ECONOMIC VIEWPOINT

Will Canada's Housing Market Lose Steam Any Time Soon?

By Benoit P. Durocher, Senior Economist, and Hendrix Vachon, Senior Economist

In most parts of Canada, the housing market has been exceptionally strong for the last few months. A number of factors lie behind the upswing, with the pandemic creating numerous market distortions. As the lockdown lifts, however, we can expect the situation to slowly get back to normal. That said, some positive factors will persist. Under these conditions, our forecasts call for the housing market to stabilize soon in most parts of the country. The uptrend should moderate rapidly following the rapid price growth seen in the last few quarters. Substantial risks persist, however. On one hand, the housing market could surprise us again with vitality that lasts longer than anticipated. On the other, we cannot rule out the possibility that the housing market will correct more than expected in the coming quarters.

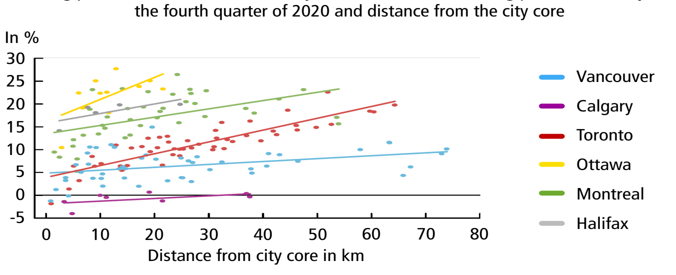
A Combination of Several Positive Factors

The housing market vitality recorded in most parts of Canada in the last few months is due to a combination of several factors. For one thing, the pandemic had fairly large direct repercussions on the housing market. Working from home and the lockdown caused many households to take another look at their housing needs. Among other things, there is a stronger preference for spacious homes. Demand for homes with a private yard in the suburbs of major cities or in rural areas has thus increased sharply, resulting in faster price growth for this type of housing (graph 1). We are also seeing stronger price growth for single-family homes (graph 2). Demand for vacation properties has also increased.

Moreover, the closure of many sectors of the economy during the pandemic limited consumption choices, which steered some consumer spending into the real estate market. Simultaneously, the various government assistance measures led to a big increase in households' disposable income. This helped boost savings, some of which may have been used to put a down payment on a property (graph 3 on page 2). The rise in savings was sharper among people with higher incomes, who are also more likely to buy a property (graph 4 on page 2). Financial institutions also helped households by allowing those affected by the pandemic to defer their payments. This seems to have curbed the number of bankruptcies and therefore the number of homes going onto the market.

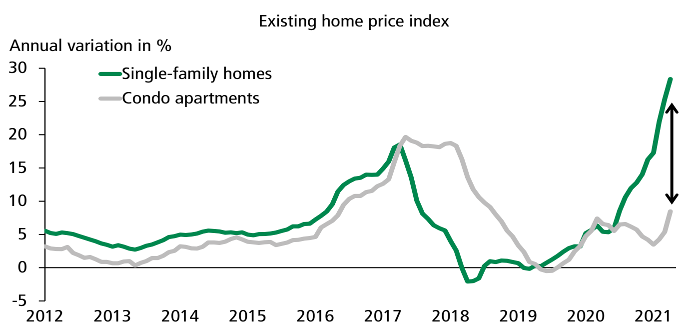
GRAPH 1
With telework, the pandemic changed the housing market's dynamics

Housing prices rose faster outside of city cores – Growth of housing prices over one year in the fourth quarter of 2020 and distance from the city core



NOTE: Each point represents a forward sortation area (a geographical unit based on the first three characters in a Canadian postal code). The lines are trend lines expressing the average relation in each city between housing price growth and the distance to the city core.
Source: Bank of Canada's April 2021 *Monetary Policy Report*

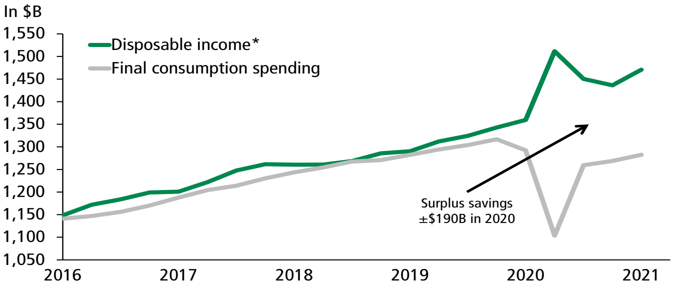
GRAPH 2
Canadians are looking for more living area



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 3
Disposable income and savings exploded in 2020

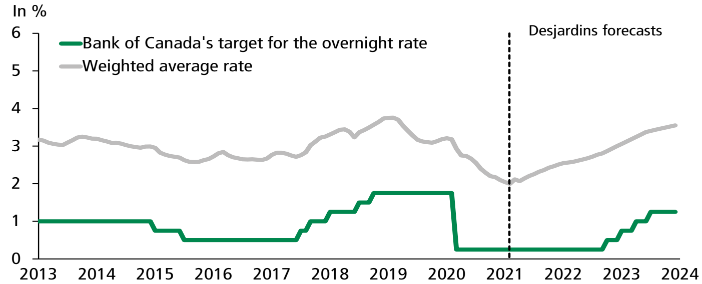
Canada – Households



* Including the variation in pension benefits.
Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 5
After declining in the last few quarters, mortgage rates should start to come back up

