ONTARIO - Housing downturn leaves a mark

The sharp cooling of Ontario’s housing market is taking a toll on provincial growth. With little else to pick up the slack, 2019 will mark the first material growth slowdown in six years.

The downturn in the Toronto-area housing market finally caught up with Ontario’s economy in the late stages of 2018. Plummeting residential investment was a key factor contributing to growth slowing down below 1% in the fourth quarter—the first such occurrence since mid-2016. The provincial economy still ended up expanding at the respectable rate of 2.2% in 2018 as a whole (thanks to impressive vigour mid-year). But the hand-off to 2019 clearly was weak. And with the housing market slump carrying over to the initial months of 2019, the sluggish economic pace has persisted. This soft patch will affect growth overall in 2019, which we now forecast to moderate to a six-year low of 1.4%.

The drop in residential investment wasn’t a surprise. The writing was on the wall the moment provincial and federal policy makers took action in 2017 and at the start of 2018 to cool overheated housing markets in southern Ontario. The effect on the home resale market was nearly immediate but it took until the fall of 2018 for new home construction to gear down in a material way. After contributing 0.4 percentage points to the average 2.5% provincial growth rate between 2015 and 2017, residential investment subtracted 0.4 percentage points in 2018. This included an outsized 1.3 percentage-point drag on annualized growth in the fourth quarter (which finished at just 0.6%).

We expect the housing-related drag to ease in the remainder of 2019. Signs of a resale market bottom have emerged this spring and housing construction picked up recently. Yet we see little scope for a material rebound in residential investment this year or next. Severe affordability issues will continue to restrain housing demand in the Toronto area and shift activity toward lower-priced units.

Non-residential investment has been a generally positive—albeit volatile—factor for Ontario’s economy and we expect this to continue in 2019. The successful conclusion of the NAFTA renegotiations (provided the tentative agreement is ratified) and recent elimination of tariffs on Canadian steel and aluminum exports to the US should boost business confidence to invest in the province. Private and public organizations in fact plan to increase their capital spending for a third consecutive year. We are especially encouraged by a recent upswing in machinery and equipment investment. We believe that this will go a long way toward addressing significant labour shortage issues in the province.

The outlook for household spending is mixed. A persistently tight labour market is poised to generate more meaningful income gains at some point. However, past interest rate increases are still filtering down to borrowers and putting a squeeze on highly indebted Ontarians. Rising debt service costs will restrain spending budgets for big ticket, discretionary items.

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