ECONOMIC VIEWPOINT

Desjardins Housing Outlook:

Rate Cuts Will Boost Sales and Prices, but Probably Won't Help Canada's Homebuilding Ambitions

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Highlights

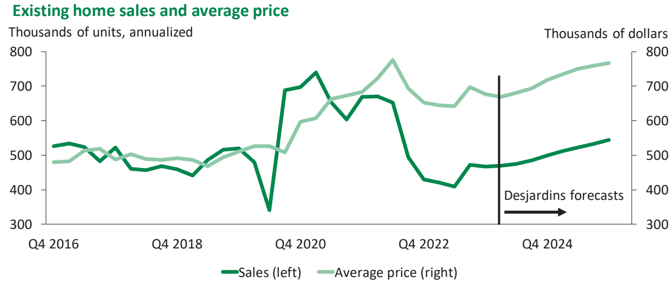
- We still expect that the Bank of Canada (BoC) will begin reducing interest rates soon and that further monetary easing will support a broad-based rebound in home sales and housing prices later in the year.
- That said, slowing economic growth in the coming quarters, still-elevated borrowing costs and still very stretched affordability will limit the scope of price and sales gains.
- Alberta housing markets continue to face the best prospects in 2024 and 2025. By contrast, rate-sensitive Ontario and BC markets should experience more softness in the near term, but also see stronger rebounds as rate cuts increasingly work their way through the economy.
- We don't think lower rates will translate into a construction boom. Monetary easing will take time to stimulate projects currently on hold, and Canadian housing construction faces myriad structural challenges. These will likely limit our homebuilding and affordable housing ambitions for the next few years.

RESALE HOUSING MARKET FORECAST

Interest rate movements appear to have underpinned changes in housing market activity over the past quarter and are very much on the minds of Canadians. Home sales rose across Canada earlier this year when central banks increasingly messaged that we'd reached the peak of the rate cycle. Since then, most markets have cooled somewhat as buyers await the BoC's June interest rate decision. New listings have also drifted somewhat higher over that period, reducing upward pressures on prices.

Desjardins Economics's view remains that the BoC will begin cutting very soon and that further monetary easing will support a broad-based rebound in home sales and housing prices later in the year (graph 1). However, a few factors will prevent a more significant recovery. First, we still expect hikes already completed

Graph 1
Home Prices Should Begin a Gradual Recovery Once Rates Come Down



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to weigh down economic growth and job creation across the country in the months ahead. It will also take time for the full effects of lower borrowing costs to take hold in the housing market and across the broader economy. Finally, affordability remains very stretched in most of the country, which should limit homebuying activity. In all, we're still assuming that the rebound will begin in earnest only after the worst of the labour market softness is behind us and more meaningful rate relief has been delivered. For listings, we suspect that moderately higher unemployment and a gradual improvement in buying activity will prompt some sellers to list their properties. Yet, that new supply could also drive new sales in the tightest local markets, while rate relief will also help the most stretched mortgage holders who might otherwise have sold.

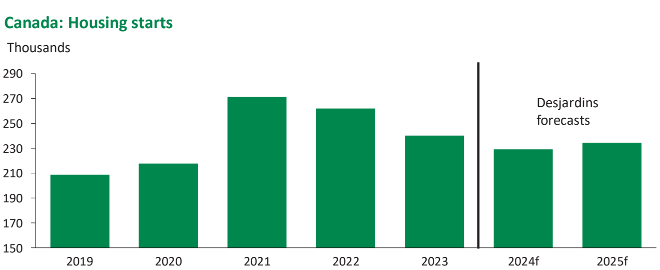
One key development since our last outlook is the federal government's announcement that it will reduce Canada's non-permanent resident (NPR) population to about 2M over the next three years. Our work has shown that this will weigh on population and economic growth primarily in 2025 and 2026. It stands to reason that this will impact housing demand in those years as well, particularly in the rental market. We discuss how the effects of the policy and other national-level trends could vary by province later in this report.

RESIDENTIAL CONSTRUCTION OUTLOOK

Homebuilding that occurs now will impact housing supply and price pressures over the longer run. In this section, we analyze the myriad challenges facing Canadian housing construction and discuss how they impact our projections.

