ECONOMIC VIEWPOINT

Desjardins Housing Outlook: Don't Expect Affordability to Be Restored This Year or Next

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Highlights

- Despite a late-2023 housing market uptick, our updated forecast still sees home sales and prices softening somewhat this spring. This reflects our expectation that still-high interest rates and economic weakness will weigh down homebuying activity.
- We also still think that high rates, elevated building costs and construction sector labour shortages will push homebuilding below 2023 levels this year.
- Once the Bank of Canada reduces interest rates towards the middle of the year, we should see a broad-based rebound in sales and prices later in 2024. We expect the strongest of those gains to come in Ontario and BC—where buying tends to be most sensitive to interest rate movements—following tougher first-half economic conditions.
- The key takeaway from this report, however, is that we do not foresee overall homeownership affordability returning to pre-pandemic levels within the next two years. That result holds up even in the event of a more severe recession than we assume in our base case forecast, where interest rates come down more quickly.

FORECAST OVERVIEW

Year-End Momentum

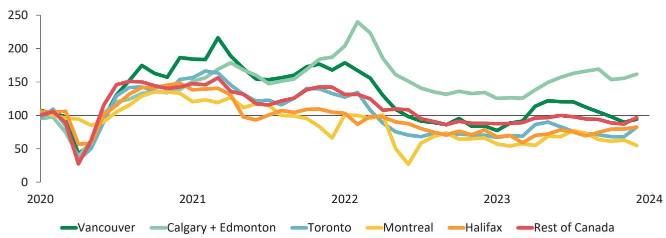
A broad-based surge in home sales in the final month of last year has increased the annual growth rates we're forecasting for sales and prices for Canada and most provinces in 2024. This is an arithmetic effect. We still expect several factors to weigh down sales and prices in the spring months; it is largely just the starting point that has changed. That said, price and sales contraction forecasts for Prince Edward Island and British Columbia (BC) respectively this year largely reflect weak handoffs from steep drops experienced late in 2023. Our expectation of weak housing demand in the first half mirrors the mild Canadian recession we're forecasting in Q1 and Q2. Moreover, the drag from still-high interest rates should continue to make qualifying for a mortgage challenging for many prospective buyers.

Interest Rates in Focus

We also continue to anticipate a broad-based rebound in home prices in the second half of 2024 that will carry into 2025. That reflects our view that the Bank of Canada will reduce borrowing costs towards the middle of this year. Our base case forecast assumes that the strongest rebounds will come in and around the higher-priced Toronto and Vancouver markets, as they tend to be more responsive to interest rate movements. However, those relatively strong bounce-backs will follow greater weakness than in the other provinces during the winter and spring. We anticipate that Ontario and BC will be among the provinces most impacted by the coming slowdown. By contrast, Alberta's economy should be spared the worst, with momentum in its major markets entering 2024 boding well for a relatively strong first half (graph 1 on page 2).

Graph 1
Alberta Housing Markets Enter 2024 with Momentum

Existing home sales
Index, 2019 = 100



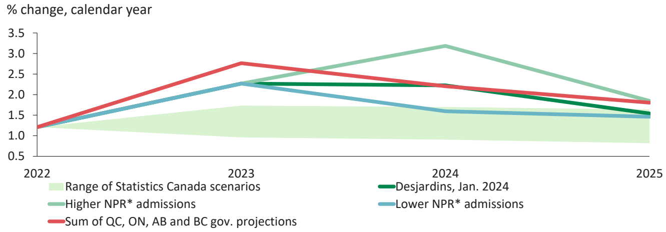
Canadian Real Estate Association, JLR and Desjardins Economic Studies

There remains uncertainty about how homebuyers will respond to lower interest rates. In our last housing outlook, we highlighted the potential for bond yields to move lower before the Bank of Canada actually begins cutting. Indeed, we've already seen the 5-year Canadian bond yield fall by about 90 basis points from its October peak, and this could help spur an early recovery. Healthy expectations for future price gains and an apparent increase in buying interest among renters support this idea and imply limited potential for a serious price correction as economic conditions sour. At this stage, however, our base case still assumes the rebound begins in earnest only after the worst of labour market softness is behind us and more meaningful rate relief has been delivered.