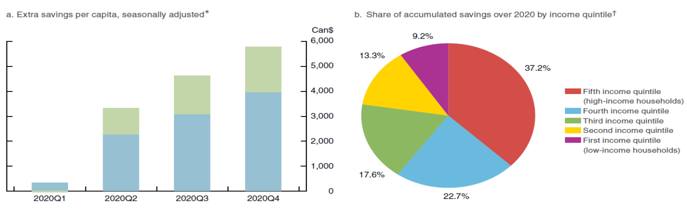
Weighted average interest rate on cash advances



Sources: Bank of Canada and Desjardins, Economic Studies

GRAPH 4
The rise in savings is primarily concentrated in the higher income brackets

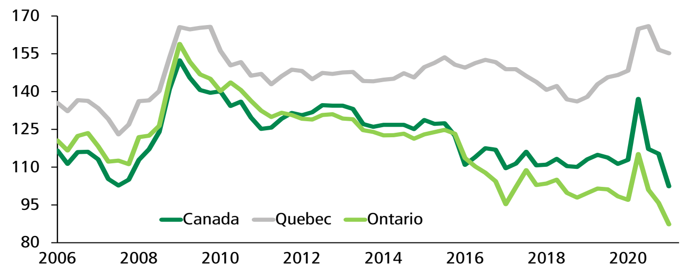
Canadians amassed an average of $5,800 in surplus savings in 2020



* Spending shortfalls and disposable-income gains are deviations from linear trends calculated from 2016 to 2019. The chart shows the accumulation of savings over 2020 for each quarter. The bar for the fourth quarter shows the total for 2020.
† Extra savings by income quintile are calculated using model simulations. Further details can be found in J. MacGee, T. M. Pugh and K. See, "The Heterogeneous Effects of COVID-19 on Canadian Household Consumption, Debt and Savings," Bank of Canada Staff Working Paper No. 2020-51 (November 2020).

Source: Bank of Canada's April 2021 *Monetary Policy Report*

GRAPH 6
The Desjardins Affordability Index contracted in the first quarter of 2021



Sources: Statistics Canada, Canadian Real Estate Association, JLR Land Title Solutions, Equifax Company, Conference Board of Canada and Desjardins, Economic Studies

Various industry players and the media also reported that the number of divorces and separations has increased since the start of the pandemic. This would create additional demand for housing. However, no official statistics have been released so far to validate the scope of the phenomenon. Since the start of the pandemic, elderly homeowners have been in less of a rush to sell their homes and move into a seniors' residence, where living conditions have become less appealing.

In addition to these factors, interest rates fell in 2020, making it easier to buy property (graph 5). In fact, our affordability index improved substantially last spring (graph 6). However, it has tended to deteriorate in the last few months, as property prices are going up rapidly and interest rates are starting to rise again. Affordability seems to be declining less in Quebec, but that is partly due to the fact that a different data source is used for Quebec.[1] In the first quarter of 2021, Quebec's income growth has also been better, another explanation for the differing evolution of affordability.

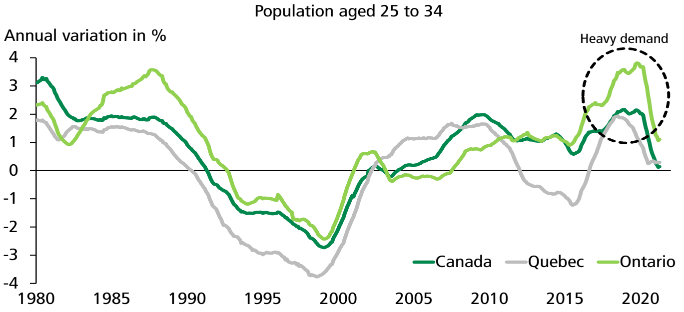
Lastly, the number of Canadians aged 25 to 34 has been rising sharply in recent years (graph 7 on page 3). This age group generally guides the trend for the number of first-time buyers. However, there was no boom in Canada's housing market between 2016 and 2019 (graph 8 on page 3). Perhaps the higher interest rates in those years put some potential first-time buyers off. Affordability was also fairly low in several markets. Under these conditions, pent-up demand may have accumulated, which is now being released.

All in all, a major imbalance between housing market supply and demand has materialized in the last few months. The number of properties sold has shot up since mid-2020 in all provinces. The number of property sales shattered a historic record in March or April in all provinces except Quebec. Quebec hit the

[1] For Quebec, the data on property prices comes from JLR Land Title Solutions, an Equifax company; for the rest of Canada, the data comes from the Canadian Real Estate Association (CREA). The Quebec data is recorded when the property is transferred at the notary's; data for the rest of Canada is recorded when the purchase offer is signed, before the visit to the notary. There may therefore be a lag of three to six months between the CREA and JLR data.

