OXFORD ECONOMICS

CANADA HOUSING QUARTERLY CHARTBOOK

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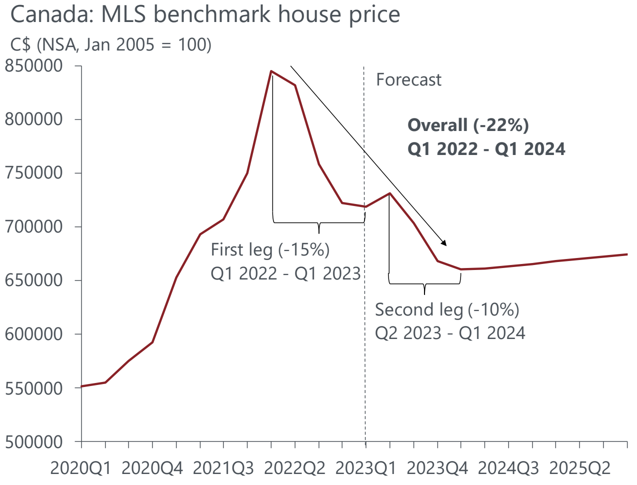
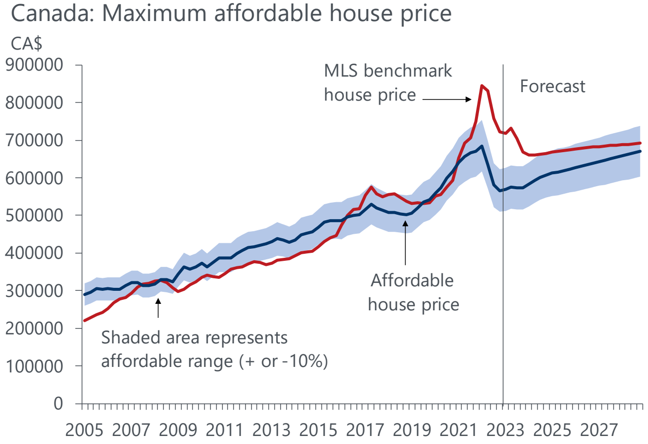
Contents

Housing spotlight: So, what's next for house prices?

- Despite an uptick in house prices now underway, we don't think Canada's house price correction is over. We expect benchmark house prices to fall another 10% by the end of this year, resulting in an overall 20%-25% peak-to-trough decline from the February 2022 high.
- After plummeting 15%-20% (depending on the price metric) between February 2022 and January 2023, house prices edged up since February this year. Signs point to another rise in April and May amid the seasonal spring housing pick-up, albeit with a light volume of sales and low listings.
- So, why do we believe house prices will resume falling?
  - We think the Canadian economy will slip into a recession this spring and don't expect it to grow again until early 2024.
  - The lagged impact of the Bank of Canada's rapid 425bps hike in interest rates won't fully hit the economy until H2 2023. And the BoC will likely hold the policy rate at 4.5% until early next year.
  - Tighter credit conditions in Canada following recent banking failures in the US and Europe will hurt mortgage and other lending.
  - The government's policies taxing house flippers, taxing underused housing and banning foreign buyers will work in tandem to help reduce speculative housing demand and boost listings.
  - Our Housing Affordability Index (HAI) also suggests prices have further to fall to realign with underlying fundamentals. We don't expect prices to fall within household borrowing capacity until 2025.
- However, our baseline forecast for house prices faces upside risks, mainly from record-high immigration and chronically low housing supply, and downside risks such as a deep credit crunch or financial crisis.