Against this backdrop, we expect strong population growth to remain a tailwind for housing market activity. Although we anticipate a significant slowing of non-permanent resident (NPR) admissions—the primary driver of the recent headcount surge—overall population growth should remain vigorous relative to history (graph 2).

Graph 2
Demographics Present Significant Upside Potential for Canada's Housing Markets This Year

Canadian population growth projections
% change, calendar year



* NPR: Non-permanent resident
Statistics Canada and Desjardins Economic Studies

Moderate Price Growth by Recent Standards

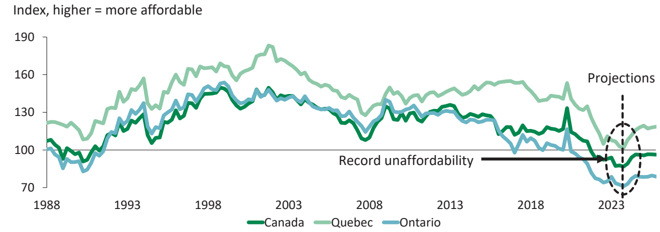
We're anticipating a return to price gains by the end of 2024, but the rate of growth in our baseline projections is mild by historical standards. At a peak national level rate of just under 4%, forecast quarterly price increases for H2 2024 and H1 2025 pale in comparison to the advances seen during the pandemic as well as much of the late-2010s. This reflects our assumption of an economic recovery that is similarly mild by historical standards. Still-stretched affordability across much of the country and the sharply higher mortgage payments that many homeowners will be making at renewal also inform this view.

AFFORDABILITY OUTLOOK

Even with our forecast for a mild recession, an eventual reduction in interest rates and modest price gains, we don't anticipate a return to pre-pandemic affordability levels within the next two years (graph 3). That primarily reflects a very unaffordable starting point. It's also important to highlight that while periods of softer economic activity do tend to result in weaker home price growth, they also mean poor income growth. Moreover, while we expect mortgage rates to come down from current levels over the next two years, they won't likely reach the rock-bottom levels of the pandemic or the early 2010s. For more details on how Desjardins measures housing affordability, see the appendix.

Graph 3
A Return to Pre-pandemic Affordability Is Unlikely in the Next Two Years

Desjardins Affordability Index*
Index, higher = more affordable

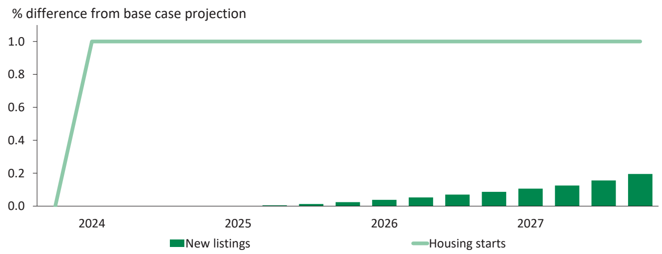


* Assumes a 20% down payment
Canadian Real Estate Association and Desjardins Economic Studies

We also still expect residential construction activity to slow meaningfully this year across the country. Labour shortages, very weak homebuilder sentiment, and still-high interest rates and building costs all point to much weaker construction activity going forward. We've also highlighted that in Toronto and Vancouver, projects financed before borrowing costs surged and the macroeconomic backdrop soured have anchored activity in recent months. Those two cities accounted for much of last year's surprising resilience in housing starts.

Our forecast focuses on the next two years, and as such does not include a significant impact on affordability from ongoing government efforts to boost the housing supply. Of course, we welcome policymakers' attention to reducing barriers to new building, but it takes time for new builds to come to market. Our estimates for Canada's housing market—which guide our projections—appear to confirm this (graph 4). Moreover, as we highlighted earlier this year, the residential construction sector faces a range of challenges beyond those related to the economic cycle.