GRAPH 7
The first-time buyer cohort has now seen a few years of strong growth

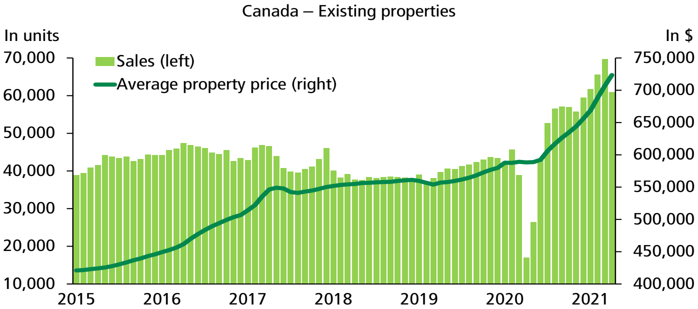
Population aged 25 to 34



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 8
Despite the large first-time buyer potential, no boom occurred in the housing market between 2016 and 2019

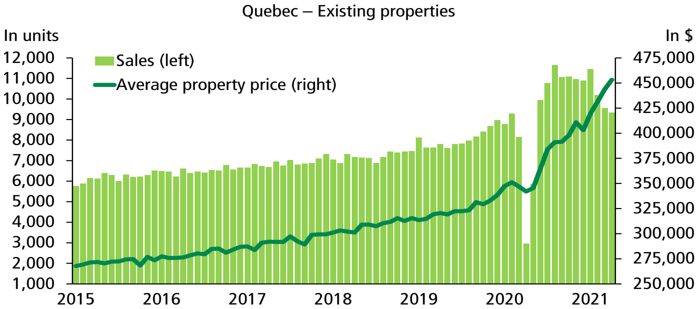
Canada – Existing properties



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 9
Housing is showing good momentum in Quebec

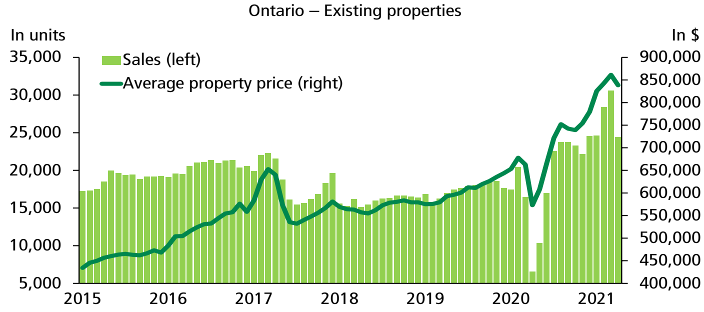
Quebec – Existing properties



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 10
Ontario's housing market is also strong

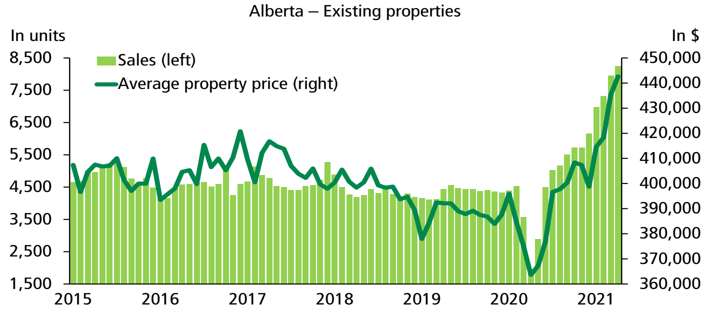
Ontario – Existing properties



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 11
In Alberta, housing market growth has picked up speed since the pandemic started

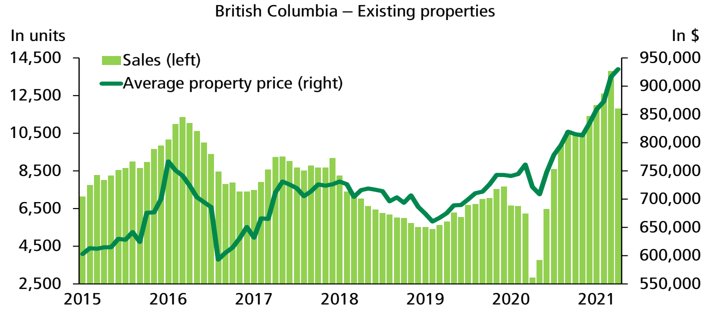
Alberta – Existing properties



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 12
British Columbia's housing market has been going strong since 2019

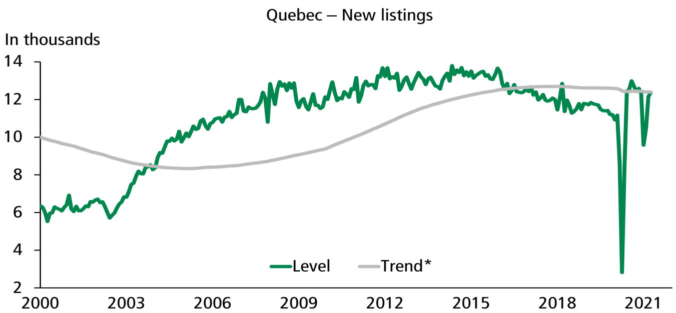
British Columbia – Existing properties



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

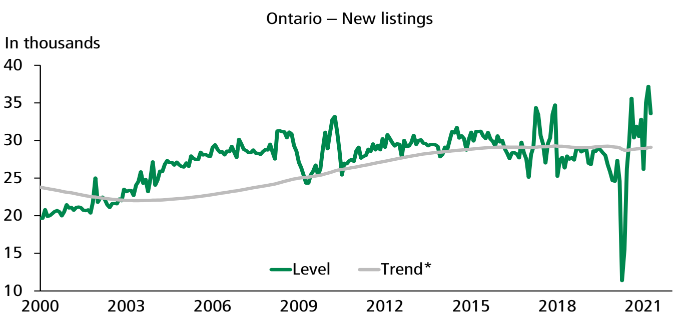
peak a little earlier, in August 2020. This resulted in a major rise in property prices, which also hit a historic high recently in most provinces (graphs 9 to 12). In tandem with rising prices, new listings have also gone up in the last few months in most provinces (graphs 13 to 16 on page 4). The increase in the supply is not enough to keep up with the strong growth in the number of transactions, however. Among other things, the increase in listings is not enough to offset the lag accumulated in Quebec in prior years. Therefore, the sales to new listings ratio is historically very high in Quebec, Ontario and in several other regions of Canada (graph 17 on page 4), leading to upward pressure on prices.

