

## CANADIAN HOUSING FORECAST

August 20, 2014

### Housing market projected to moderate in 2015

We expect that rising interest rates and increasingly strained affordability will cool Canada's housing market during the next year and cause home prices to decelerate substantially in 2015.

We forecast home resales to edge slightly lower by 0.9% to 463,100 units nation-wide in 2015 following an increase of 2.1% to 467,200 units in 2014; and home price gains to moderate to just 1.1% next year from 4.3% this year.

These forecasts represent modest upward revisions from our previous projections in May. Changes are justified on the basis that activity has been somewhat stronger than we anticipated in recent months—fuelled in large part by an easing in mortgage rates since the start of this year—and likely to be sustained at higher levels for longer than we thought previously.

Nonetheless, our view for Canada's housing market remains that overall homebuyer demand will face intensifying downward pressures going forward. We believe that the current historically low levels of interest rates in Canada are not sustainable and that longer term rates will begin to rise later this year in anticipation of a return to tightening mode by the Bank of Canada in 2015. We expect the cumulative increases in longer term rates to be quite meaningful by the late stages of 2015 (for example, RBC forecasts government of Canada five-year bond yields to more than double to 3.30% by year-end 2015 from the current levels hovering around 1.50%).

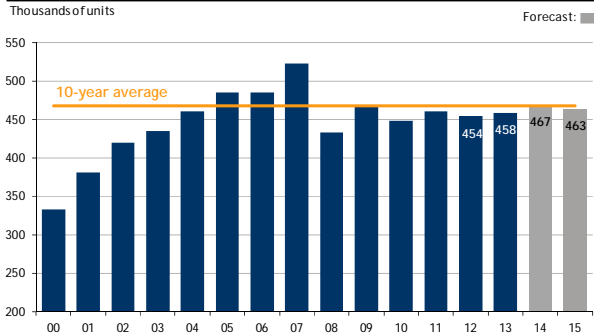
While continued growth in household income will provide some offset, we expect rising rates to erode housing affordability, which is already stretched in some markets across Canada. Affordability issues thus will become a greater obstacle to home ownership as the interest rate normalization unfolds.

We believe that intensifying downward pressures will lead to a cooling of the market, not a crash. Housing demand in Canada will continue to be supported by factors such as demographics (e.g. fairly steady immigration) and generally upbeat macroeconomic environment (including employment prospects)—and still-low interest rates despite their projected rise. These factors will continue to pump some fuel into the market and protect it from a crash.

Any faltering in the economy causing a surge in unemployment would lead to a much harsher outcome, however. Canada's housing market is in a fairly vulnerable position to withstand an unanticipated shock—household indebtedness is near record-high, property valuation is stretched in many markets and interest rates have limited room to drop further to offset any shock.

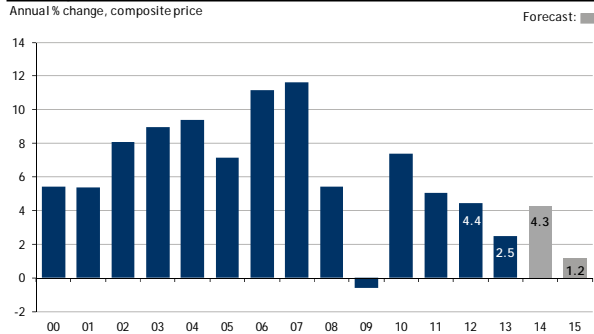
We expect the current upward momentum in home prices to wane gradually, as demand cools and more home sellers emerge. We expect that the current condo construction boom in large urban centres will bring more properties on the resale market as units are completed. While the majority of condo units under construction are already sold, rapid increase in the stock of existing condos is likely to create a displacement effect whereby older units are vacated in favour of newer ones.

Home resales: Canada



Source: Canadian Real Estate Association, RBC Economics Research

Home prices: Canada



Source: Royal LePage, RBC Economics Research

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## Forecast assumptions

	2013	2014f	2015f
BoC overnight rate (year-end)	1.00	1.00	1.75
5-year bond yield (year-end)	1.95	2.35	3.30
Population growth (y/y)	1.2	1.2	1.1
Unemployment rate			
Canada	7.1	6.9	6.6
British Columbia	6.6	6.2	6.2
Alberta	4.6	4.4	3.9
Saskatchewan	4.0	4.0	4.0
Manitoba	5.3	5.4	5.1
Ontario	7.5	7.3	6.9
Quebec	7.6	7.7	7.5
Atlantic	10.1	10.1	9.9

The dynamics of cooling demand-growing supply are expected to show up in greater evidence by the late stages of 2015 in our two-year scenario for the housing market. Consequently, we expect price increases to slow significantly in 2015—particularly for condos.

