

# CANADIAN HOUSING MARKET FORECAST

August 2018

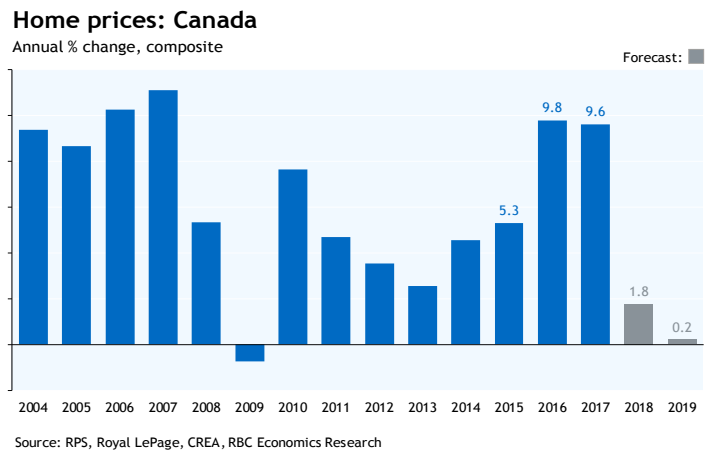
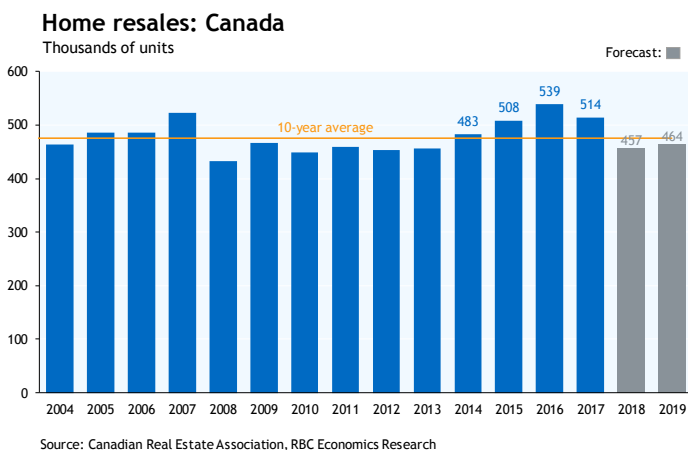
## Outlook for home prices in Canada: dull... for a change

After the fireworks of 2016 and 2017 that propelled property values by an average of nearly 10% per year, **a much tamer pricing environment is in the cards for Canada's housing market in 2018 and 2019.** Yet would-be buyers hoping for a meaningful break will likely be disappointed—we don't expect aggregate prices to fall on an annual basis either this year or next. We project aggregate prices in Canada to rise a modest 1.8% in 2018 with a slower 0.2% gain in 2019. In fact, our views on prices haven't really changed since our May forecast despite resale activity coming in weaker than we expected so far in 2018. The thing is that fewer homes are also being put up for sale, which keeps—and in our view, will continue to keep—the market in balance. Soft activity to date, however, prompted us to revise our resales forecast materially. We now project a steeper drop 11.5% to 456,700 units in 2018 instead of the 4.3% decline to 493,900 units we projected in May. Ontario and British Columbia will account for most of this drop. **We now believe that the new stress test on uninsured mortgages will have larger, longer-lasting dampening effect on resales than we previously assumed.** Nonetheless, the effect will taper off over time with the market's still-positive fundamentals—an economy running at capacity, low unemployment rates, rising incomes and rapid population growth—providing scope for a slight 1.6% increase in resales in 2019. Still, stiff interest rate headwinds will leave the level of activity that year below the 10-year average.

## Stress test and rising interest rates leaving their mark

The market's reaction to the new stress test undoubtedly was the highlight of the first half of 2018. It was the primary factor behind resales tumbling by 13% nationwide compared to the same period a year ago. **While part of the decline was temporary payback for activity pulled forward ahead of the January 1 implementation date, a significant portion represented a more permanent shift.** The stress test has raised the qualifying bar for mortgage borrowers—shutting out a certain segment of homebuyers from the market possibly for an extended period of time. So some of the impact will continue to be felt in the period ahead (albeit with diminishing intensity as the market adjusts).