GRAPH 13
New listings are up in Quebec, without wiping out the lag of recent years



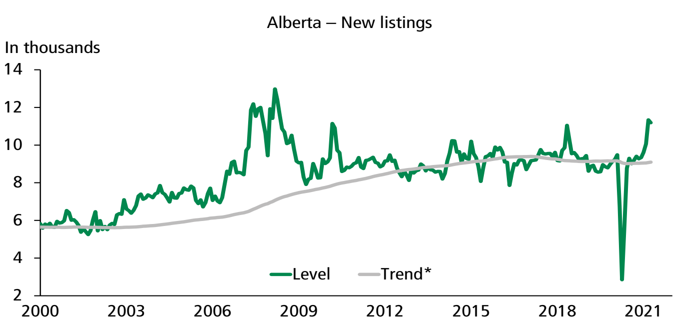
* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 14
In Ontario, new listings are above the long-term trend



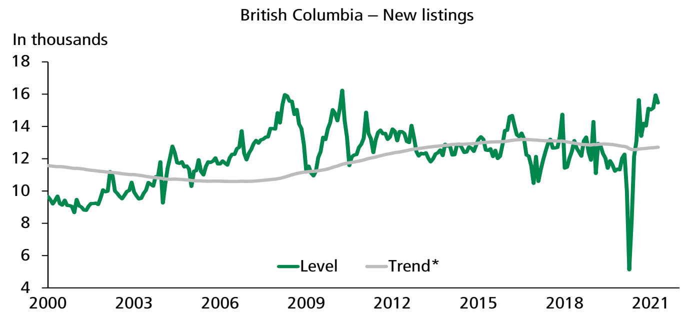
* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 15
New listings increased recently in Alberta



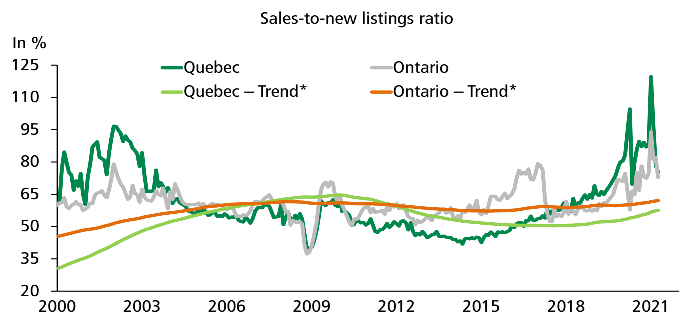
* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 16
In British Columbia, new listings are high from a historical perspective



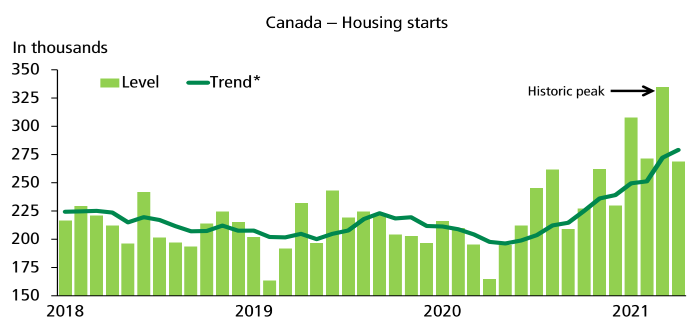
* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 17
Major imbalance between supply and demand in Quebec and Ontario



* 10-year moving average.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 18
Housing starts are trending up in Canada

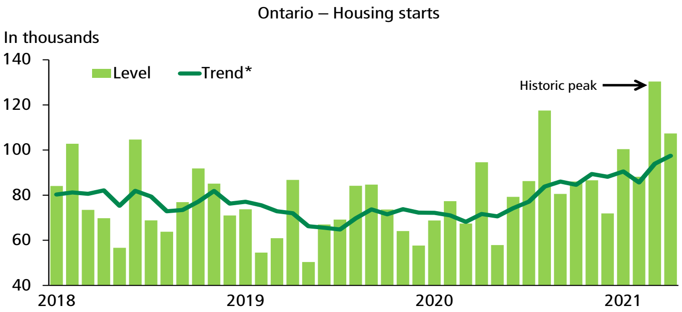


* 6-month moving average.
Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

In a context of scarcity, more potential buyers go after the same properties. This increases the phenomenon of multiple offers and bidding wars, accelerating price growth. According to the industry, offers with no visit or inspection have increased. However, no official public data is available to properly assess the magnitude of these phenomena.