It is important to note that 2015 would unlikely mark the end of the housing cycle in Canada. In fact, the bigger test could well await after 2015 should interest rates normalize fully over the medium term. In this case, we could see outright price declines in the 2016 or later time-frame because we believe that prices will be the principal adjustment mechanism preventing affordability from reaching dangerously poor levels in the face of a substantial cumulative rise in interest rates—growing household incomes would provide only partial offset.

Furthermore, the higher home prices get relative to income by the time rising interest rates really start to bite, the more prices will have to adjust (downwardly) over time to keep longer-term affordability from reaching intolerable levels. This means that any price increases exceeding the rate of household income gains in the near term (2014 and 2015) likely would result in steeper price declines down the road.

## Regional overview

Housing market conditions vary substantially across the country. To date in 2014, we have seen a fairly stark contrast between ‘hotter’ local markets such as Toronto, Calgary and, increasingly, Vancouver, and softer markets such as Ottawa, Montreal and Halifax.

Our provincial housing forecasts show wide regional differences in 2014. We project home resales to grow vigorously in most Western Provinces—where the economy is stronger and population is growing faster—while remaining flat or declining modestly in Central Canada and the Atlantic Provinces. We project home prices to rise solidly in Alberta and Ontario—where demand-supply conditions are tilted in favour of sellers in key local markets—but more moderately so in other provincial markets where market conditions are balanced.

Our forecasts for 2015, on the other, show some (albeit partial) convergence in regional resale and price outcomes. The main reason for this convergence is that the projected rise in interest rates will have a common, pervasive effect across markets in the country. For home resales, we expect all but two regions (Alberta and Atlantic Canada) to experience a decline in 2015. High-priced British Columbia (mainly Vancouver) and Ontario (mainly Toronto) markets are projected to see the bigger drops (2.3% and 1.3%, respectively), reflecting a more extensive erosion of affordability. We forecast the resale declines in the other provinces to be modest to marginal.

For prices, we expect all provincial markets but one (Atlantic Canada) to see a marked slowdown in the rate of appreciation in 2015. In the case of Quebec, we even project a very slight decline due to strong and growing availability of supply (especially for condos) in markets such as Montreal. Generally subdued price gains across provincial markets next year reflect the negative pressures building on homebuyer demand from increasingly strained affordability and rising interest rates. Prices in BC and Ontario are forecasted to show greater moderation since this is where these negative pressures will be more intense. Alberta remains at the top of our rankings for next year thanks to its strong economy and in-migration keeping the demand-supply equation still somewhat tight. We expect prices in Atlantic Canada to continue to track a slight upward trajectory.

## Home resales forecast (units)

	2007	2008	2009	2010	2011	2012	2013	2014f	2015f
Canada*	522,500 <i>7.7</i>	433,100 <i>-17.1</i>	466,200 <i>7.6</i>	447,900 <i>-3.9</i>	459,800 <i>2.7</i>	454,300 <i>-1.2</i>	457,800 <i>0.8</i>	467,200 <i>2.1</i>	463,100 <i>-0.9</i>
British Columbia	102,800 <i>6.3</i>	68,900 <i>-33.0</i>	85,000 <i>23.4</i>	74,600 <i>-12.2</i>	76,700 <i>2.8</i>	67,600 <i>-11.9</i>	72,900 <i>7.8</i>	79,800 <i>9.5</i>	78,000 <i>-2.3</i>
Alberta	71,000 <i>-4.1</i>	56,000 <i>-21.1</i>	57,500 <i>2.7</i>	49,700 <i>-13.6</i>	53,800 <i>8.2</i>	60,400 <i>12.3</i>	66,100 <i>9.4</i>	70,500 <i>6.7</i>	71,000 <i>0.7</i>
Saskatchewan	12,500 <i>31.6</i>	10,500 <i>-16.0</i>	11,100 <i>5.7</i>	10,900 <i>-1.8</i>	13,100 <i>20.2</i>	13,900 <i>6.1</i>	13,500 <i>-2.9</i>	13,900 <i>3.0</i>	13,800 <i>-0.7</i>
Manitoba	13,900 <i>6.9</i>	13,400 <i>-3.6</i>	13,100 <i>-2.2</i>	13,100 <i>0.0</i>	13,900 <i>6.1</i>	13,900 <i>0.0</i>	13,700 <i>-1.4</i>	13,900 <i>1.5</i>	13,800 <i>-0.7</i>
Ontario	214,800 <i>9.4</i>	182,300 <i>-15.1</i>	197,000 <i>8.1</i>	196,700 <i>-0.2</i>	201,800 <i>2.6</i>	197,600 <i>-2.1</i>	198,700 <i>0.6</i>	198,200 <i>-0.3</i>	195,700 <i>-1.3</i>
Quebec	80,600 <i>12.6</i>	76,800 <i>-4.7</i>	79,100 <i>3.0</i>	80,000 <i>1.1</i>	77,200 <i>-3.5</i>	77,400 <i>0.3</i>	71,200 <i>-8.0</i>	70,100 <i>-1.5</i>	69,900 <i>-0.3</i>
Atlantic Canada	26,300 <i>14.8</i>	24,500 <i>-6.8</i>	22,800 <i>-6.9</i>	22,500 <i>-1.3</i>	22,900 <i>1.8</i>	23,100 <i>0.9</i>	21,200 <i>-8.2</i>	20,400 <i>-3.8</i>	20,500 <i>0.5</i>