The rise in interest rates also played a role in cooling the market this year. We expect rate increases to become more prominent going forward. Our forecast calls for the Bank of Canada to hike its overnight rate three more times to 2.25% by the middle of 2019—a rise of 75 basis points from today's level. We also expect longer-term rates to climb with the 5-year Canada bond yield reaching 2.7% by mid-2019 from less than 2% at the start of 2018. These rate hikes will make it even harder for first-time buyers to qualify for a mortgage and





increasingly impact existing owners as well. **For the first time since 2008, for example, fixed-rate mortgage holders will face a higher rate when renewing a maturing five-year term.** This will throw some sand in the gears of move-up buying activity in certain markets. Markets where affordability is stretched and household debt is high will be most sensitive to a rise in interest rates.

The bottom line is that we expect the stress test, rising interest rates and new market-cooling policy measures adopted in British Columbia this year to shrink home resales to a six-year low in Canada in 2018. **Far from a sign of trouble, we view this cooling constitutes as a healthy correction** that would prevent overheating conditions from re-emerging in parts of Canada such as the Vancouver and Toronto areas. We expect a modest recovery to take shape in 2019.

**We see little risk of a downward spiral because demand and supply conditions are balanced in the majority of local markets and expected to remain so over the forecast horizon.**

Generally solid economic and demographic conditions will maintain a 'safety net' under the demand, while a host of factors (including regulatory and administrative) will continue to constrain the supply side of the market—especially in the more affordable segments. These elements should keep prices above water in most regions. More muted homebuyer demand will also lighten upward price pressure considerably compared to 2016 and 2017. Thus our outlook for prices calls for modest increases in the period ahead. Markets in Ontario will account for most of the easing. It's quite possible that we might see absolute price drops in certain local markets (e.g. in the Toronto area).

## Provincial market overviews

**British Columbia:** The stress test and new market-cooling measures announced in the 2018 BC budget are dampening homebuyer demand significantly this year. We now project home resales to plummet by 20.5% in 2018—the largest annual decline in the province since 2008. We expect aggregate prices in BC to rise by 5.7% though this largely reflects strength early this year. After re-accelerating last fall, the rate of price increase is easing again in Vancouver.

**Alberta:** The market is having a setback this year despite further recovery in the provincial economy. Home resales are poised to fall by 5.8% following a promising 4.4% rise last year. We expect prices to be largely flat with the aggregate benchmark eking out a small 0.5% advance. Markets such as Calgary and Edmonton remain abundantly supplied at this stage.

**Saskatchewan:** Job market and demographic trends will provide only mild support for the province's housing market at a time when high inventories continue to be an issue. We forecast resales to drop by 5.4% and prices to edge marginally lower by 0.2% this year.

**Manitoba:** We expect the market to lose more steam with home resales dropping by 4.9% in 2018. This won't likely disrupt the long-standing balance between demand and supply though buyers will gain some pricing power. We project prices to be unchanged from 2017.

**Ontario:** Markets such as the Greater Toronto Area have cooled considerably since the spring of 2017. The new stress test and rising interest rates will exacerbate affordability issues in the area. Our forecast calls for provincial resales to decline by 15.5% this year and prices to level off (rising by just 0.4%). Toronto-area prices could fall outright (on a full-year basis).

**Quebec:** The provincial market has shown some resilience this year thanks to a strong economy. Yet we expect the stress test and rising interest rates will cause resales growth to slow from 5.8% in 2017 to 1.6% this year, and prices to decelerate from 3.8% to 3.0%. The Montreal market remains on an impressive upswing.

**Atlantic Canada:** The new stress test and interest rates will be the central story in most of Atlantic Canada. We expect home resales to ease throughout the region except in Nova Scotia where we project them to rise by 1.9% in 2018. Despite weakening activity, our forecast calls for prices to continue to rise modestly in New Brunswick and PEI where we expect balanced conditions to persist.

