MONTHLY HOUSING MARKET UPDATE

February 14, 2014

Home resales in Canada continued to slow in January 2014

It may have been because of poor weather or a lack of 'quality' listings in certain local markets but the recent slowing in Canada's residential real estate market continued to be in evidence at the start of 2014. Statistics released this morning by the Canadian Real Estate Association (CREA) showed that home resales fell for the fifth-straight month in January in Canada, down 3.3% from December. The recent string of declines (-8.9% cumulatively since August 2013) has now reversed most of the surprisingly strong 14.3% rally in the spring and summer last year. We believe that the average level of activity during the past four months nationally (457,000 units annualized) is within close proximity of what can be sustained under the current macroeconomic environment, thereby suggesting that the market more or less has reached its 'cruising speed'. That being said, there was no doubt a certain weather element that depressed activity in January and, arguably, December, which provides some scope for a near-term strengthening in resales.

With respect to demand-supply balance, the broad picture continues to be generally constructive with the majority of local markets still considered in equilibrium. At the national level, the drop in resales and a slight increase in new listings moderated the sales-to-new listings ratio in January to 0.52 – still comfortably within balanced territory. The few markets that bucked the trend tended to be short supplied. Among them were Calgary, Edmonton and perhaps Toronto. These were the markets where home prices showed the strongest increases in the country. For the vast majority of markets, however, home price gains continued to be subdued (well under 4% y/y). Nonetheless, the heat in Calgary and Toronto, in particular, led to the fastest annual rate of increase in the national composite MLS (4.8%) since the end of 2011.

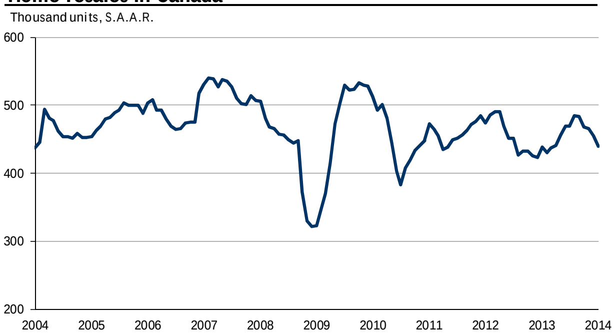
As we warned previously, any acceleration in the rate of property appreciation much beyond personal income growth (which averaged a little more than 4% overall in Canada in the past two years) could be detrimental to housing affordability. To date, affordability trends have been generally static at modestly stretched levels, although some deterioration occurred in markets such as Toronto. At this stage, we continue to expect that upward pressure on prices will ease in the period ahead on the basis that supply of homes (consisting increasingly of condos) available for sale will become more plentiful as 2014 unfolds.

The highlights from CREA's January report were:

- Home resales fell 3.3% between December 2013 and January 2014 (on a seasonally-adjusted basis), following a 2.3% drop the previous month. January resales were up just 0.4% (unadjusted) from a year ago, representing the slowest year-over-year advance since June

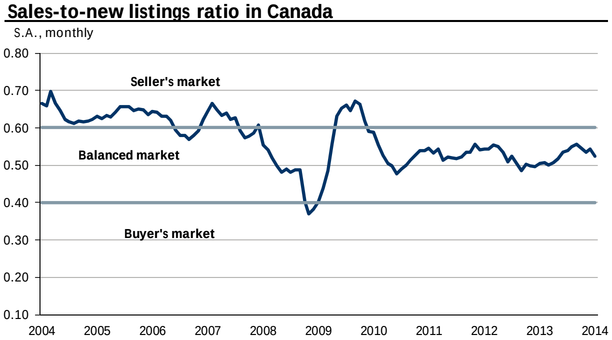
January Snapshot				
	Home resales	New listings	MLS HPI (Composite)	Sales-to-new listings ratio
Region	Y/Y %change	Y/Y %change	Y/Y %change	
Canada	0.4	-3.3	4.8	0.52
Toronto	-5.5	-17.0	7.1	0.59
Montreal	-2.2	-0.3	1.9	0.45
Vancouver	31.3	4.6	3.2	0.55
Calgary	14.6	-3.0	9.0	0.75

Home resales in Canada



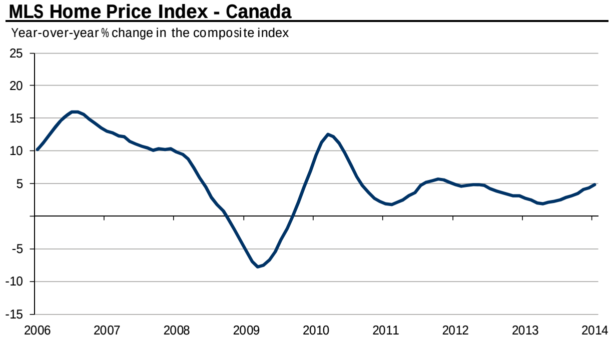
Source: CREA, RBC Economics Research

Sales-to-new listings ratio in Canada



Source: CREA, RBC Economics Research

MLS Home Price Index - Canada



Source: CREA, RBC Economics Research

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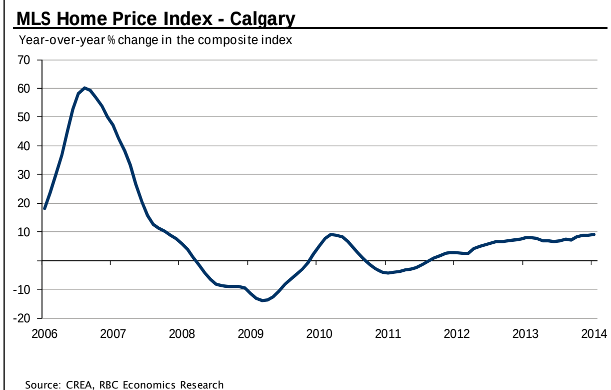
2013.