\* Includes sales in the Territories.

Annual percent changes are in italics.

Source: Canadian Real Estate Association, RBC Economics Research

## Home price forecast

Composite price	2007	2008	2009	2010	2011	2012	2013	2014f	2015f
Canada*	284,100 <i>11.6</i>	299,600 <i>5.5</i>	297,800 <i>-0.6</i>	319,800 <i>7.4</i>	336,000 <i>5.1</i>	350,900 <i>4.4</i>	359,600 <i>2.5</i>	374,900 <i>4.3</i>	379,200 <i>1.1</i>
British Columbia	424,900 <i>11.0</i>	457,100 <i>7.6</i>	447,000 <i>-2.2</i>	493,000 <i>10.3</i>	525,100 <i>6.5</i>	528,200 <i>0.6</i>	524,100 <i>-0.8</i>	547,300 <i>4.4</i>	551,900 <i>0.8</i>
Alberta	370,000 <i>30.8</i>	346,800 <i>-6.3</i>	324,400 <i>-6.5</i>	330,500 <i>1.9</i>	330,100 <i>-0.1</i>	339,600 <i>2.9</i>	353,000 <i>3.9</i>	375,500 <i>6.4</i>	390,100 <i>3.9</i>
Saskatchewan	237,000 <i>43.7</i>	295,300 <i>24.6</i>	288,800 <i>-2.2</i>	307,700 <i>6.5</i>	321,600 <i>4.5</i>	341,400 <i>6.2</i>	355,100 <i>4.0</i>	362,700 <i>2.1</i>	368,100 <i>1.5</i>
Manitoba	200,900 <i>8.8</i>	220,600 <i>9.8</i>	232,800 <i>5.5</i>	254,900 <i>9.5</i>	268,700 <i>5.4</i>	286,000 <i>6.4</i>	299,800 <i>4.8</i>	308,500 <i>2.9</i>	314,500 <i>1.9</i>
Ontario	296,900 <i>7.7</i>	314,900 <i>6.1</i>	313,100 <i>-0.6</i>	337,400 <i>7.8</i>	355,600 <i>5.4</i>	379,000 <i>6.6</i>	393,400 <i>3.8</i>	416,000 <i>5.7</i>	421,300 <i>1.3</i>
Quebec	198,000 <i>6.3</i>	210,000 <i>6.1</i>	216,800 <i>3.2</i>	231,900 <i>7.0</i>	245,200 <i>5.7</i>	255,300 <i>4.1</i>	259,600 <i>1.7</i>	265,700 <i>2.3</i>	265,400 <i>-0.1</i>
Atlantic Canada	172,500 <i>7.7</i>	187,200 <i>8.5</i>	194,200 <i>3.7</i>	203,600 <i>4.8</i>	213,300 <i>4.8</i>	223,200 <i>4.6</i>	227,800 <i>2.1</i>	228,900 <i>0.5</i>	230,700 <i>0.8</i>

\* Weighted average, using provincial population as weights.

Annual percent changes are in italics.

Source: Royal LePage, Statistics Canada, RBC Economics Research

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