## Forecast assumptions

%, unless specified otherwise

|                                 | 2017 | 2018f | 2019f |
|---------------------------------|------|-------|-------|
| BoC overnight rate (year-end)   | 1.00 | 1.75  | 2.25  |
| 5-year bond yield (year-end)    | 1.87 | 2.45  | 2.70  |
| Population growth (y/y)         | 1.2  | 1.4   | 1.4   |
| Oil prices (WTI, avg. US\$/bbl) | 51   | 68    | 76    |
| Unemployment rate               |      |       |       |
| Canada                          | 6.3  | 5.8   | 5.8   |
| British Columbia                | 5.2  | 5.0   | 5.1   |
| Alberta                         | 7.8  | 6.6   | 6.5   |
| Saskatchewan                    | 6.3  | 6.1   | 5.7   |
| Manitoba                        | 5.4  | 5.9   | 5.8   |
| Ontario                         | 6.0  | 5.6   | 5.5   |
| Quebec                          | 6.1  | 5.5   | 5.5   |
| Atlantic                        | 9.8  | 9.3   | 9.1   |



## Home resales forecast (units)

|                         | 2010         | 2011        | 2012         | 2013         | 2014        | 2015         | 2016        | 2017        | 2018f        | 2019f       |
|-------------------------|--------------|-------------|--------------|--------------|-------------|--------------|-------------|-------------|--------------|-------------|
| Canada*                 | 449,600      | 461,400     | 455,600      | 458,400      | 484,600     | 510,700      | 540,800     | 516,300     | 456,700      | 464,100     |
|                         | <i>-4.0</i>  | <i>2.6</i>  | <i>-1.3</i>  | <i>0.6</i>   | <i>5.7</i>  | <i>5.4</i>   | <i>5.9</i>  | <i>-4.5</i> | <i>-11.5</i> | <i>1.6</i>  |
| British Columbia        | 74,600       | 76,700      | 67,600       | 72,900       | 84,100      | 102,500      | 112,200     | 103,800     | 82,500       | 87,200      |
|                         | <i>-12.2</i> | <i>2.8</i>  | <i>-11.9</i> | <i>7.8</i>   | <i>15.4</i> | <i>21.9</i>  | <i>9.5</i>  | <i>-7.5</i> | <i>-20.5</i> | <i>5.7</i>  |
| Alberta                 | 50,900       | 55,300      | 62,200       | 67,400       | 75,100      | 59,300       | 54,800      | 57,200      | 53,900       | 56,100      |
|                         | <i>-13.7</i> | <i>8.6</i>  | <i>12.5</i>  | <i>8.4</i>   | <i>11.4</i> | <i>-21.0</i> | <i>-7.6</i> | <i>4.4</i>  | <i>-5.8</i>  | <i>4.1</i>  |
| Saskatchewan            | 11,500       | 12,800      | 13,400       | 13,100       | 13,500      | 12,000       | 11,300      | 11,100      | 10,500       | 11,000      |
