ECONOMIC VIEWPOINT

Canadian Residential Real Estate Outlook: The Housing Market Rout May Not Be as Bad as We Once Feared

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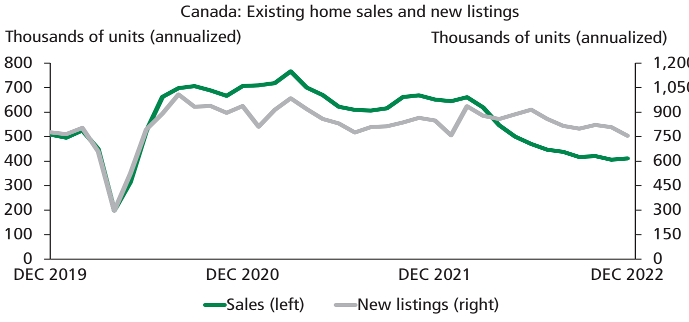
- The Canadian housing market has corrected sharply from its pandemic highs. But looking ahead, we expect it to find a bottom by the end of the year. This is likely to be the result of falling interest rates, a tight labour market, elevated household savings and heightened immigration.
- We are expecting national home sales to reach a low in the second half of 2023 before lifting off again. The increase in sales should outpace listings, spurring a return to a seller's market in some provinces before the end of 2024 and, hence, higher prices. This will act as a brake on improved affordability at the national level next year.

Housing in Canada Is Searching for a Bottom

At the national level, the Canadian housing market has corrected sharply from its pandemic highs. Existing home sales have fallen over 38% from their recent peak in February 2022 (graph 1). New listings have remained more stable recently but have still dropped almost 20% over the same period. The average home price has fallen nearly 20% from recent highs as well, while the benchmark home price—which adjusts for market composition–is down roughly 14% (graph 2). The decline in sales but relatively steady listings helped to push the national housing market into balanced territory (graph 3 on page 2). This is down from a ratio of more than 85 at the start of last year, which leaned significantly in favour of sellers.

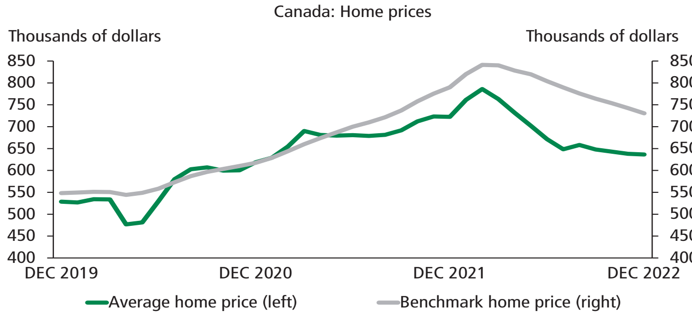
Looking ahead, we expect the Canadian housing market to find a bottom by the end of the year. The Bank of Canada's recent pivot suggests the central bank is likely to remain on hold for the foreseeable future and may even begin cutting rates before

GRAPH 1
Home sales have fallen faster than new listings since the start of 2022



Sources: Canadian Real Estate Association and Desjardins Economic Studies

GRAPH 2
Home prices have fallen considerably from their pandemic peak

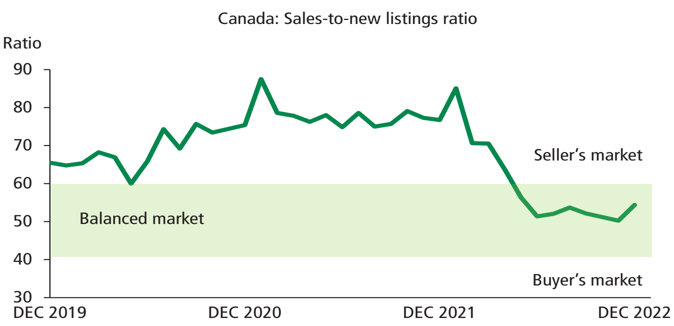


Sources: Canadian Real Estate Association and Desjardins Economic Studies

the year is out (graph 4). But still-high interest rates will continue to weigh on housing market activity, while the impact of prior rate hikes has yet to be fully felt in the economy (graph 5). As such, there is likely more pain ahead for Canadians, including a recession in 2023. (See our recent Economic and Financial Outlook for more information.)

