

# CANADIAN HOUSING MARKET FORECAST

May 2018

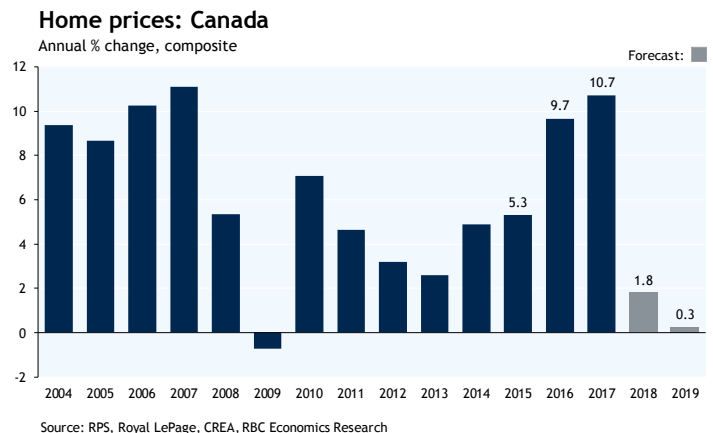
## Home price appreciation to wane in 2018 as Canadian market continues to cool

Recent policy actions and rising interest rates will take the wind out of home prices' sail this year in Canada. We expect aggregate prices to inch higher by only 1.8% nationwide in 2018 after surging by more than 10% on average in the past two years. Ontario's Fair Housing Plan triggered the cooling process in April 2017 and three interest rate hikes since July reduced the market's heat even more. The new stress test for uninsured mortgages, measures announced in the 2018 BC budget and the prospect for further interest rate hikes will keep homebuyers on edge in 2018. We project home resales to dip for a second-straight year—something Canada hasn't seen since the mid-1990s. Most of this decline in activity will be concentrated in Ontario and British Columbia. Policy measures and rising interest rates will also compress buyers' budgets applying further downward price pressure. Still, we see the risks of a major price correction nationwide as contained. We expect demand-supply conditions to remain balanced in the majority of local markets, including in Ontario and British Columbia. Solid economic and demographic fundamentals will maintain steady support.

### Canada: stress test and interest rates to generate headwinds

The new stress test that came into effect on January 1, 2018, generated substantial market volatility in the late stages of 2017 and early 2018. Our view is that new stress test will ultimately dampen homebuyer demand in Canada. We expect that a certain segment of mortgage borrowers will no longer qualify, or will delay their buying decisions for an extended period of time. Perhaps more importantly, **the new stress test will reduce the home purchasing budgets of many qualifying borrowers.** This will fuel demand for lower-priced units (e.g. condos) at the expense of more expensive options (e.g. single-detached homes). These dynamics, in fact, are already at play in markets such as the Toronto and Vancouver areas where sales and price trends have been much softer in the single-detached segment than in the condo segment over the past year. To date, this was mainly a relative affordability story across housing segments. Going forward, the new stress test will consolidate these trends and extend them to other cities.

The new stress test won't be the only factor squeezing home purchasing budgets and cooling homebuyer demand in 2018. **The rise in interest rates since July last year and the further hikes that we expect over the coming year will raise the qualifying threshold for new mortgages even higher.** This will knock more prospective buyers out of the market and leave others with still-lower mortgage amounts to house-hunt. Higher interest rates will also gradually affect existing owners with a mortgage. For the first time since 2008, fixed-rate mortgage holders will face an increase in mortgage rates 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.





We believe that higher interest rates will leave a bigger mark on Canada's housing market later this year. That's when we see the cumulative increase weighing more heavily on demand. We expect the Bank of Canada to hike its overnight rate four more times to 2.25% by the middle of 2019—a rise of 100 basis points from today's level. We also expect longer-term rates to climb with the 5-year Canada bond yield reaching 2.8% by mid-2019 from less than 2% at the start of 2018.

In short, Canada's housing market will face significant headwinds in the period ahead that we believe will cause activity to shrink modestly for a second-straight year. Our forecast calls home resales to decline by 4.3% to 493,900 units in 2018, following a 4.5% drop in 2017. This would be the first back-to-back annual decrease since the mid-1990s. Still, **our view is that it would represent a healthy correction**. The level in 2016 was unsustainably strong in certain parts of Canada, which led to overheating conditions in the Vancouver and Toronto areas.