Source: Oxford Economics/Haver Analytics

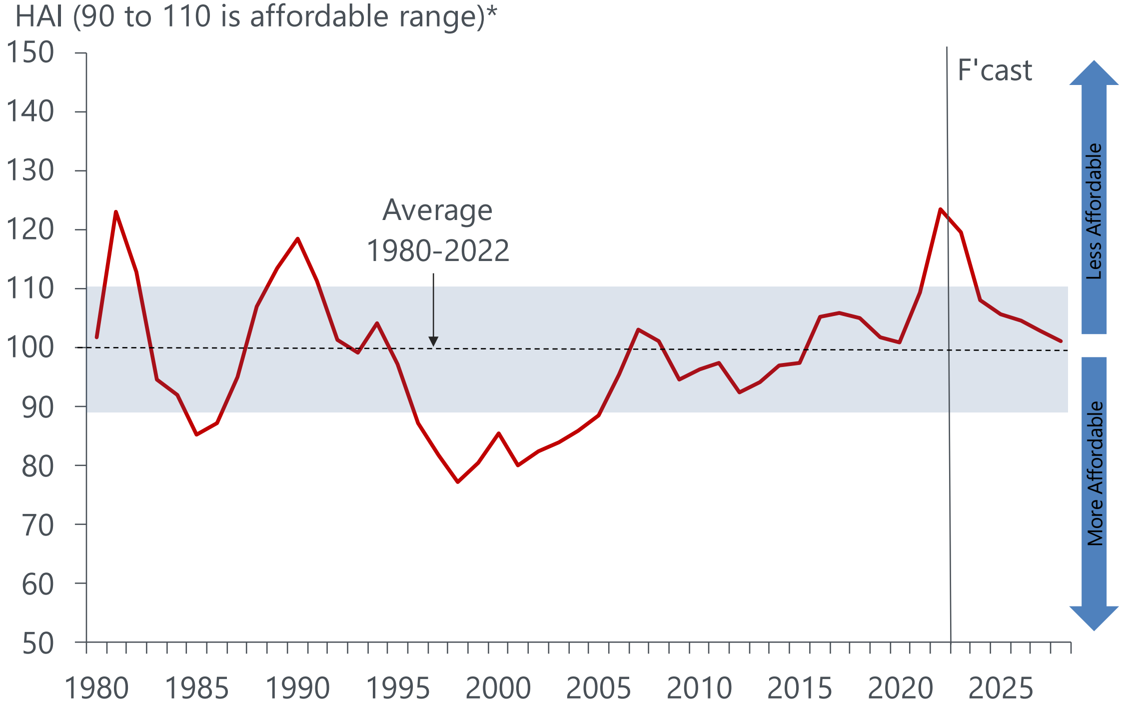


Source: Oxford Economics/Haver Analytics
* MLS benchmark house price (NSA), median household income, 20% downpayment, 39% gross debt service ratio, 5 -year mortgage rate and 25 -year amortization period.

Housing spotlight: So, what's next for house prices? (cont'd)

- Our housing affordability index suggests prices have further to fall to realign with household borrowing capacity, a key reason why we think there will be another leg to Canada's house price correction.
- Our HAI uses a household borrowing capacity approach to estimate the maximum a median-income household can borrow to purchase a home, assuming varying down payments. We then compare the maximum affordable house price to the actual price to construct our HAI. An HAI level of 100 is affordable with a 20% down payment, with 110 (30% down payment) and 90 (10% down payment) being the top and bottom of the affordable range.
- Looking back to 1980 shows that housing can be unaffordable for years, but house prices always eventually realign with borrowing capacity. The HAI averaged about 100 from 1980 to 2022. So, on average over the past 40+ years, prices have been aligned with what households can borrow to purchase a home.
- In the unaffordability episodes of the 1980s and 1990s, it took three to four years for a combination of falling house prices, lower mortgage rates, and steady income growth to restore affordability.
- This time, with mortgage rates likely to ease only modestly, the initial return of affordability will have to come largely from lower nominal house prices. Still, our forecast doesn't expect the HAI will slide lower than the top of the affordability range until 2025.
- Moreover, unlike the 1980s and 1990s, we don't anticipate affordability will fall below our affordable range due to a persistent lack of housing supply and solid underlying demographic demand, largely reflecting Canada's ambitious immigration plans.

Housing Affordability Index (HAI): Canada

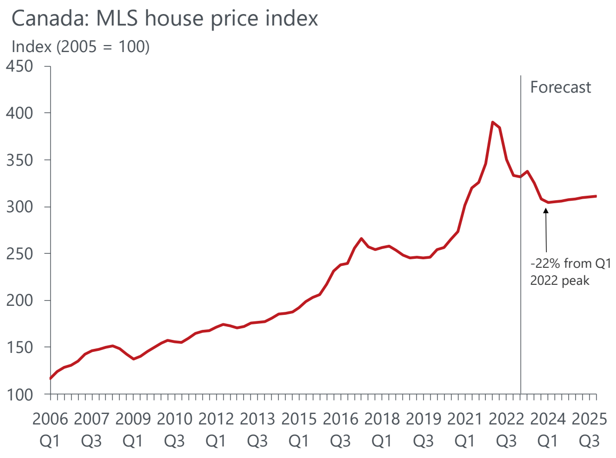


Source: Oxford Economics/Haver Analytics

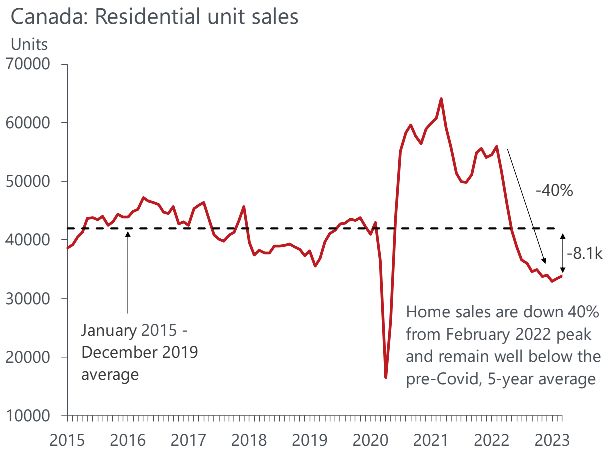
* CREA average house prices, median household income, 10%, 20% & 30% downpayments, 39% gross debt service ratio, 5 -year mortgage rate and 25 -year amortization period.