Housing starts remained strong in 2023 because of commitments made in prior years, but we expect that to change as we progress through 2024 (graph 2). The effects of higher borrowing costs seem to finally be showing up. Total housing starts over the past six months averaged about 219k (saar), down significantly from 239k in the previous 6-month period.

Graph 2
Housing Starts Are Expected to Be Lower in 2024 and 2025



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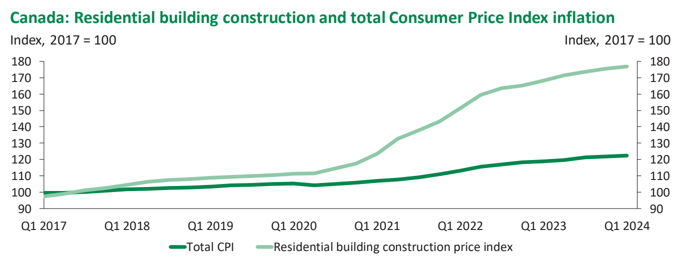
Residential Construction Prices Are Skyrocketing

The cost of living has risen for Canadians, but the cost of doing business has risen even more for homebuilders. Between Q1 2020 and Q1 2024, total CPI inflation rose 16%, whereas the residential building construction price index climbed a whopping 59% (graph 3)!

Graph 3
Residential Construction Costs Have Skyrocketed



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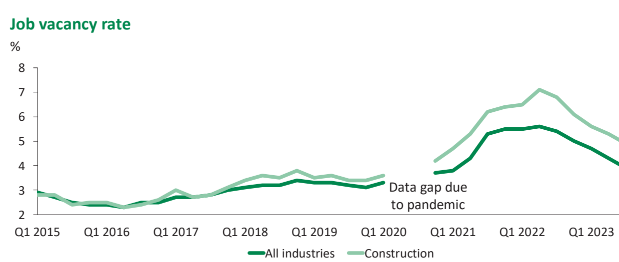
Declining Presales Delay Project Financing

Presales—a critical component of construction industry financing that minimize the lender's risk—are declining, particularly in centres like Toronto. That partly reflects the fact that younger adults have responded to the lack of affordability by moving to more affordable parts of the country, a trend we expect to persist to some degree going forward.

Labour Shortages Persist

While job vacancies have come down from their peak, construction worker shortages remain higher than the pre-pandemic average and higher than the all-industry average (graph 4). The federal government and the provinces have implemented various programs to address this issue by encouraging Canadian youth to consider careers in the

Graph 4
Construction Labour Shortages Persist



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trades and prioritizing the express entry of immigrants with skilled trades backgrounds. However, registration in Canadian apprenticeship programs declined at the beginning of the pandemic—losses that have yet to be recovered. In fact, young people's share of the total construction workforce has fallen steadily over the past 15 years. Recall that two years ago, Ottawa estimated that 700k skilled trades workers are expected to retire by 2028.

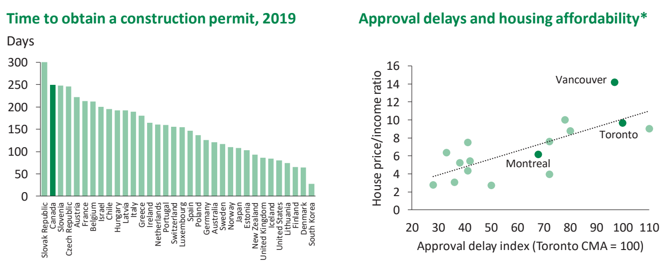
Higher Financing Rates Impact Construction

Interest rates have a profound impact on the housing construction sector. When the BoC raised its key interest rate to combat inflation, borrowing costs for construction projects surged. The resulting financial pressure has forced some builders to delay or even cancel planned developments, while other projects have gone into receivership. Meanwhile the Canadian Home Builders' Association recently reported that 65% of members built fewer units than they would have otherwise. Urbanation confirmed this trend, reporting that over 21k units across 60 projects in the Toronto–Hamilton area have been shelved indefinitely since the market peak in 2022. Looking ahead, builder sentiment is quite low in both the single- and multi-unit residential construction markets.

Regulation and Policy Add to Costs and Delays

Regulations governing housing construction exacerbate costs and delays. Canada is among the worst in the OECD for construction permit delays, which are correlated with lower housing affordability (graph 5).

