ECONOMIC VIEWPOINT

No True Price Drops for Existing Homes in Canada

The housing market has struggled since the start of 2018, with existing home sales showing a significant decline. Although certain data also point to price drops, some more reliable indexes suggest that prices are stable, increasing even in some market segments. At the moment, adjustments to the restrictive measures and gradually climbing interest rates are coming into play relatively slowly, without affecting the value of Canadians' real estate assets too much.

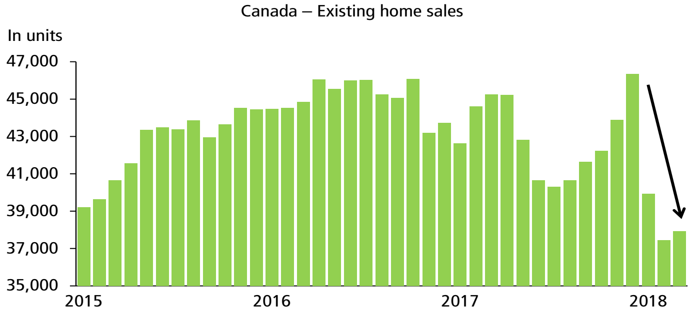
The new restrictive measures introduced by the Office of the Superintendent of Financial Institutions (OSFI) took effect on January 1st, 2018. What's more, the OSFI is now imposing that the rate used to qualify for uninsured mortgages be the greater of the 5-year benchmark rate published the Bank of Canada or the contractual mortgage rate +2%. This is in addition to the measures introduced by the British Columbia and Ontario governments to specifically target the Vancouver and Toronto markets. These measures, combined with a slight uptrend in interest rates, have stifled the existing home market since the start of the year.

Existing home sales across Canada tumbled by 13.8% in January and 6.3% in February as a result (graph 1). March ended with a slight 1.3% increase, but the level of sales is still very low compared with the trend seen in recent years. This correction appears to be fairly widespread geographically, although most regions have seen home sales slide in the past few months (graph 2).

Should We Fear Falling Prices?

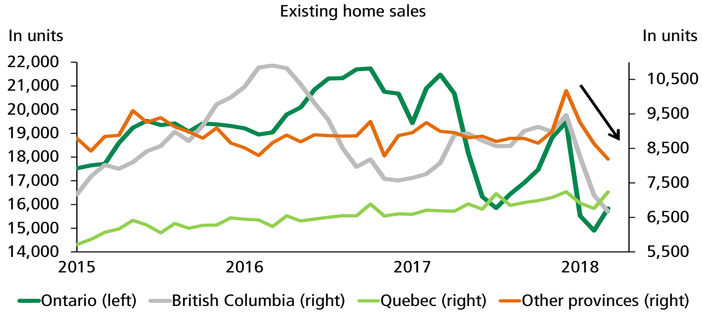
At first glance, the recent slowdown in existing home sales is also being felt on prices. According to monthly transactions, the average price has fallen in the past few months. The average price for an existing home in Canada has fallen by 8.2% since the end of 2017 based on this measure, which raises some concerns. If this trend continues, this drop in property value could have a major impact on the housing market and the Canadian economy in general, especially in a context where several households are grappling with high debt levels. Moreover, households' balance sheets could significantly deteriorate due to drop in the value of their real estate assets, a situation that could echo what happened in the United States during the last financial crisis.

GRAPH 1
The number of transactions since the start of 2018 has clearly dropped



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 2
Several regions are showing a decline in the number of transactions



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

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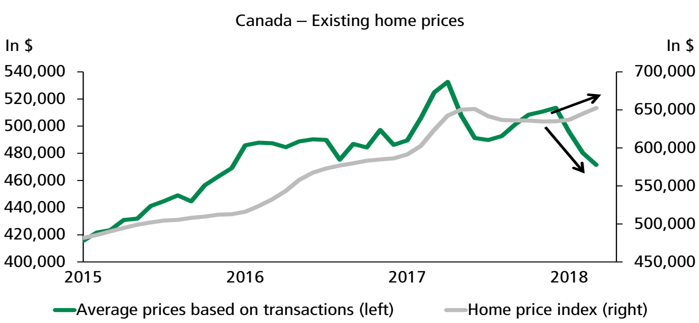
That said, another measure of the changes in existing home prices provides a very different snapshot of the current situation. As shown in graph 3, the home price index (HPI) compiled by The Canadian Real Estate Association has not really recorded any declines in the last few months. In fact, a slight increase was noted recently. Both measures have clearly been tracking largely divergent paths in the past few months. The nature of the HPI explains this major difference; the HPI tracks the change in prices for comparable homes over time. As such, the HPI takes several geographical and qualitative characteristics into account to explain home prices, such as the number of rooms and bathrooms, the size of the main living area and the basement, whether there is a fireplace, the lot size, the age of the home, etc.