Housing outlook: Downturn to continue in H2 2023

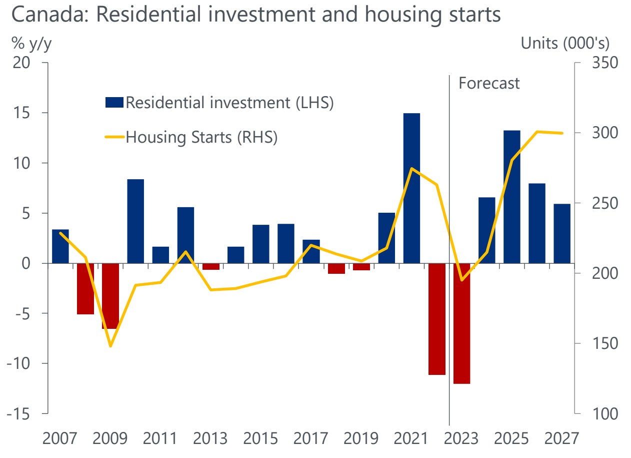
- We think there will be another leg down in house prices after a fleeting pick-up this spring. We now forecast benchmark house prices will fall another 10% from Q2 2023 to Q1 2024, leaving them down a cumulative 22% from the Q1 2022 peak. The drop in H2 2023 will be driven the onset of a recession, elevated interest rates, tighter credit conditions, near-record unaffordability, and the impact of government policies to curb speculation and ban foreign buyers.
- Residential investment shrank 2.3% q/q in Q4 2022 and was down 15.2% from Q1 2022. In total, we forecast residential investment to decline 21.5% peak-to-trough by Q3 2023.
- Housing starts fell 14% q/q to 226,600 units in Q1 2023. We expect new home building will fall further this year before picking up in the medium term as government efforts to boost supply begin to show results.
- The BoC will likely hold the overnight rate at 4.5% until early 2024, before gradually easing to a neutral level. This will keep mortgage rates elevated this year, weighing on housing and affordability. A slow easing of mortgage rates in 2024 will help support a modest rebound in housing activity and prices next year.



Source: Oxford Economics/Haver Analytics



Source: Oxford Economics/Haver Analytics

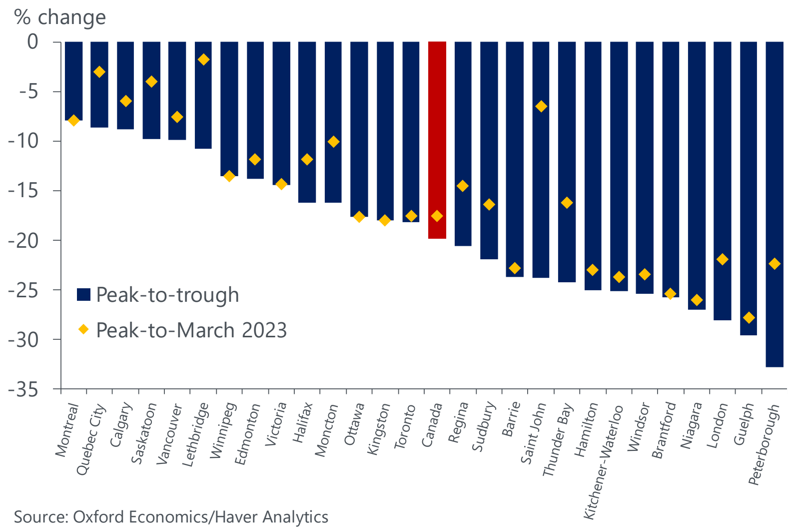


Source: Oxford Economics/Haver Analytics

Source: Oxford Economics/ Haver Analytics

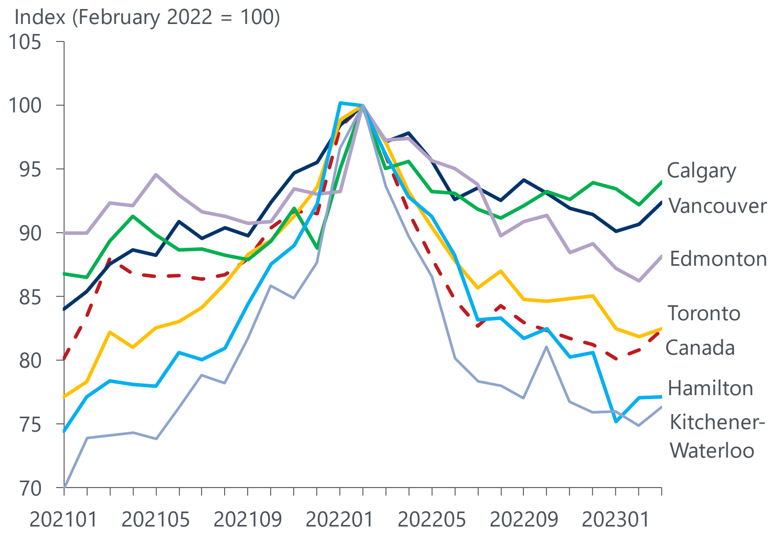
Metro update: Where do house prices stand across the country?

