Canadian Housing Outlook

Trying times

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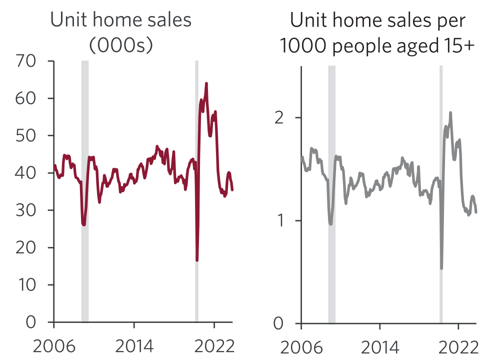
The housing market in Canada is in recessionary territory, as it faces its most significant test since the 1991 recession. Unit sales reached a peak of 64,000 in early 2021, and are now down by 45%, leaving them 12% below their pre-pandemic decade-average level (Chart 1, left). In per capita terms, activity looks even more depressed, with sales at lows not seen since the 2008 recession (outside of the early Covid lockdowns) (Chart 1, right). And activity will deteriorate further into the first half of 2024 as interest rates remain elevated, and supply floods the market.

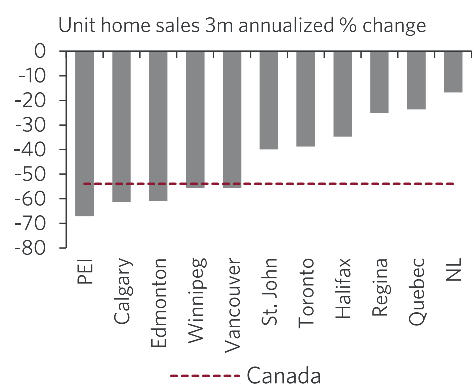
The weakness is pronounced in overvalued centers where debt service burdens are high, namely Toronto and Vancouver, causing a free fall in unit sales in those cities. But even areas that have seen a population influx aren't shielded from the weakness, as 3-month annualized sales are still down across the Atlantic and Prairie regions (Chart 2). Unit sales in those areas are still running above pre-pandemic levels, with the exception of Halifax and St. John. Still, we expect the downward pressure to get worse before it gets better. While the Bank of Canada has likely reached its terminal rate of interest, we do not expect a repeat of the speedy recovery seen immediately following the pause in rate hikes announced in January (Chart 3).

Chart 1: Unit home sales down sharply (l), per-capita sales even more depressed (r)



Source: CREA, CIBC.

Chart 2: Sales falling across the country



Source: CREA, CIBC.

Average price was shielded by lack of supply — that's changing

The reality is that despite the sharp correction in unit sales, the benchmark home price is down by only 11% since its peak in early 2022 and is still 38% above its pre-pandemic level. The rise in single-family home prices easily outpaced condo prices in the run-up during the low interest rate era of Covid, and a greater drop in that segment still leaves prices 42% above pre-Covid levels, compared to a still-lofty 30% for condo prices. Given that prices remain so far above pre-Covid levels, they are likely to fall further ahead, which would be in line with what historical price corrections have shown when accounting for the pace of run-up in prices.

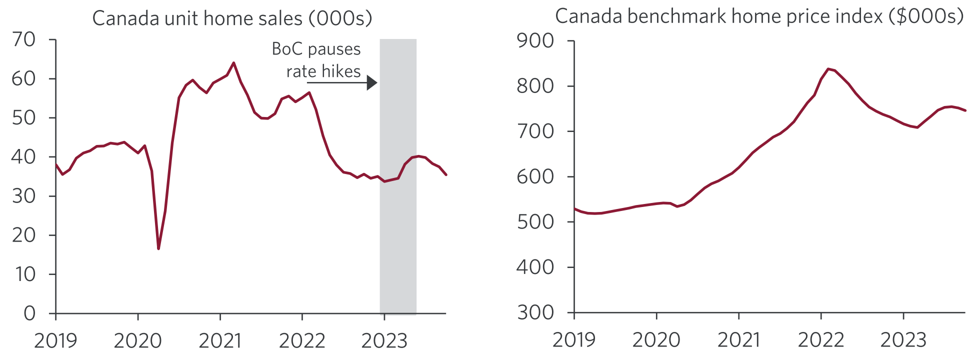
A big part of the immunity of prices to the drop in unit sales has been the lack of new listings on the market (Chart 4, left). From early 2022 to early 2023, the number of new listing was free falling, and declined by no less than 31%. That listing drought in an environment of falling sales worked to limit the decline in prices, and propped them up during the recovery in the spring of 2023.