Graph 5
Canada Has among the Longest Construction Permit Delays



* Includes municipalities that responded to the 2022 Municipal Land Use and Regulation Survey. House price and household income data obtained from the 2021 Canadian Census.
World Bank, CMHC and Desjardins Economic Studies

Higher development charges also add to the cost of housing. For example, Toronto condo development charges rose by 20.7% in May 2024. While these charges are paid by the developer at the time building permits are issued, they're ultimately passed on to buyers who finance the cost as part of their mortgage.

The increase in capital gains tax rates announced in the latest federal budget may also deter would-be investors from purchasing presale condos. While this may seem like good news for potential owner-occupiers, keep in mind that absent corresponding decreases in condo prices, the tax hike will probably just delay when shovels break ground, limiting housing supply growth. Now-higher switching costs may also result in house hoarding by current investors who hope for the policy to be rolled back in the future.

More optimistically, recent federal and provincial government announcements have started to support additional housing construction, particularly for purpose-built rentals. But it can take years from when funds start to flow until shovels break ground. It then takes more time before units are ultimately move-in ready, as demonstrated by our estimates of how new listings respond to starts. See our report on global housing supply success stories for our recommendations on how to accelerate homebuilding.

Putting everything together, we anticipate a slowdown of about 15% in housing starts from the peak of over 270k in 2021 to an average of around 229k this year. Although we're still forecasting that the Bank will soon start to cut rates, it will take some time before we see postponed construction projects move forward. Similarly, any rise in inventories stemming from higher unemployment could potentially loosen supply–demand balances, meaning that even when conditions improve, there will likely be a delay before new construction picks up again.

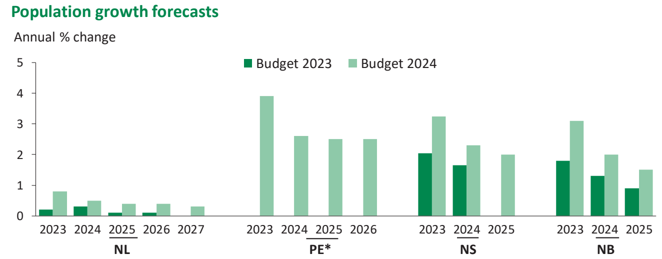
ATLANTIC REGION

Atlantic Canadian real estate markets continue to demonstrate a greater degree of stability than we've seen in most of the rest of the country. Although sales did pick up towards the end of 2023 and in the early months of this year, gains were not nearly as strong as in more interest rate-sensitive provinces. Home sales and prices in these markets were resilient to both the initial round of aggressive monetary tightening and subsequent increases in June and July of last year. This speaks to the region's relatively muted sensitivity to borrowing cost fluctuations. Better housing affordability than in most of the rest of Canada has helped as well, though a shift in demand towards cheaper apartment and townhome segments suggests affordability is still impacting homebuyer choices. Population growth has also continued to exceed historical norms by more than in most of the rest of Canada, and this year's budgets revised forecast expansions higher (graph 6).

In the longer term, population growth prospects are generally positive. The fact that recent explosive gains haven't depended much on NPRs suggests the region is relatively unexposed to Ottawa's planned reduction. That said, the pandemic-era telework-driven boom in net interprovincial migration continues to fade (graph 7).

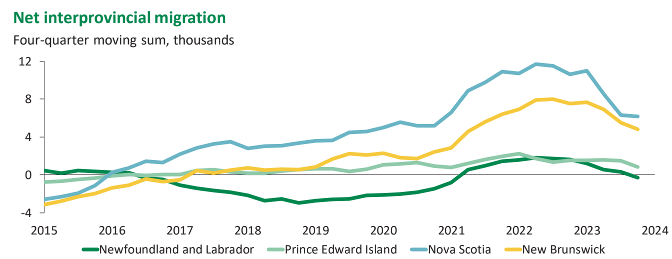
We still expect that the next few months will be less difficult on the East Coast than in other regions as the accumulated effects of higher interest rates increasingly bite. But the ensuing cut-driven rebound should also be more moderate. There's some potential for Newfoundland and Labrador to outperform the rest of the region given its stronger economic prospects.