**These factors point to a significant easing of price pressures overall in Canada this year.** We project the rate of increase in aggregate prices to decelerate sharply from 10.7% in 2017 to 1.8% in 2018. Markets in Ontario will account for most of this change. It's quite possible that we might see absolute price drops in certain local markets (e.g. in the Toronto area) though we believe that the odds of a nationwide decline is low at this stage. Despite generally softening activity, we expect demand-supply conditions to be balanced in the majority of local markets. Economic and demographic conditions will generally remain solid, 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 will maintain some degree of support for home prices.

## Provincial market overviews

**British Columbia:** We project home resales to drop by 10.9% in 2018. New market-cooling measures announced in the 2018 BC budget are poised to temper homebuyer demand, including in markets outside the Vancouver area. We expect BC prices to show the strongest annual gain among the province though that's only because of strength early this year. Home prices in Vancouver heated up again since the middle of 2017 as demand-supply conditions tightened. We expect that the price trajectory will level off over the remainder of this year.

**Alberta:** We project the provincial market to remain largely flat overall in 2018 with minimal increases of 0.7% in home resales and 1.0% in aggregate prices. Further recovery in Alberta's economy will be a positive factor, although the lingering effects of the 2015-16 recession will continue to weigh on migration flows. High household debt will also be an obstacle. Markets such as Calgary still deal with plentiful inventories.

**Saskatchewan:** Labour market and demographic trends will provide only mild support for Saskatchewan's housing market at a time when high inventories continue to be an issue. We forecast home resales to remain unchanged from 2017 levels and prices to edge marginally lower by 0.2% this year.

**Manitoba:** We expect the market to lose a bit of steam with home resales easing slightly by 2.1% in 2018. This wouldn't disrupt the long-standing balance between demand and supply in the province. We project prices to rise by 1.0%.

**Ontario:** The cooling process will continue in markets such as the Greater Toronto Area. The new stress test and rising interest rates will exacerbate affordability issues. Our forecast calls for provincial resales to decline by 5.3% 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 is poised to lead all other regions in Canada in 2018. Yet it won't be entirely sheltered from headwinds. We project resales growth to slow from 5.8% in 2017 to 1.2% this year, and prices to decelerate from 4.2% to 3.1%. The Montreal market is on an impressive upswing supported by a strong regional economy.

## 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	2.55	2.65
Population growth (y/y)	1.2	1.3	1.2
Oil prices (WTI, avg. US\$/bbl)	51	63	65
Unemployment rate			
Canada	6.3	5.9	5.9
British Columbia	5.2	5.0	5.0
Alberta	7.8	6.9	6.5
Saskatchewan	6.3	6.1	5.8
Manitoba	5.4	5.1	5.2
Ontario	6.0	5.7	5.6
Quebec	6.1	5.5	5.7
Atlantic	9.8	9.8	9.6



**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 remain unchanged from 2017. Despite weakening activity, our forecast calls for prices to continue to rise modestly for the most part because we expect balanced conditions to persist.