However, things are changing. The number of new listings has rebounded notably in recent months, rising by 31% from the 19-year low reached in March 2023 (excluding the Covid lockdown months). That surge in part reflects increased distress sales as owners list their properties due to financing issues as mortgages payments increase rapidly (Chart 4, right).

Approaching a buyers' markets with no buyers

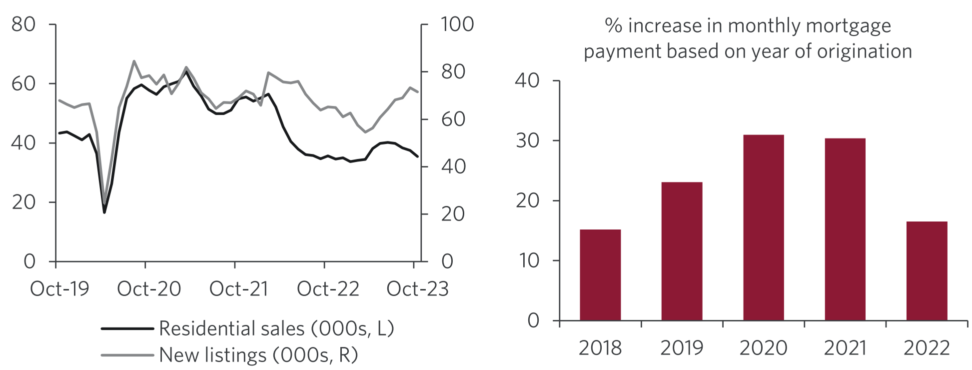
The result is that the sales-to-new listings ratio at the national level has moved from sellers' territory into a balanced market, but is swiftly heading towards buyers' territory (Chart 5, left), with the Toronto market already there, and Vancouver not far behind (Chart 5, right). Markets in the Atlantic and Prairie regions are closer to sellers' territory but are on a softening trajectory. The fact that we are at or approaching a buyers' market does not mean that there will be a significant increase in demand, as low affordability will keep potential buyers on the sidelines.

Chart 3: Sales quickly accelerated after BoC's pause from rate hikes in early 2023 (l), supporting a turnaround in home prices (r)



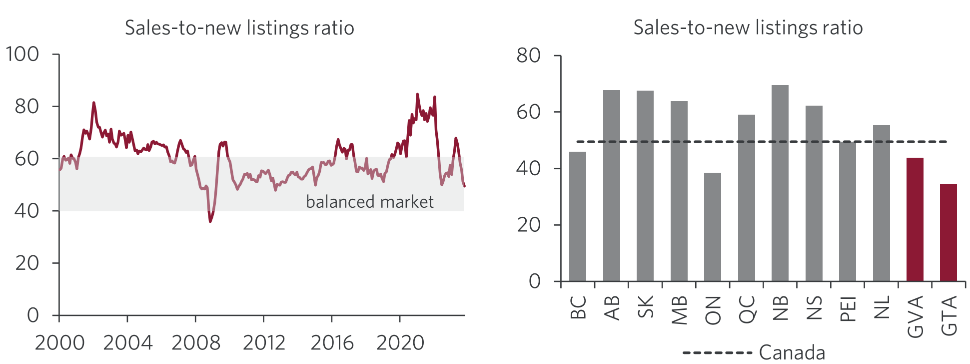
Source: CREA, CIBC.