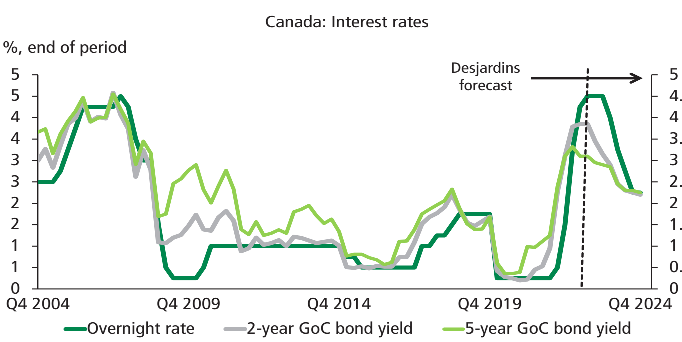
That said, there are tailwinds to the Canadian housing market. The labour market remains very tight (graph 6). And while inflation has caused real wage growth to turn negative, cooling price growth should help to reverse that trend, if only modestly. Pandemic-era household savings also remain elevated, despite falling financial market and housing wealth (graph 7). Finally, the heightened level of immigration is supporting demand, pushing up rents and helping to keep a floor on housing market activity (graph 8).

GRAPH 3
Canada's housing market is balanced for the first time since 2019



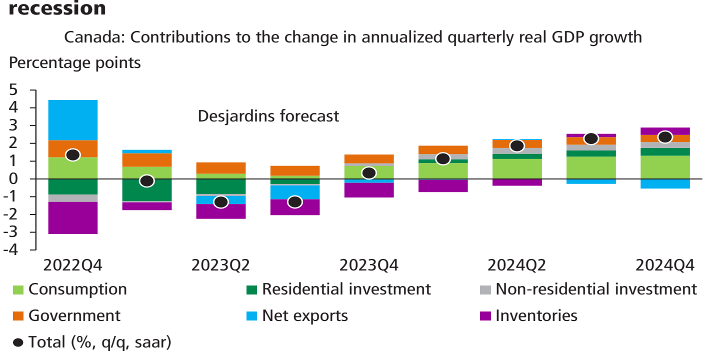
Sources: Canadian Real Estate Association and Desjardins Economic Studies

GRAPH 4
We expect the Bank of Canada is done hiking rates



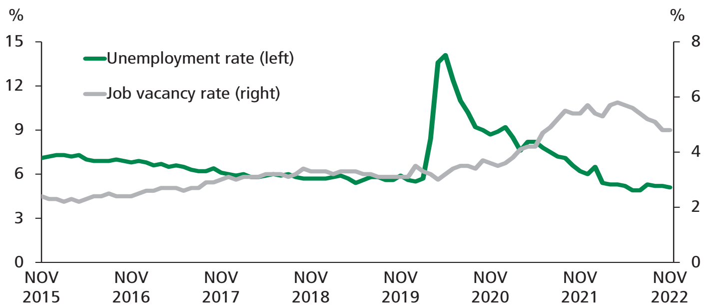
Sources: Bank of Canada and Desjardins Economic Studies

GRAPH 5
Interest-rate sensitive sectors are likely to push Canada into recession



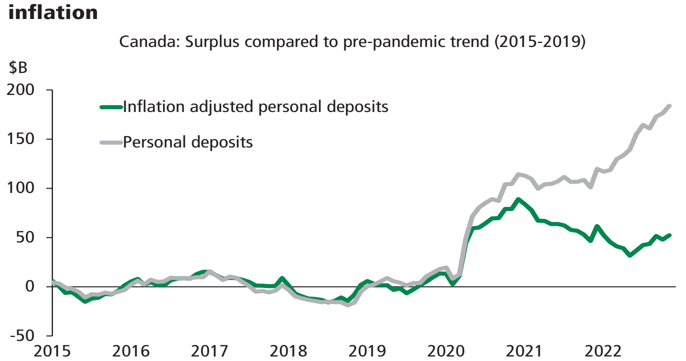
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 6
The unemployment and job vacancy rates are near unprecedented levels