Graph 6
Stronger Population Growth Is Expected in Atlantic Canada



* Budget 2023 did not include outer-year population growth projections.
Provincial budget documents and Desjardins Economic Studies

Graph 7
The Interprovincial Migration Boom Continues to Fade



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QUEBEC

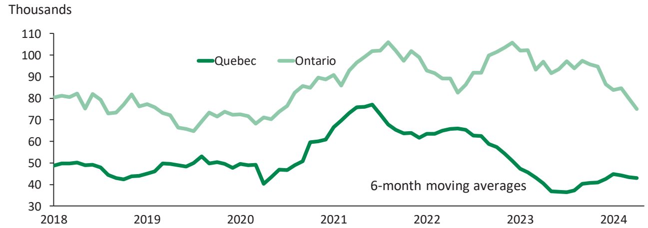
Quebec's housing market has begun to recover. However, the residential sector has fallen more sharply in Quebec than in the rest of Canada over the past two years, especially when it comes to rental apartments. However, Ontario is headed in the opposite direction (graph 8), partly due to insufficient pre-sale demand from would-be condominium buyers.

These trends are expected to continue in both provinces over the coming months. The relative importance of market segments such as condominiums and rental housing is a key reason why the two provinces are in different places in the residential construction cycle. In Ontario and especially the Greater Toronto Area, condominiums typically account for 50% of total housing starts. According to the Canada Mortgage and Housing Corporation, in many cases a project's pre-sale phase, which generates financing to start construction, is completed years earlier. That helped keep Ontario construction stronger for longer.

In Q1 2024, total housing starts increased by 11.2% in Quebec compared to the same period last year, with rental units rising 28.6% and single-family homes up 25.3%. However, condominiums fell sharply. The recovery in construction is therefore underway in two market segments.

Although rental market housing starts have fallen in the last two years, this market segment accounted for about 60% of housing starts in Quebec. For some time, many cities and municipalities in Quebec have been increasingly changing some aspects of their regulations and have also sped up the project approval process. That said, the action taken does seem to have helped restart some projects. As analyzed in an Economic Viewpoint published last fall, a number of solutions were identified with the potential to stimulate construction of rental apartments and help drive a recovery in Quebec. As government policy increasingly takes hold and builder confidence improves following monetary easing, we should see some construction activity restart. The recent agreement between Quebec and the federal government, which represents an investment of $1.8B funded equally by each of the two levels of government, represents additional support for rental homebuilding.

Graph 8
Housing Starts Are Recovering in Quebec but Continuing to Drop in Ontario
Number of housing starts



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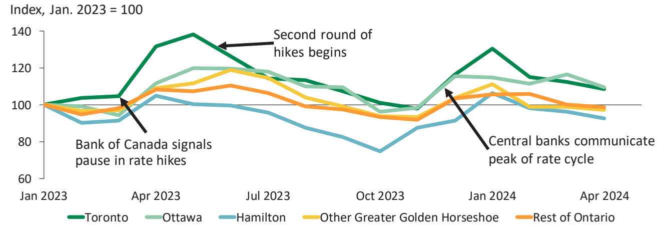
ONTARIO

It's been a wild ride for Ontario housing markets. After bearing the brunt of the Bank of Canada's second round of interest rate hikes, they benefited more as a group from the late-2023 drop in mortgage rates than any other province. Now sales are softening again— seemingly victims of the gentle climb in borrowing costs experienced since that time—with Toronto and nearby centres experiencing the most marked movements (graph 9). A weakening economy likely also contributed. We suspect the next few months will be more challenging as the full effects of past rate hikes increasingly work their way through the economy.

As monetary policy becomes less restrictive, we expect a rebound in home sales activity and prices to materialize. That reflects the provincial economy's high sensitivity to interest rate movements. Still, the rebound may not begin immediately. Just as the full effects of higher borrowing costs took time to be felt, so too will the stimulative effects of reductions. The economic slowdown we've penciled in for Ontario for the coming months should weigh on home resale activity. Federal government reductions in the temporary resident population should also remove a tailwind for housing demand in 2025 and 2026. And of course, affordability remains very stretched.

We're still expecting Ontario to be a driver of the housing starts slowdown this year. Construction activity remained high last year in large part because of Toronto-area projects that were financed before rates rose. This year, higher borrowing costs combined with factors like construction industry labour shortages and very weak homebuilder sentiment should bite. However, we see better prospects for Ontario homebuilding beginning in 2025 as developers and a suite of government programs work to meet pent-up housing demand.