Graph 4
New Builds Take Time to Hit the Market
Estimated impact of a 1% permanent increase in Canadian housing starts



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This doesn't mean we should give up on efforts to improve housing affordability. Meeting our targets on that front has always been a longer-term objective, and we've argued multiple times that the public discourse should recognize this rather than pointing fingers. And there's even more that can be done to increase Canada's housing supply, both by building more and repurposing existing assets.

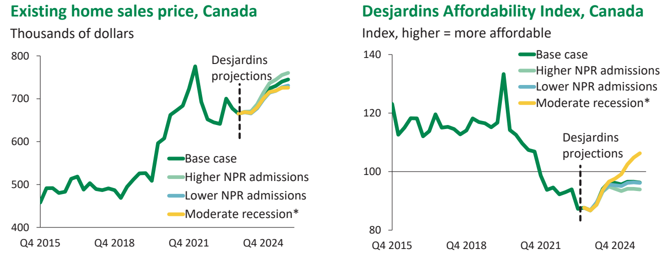
SCENARIO ANALYSIS

With much uncertainty about the outlook at the time of writing, we used Desjardins's econometric framework of Canada's economy to predict possible paths for home values and affordability in the next two years. Like our base case forecast, alternative scenarios do not suggest a return to pre-pandemic affordability by the end of next year (graph 5).

In our first two scenarios, we projected home sales and prices under the high- and low-NPR admission scenarios we discussed in January. To do so, we adjusted trend and actual unemployment, population growth and interest rates under those two alternative trajectories and observed how the broader economy reacted.

Our third scenario assumed a recession more severe than we're projecting in our base case. We changed real GDP according to the pattern seen during three prior recessions: the 1980s downturn, the 1990s recession and the Global Financial

Graph 5
A Return to Pre-pandemic Affordability Levels Is Unlikely during the Forecast Window



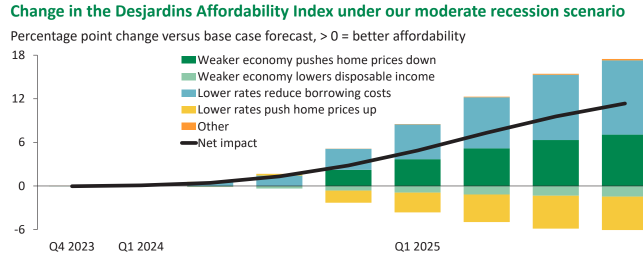
* Recession scenario is based on 1980s and 1990s recessions plus the Global Financial Crisis
Canadian Real Estate Association and Desjardins Economic Studies

Crisis (GFC). We also incorporated a reduction in interest rates, which would almost certainly be prompted by economic conditions weaker than our base case.

Our analysis illustrates how different parts of the economy can work at cross purposes when it comes to affordability. Our recession scenario shows that softer economic conditions could be expected to reduce home prices relative to the baseline. But they'd also reduce the income available to purchase a home. By the same token, lower interest rates would reduce mortgage carrying costs but increase the size of the mortgage by stimulating upward price pressure (graph 6).

Graph 6
Counteracting Forces Could Prevent Bigger Affordability Improvements

Change in the Desjardins Affordability Index under our moderate recession scenario



Statistics Canada, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

The aggregate recession-induced affordability improvement forecast for the next two years may not be significant, but the economic and social costs certainly would be. Relative to the baseline, our recession scenario is associated with a nearly $25 billion reduction in disposable income and more than 350k fewer jobs by the end of 2025. And this analysis does not delve into the implications of structural economic changes or longer-term unemployment that could be expected to come following an extended economic downturn.

APPENDIX: THE DESJARDINS AFFORDABILITY INDEX

The Desjardins Affordability Index (DAI) measures the aggregate level of homeownership affordability for the Canadian, Quebec and Ontario economies. It's equal to the average per-household disposable income divided by the household income required to qualify for a mortgage. The qualifying income series incorporates home prices, mortgage rates and homeownership costs such as property taxes and utilities.