|                         | <i>-2.5</i>  | <i>11.3</i> | <i>4.7</i>   | <i>-2.2</i>  | <i>3.1</i>  | <i>-11.1</i> | <i>-5.8</i> | <i>-1.8</i> | <i>-5.4</i>  | <i>4.8</i>  |
| Manitoba                | 13,100       | 13,900      | 13,900       | 13,700       | 13,800      | 14,000       | 14,600      | 14,400      | 13,700       | 13,600      |
|                         | <i>0.0</i>   | <i>6.1</i>  | <i>0.0</i>   | <i>-1.4</i>  | <i>0.7</i>  | <i>1.4</i>   | <i>4.3</i>  | <i>-1.4</i> | <i>-4.9</i>  | <i>-0.7</i> |
| Ontario                 | 196,400      | 201,900     | 197,600      | 198,200      | 206,100     | 226,200      | 245,400     | 222,000     | 187,500      | 190,300     |
|                         | <i>-0.2</i>  | <i>2.8</i>  | <i>-2.1</i>  | <i>0.3</i>   | <i>4.0</i>  | <i>9.8</i>   | <i>8.5</i>  | <i>-9.5</i> | <i>-15.5</i> | <i>1.5</i>  |
| Quebec                  | 80,000       | 77,200      | 77,400       | 71,200       | 70,600      | 74,100       | 78,100      | 82,600      | 83,900       | 81,600      |
|                         | <i>1.1</i>   | <i>-3.5</i> | <i>0.3</i>   | <i>-8.0</i>  | <i>-0.8</i> | <i>5.0</i>   | <i>5.4</i>  | <i>5.8</i>  | <i>1.6</i>   | <i>-2.7</i> |
| New Brunswick           | 6,700        | 6,600       | 6,400        | 6,300        | 6,300       | 6,700        | 7,400       | 7,900       | 7,800        | 7,700       |
|                         | <i>-4.3</i>  | <i>-1.5</i> | <i>-3.0</i>  | <i>-1.6</i>  | <i>0.0</i>  | <i>6.3</i>   | <i>10.4</i> | <i>6.8</i>  | <i>-1.3</i>  | <i>-1.3</i> |
| Nova Scotia             | 10,200       | 10,400      | 10,700       | 9,400        | 9,100       | 9,400        | 10,100      | 10,600      | 10,800       | 10,500      |
|                         | <i>0.0</i>   | <i>2.0</i>  | <i>2.9</i>   | <i>-12.1</i> | <i>-3.2</i> | <i>3.3</i>   | <i>7.4</i>  | <i>5.0</i>  | <i>1.9</i>   | <i>-2.8</i> |
| Prince Edward Island    | 1,500        | 1,500       | 1,500        | 1,400        | 1,400       | 1,700        | 2,100       | 2,200       | 2,100        | 2,000       |
|                         | <i>7.1</i>   | <i>0.0</i>  | <i>0.0</i>   | <i>-6.7</i>  | <i>0.0</i>  | <i>21.4</i>  | <i>23.5</i> | <i>4.8</i>  | <i>-4.5</i>  | <i>-4.8</i> |
| Newfoundland & Labrador | 4,300        | 4,500       | 4,400        | 4,300        | 4,200       | 4,200        | 4,100       | 3,900       | 3,700        | 3,600       |
|                         | <i>-4.4</i>  | <i>4.7</i>  | <i>-2.2</i>  | <i>-2.3</i>  | <i>-2.3</i> | <i>0.0</i>   | <i>-2.4</i> | <i>-4.9</i> | <i>-5.1</i>  | <i>-2.7</i> |