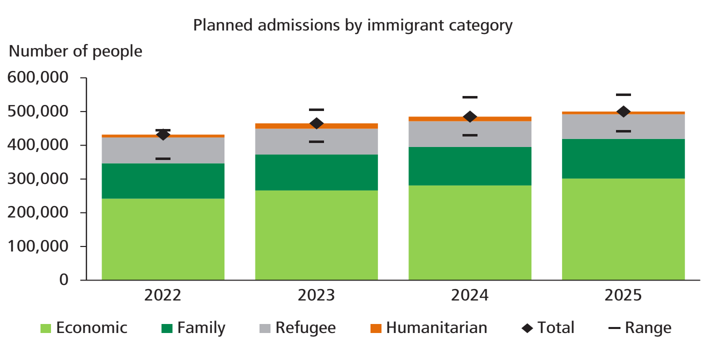
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 7
Pandemic-era savings are still high but are being eroded by inflation



Sources: Bank of Canada and Desjardins Economic Studies

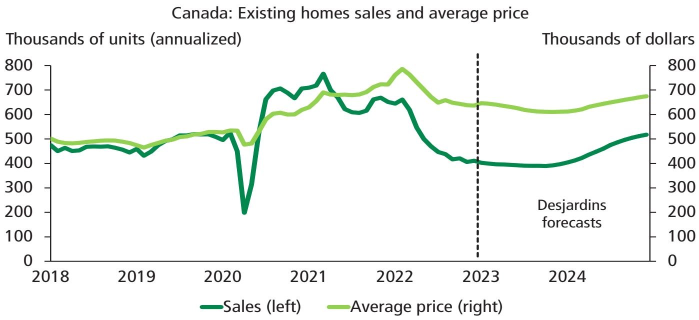
GRAPH 8
Immigration to Canada is expected to keep setting new records



Sources: Immigration, Refugees and Citizenship Canada and Desjardins Economic Studies

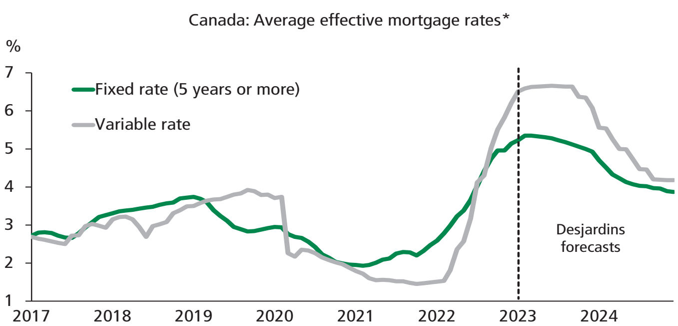
Taken together, we are expecting national home sales to reach a low in the second half of 2023 before lifting off again (graph 9). Falling borrowing costs should be a major driver of the rebound (graph 10), although the aforementioned tailwinds to the housing market will also make an important contribution. New listings should similarly reach their trough by the end of 2023, but not enough to keep the sales-to-new listings ratio from moving higher. Meanwhile, housing starts are likely to lag behind existing home sales and listings by a quarter or two. But they too should rebound in 2024 after a relatively brief downturn.