The details of these calculations are important. Disposable income and home prices are forecast in Desjardins's Economic and Financial Outlook (EFO), while household projections are linked to the population forecasts also contained in the EFO. We use the Canada Mortgage and Housing Corporation's conventional five-year mortgage lending rate to measure debt servicing costs for mortgage holders, and forecast that lending rate using bond rate projections from the EFO. For ease of comparability across higher- and lower-priced markets, we base mortgage payment calculations on a 20% down payment. Homeownership costs are assumed to grow in line with the total consumer price index.

Look for more detailed projections and scenario analyses for other Canadian jurisdictions in the months ahead.

FORECAST DETAILS

TABLE 1
Canada: Major housing indicators by province

	2019	2020	2021	2022	2023	2024f	2025f
ANNUAL % CHANGE (UNLESS OTHERWISE INDICATED)							
Existing home sales – Canada	**6.4**	**12.4**	**20.8**	**-25.1**	**-11.1**	**3.5**	**11.5**
Newfoundland and Labrador	9.7	14.7	45.5	-7.2	-15.2	5.3	8.7
Prince Edward Island	-6.8	9.7	14.8	-18.2	-4.9	3.9	8.1
Nova Scotia	10.9	13.2	14.1	-21.7	-17.2	9.3	7.8
New Brunswick	12.5	13.7	22.4	-20.5	-13.5	2.8	6.5
Quebec	11.1	16.5	-2.5	-20.4	-12.7	2.2	10.5
Ontario	9.0	8.5	19.1	-32.0	-12.3	2.3	12.9
Manitoba	8.5	14.3	17.2	-20.1	-10.0	5.8	8.0
Saskatchewan	1.5	24.6	24.1	-11.7	-3.3	9.5	10.1
Alberta	-0.1	4.3	53.6	-1.9	-9.0	12.2	11.2
British Columbia	-1.4	21.2	32.8	-35.1	-9.2	-4.0	12.2
Average home resale price – Canada	**2.5**	**12.9**	**21.2**	**2.4**	**-3.6**	**3.1**	**8.0**
Newfoundland and Labrador	-3.3	3.1	9.9	6.7	0.6	3.4	5.7
Prince Edward Island	12.2	18.8	20.6	13.8	-1.6	-4.0	8.2
Nova Scotia	7.9	13.7	23.1	14.8	2.9	5.9	7.4
New Brunswick	2.9	10.5	25.9	17.6	2.7	2.4	4.1
Quebec	5.2	16.4	16.4	11.3	-0.1	2.1	6.8
Ontario	6.4	16.2	23.4	6.7	-6.3	3.0	7.6
Manitoba	-0.1	4.4	9.8	7.9	-3.2	5.2	6.0
Saskatchewan	-0.4	2.5	6.9	0.6	-0.6	0.9	5.7
Alberta	-2.7	1.2	9.2	5.3	0.7	5.0	9.8
British Columbia	-1.4	11.6	18.5	7.5	-2.6	2.1	10.0
Housing starts – Canada (thousands)	**208.7**	**217.8**	**271.2**	**261.8**	**240.3**	**219**	**235**
Newfoundland and Labrador	0.9	0.8	1.0	1.4	1.0	1.0	1.3
Prince Edward Island	1.5	1.2	1.3	1.3	1.1	0.8	1.1
Nova Scotia	4.7	4.9	6.0	5.7	7.2	6.0	5.6
New Brunswick	2.9	3.5	3.8	4.7	4.5	3.8	4.0
Quebec	48.0	54.1	67.8	57.1	38.9	45.2	54.0
Ontario	69.0	81.3	99.6	96.1	89.3	73.0	76.0
Manitoba	6.9	7.3	8.0	8.1	7.1	6.5	7.0
Saskatchewan	2.4	3.1	4.2	4.2	4.6	4.5	4.5
Alberta	27.3	24.0	31.9	36.5	36.0	37.0	39.0
British Columbia	44.9	37.7	47.6	46.7	50.5	41.0	42.0

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