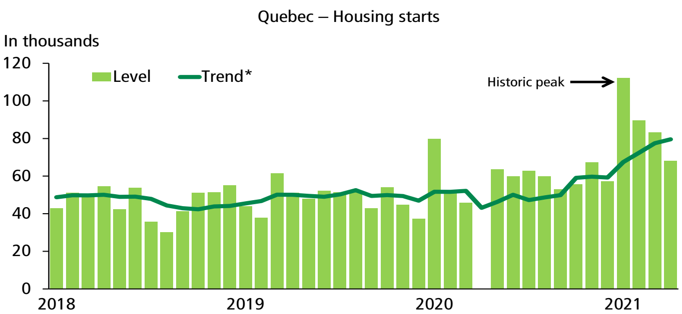
The scarcity of homes for sale is giving a strong impetus to new construction. In Canada, and in Ontario, housing starts hit a record peak last March (graphs 18 and 19 on page 5). Quebec hit a peak in January 2021 (graph 20 on page 5). Housing starts have declined slightly since then but still remain high. In fact, there is a limit to increasing the supply in the new construction

GRAPH 19
Housing starts are also trending up in Ontario



* 6-month moving average.
Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

GRAPH 20
The trend for housing starts accelerated recently in Quebec



* 6-month moving average.
Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

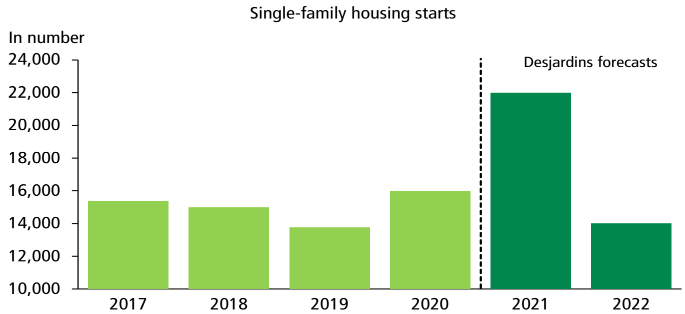
GRAPH 21
Construction costs are shooting up, particularly in Montreal

Sources: Statistics Canada and Desjardins, Economic Studies

segment. In terms of workers, equipment and materials, capacity is limited. This is affecting construction costs, which have shot up in the last few quarters (graph 21).

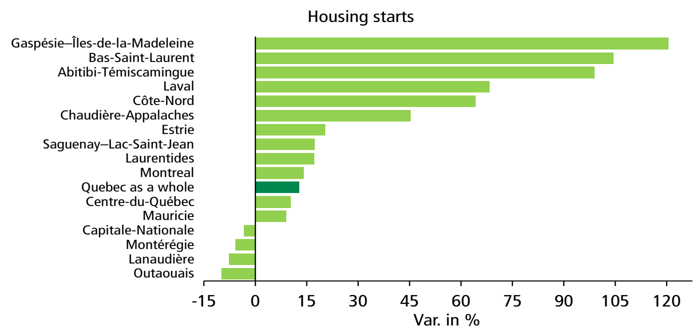
The pressure is even higher on single-family home construction. After declining for a number of years, buyers' change in preference have given this segment of the housing market new

GRAPH 22
Single-family home construction is forecast to rebound substantially in Quebec



Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

GRAPH 23
New construction accelerated in Quebec's remote regions in 2020



Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

momentum (graph 22). Moreover, remote regions seem to have more benefited from the rebound in construction (graph 23). These regions also have more lots available for building single-family residences.

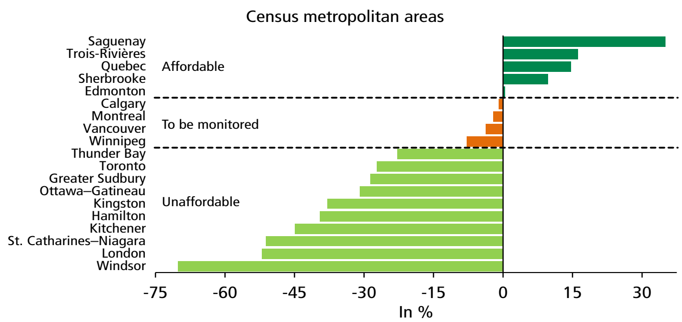
Together, these pressures mean that new home buyers must cope with higher monthly payments. Take, for example, a typical household that buys an existing property at the average price with a minimum down payment and 25-year amortization (table 1 on page 9). For Canada as a whole, the average resale price went from $587,500 in February 2020 to $723,500 in April 2021. This price increase was partially offset by a drop in the weighted average mortgage rate, which was at 2.07% in April, compared with 3.18% in February 2020. All in all, the monthly payment on purchasing a property increased $223 from February 2020 to April 2021 for typical Canadian buyers, which represents an increase of 8.0%. Annually, the increase is $2,676, a significant amount, especially for first-time buyers. However, there are major differences from region to region. For the typical household, the increase in monthly payments is $242 (+13.5%) in the Greater Montreal area and $171 (+4.3%) in the Greater Toronto area. In contrast, Calgary saw a typical household's monthly payments decline $92 (-4.6%), while

Greater Vancouver is showing a decrease of $72 (-1.5%). In the latter two cases, the drop in interest rates more than offset the price increase.

The Situation Is Expected to Calm Down after the Pandemic

It is hard to believe that the housing market's current strength will last for several more quarters. Already, the recent increase in longer-term interest rates and higher property prices is hurting accessibility. The issue is particularly serious in Ontario, where several census metropolitan areas (CMAs) were in unaffordable territory in the first quarter of 2021 (graph 24). The situation seems less critical in most parts of Quebec, and four CMAs even remain affordable.