Canada: House price declines from early-2022 peak*



Source: Oxford Economics/Haver Analytics
*CREA average house price. Montreal and Quebec City are benchmark house prices due to lack of data availability. Peak and trough period varies by metro.

Canada: Average house prices in major metros



Source: Oxford Economics/Haver Analytics

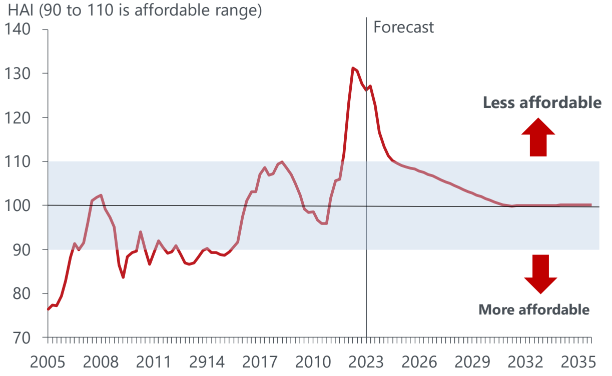
- Average house prices in Canada fell 19.9% between February 2022 and January 2023, and material price declines have occurred in nearly all major metros. Prices have rebounded modestly in early-2023 but are still well below previous peaks in most areas.
- As we anticipated, price declines have been most pronounced in metros that had the steepest run-up in prices and sharpest deterioration in affordability during the pandemic. These include smaller towns in southern Ontario, such as Peterborough (-32.8%), Guelph (-29.5%), London (-28%), Niagara (-27%), and Brantford (-25.8%), but also Saint John (-23.8%) and Regina (-20.6%).
- Price declines have been most muted in Quebec (-7.4%) and the prairie provinces. Average prices in Calgary (-8.8%), Saskatoon (-9.8%), Lethbridge (-10.8%), Winnipeg (-13.5%), and Edmonton (-13.8%) have fallen by much less than the national average.
- Toronto house prices fell 18.1% from February 2022 to January 2023, roughly in line with the national average, while average house prices in Vancouver fell just 9.9% over the same period.

Housing affordability: Improving, but still well out of reach

- Canada’s Housing Affordability Index (HAI) eased to 126.2 in Q1 2023 after peaking at 131.2 in Q2 2022, indicating the typical home was 26% above the borrowing capacity of median-income households.
- While falling house prices have led to affordability steadily improving over the past year, buying a home is still well out of reach for typical households, in part due to higher mortgage rates.
- Since early 2022, smaller southern Ontario towns that witnessed the sharpest drop in house prices also experienced the largest affordability improvements.
- Between Q2 2022 and Q1 2023, affordability improved in 20 of 24 metros we cover, led by St. Catherines-Niagara, Peterborough, Barrie, Brantford, London, and Hamilton. Calgary, Saskatoon, Quebec City, and Saint John are the only metros where affordability worsened over this period.
- We expect housing affordability to continue to improve this year, as house prices tumble further in H2 2023 while steady growth in nominal median income and a down tick in mortgage rates boost household borrowing capacity. We think Canada's HAI will slide to 117 by the end of 2023 but not return to the affordable range (below 110) until 2025.

Canada: Housing affordability index (HAI)*

HAI (90 to 110 is affordable range)

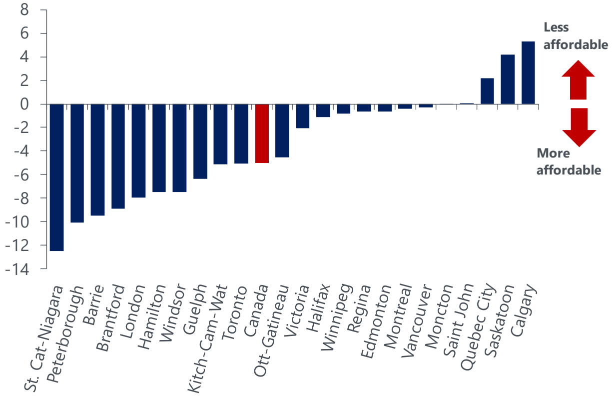


Source: Oxford Economics/Haver Analytics *

MLS benchmark house price (NSA), median household income, 20% downpayment, 39% gross debt service ratio, 5 -year mortgage rate and 25 -year amortization period.