GRAPH 9
The housing market has corrected but should ease more slowly ahead



Sources: Canadian Real Estate Association and Desjardins Economic Studies

GRAPH 10
Borrowing costs are on the rise but are likely to peak soon



Sources: Bank of Canada and Desjardins Economic Studies

The Provincial Housing Outlook Varies Widely

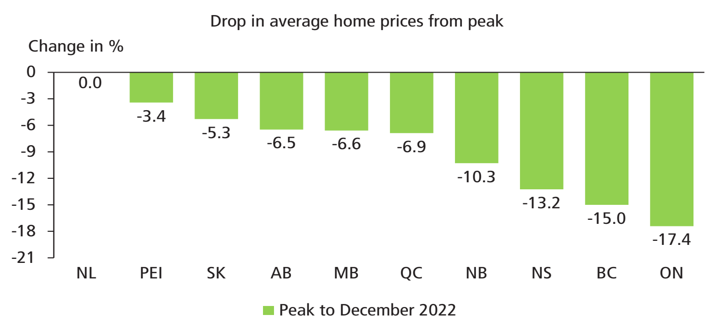
While the national housing market outlook is interesting, all real estate is local. At the end of the day, it comes down to location, location, location. And nowhere is this truer than in Canada, where the dispersion of provincial economic developments is often wide and varied. (See our most recent [Provincial Outlook] for the latest regional economic forecast.)

<u>Ontario</u>

Central to our housing market outlook is the forecast for Canada's most populous province. Ontario has borne the brunt of the housing market correction so far (graph 11). And as the correction continues, Ontario's economy is expected to stall this year.

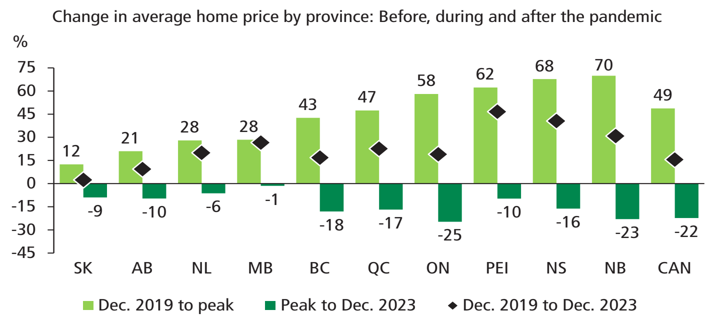
But it isn't all bad news. In recent years, Ontario has attracted nearly half of the new immigrants to Canada. Along with falling interest rates and solid household savings, this will provide a foundation for the housing market recovery that we anticipate to begin before the end of 2023. As a consequence, sales activity should return to roughly its pre-pandemic pace by the end of 2024. Meanwhile, the average home price in Ontario could ultimately end 2023 nearly 25% below the pandemic peak before gradually moving higher (graph 12).

GRAPH 11
Price declines have varied widely across provinces



Sources: Canadian Real Estate Association and Desjardins Economic Studies

GRAPH 12
Home prices may fall but should keep some of their pandemic gains

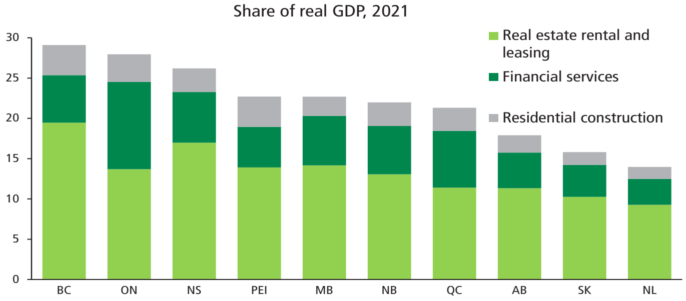


Sources: Canadian Real Estate Association and Desjardins Economic Studies

British Columbia

British Columbia finds itself in a similar situation to Ontario. A substantial share of its economy is linked to the real estate sector, and it's been hit particularly hard by the interest-rate-driven decline in housing market activity as a result (graph 13). However, much like Ontario, it continues to welcome large numbers of newcomers, which should help to underpin the residential real estate rebound as interest rates keep coming down.