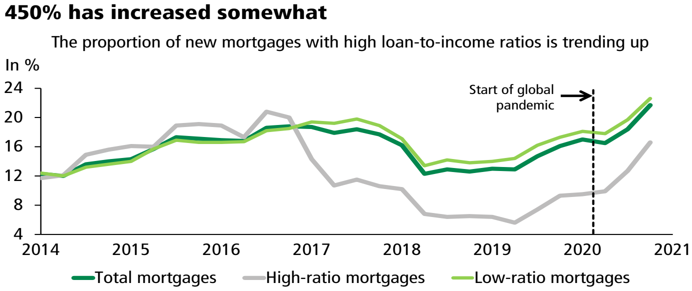
GRAPH 24
Spread between the Desjardins Affordability Index and its historical average in the first quarter of 2021



Sources: Statistics Canada, Canadian Real Estate Association, JLR Land Title Solutions, Equifax Company, Conference Board of Canada and Desjardins, Economic Studies

The surge in property prices is also foregrounding the concerns over excessively high household debt loads. In a recent report, the Bank of Canada stressed that a growing proportion of households are taking on a level of debt that is deemed problematic (graph 25). The debt-service ratio, which shows the evolution over time of interest and principal repayment costs, is also a good indicator of the debt's sustainability. In Canada,

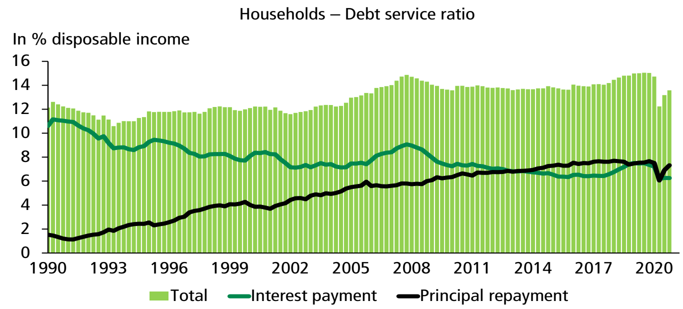
GRAPH 25
The share of new mortgages with a loan-to-income ratio above 450% has increased somewhat



NOTE: Data include purchases and refinancing originated by federally regulated financial institutions. High-ratio mortgages have a loan-to-value ratio greater than 80% and must be insured. Low-ratio mortgages have a loan-to-value ratio of 80% or less.
Source: The Bank of Canada's April 2021 *Update on housing market imbalances and household indebtedness*

this ratio was already high, historically speaking, before the pandemic. Interest rates dropped at the start of the pandemic, which helped the ratio improve, but rates are already tending to rise again (graph 26), mainly because property prices have gone up. With mortgage rates forecast to rise, the debt-service ratio should quickly soar to new heights.

GRAPH 26
Debt service declined at the start of the pandemic, but is now starting to trend up again in Canada



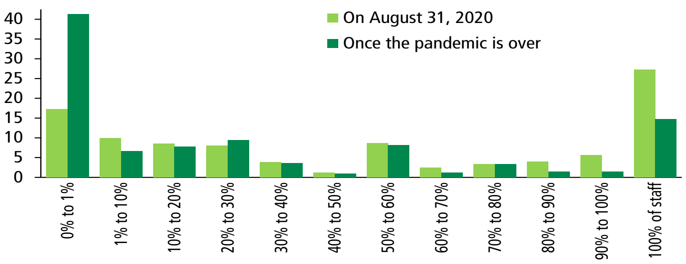
Sources: Statistics Canada and Desjardins, Economic Studies

Governments and regulators are very aware of the risks created by the effervescent real estate market, particularly for financial stability. The Office of the Superintendent of Financial Institutions (OSFI) and federal government recently announced new macroprudential measures. Among other things, since June 1, the minimum qualifying rate for uninsured mortgages (home mortgages with a down payment of at least 20%) is the greater of the mortgage contract rate plus 2.00% or 5.25%. This means it is now harder to qualify for a mortgage.

In the long run, price evolution will continue to be dictated by supply and demand. The high prices and rising interest rates are likely to discourage future buyers, particularly first-time buyers. At the same time, high prices will likely continue to encourage sellers, particularly those who have stayed on the sidelines because of the pandemic. The combination of softer demand and a bigger supply would help to gradually rebalance the market. Normally, this would argue for more subdued price growth or even slight price decreases in some places.

The ending of the pandemic should also see some adjustments in the housing market. First, the elimination of lockdown measures, including the end of full-time teleworking for some workers, will make large, remote homes less popular. At the very least, buyers could become less inclined to pay a premium for this type of home. A survey of Canadian businesses revealed that most of them plan to return to a situation in which teleworking represents a smaller proportion of work (graph 27 on page 7) than it did during the pandemic. Subsequently, the reopening of all parts of the economy will redirect spending. People will start to travel again, go to the restaurant, and have fun outside

GRAPH 27
Most businesses will privilege on-site work or a hybrid model after the pandemic