Canada: Change in Housing Affordability Index

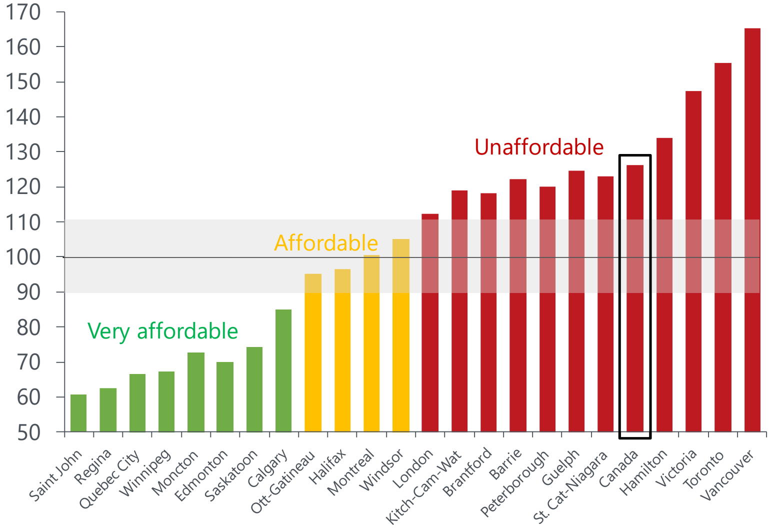
Index change between Q2 2022 and Q1 2023



Source: Oxford Economics/Haver Analytics

Canada: Housing Affordability Index (HAI), Q1 2023

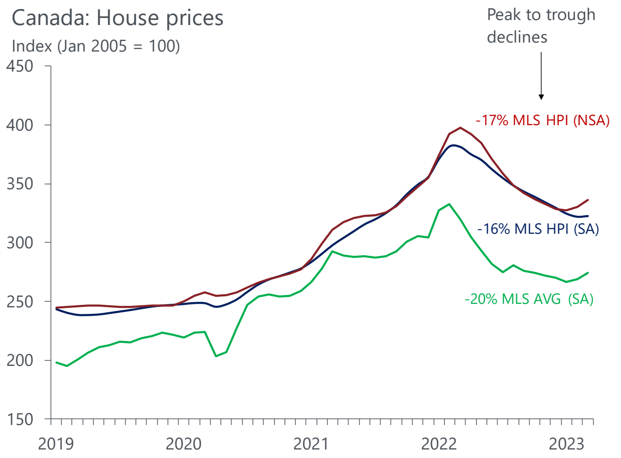
HAI (90 to 110 is affordable range)



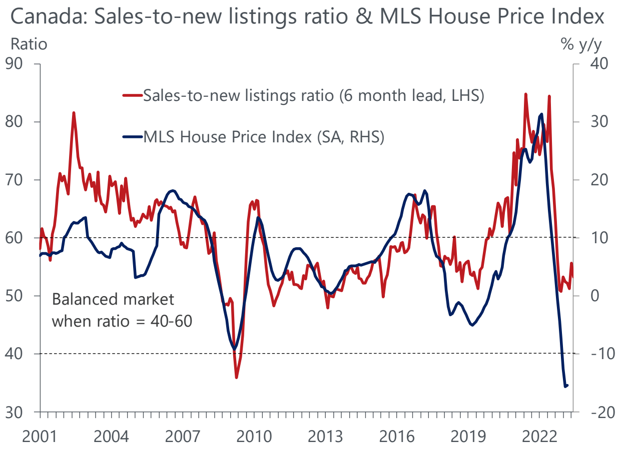
Source: Oxford Economics/Haver Analytics

Resale housing: Activity has picked up, but only temporarily

- Home buyers began returning to the market in Q1 2023. The number of home sales rose 1.5% m/m in February and 1.4% in March, after plunging 40% between February 2022 and January 2023. Resale activity remains quite low by historical standards, with unit sales in March still about 8,000 or 20% below the pre-pandemic, 5-year average.
- Meanwhile, inventories of homes for sale remain lean. A 6% monthly drop in new listings in March helped push the sales-to-new listings ratio up 4.5ppts to 63.5, entering sellers' territory. After steadily moving higher throughout last year, months of inventory ticked down to 3.9 in March 2023.
- After tumbling 15.6% from its March 2023 peak, the seasonally-adjusted benchmark price edged up 0.2% m/m in March 2023. Both non-seasonally adjusted benchmark price and seasonally adjusted average prices rose in February and March 2023, following sharp peak-to-trough declines from a year earlier.
- Home prices and activity will likely continue to pick up this spring as demand temporarily revives amid low supply. But we expect high interest rates, elevated unaffordability, new government policies, and job losses to cause listings to grow and demand to dry up in H2, driving prices down another 10%.