GRAPH 3
Existing home prices tracking different price paths



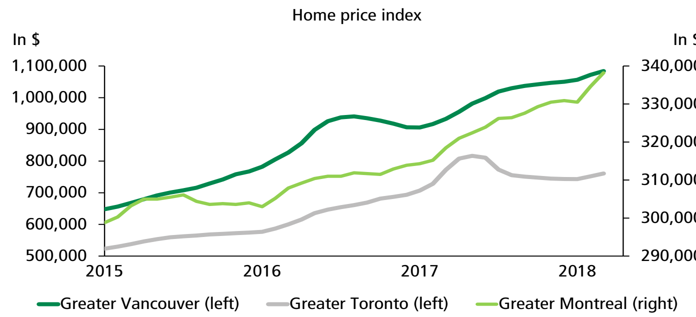
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

Demand Shifting toward Less Expensive Properties

Unlike the average price, which is based on the monthly transactions recorded, the HPI is not affected by developments in demand for the type or geographic location of the homes that have changed hands. This divergence between the two measures in recent months can be explain by the fact that buyers are increasingly turning to less expensive homes. This has had a negative impact on the average price (based on the number of transactions), but not on the HPI. For example, sales of existing homes have plunged by 29.4% in Toronto and 33.2% in Vancouver since the end of 2017, whereas sales in the other regions declined by only 13.9%. Since home prices are higher in Toronto and Vancouver, the steeper drop in sales in these markets affects the average price of existing homes, which is based on monthly transaction data.

As such, the HPI's stability suggests instead that home prices in Canada have not genuinely declined in the last few months. In reality, prices continue to climb in several regions, especially in Vancouver and Montreal, while home prices in Toronto have been stabilizing somewhat since mid-2017 (graph 4).

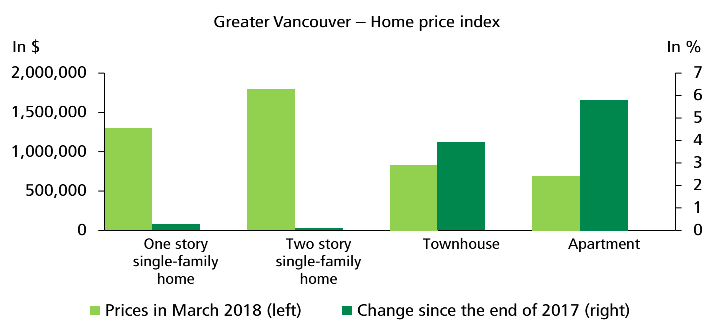
GRAPH 4
Prices in Toronto are flat, but continue to climb in Montreal and Vancouver



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

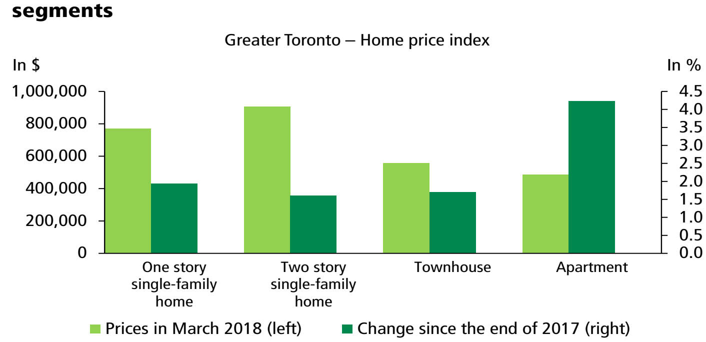
In Vancouver, price growth has been recorded across all markets segments since the end of 2017 (graph 5). That said, less expensive homes—townhouses and apartments (condos mainly)—have seen the sharpest growth. This supports the assumption that demand is shifting toward these types of property. The same can be said for Toronto (graph 6), where

GRAPH 5
Stronger price growth in Vancouver's less expensive segments



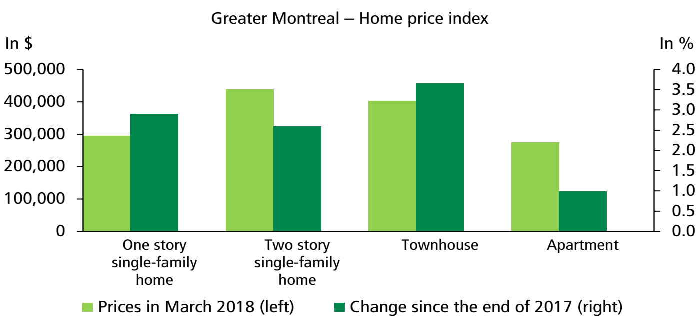
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 6
Price growth is also stronger in Toronto's less expensive segments



Sources: Canadian Real Estate Association and Desjardins, Economic Studies apartment prices have outpaced those for other types of property. The situation appears to be different in Montreal, where the price differences are not as great (graph 7). Prices for most types of home have shot up since the end of 2017.

GRAPH 7
Price growth is more similar in the Montreal area



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

Smooth Adjustments

Even if the new restrictive measures and the uptick in interest rates had a strong impact on the number of transactions, property prices thus far do not appear to be suffering from the situation. This suggests that the adjustments are taking shape relatively smoothly, which is reassuring—for now at least. At first glance, this should cheer up the monetary authorities and pave the way for more increases to the overnight rate. However, the risk that the housing market could deteriorate further in the months ahead remains high, which could potentially lead to a genuine drop in property prices. The situation will have to be monitored closely in the coming quarters, arguing in favour of a very gradual approach to key rate increases.

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