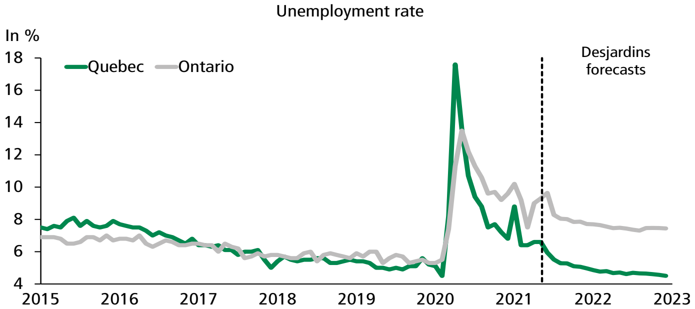


Sources: Statistics Canada and Desjardins, Economic Studies

the house. This will reduce the budget available for housing. Lastly, many older people who had put off moving into a seniors' residence could finally get into gear and put their homes up for sale. This will increase the supply in the market. Under these conditions, the bidding war phenomenon, which is currently accelerating price growth, should fade.

However, the improving economic situation will remain favourable to the housing market. The decrease in economic uncertainty and drop in the unemployment rate will be notable (graph 28). Housing market corrections are generally rare when the economy is doing well. Households also have substantial savings, which could keep boosting the housing market.

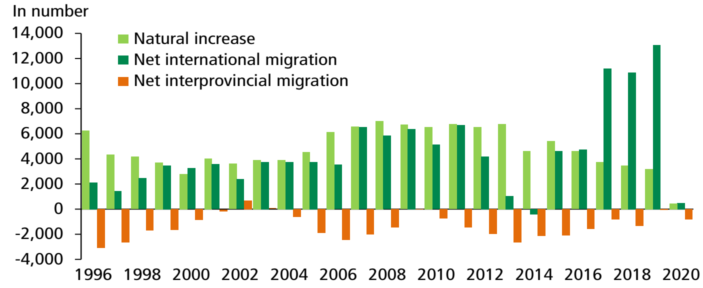
GRAPH 28
The unemployment rate should keep falling in Quebec and Ontario



Sources: Statistics Canada and Desjardins, Economic Studies

One factor has not yet been addressed: immigration. New arrivals constitute new demand on the housing market. In Quebec, immigration had surged from 2017 to 2019 (graph 29). Immigration plunged during the pandemic, but the effect on the housing market was largely offset by other factors. For the post-pandemic period, it is reasonable to believe that immigration's recovery will partially offset some housing market negatives. That said, the impact could vary by region and we do not

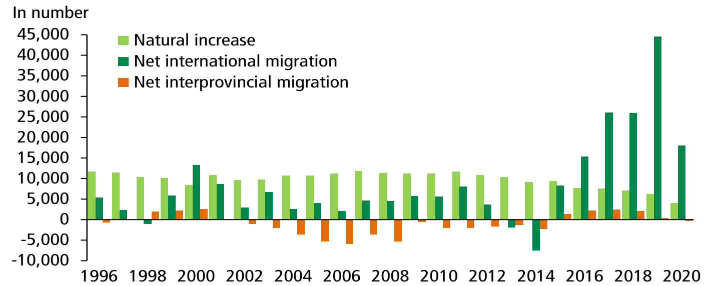
GRAPH 29
The pandemic had major repercussions for the evolution of Quebec's population



Sources: Statistics Canada and Desjardins, Economic Studies

know exactly what pace migratory flows will set in the coming quarters. Usually, immigration is focused in the major centres. In Quebec, the Montreal region could probably do better than most other regions. In Ontario, the impact of immigration fluctuations on the real estate market was smaller during the pandemic. While international immigration also declined in 2020 (graph 30) in Ontario, it remained much higher than in Quebec.

GRAPH 30
The pandemic also had repercussions for the evolution of Ontario's population



Sources: Statistics Canada and Desjardins, Economic Studies

Toward Stabilization

As the summary table (table 2 on page 10) shows, most of the factors currently affecting the housing market are temporary, arising from the turbulence caused by the pandemic. If the pandemic continues to wane as projected, we can expect most of these factors to slowly normalize over the coming months. The housing market should then start to see a better balance between supply and demand.

Under these conditions, our forecasts call for the housing market to stabilize soon in most parts of the country. The uptrend should rapidly moderate, probably this summer, after the strong price growth recorded in the last few quarters. Thereafter, we should see some stability. For Quebec and Ontario, this would take us toward price growth that is barely on the positive side for 2022 (graph 31).

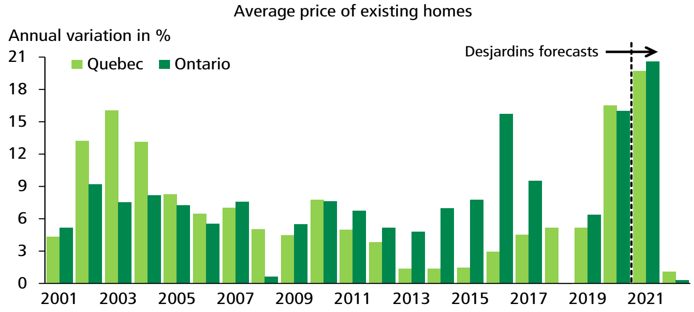
In tandem with that, we also expect the level of resales and housing starts in Quebec and Ontario to moderate. That said, activity should still remain high, historically speaking (graph 32).