\* Includes sales in the Territories.

Annual percent changes are in italics.

Source: Canadian Real Estate Association, RBC Economics Research

## Home price forecast

| Aggregate price         | 2010        | 2011       | 2012       | 2013       | 2014        | 2015       | 2016        | 2017        | 2018f       | 2019f       |
|-------------------------|-------------|------------|------------|------------|-------------|------------|-------------|-------------|-------------|-------------|
| Canada                  | 339,000     | 354,900    | 367,400    | 376,800    | 393,900     | 414,800    | 455,300     | 499,000     | 507,900     | 509,000     |
|                         | <i>7.1</i>  | <i>4.7</i> | <i>3.5</i> | <i>2.6</i> | <i>4.5</i>  | <i>5.3</i> | <i>9.8</i>  | <i>9.6</i>  | <i>1.8</i>  | <i>0.2</i>  |
| British Columbia        | 516,000     | 545,400    | 546,700    | 546,800    | 581,600     | 632,400    | 750,300     | 798,500     | 844,100     | 835,500     |
|                         | <i>7.0</i>  | <i>5.7</i> | <i>0.2</i> | <i>0.0</i> | <i>6.4</i>  | <i>8.7</i> | <i>18.6</i> | <i>6.4</i>  | <i>5.7</i>  | <i>-1.0</i> |
| Alberta                 | 378,400     | 383,200    | 392,100    | 406,600    | 428,300     | 434,700    | 427,700     | 431,800     | 433,800     | 443,200     |
|                         | <i>3.1</i>  | <i>1.3</i> | <i>2.3</i> | <i>3.7</i> | <i>5.3</i>  | <i>1.5</i> | <i>-1.6</i> | <i>1.0</i>  | <i>0.5</i>  | <i>2.2</i>  |
| Saskatchewan            | 281,500     | 289,500    | 308,200    | 321,600    | 326,300     | 326,500    | 327,000     | 324,000     | 323,200     | 329,200     |
|                         | <i>5.8</i>  | <i>2.8</i> | <i>6.5</i> | <i>4.3</i> | <i>1.5</i>  | <i>0.1</i> | <i>0.2</i>  | <i>-0.9</i> | <i>-0.2</i> | <i>1.9</i>  |
| Manitoba                | 227,600     | 243,600    | 260,200    | 268,300    | 276,800     | 280,200    | 284,600     | 292,400     | 292,300     | 296,700     |
|                         | <i>8.3</i>  | <i>7.0</i> | <i>6.8</i> | <i>3.1</i> | <i>3.2</i>  | <i>1.2</i> | <i>1.6</i>  | <i>2.7</i>  | <i>0.0</i>  | <i>1.5</i>  |
| Ontario                 | 342,600     | 359,400    | 378,400    | 392,000    | 412,200     | 442,600    | 501,100     | 583,300     | 585,700     | 585,800     |
|                         | <i>8.7</i>  | <i>4.9</i> | <i>5.3</i> | <i>3.6</i> | <i>5.2</i>  | <i>7.4</i> | <i>13.2</i> | <i>16.4</i> | <i>0.4</i>  | <i>0.0</i>  |
| Quebec                  | 264,000     | 280,900    | 289,400    | 293,300    | 297,600     | 301,500    | 311,600     | 323,400     | 333,100     | 335,200     |
|                         | <i>7.3</i>  | <i>6.4</i> | <i>3.0</i> | <i>1.3</i> | <i>1.5</i>  | <i>1.3</i> | <i>3.3</i>  | <i>3.8</i>  | <i>3.0</i>  | <i>0.6</i>  |
| New Brunswick           | 175,200     | 180,500    | 183,800    | 185,600    | 190,000     | 190,700    | 197,700     | 196,600     | 200,200     | 201,700     |
|                         | <i>4.2</i>  | <i>3.0</i> | <i>1.8</i> | <i>1.0</i> | <i>2.4</i>  | <i>0.4</i> | <i>3.7</i>  | <i>-0.6</i> | <i>1.8</i>  | <i>0.7</i>  |
| Nova Scotia             | 209,300     | 216,300    | 224,000    | 227,100    | 230,300     | 232,800    | 239,100     | 247,100     | 246,800     | 248,800     |
|                         | <i>3.8</i>  | <i>3.3</i> | <i>3.6</i> | <i>1.4</i> | <i>1.4</i>  | <i>1.1</i> | <i>2.7</i>  | <i>3.3</i>  | <i>-0.1</i> | <i>0.8</i>  |
| Prince Edward Island    | 176,900     | 187,000    | 187,400    | 188,700    | 187,600     | 196,700    | 207,700     | 231,900     | 251,300     | 256,400     |
|                         | <i>-1.4</i> | <i>5.7</i> | <i>0.2</i> | <i>0.7</i> | <i>-0.6</i> | <i>4.9</i> | <i>5.6</i>  | <i>11.7</i> | <i>8.4</i>  | <i>2.0</i>  |
| Newfoundland & Labrador | 233,900     | 246,300    | 261,500    | 279,900    | 286,900     | 291,600    | 290,600     | 289,400     | 285,100     | 284,000     |
|                         | <i>10.0</i> | <i>5.3</i> | <i>6.2</i> | <i>7.0</i> | <i>2.5</i>  | <i>1.6</i> | <i>-0.3</i> | <i>-0.4</i> | <i>-1.5</i> | <i>-0.4</i> |

Annual percent changes are in italics.

Source: RPS, Royal LePage, Statistics Canada, RBC Economics Research

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