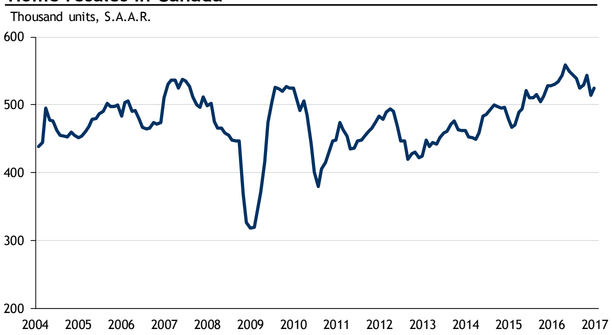
MONTHLY HOUSING MARKET UPDATE

January 16, 2017

Canada's housing market ended 2016 on an upbeat note, although cooling trend prevails

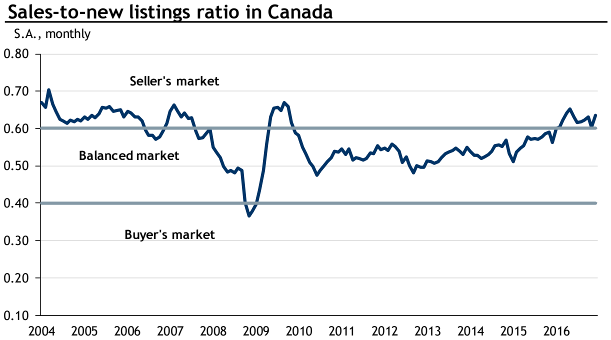
- Home resale activity in Canada reversed part of a steep decline recorded in November against the odds that the implementation of tighter rules for portfolio-insured mortgages on November 30 would cause further weakening in December.
- Data released today by the Canadian Real Estate Association (CREA) revealed that home resales rose by 2.2% month-over-month in Canada in December on a seasonally-adjusted basis, following a 5.5% drop in November. Despite this modest pickup in activity, the trend since the spring of 2016 still slopes downwardly (resales are down 5.9% since April), consistent with our view that Canada's market is in a cooling phase.
- The partial rebound in December was widespread across the country with gains in the majority of major markets, including the Vancouver (+2.5%) and Toronto (+1.0%) areas, as well as in Calgary (+19.1%), Edmonton (+16.9%) and Saskatoon (+14.4%) where resales plummeted in November.
- Homeowners have not taken recent policy changes as reasons to sell their properties. New listings fell by 3.0% nation-wide in December and were down 14.7% from a year ago, with steep declines recorded in virtually every major market.
- Generally tighter demand-supply conditions maintained support for prices in December, although earlier cooling in markets such as the Vancouver area, Saskatoon and Calgary contributed to a further easing in the annual rate of price increases at the Canada-wide level. The national composite MLS Home Price Index (HPI) rose by 14.2% year-over-year in December, down slightly from 14.4% in November and 14.6% in October.
- Locally, price trends in Toronto and Vancouver continue to run in opposite directions: Toronto-area prices are still firmly in an accelerating mode (+21.0% year over year in December, compared to 20.3% in November) whereas prices in the Vancouver area are in a rapidly decelerating mode (+17.8% in December, down from 20.5% in November and a cyclical high of 32.6% in August).
- Upward price pressure remains highly regionalized in Canada and concentrated in pockets of Southern Ontario—including the Toronto area, Hamilton, Kitchener-Waterloo, London and the Niagara region—and British Columbia—including the Fraser Valley and Victoria. The majority of other markets continue to be balanced across Canada.
- Clearly 2016 was an remarkable year for Canada's housing market with resales setting a new record high. Looking ahead, we expect that housing policy changes, stretched affordability and rising interest rates will exert a cooling effect on the market. In fact, such is already visible in markets such as Vancouver. We project home resales to fall by 10.9% nationwide and benchmark prices to rise by just 2.1% in 2017.