Graph 9
Housing Markets Closest to Toronto Have Been the Most Sensitive to Interest Rate Movements
Existing home sales



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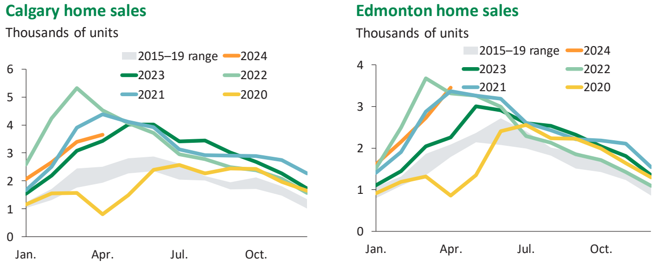
PRAIRIE PROVINCES

Alberta continues to be home to some of the strongest local housing markets in Canada. Even after the rate hike-induced slowdown, sales activity is well above historical levels (graph 10). This reflects three fundamental factors. One is the province's strongest-in-the-nation economy and labour market, which have buoyed housing demand. Rising oil production is part of that story, but lower household indebtedness and exposure to housing-related industries have also safeguarded Wild Rose Country's economy from higher rates. Another factor is the relative affordability of homeownership, which is driving young people to the province. Partly because of that, Alberta's population growth leads the country.

Housing market outperformance should continue to some degree in Alberta and Saskatchewan, where sales are also above pre-COVID levels. While we believe economic growth is likely to slow in the quarters ahead, the effect should be less pronounced among the oil-producing provinces. Relatively little reliance on temporary migration also means less of a drag from Ottawa's plans to reduce the NPR population. Although we expect homebuilding to slow this year in the prairies—as in the rest of the country—the region's cities remain less constrained by land availability than, for example, Toronto and Vancouver. In any case, the strength of population and economic growth appears to be translating into very sharp rent increases in Alberta (graph 11), where annual rent hikes are not capped.

We still anticipate decent prospects for Manitoba's housing market. Though it's clearly felt the effects of higher interest rates, residential resale activity in the province has outperformed that of all but the oil producers (graph 12). Going forward, the province's broad industrial base should prevent a significant deterioration of the economic backdrop and labour market, supporting relatively balanced supply and demand with solid home purchasing volumes.

Graph 10
Alberta Home Sales Were Still Strong in Early 2024



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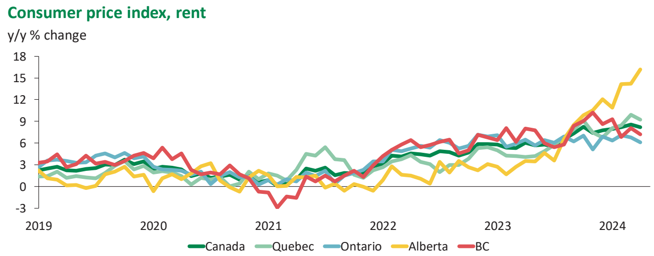
Graph 11
Rent Prices Have Skyrocketed in Alberta



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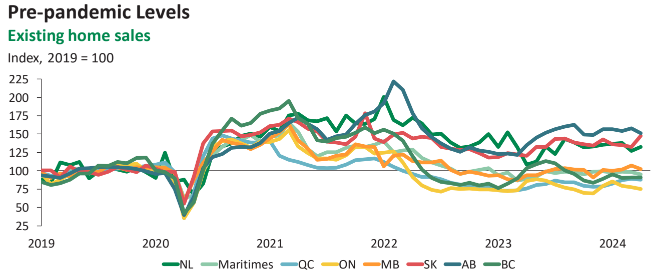
Graph 12
Home Sales in the Prairies and Newfoundland and Labrador Are above Pre-pandemic Levels



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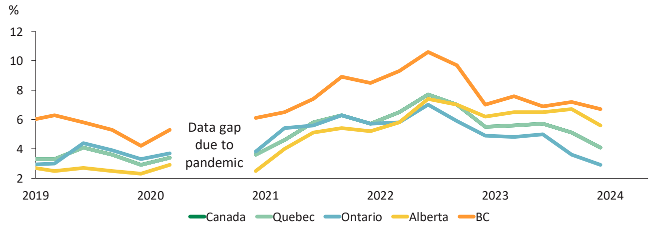
BRITISH COLUMBIA