Chart 4: Lower new listings propped up prices as BoC paused in early 2023 (l), financing issues as mortgages renew are triggering listings increase (r)



Source: CREA, CIBC.

Chart 5: Sales-to-new listings ratio balanced at national level (l), while overvalued markets approach buyers' market territory (r)



Source: CREA, CIBC.

The condo market will soften the most

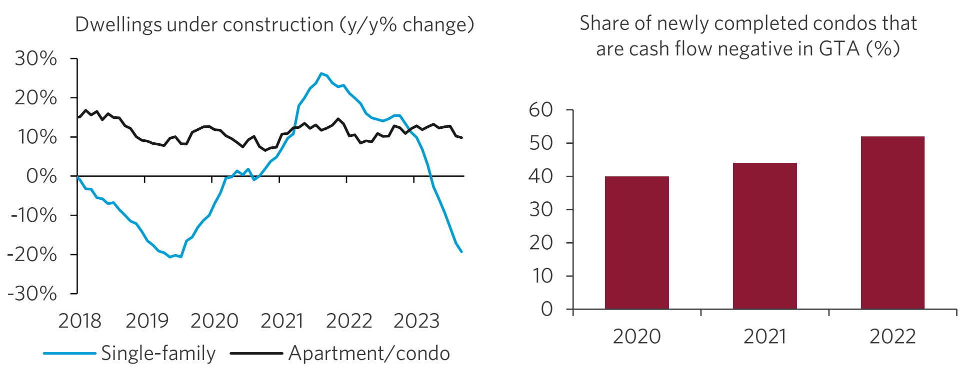
That softening trend will continue in the coming quarters and will be most visible in the condo market. While the recent slowing has led to a notable decline in the number of low rise units under construction, that's not the case in the condo space, where the number of units under construction is up by no less than 10% y/y (Chart 6, left). Adding to that new supply is increased selling in the resale market, as investors (mostly of multiple unit holders) are listing aggressively due to growing negative cash flow positions (Chart 6, right). Indeed, rent is increasing strongly at 7% y/y, but mortgage interest costs are escalating by 31% y/y, making owning financially unfeasible as an investor.

Similarly, the new construction data has shown an upward trend in multi-family construction per capita despite a deterioration in demand from investors (Chart 7, left), in contrast to the pull back seen in the single-family market, which further suggests that the condo space will see the bulk of the weakness ahead. However, the recent drop in condo presales in Toronto implies a slowdown in building ahead despite permit issuance trends (Chart 7, right).

The mortgage market — a shadow of its former self

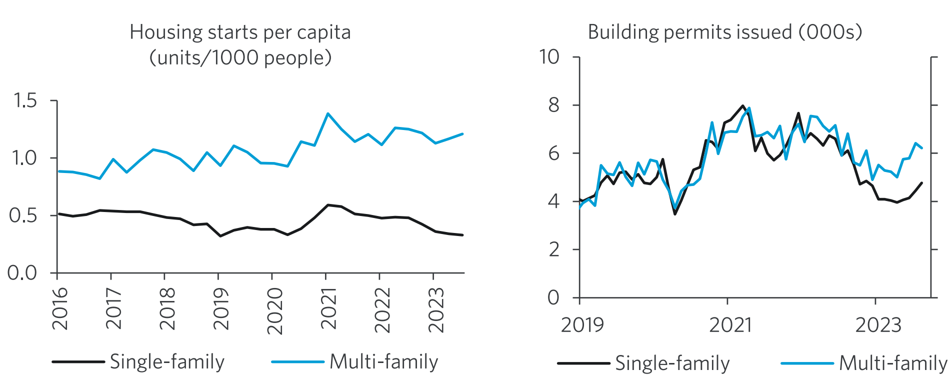
Reflecting that weakness, activity in the mortgage market has slowed notably, with the number of mortgages now slightly below its year-ago level, and mortgages outstanding growth plummeting in year-over-year terms (Chart 8, left), reflecting the drop in originations in 2022-23, and smaller mortgages on average.