Home resales in Canada



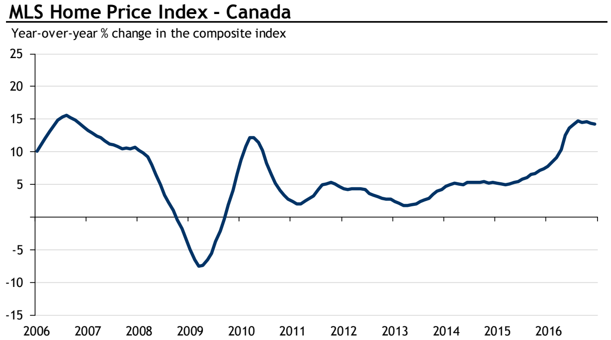
Source: CREA, RBC Economics Research

Sales-to-new listings ratio in Canada



Source: CREA, RBC Economics Research

MLS Home Price Index - Canada



Source: CREA, RBC Economics Research

December Snapshot

Region	Home resales Y/Y %change	New listings Y/Y %change	MLS HPI (Composite) Y/Y %change	Sales-to-new listings ratio
Canada	-5.0	-14.7	14.2	0.63
Toronto	7.9	-12.4	21.0	0.77
Montreal	1.9	-6.9	3.3	0.57
Vancouver	-40.0	-34.9	17.8	0.66
Calgary	5.3	-33.3	-3.7	0.67

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Let's keep the focus on trends—they are is still moderating for the most part...

The pullback in November resales—the steepest monthly decline (-5.5%) in more than four years—quite possibly was exaggerated by the shifting of transactions into October to 'beat' the implementation of higher qualifying rates for mortgage insurance on fixed-rate mortgages with terms of five years or longer. A second regulatory change affecting portfolio-insured mortgages that came into effect on November 30 did not dampen sales further in December at the national level as we thought it might. Nonetheless, the rebound in resales that took place in December was modest, such that the level of activity remained on a downward trend in Canada. The main factor contributing to this cooling trend since the spring has been the sharp drop in activity in the Vancouver area—formerly Canada's hottest market—that was partly engineered by policymakers.

...except in Toronto

That being said, Canada's other 'hot market'—Toronto—still showed few signs of cooling as the sun set on 2016. Home resales remained near record-high levels and prices kept escalading at an increasingly worrying pace, fueled by the powerful combination of persistently-strong demand and a dearth of homes available for sale. The Toronto area's MLS HPI has risen month over month for 27 consecutive months, and at 21.0%, its annual rate of increase is the highest on record dating back to 2005. Considering the intense affordability strains already challenging buyers in the area (and the associated risks for the stability of the market), it is likely that any further price acceleration would boost the odds of some kind of policy intervention to cool the market down—just as '30%-plus' price increases in Metro Vancouver compelled the BC government to act in August.

Interest rates expected to climb

Affordability issues in Toronto and elsewhere will come onto even greater focus as interest rates continue to rise in the period ahead. The spike in Canadian bond yields following the surprise election of Donald Trump as US President and attendant upward pressure on US bond yields has prompted a number of financial institutions to raise certain mortgage rates since early November. We expects bond yields to rise materially further this year amid a tightening of monetary policy in the United States, which is bound to keep fixed mortgage rates on an upward trajectory in Canada. Housing affordability in high-priced markets such as Vancouver and Toronto would be particularly sensitive to large increases in interest rates.

Outlook for 2017: lower resales and more modest price increases nationally

Recent housing market trends have been broadly in line with our expectation that a soft landing is underway in Canada (with the exception of some regions). Nonetheless, in light of slightly stronger-than-expected handoff to 2017, we made minor tweaks to our forecasts for this year: we now project home resales in Canada to fall by 10.9% in 2017 (revised from –11.5% previously) to 475,800 units, and benchmark prices to increase by 2.1% (revised from 1.6%).