Source: Oxford Economics/Haver Analytics



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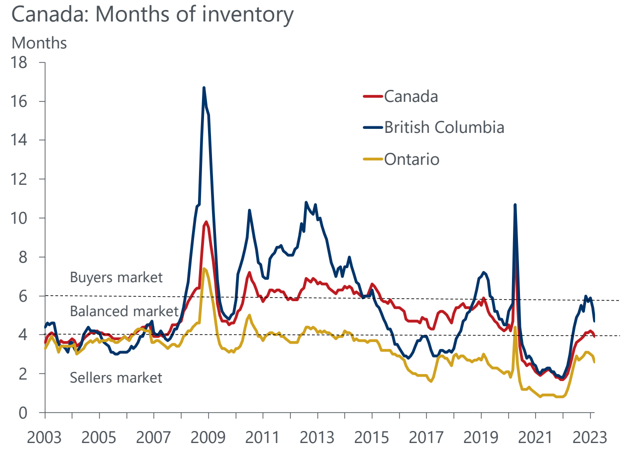

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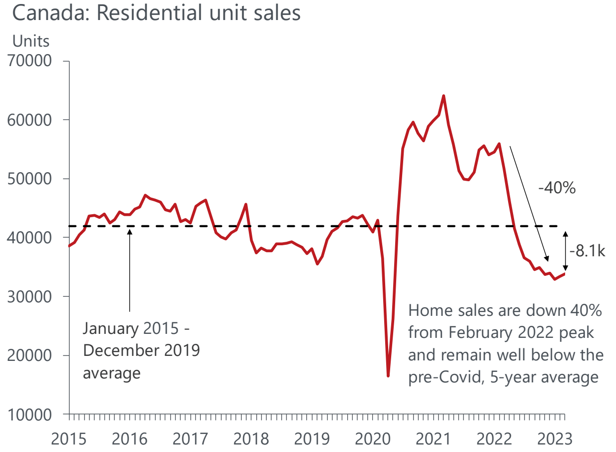
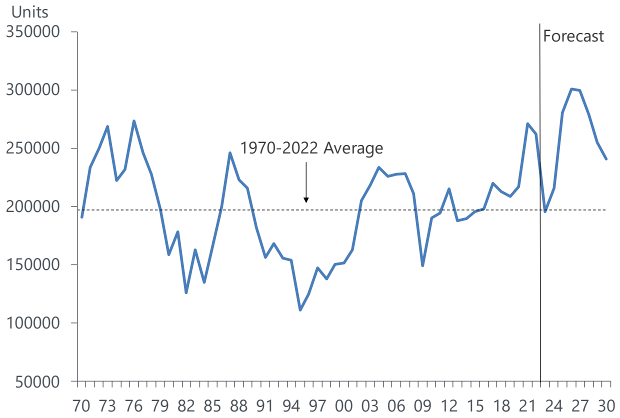


Source: Oxford Economics/Haver Analytics

New housing: Housing starts to tumble this year

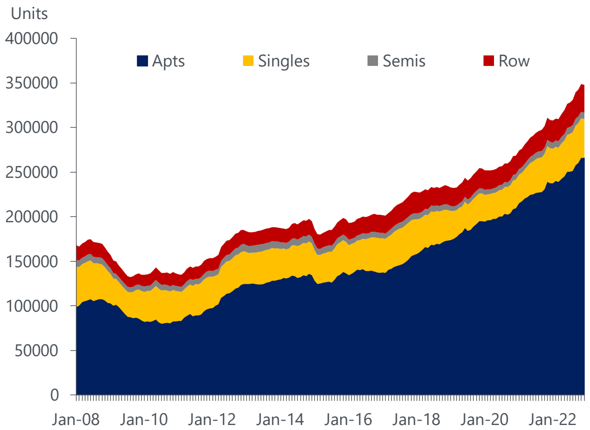
- We forecast new home building will slump this year amid high mortgage rates, tighter lending standards, falling home prices, and weaker demand.
- Although housing starts are forecast to fall considerably from the record 300k range reached during the pandemic, they are expected to remain historically strong in the near term despite the economic downturn.
- Housing starts fell 14% q/q to 222,600 (SAAR) units in Q1 2023 and we expect they will weaken further in the next few quarters. For 2023 overall, we forecast starts will tally less than 200,000 units, down smartly from 263,000 last year.
- We are cautiously optimistic that new home building will pick up materially in 2024 as the economy recovers, interest rates ease, and government measures to boost supply take effect.
- Following on the earlier strength in housing starts, we forecast housing completions to rise 7.1% y/y to 235,500 units in 2023, the highest level since 1978.
- The new house price index (NHPI, including land) fell by 0.2% m/m in both January and February. The NHPI is now down 1.0% from its August peak but is still up 1.4% from a year earlier.

Canada: Housing Starts



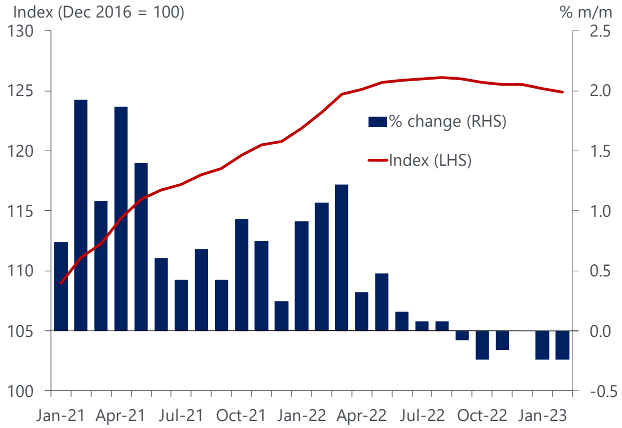
Source: Oxford Economics/Haver Analytics