GRAPH 13
BC and Ontario are the most vulnerable provinces to a housing downturn



Sources: Statistics Canada and Desjardins Economic Studies

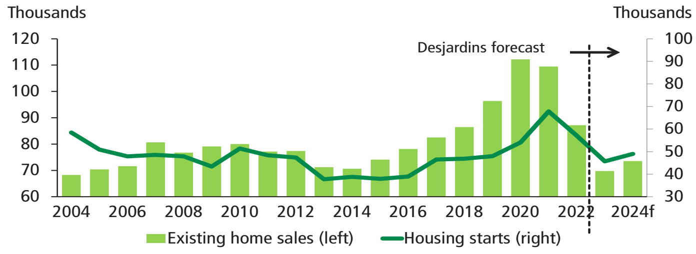
Quebec

Quebec's housing sector will continue to deteriorate in the coming months. Housing starts declined 15.8% in 2022 and are projected to fall another 20% this year. We expect 45,700 new homes to be built in 2023, the fewest since 2016. Although immigration has resumed after the pandemic hiatus, it hasn't been enough to spur new construction. Due to high interest rates, developers are struggling to turn a profit, especially on rentals.

Like last year, existing home sales will likely decline 20% in 2023, approaching a 10-year low (graph 14). In December, prices were already down 6.9% from their April 2022 peak. That figure is expected to hit 17% by the end of the year.

But real estate activity should gradually pick up in 2024. Affordability will improve significantly on lower mortgage rates and home prices, which are down from their 2022 peak. As existing home sales rebound, prices should slowly start to recover in 2024.

GRAPH 14
In Quebec, existing home sales and housing starts are expected to fall again this year before rebounding in 2024



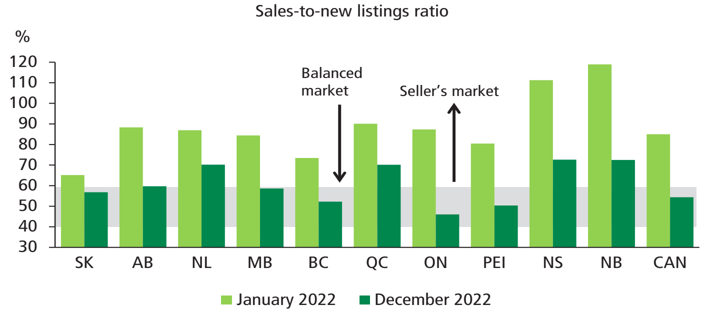
Sources: Canadian Real Estate Association, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

Atlantic provinces

One of the biggest surprises of 2022 was the resiliency of the housing markets of the Maritime provinces—New Brunswick, Nova Scotia and Prince Edward Island. Despite seeing the largest run-up in prices in Canada during the pandemic, prices have yet to adjust as much as they have in Central Canada or British Columbia. As a result, most of these markets remain in seller's territory (graph 15). This partly reflects the surge in outward migration from Ontario to Atlantic Canada that persisted through 2022. However, we may be seeing the early stages of a reversal in that trend, as push from pandemic-related migration has now subsided.

Commodity-producing provinces are also increasingly a draw for Canadians, thanks to greater affordability and the promise of well-paid employment. In Newfoundland and Labrador, stronger economic growth anchored by rallying oil production may help offset any drag from weaker interprovincial migration.

GRAPH 15
Most but not all provincial housing markets have returned to balance

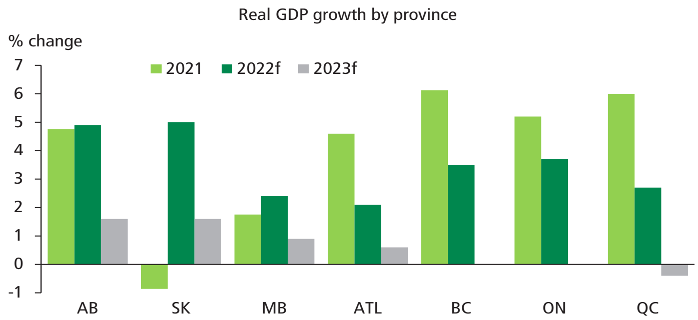


Sources: Canadian Real Estate Association and Desjardins Economic Studies

Prairie provinces

Commodity-driven growth also characterizes the outlook for the Prairie provinces, which are expected to be at the top of the growth leader board in 2023 (graph 16). And that relative economic outperformance should be reflected in their housing markets as well. These provinces are likely to not just benefit from high commodity prices, but also an influx of newcomers to Canada and Canadians from other provinces looking for employment opportunities and more affordable housing options. Indeed, cities like Calgary, Edmonton and Winnipeg rank among the most affordable in the country. These factors should support sustained residential investment in spite of still-elevated interest rates.