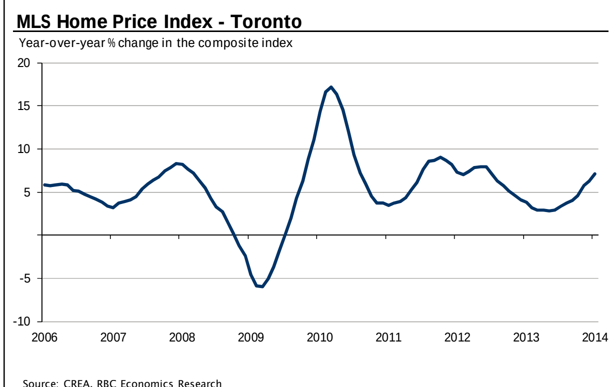
- The majority of local markets registered month-to-month declines in resales, led by Regina (-17.4%), Toronto (-4.2%), Vancouver (-3.9%), Ottawa (-2.2%) and Winnipeg (-0.6%). In the case of Toronto this constituted the fourth straight monthly decline (for a cumulative drop of 16.9% since September), although unusually poor weather in December (ice storm) and January (frigid temperatures) likely explained at least part the more recent weakness. Markets posting monthly increases in January included Saskatoon (12.4%), Calgary (6.6%) and Montreal (0.8%). Relative to a year ago, resales were up for a small minority of markets (including strong advances of 31.3% in Vancouver and 14.6% in Calgary), although several major markets registered declines, including Edmonton (-8.3%), Winnipeg (-6.4%), Toronto (-5.5%) and Montreal (-1.6%).
- Nationally, new listings edged 0.2% higher between December and January, but were down 3.3% relative to January 2013.
- The sales-to-new listings ratio eased from 0.54 in December to 0.52 in January – still in the middle of the 0.40 to 0.60 range typically associated with market balance. Balanced demand-supply conditions generally continue to prevail across Canada's local markets. Calgary and Edmonton were among the markets where the ratio suggested that sellers had the upper hand in setting prices. With a ratio of 0.59, the Toronto area nearly classified as a sellers' market. The other measure of market balance in CREA's report – the number of months worth of total inventory – showed a slight increase nationally in January to 6.4 from 6.3 in December (revised from 6.2 previously), thereby indicating a marginal loosening of market conditions.
- The annual rate of increase in the national composite MLS Home Price Index (HPI) accelerated for the ninth consecutive month in January to 4.8% from 4.3% in December, and a two-year low of 1.9% in April. The latest reading was the strongest since December 2011. The main contributors of the acceleration continued to be the Calgary and Toronto areas, which led all other major markets with annual gains of 9.0% and 7.1%, respectively. Vancouver (3.2%), the Lower Mainland (2.5%) and Saskatoon (3.6%) saw further acceleration, whereas the pace moderated nearly in all other major markets, including Montreal (to 1.9%) and Ottawa (to -0.1%).

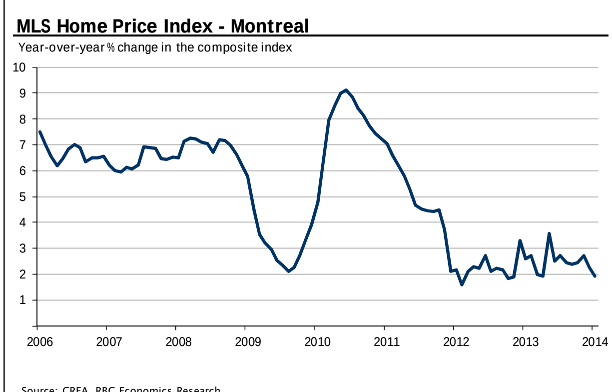
Commentary

While poor weather could well have disrupted resale activity in January (and possibly December), developments since early fall suggests to us that the surprisingly strong market rally in the spring and summer last year partly comprised a transitory element that has now run its course. We believe that once the more recent weather related setbacks are reversed in the coming months, the market will maintain an average 'cruising speed' that will be neither too hot nor too cold, and such that total 2014 resales in Canada will be only modestly stronger than in 2013. Our outlook for 2014 calls for resales to rise by just 0.6% to 461,000 units in Canada, with downward pressure building later this year from rising longer-term interest rates and increasingly strained affordability.

On a regional basis, we expect home resales in markets in Alberta to benefit from a booming economy (and population growth) and continue to grow strongly in 2014. Similarly positive dynamics will also support moderate gains in Saskatchewan and Manitoba. We expect, however, that resales will decline slightly in Central Canadian markets, mainly because of affordability becoming more of a concern in certain







market segments.

The issue of affordability is likely to become a more prominent element of risk in 2014, especially if the recent re-acceleration in home price increases across several markets is sustained. Undue pressure could emerge in certain parts of the country (including Toronto) and such pressure even could be amplified by any mortgage rate increases. While we anticipate the Bank of Canada to leave its overnight rate unchanged in 2014, we project bond yields – the main driver of fixed mortgage rates – to drift gently upward throughout the year.

On the supply side, the focus of attention will remain on the high number of condo units currently under construction in Canada's largest markets and the possible effect on homes available for sale upon their completion. At this stage, the evidence suggests that completed units are being mostly absorbed and, therefore, are unlikely to have a destabilizing effect in the short term.

We expect, nonetheless, that softening demand later this year and growing supply of newly completed condo units will rein in price increases in 2014. We project home prices to increase by 1.5% nationally in 2014.