Canada: Dwellings under construction, centres 50,000+



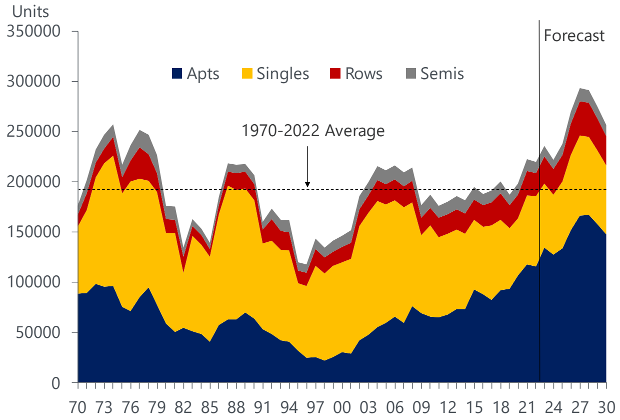
Source: Oxford Economics/Haver Analvtics

Canada: New house price index



Source: Oxford Economics/Haver Analytics

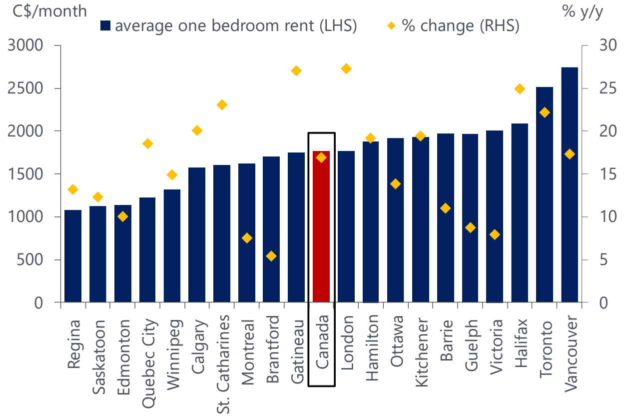
Canada: Housing Completions



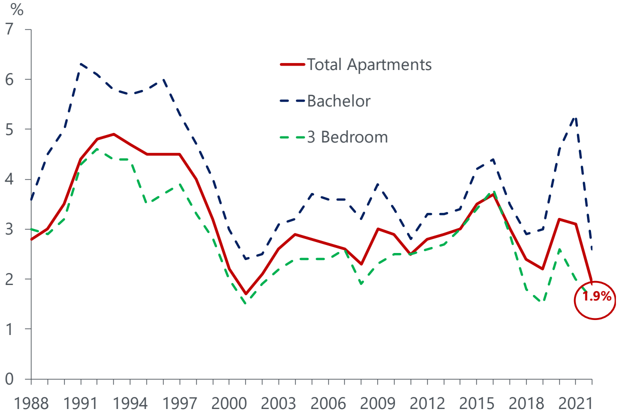
Source: Oxford Economics/Haver Analytics

Rental housing: Rents continue to soar

- Strong rental demand continues to outpace supply. According to Rentals.ca, average rent across Canada surged 10.8% y/y in March to C$2,004, on average for all unit types.
- Robust rental demand is likely being driven by out-of-reach house ownership, record immigration, and strong labour markets. Rising mortgage rates and still too-high prices have made homeownership less affordable, pushing many to rent rather than buy.
- Condos in Canada are, on average, more expensive than apartments. The average rent for a two-bedroom condo rose by 3.3% y/y to C$2,342 in March 2023. Compared to an apartment, rent for a two-bedroom condo is about C$269 a month higher.
- Supply of new rentals will rise this year, likely nudging up vacancy rates but with little impact on rents.
  - Our forecast for a record 235,500 housing completions this year includes an estimated 80,000 purpose-built rental units.
  - Also, a majority of recent pre-construction condo sales were to investors who likely plan to rent their units once built. This could add roughly 40-50,000 units to the rental supply this year, unless investors decide to sell and profit from the resale of their condos.