Chart 6: New condo supply set to increase further (l), while a rising share of existing owners in a negative cash flow position are adding supply to the resale market (r)



Source: CMHC, Urbanation, Teranet, CIBC.

Chart 7: Supply pipeline for new multi-family units rising in per capita terms (l); building permits increasing (r)

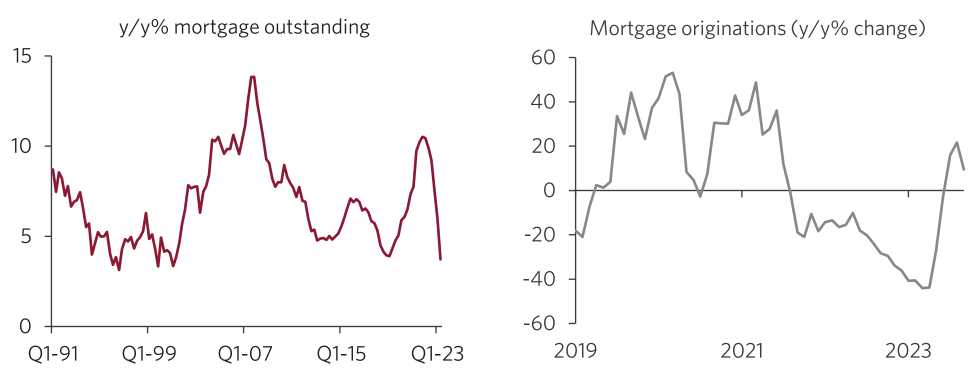


Source: CMHC, CIBC.

In fact, the current pace of slowing in mortgages outstanding is the fastest on record. While mortgage originations turned higher temporarily in the summer months (Chart 8, right) as signs of the overnight rate peaking presumably attracted some buyers back into the market, that move hasn't been sustained based on the more timely unit sales data. Although delinquency rates in the mortgage market remain low and are well below pre-pandemic levels, a further rise in the unemployment rate along with widespread mortgage renewals at higher interest rates are likely to result in an increase in delinquencies ahead.

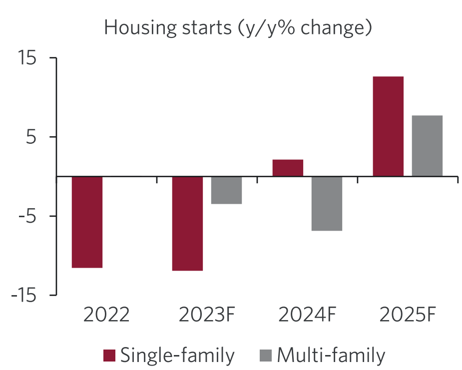
With listings on an upward trajectory, and demand from strong population growth and a relatively tight labour market eroded by high interest rates, housing market activity will continue to deteriorate. Caution amongst investors will account for a significant portion of the slowing, as investors account for almost one third of home sales and are highly leveraged. Accordingly, condo sales and prices will see the most significant damage. Total unit home sales could fall by additional 10-15% from now through Q1 2024, and are unlikely to rebound to 2019 levels before early to mid-2025. Homebuilding will retreat further, particularly in the condo space where presales have dropped off, which will make a tight rental market even tighter (Chart 9). As the Bank of Canada begins cutting interest rates in 2024, demand will start to recover, particularly in the second half of the year and into 2025, resulting in a rebound in home prices.

Chart 8: Mortgages outstanding growth close to stalling (l), originations bounced back temporarily (r)



Source: Statistics Canada.

Chart 9: Multi-family building will be hit hard next year; single-family to rebound as interest rates drop in H2



Source: CMHC, CIBC.