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	493,900	491,600
	<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>-4.3</i>	<i>-0.5</i>
British Columbia	74,600	76,700	67,600	72,900	84,100	102,500	112,200	103,800	92,500	89,000
	<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>-10.9</i>	<i>-3.8</i>
Alberta	50,900	55,300	62,200	67,400	75,100	59,300	54,800	57,200	57,600	61,000
	<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>0.7</i>	<i>5.9</i>
Saskatchewan	11,500	12,800	13,400	13,100	13,500	12,000	11,300	11,100	11,100	11,800
	<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>0.0</i>	<i>6.3</i>
Manitoba	13,100	13,900	13,900	13,700	13,800	14,000	14,600	14,400	14,100	13,800
	<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>-2.1</i>	<i>-2.1</i>
Ontario	196,400	201,900	197,600	198,200	206,100	226,200	245,400	222,000	210,300	210,500
	<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>-5.3</i>	<i>0.1</i>
Quebec	80,000	77,200	77,400	71,200	70,600	74,100	78,100	82,600	83,600	81,300
	<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>1.2</i>	<i>-2.8</i>
New Brunswick	6,700	6,600	6,400	6,300	6,300	6,700	7,400	7,900	7,700	7,600
	<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>-2.5</i>	<i>-1.3</i>
Nova Scotia	10,200	10,400	10,700	9,400	9,100	9,400	10,100	10,600	10,600	10,300
	<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>0.0</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	334,500	350,400	362,400	371,600	389,700	410,400	450,300	498,500	507,400	508,700
	<i>7.2</i>	<i>4.8</i>	<i>3.4</i>	<i>2.5</i>	<i>4.9</i>	<i>5.3</i>	<i>9.7</i>	<i>10.7</i>	<i>1.8</i>	<i>0.3</i>
British Columbia	507,800	538,000	534,300	533,500	570,400	618,000	730,300	787,300	828,600	818,100
	<i>7.4</i>	<i>5.9</i>	<i>-0.7</i>	<i>-0.1</i>	<i>6.9</i>	<i>8.3</i>	<i>18.2</i>	<i>7.8</i>	<i>5.2</i>	<i>-1.3</i>
Alberta	372,700	377,500	387,000	400,900	421,800	427,700	422,100	429,900	434,300	445,200
	<i>3.3</i>	<i>1.3</i>	<i>2.5</i>	<i>3.6</i>	<i>5.2</i>	<i>1.4</i>	<i>-1.3</i>	<i>1.8</i>	<i>1.0</i>	<i>2.5</i>
Saskatchewan	276,000	284,300	303,900	318,200	322,900	322,500	324,700	325,700	325,200	333,100
	<i>6.5</i>	<i>3.0</i>	<i>6.9</i>	<i>4.7</i>	<i>1.5</i>	<i>-0.1</i>	<i>0.7</i>	<i>0.3</i>	<i>-0.2</i>	<i>2.4</i>
Manitoba	223,100	238,200	254,700	263,800	273,300	277,300	280,800	292,600	295,600	300,000
	<i>8.9</i>	<i>6.8</i>	<i>6.9</i>	<i>3.6</i>	<i>3.6</i>	<i>1.5</i>	<i>1.3</i>	<i>4.2</i>	<i>1.0</i>	<i>1.5</i>
Ontario	337,400	354,000	373,100	386,600	407,800	438,400	496,400	583,800	586,200	586,800
	<i>8.7</i>	<i>4.9</i>	<i>5.4</i>	<i>3.6</i>	<i>5.5</i>	<i>7.5</i>	<i>13.2</i>	<i>17.6</i>	<i>0.4</i>	<i>0.1</i>
Quebec	264,000	280,600	288,700	293,000	298,700	303,200	314,100	327,300	337,500	339,500
	<i>7.5</i>	<i>6.3</i>	<i>2.9</i>	<i>1.5</i>	<i>1.9</i>	<i>1.5</i>	<i>3.6</i>	<i>4.2</i>	<i>3.1</i>	<i>0.6</i>
New Brunswick	172,600	177,900	181,600	184,600	189,100	189,400	196,500	196,800	202,600	203,600
	<i>3.6</i>	<i>3.1</i>	<i>2.1</i>	<i>1.7</i>	<i>2.4</i>	<i>0.2</i>	<i>3.7</i>	<i>0.2</i>	<i>2.9</i>	<i>0.5</i>
Nova Scotia	205,000	211,700	220,200	222,000	225,100	228,900	235,600	244,100	246,100	248,400
	<i>4.0</i>	<i>3.3</i>	<i>4.0</i>	<i>0.8</i>	<i>1.4</i>	<i>1.7</i>	<i>2.9</i>	<i>3.6</i>	<i>0.8</i>	<i>0.9</i>
Prince Edward Island	175,200	187,000	186,900	188,000	186,500	195,900	206,700	225,400	231,800	234,300
	<i>-1.6</i>	<i>6.7</i>	<i>-0.1</i>	<i>0.6</i>	<i>-0.8</i>	<i>5.0</i>	<i>5.5</i>	<i>9.0</i>	<i>2.8</i>	<i>1.1</i>
Newfoundland & Labrador	230,500	242,200	257,600	275,700	284,500	289,400	288,900	295,400	294,800	295,000
	<i>10.4</i>	<i>5.1</i>	<i>6.4</i>	<i>7.0</i>	<i>3.2</i>	<i>1.7</i>	<i>-0.2</i>	<i>2.2</i>	<i>-0.2</i>	<i>0.1</i>

Annual percent changes are in italics.

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

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