Source: Oxford Economics/Rentals.ca network data



Source: Oxford Economics/Haver Analytics/CMHC

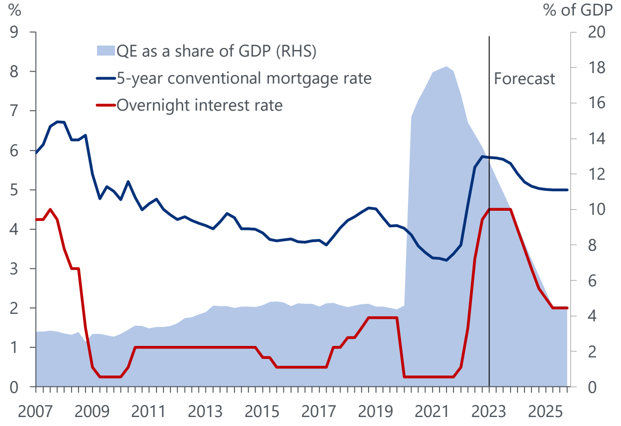
Average rent and average change in rent: March 2023										
	Average rent C$/month					% (y/y)				
Type	Total	0 Bed	1 Bed	2 Bed	3 Bed	Total	0 Bed	1 Bed	2 Bed	3 Bed
Apartment	1879	1361	1695	2073	2370	13.5	5	13.4	13.8	8.6
Condominium	2233	1867	2049	2342	2618	5.5	N/A	5.2	3.3	-1.8
House/Townhouse	2216	N/A	1391	1799	2358	8.7	N/A	2.7	5.6	8.2
All	**2004**	**1413**	**1720**	**2076**	**2373**	**10.8**	**5.8**	**9.5**	**10.1**	**7.6**

Source: Oxford Economics/Urbanation Inc/ Rentals.ca network data

Mortgage trends: Lending rates to remain elevated this year

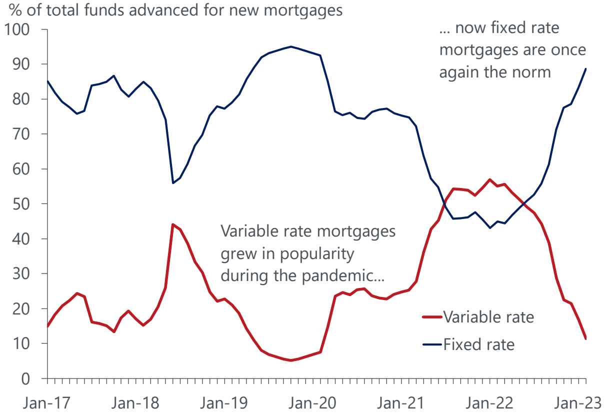
- The Bank of Canada held the target for the overnight rate steady at 4.5% in April. We expect the Bank to keep rates steady through the rest of this year before beginning to gradually ease the policy rate to its neutral level in early 2024.
- Higher mortgage rates have been a key trigger of the current housing correction. The average five-year conventional mortgage rate is still near its cycle high of 5.8%. We expect mortgage rates to ease slightly in 2023, before sliding to 5% by the end of next year.
- The share of new variable rate mortgages continued to fall in early 2023 as fixed term rates became more attractive. Variable rate mortgages accounted for just 11% of new mortgages in March 2023, down considerably from a peak 57% share in January 2022.
- High loan-to-income (LTI) mortgages make the economy more vulnerable to income or interest rate shocks. During the pandemic, high LTI mortgages became more popular, especially among first time homebuyers. However, since peaking in Q1 2022, the share of new mortgages with a high LTI (above 450%), has fallen for all types of homebuyers.
- The share for mortgages in arrears of all mortgages has ticked up from historic lows, and it likely will rise further as the economy slips into a recession this year.

Canada: Mortgage rate, overnight rate and QE



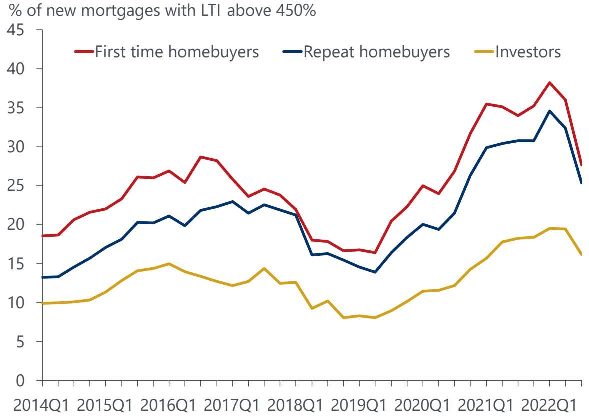
Source: Oxford Economics/ Haver Analytics

Canada: Funds advanced for new mortgages



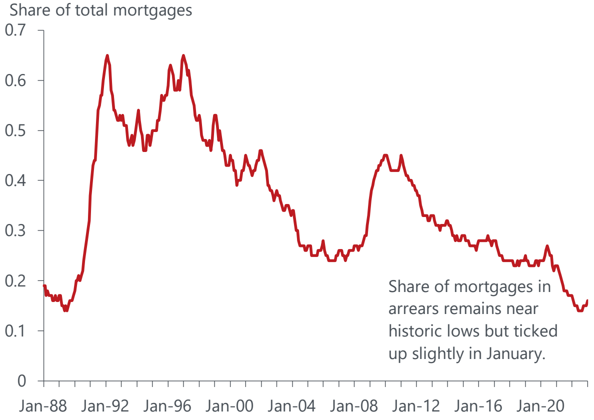
Source: Oxford Economics/Haver Analytics

Canada: Share of high loan-to-income (LTI) mortgages



Source: Bank of Canada

Canada: Mortgages in arrears



Source: Oxford Economics/Haver Analytics

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