Substantial risks persist, however. On one hand, the housing market could surprise us again with vitality that lasts longer than anticipated. Additional macroprudential measures could then be needed, akin to the recent increase in the reference rate applicable to uninsured mortgages ordered by the OSFI. On the other, we cannot rule out the possibility that the housing market will correct more than expected in the coming quarters.

Nonetheless, it would be sensible to learn a few lessons from this exuberant period. In particular, it would be desirable, in the future, to make the process of buying a property more transparent. In Quebec, the government is considering the possibility of preventing no-inspection transactions, and making the various purchase offers on the same property public. This would be a good way to keep property prices from ballooning in the case of multiple offers and bidding wars. However, other provinces would have to follow Quebec's lead for it to have a real impact across the country. As housing market regulation is a provincial matter, nothing can be taken for granted on this subject.

GRAPH 31

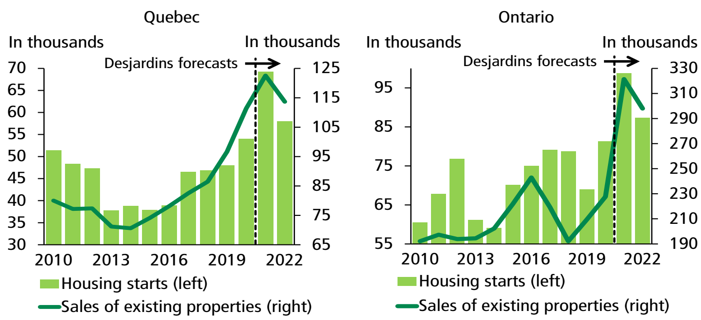
The sharp acceleration in property prices should moderate in the coming months in Quebec and Ontario



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 32

Real estate market activity will slow but should remain at levels that are high historically



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

Annex

TABLE 1
Evolution of monthly mortgage payments

	CANADA		MONTREAL		TORONTO		CALGARY		VANCOUVER	
	Feb. 2020	April 2021	Feb. 2020	April 2021	Feb. 2020	April 2021	Feb. 2020	April 2021	Feb. 2020	April 2021
Average price ($K)	587.5	723.5	376.7	483.2	848.3	1,005.5	415.4	447.8	1,022.9	1,141.9
Minimum down payment[1] ($K)	33.75	47.35	18.84	24.16	59.83	75.55	20.77	22.39	77.29	89.19
Mortgage loan ($K)	553.8	676.2	357.9	459.0	788.5	930.0	394.6	425.4	945.6	1,052.7
Weighted average mortgage rate (%)	3.18	2.07	3.18	2.07	3.18	2.07	3.18	2.07	3.18	2.07
Amortization (year)	25	25	25	25	25	25	25	25	25	25
Monthly payment[2] ($)	2,779	3,002	1,796	2,038	3,957	4,128	1,980	1,888	4,745	4,673
Spread ($)	---	223	---	242	---	171	---	-92	---	-72
Spread (%)	---	8.0	---	13.5	---	4.3	---	-4.6	---	-1.5

[1] 5% of the first $500,000 of the loan's value plus 10% of the remaining value of the loan.
[2] Including the Canada Mortgage and Housing Corporation premium.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

TABLE 2
Summary

	EFFECT ON HOUSING PRICES*	TEMPORARY OR PERMANENT	COMMENTS
Preference for more space (lockdown and working from home)	↑	Partially temporary	Some companies should continue facilitating working remotely. We should not fully return to the pre-pandemic situation.
Enthusiasm for vacation homes	↑	Partially temporary	The removal of public health measures will give households other options for getting away.
Bidding wars/multiple offers	↑	Temporary	We expect this to moderate as market conditions normalize after the pandemic.
Low interest rates	↑	Temporary, gradual reversal	Interest rates have already started to go up, but will do so gradually. We expect Canada's first key interest rate increase to come in October 2022. High debt loads make households more sensitive to rate increases.
Government support (growth in disposable income)	↑	Temporary	Most support measures should be rolled back once the pandemic is over. However, we do not expect a negative shock to income.
High savings	↑	Permanent	The high savings rate in recent quarters could facilitate access to ownership for some households that capitalized on the situation to save for a down payment more rapidly.
Increase in the budget that can be earmarked for housing	↑	Temporary	The lifting of public health measures will see an increase in spending in non-housing sectors.
Drop in immigration	↓	Temporary	Assuming that migration resumes and potentially some catching up to make up for the 2020 shortfall.
Divorces/separations	↑	Temporary, gradual reversal	Hard to predict. Data not available. The phenomenon could gradually ebb.
Supply insufficient initially	↑	Temporary, gradual reversal	A shortage existed in some housing markets before the pandemic. It could take some time to return to normal.
Pent-up supply (seniors or people not interested in selling during the pandemic)	↑	Temporary	After the pandemic, pent-up supply could be unleashed. Hard to predict the pace and scope.
High prices encouraging people to sell	↓	Permanent, conditional on the market robustness	In the context of high prices, owners could want to capitalize on the situation and sell.
New construction	↓	Permanent	Even if construction slows, the pace of housing starts should remain high historically and help reduce the shortage.
Construction costs	↑	Temporary, gradual reversal	It would be surprising for input costs to drop suddenly. We still expect them to subside toward normal gradually.
Difficult economic situation and uncertainty	↓	Temporary	After a very challenging 2020, we expect the situation to improve rapidly in the coming months, with uncertainty declining substantially.

* In the last few quarters.
Source: Desjardins, Economic Studies