GRAPH 16
The Prairies should experience the mildest economic slowdown



Sources: Statistics Canada and Desjardins Economic Studies

Conclusion

Canada's housing market has corrected significantly from the frenetic pace of activity during the pandemic. Going forward, we expect sales activity to grind gradually lower through 2023 before rebounding in the second half of the year and into 2024. This is likely to result from falling borrowing costs as cooling inflation eventually opens the door to rate cuts by the Bank of Canada. Support for the housing market will also come from elevated levels of immigration.

TABLE
Canada: Major housing market indicators by province

ANNUAL AVERAGE IN % (UNLESS OTHERWISE INDICATED)	2019	2020	2021	2022	2023f	2024f
Existing home sales – Canada	**6.5**	**12.6**	**20.5**	**-25.2**	**-20.7**	**16.7**
Newfoundland and Labrador	9.7	14.7	45.5	-7.1	-19.8	1.1
Prince Edward Island	-6.8	9.7	14.8	-17.9	-28.8	20.0
Nova Scotia	10.9	13.2	14.1	-21.6	-19.2	6.4
New Brunswick	12.6	13.7	22.4	-20.5	-26.3	2.3
Quebec	11.5	16.4	-2.4	-20.4	-19.9	5.4
Ontario	9.0	8.8	18.5	-32.3	-18.4	26.7
Manitoba	8.5	14.3	17.2	-20.2	-19.9	10.6
Saskatchewan	1.5	24.6	24.1	-11.7	-16.8	2.6
Alberta	-0.1	4.3	53.6	-1.9	-21.9	2.4
British Columbia	-1.5	21.5	32.9	-35.2	-26.0	29.7
Average home prices – Canada	**2.5**	**12.9**	**21.3**	**2.4**	**-9.6**	**4.0**
Newfoundland and Labrador	-3.3	3.1	9.9	6.7	2.2	1.6
Prince Edward Island	12.2	18.8	20.6	13.6	-4.1	5.4
Nova Scotia	7.9	13.7	23.1	14.8	-7.5	-2.9
New Brunswick	2.9	10.5	26.0	17.5	-12.1	-8.7
Quebec	5.2	16.4	16.4	10.3	-11.0	-0.2
Ontario	6.4	16.0	23.6	6.8	-9.1	0.8
Manitoba	-0.1	4.4	9.8	8.1	-2.8	4.9
Saskatchewan	-0.4	2.5	6.9	0.6	-6.5	3.5
Alberta	-2.7	1.2	9.2	5.3	-2.7	1.0
British Columbia	-1.5	11.6	18.7	7.5	-10.0	0.2
Housing starts – Canada	**-2.0**	**4.4**	**24.5**	**-3.4**	**-19.5**	**2.0**
Newfoundland and Labrador	-13.8	-19.3	33.8	35.1	-23.0	20.0
Prince Edward Island	38.1	-22.7	8.4	4.6	-7.9	16.3
Nova Scotia	-1.4	3.1	22.8	-4.4	-7.0	0.6
New Brunswick	26.1	18.7	9.9	22.2	-21.5	1.0
Quebec	2.3	12.7	25.4	-15.8	-20.0	7.2
Ontario	-12.4	17.9	22.5	-3.5	-14.2	-3.5
Manitoba	-5.8	5.3	9.7	0.9	-25.3	-2.5
Saskatchewan	-32.8	27.2	35.1	0.9	-27.2	9.5
Alberta	4.8	-12.1	32.9	14.4	-34.4	0.8
British Columbia	10.0	-16.0	26.2	-1.9	-18.8	6.7

f: forecasts
Sources: Canadian Real Estate Association, Canada Mortgage and Housing Corporation and Desjardins Economic Studies.