BC's housing markets have held up better than many—especially Ontario's—following the late-2023/early-2024 bounce back, but we still think the province has one of the weaker outlooks in the near term. Relative housing market resilience follows a Q4 2023 rebound in real GDP growth, which we suspect was partly a reflection of recovering trade flows at the Port of Vancouver. But that effect should fade this year, and BC's highly indebted consumers and housing-oriented economy will likely feel the pinch increasingly in the months ahead. The coming wave of renewals at higher rates should also disproportionately affect BC in 2025 and 2026. Very stretched affordability remains a disadvantage as well. Just as in Ontario, we anticipate a pickup in sales and prices as we progress towards 2025 and rates come down. However, our base case forecasts assume that this holds back a stronger rebound than we'd normally expect under an environment of easing monetary policy. Finally, the recent demographic expansion's reliance on temporary migration suggests BC is particularly vulnerable to federal government plans to cut the NPR population.

Ontario and BC drove the 2023–24 resilience in housing starts, but we don't see how this can continue. And like Ontario, BC construction benefited from pre-financing last year. Moreover, sectoral labour shortages are particularly acute in the province (graph 13).

Graph 13
Construction Industry Labour Shortages Are Particularly Acute in BC

Job vacancy rate, construction



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FORECAST TABLES

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**	**5.1**	**9.9**
Newfoundland and Labrador	9.7	14.7	45.5	-7.2	-15.2	3.1	9.4
Prince Edward Island	-6.8	9.7	14.8	-18.2	-4.9	4.9	9.3
Nova Scotia	10.9	13.2	14.1	-21.7	-17.2	2.4	8.6
New Brunswick	12.5	13.7	22.4	-20.5	-13.5	5.6	7.8
Quebec	11.4	16.4	-2.4	-20.4	-12.8	6.6	6.8
Ontario	9.0	8.5	19.1	-32.0	-12.3	4.0	9.8
Manitoba	8.5	14.3	17.2	-20.1	-10.0	8.2	8.1
Saskatchewan	1.5	24.6	24.1	-11.7	-3.3	8.6	12.9
Alberta	-0.1	4.3	53.6	-1.9	-9.0	10.4	12.3
British Columbia	-1.4	21.2	32.8	-35.1	-9.2	-0.7	10.6
Average Home Resale Price – Canada	**2.5**	**12.9**	**21.2**	**2.4**	**-3.6**	**2.5**	**8.8**
Newfoundland and Labrador	-3.3	3.1	9.9	6.7	0.6	6.0	5.3
Prince Edward Island	12.2	18.8	20.6	13.8	-1.6	1.5	7.9
Nova Scotia	7.9	13.7	23.1	14.8	2.9	4.9	7.9
New Brunswick	2.9	10.5	25.9	17.6	2.7	7.4	4.0
Quebec	5.2	16.4	16.4	11.3	-0.1	5.1	6.3
Ontario	6.4	16.2	23.4	6.7	-6.3	1.0	9.1
Manitoba	-0.1	4.4	9.8	7.9	-3.2	5.8	6.1
Saskatchewan	-0.4	2.5	6.9	0.6	-0.6	5.5	7.9
Alberta	-2.7	1.2	9.2	5.3	0.7	9.9	9.8
British Columbia	-1.4	11.6	18.5	7.5	-2.6	3.1	8.9
Housing Starts (thousands) – Canada	**208.7**	**217.8**	**271.2**	**261.8**	**240.3**	**229**	**235**
Newfoundland and Labrador	0.9	0.8	1.0	1.4	1.0	1.2	1.3
Prince Edward Island	1.5	1.2	1.3	1.3	1.1	1.0	1.1
Nova Scotia	4.7	4.9	6.0	5.7	7.2	6.5	5.6
New Brunswick	2.9	3.5	3.8	4.7	4.5	4.3	4.0
Quebec	48.0	54.1	67.8	57.1	38.9	45.8	49.4
Ontario	69.0	81.3	99.6	96.1	89.3	75.0	79.0
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	40.5	40.0
British Columbia	44.9	37.7	47.6	46.7	50.5	43.5	43.0

f: forecasts
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