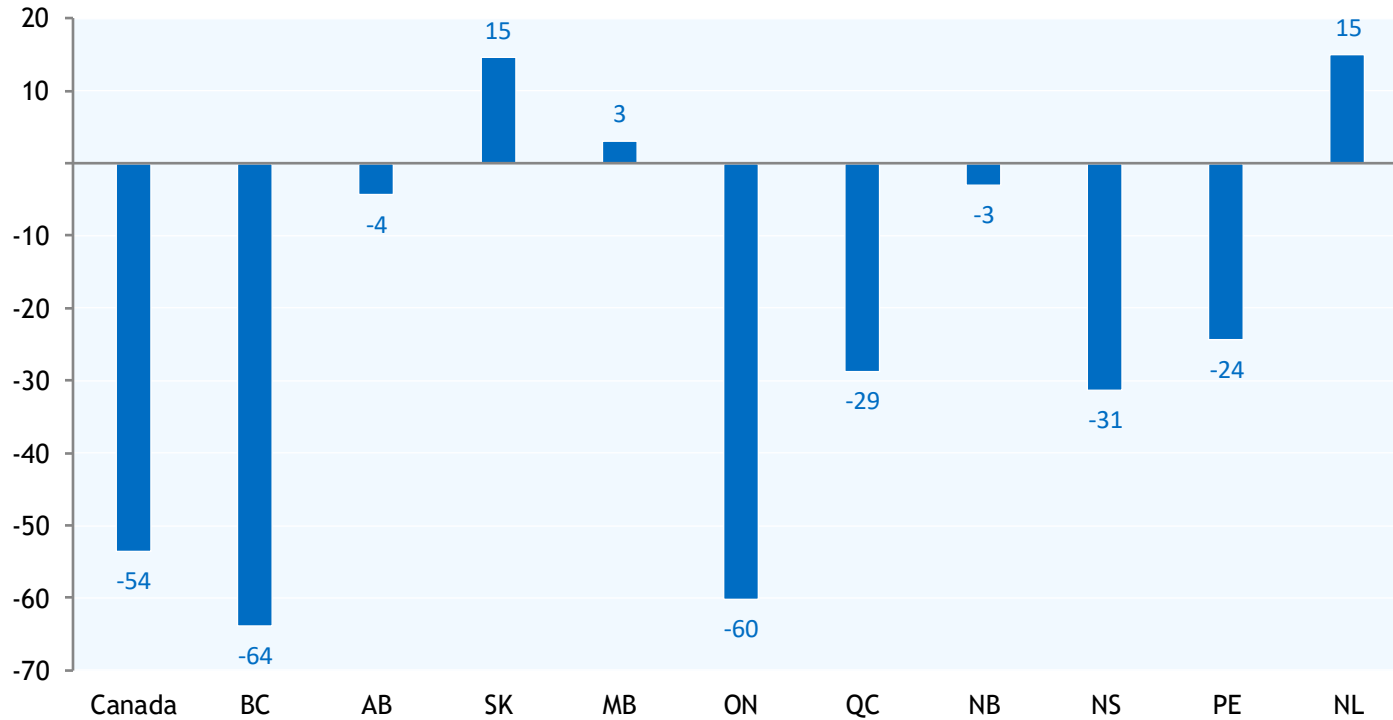
But pre-pandemic affordability was favourable in the Prairies and parts of ATL



Diverging paths to “affordable” levels

Price change needed to set affordability measure at 33%

By Q4 2023, assuming moderate household income growth and expected interest rate path



Source: RPS, Statistics Canada, Bank of Canada, RBC Economics

Ownership costs in BC and Ontario least likely to ever become affordable



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