Canada Housing Market Outlook: Time for Slower Price Growth

Introduction

The housing market in Canada seems to have stabilized. House price growth slowed between early last year and the middle of this year, though home sales and house price growth increased in July and August. Since mid-2016, provincial governments, the Office of the Superintendent of Financial Institutions, and the Bank of Canada have successively intervened to slow housing demand with interest rate hikes, mortgage borrower stress tests, and taxes on purchases by foreign nonresidents. British Columbia and Ontario have also passed supply-side measures, including taxes on vacant apartment homes and reduced restrictions on urban construction. The main downside risk now is that the measures taken to stabilize housing affordability and mortgage credit quality may prove too strong and may precipitate not just a house price correction, but also an extended decline in sales and possibly a reduction in homeownership. However, the data for July and August indicate that home sales and house price growth have started to rally, so it is too soon to be pessimistic.

The national housing market still has a long way to go before it regains the level of affordability it had before 2015, when prices in Toronto and Vancouver took off, but has now taken the first steps to do so. The overall effect of policy interventions to slow purchase demand can be seen by comparing current and projected short-term house price growth with house price growth before policy interventions took effect. The important points are, first, that there is no serious projected house price correction. Second, median family income growth will have a good chance of keeping up with and even outpacing house prices in coming years, improving affordability. Third, the lack of a significant house price decline will prevent mortgage debt performance from deteriorating, especially after 2020, when mortgage rates level off. But given that most of the house price increases took place in Toronto and Vancouver, there is still the downside risk that higher mortgage rates and the borrower stress tests could push down demand in the Atlantic and Prairie provinces, leading to a full house price correction and a perceptible drop in sales in these regions.

Canada Housing Market Outlook: Time for Slower Price Growth

BY ANDRES CARBACHO-BURGOS

The housing market in Canada seems to have stabilized. House price growth slowed between early last year and the middle of this year, though home sales and house price growth increased in July and August. Since mid-2016, provincial governments, the Office of the Superintendent of Financial Institutions, and the Bank of Canada have successively intervened to slow housing demand with interest rate hikes, mortgage borrower stress tests, and taxes on purchases by foreign nonresidents. British Columbia and Ontario have also passed supply-side measures, including taxes on vacant apartment homes and reduced restrictions on urban construction. The main downside risk now is that the measures taken to stabilize housing affordability and mortgage credit quality may prove too strong and may precipitate not just a house price correction, but also an extended decline in sales and possibly a reduction in homeownership. However, the data for July and August indicate that home sales and house price growth have started to rally, so it is too soon to be pessimistic.

Still, the slowdown in house price growth is real. Condo apartment prices as measured by Real Property Solutions have leveled off in Toronto and have started to fall in Vancouver and Montréal over the past three to four months. Single-family house price growth has varied more across regions but on average has turned flat since mid-2017, when mortgage rates started to increase, with further downward pull in January with the imposition of the OSFI stress tests. In the second quarter, the ratio of the national median composite house price level to estimated median family income fell for the first time since 2011. The national housing market still has a long way to go before it regains the level of affordability it had before 2015, when prices in Toronto and Vancouver took off, but given that most of the house price increase took place in those metro areas, there is still a slight downside risk that higher mortgage rates and the borrower stress tests could push down demand in the Atlantic and Prairie provinces too strongly, leading to a full house price correction and a perceptible drop in sales.

Recent Performance

Because of falling affordability, policy interventions, and mortgage rate hikes, sales have trended downward since mid-2016, though they may well have reached bottom. According to the Canadian Real Estate Association, sales outside Québec peaked at 550,000 annualized in the second quarter of 2016 and reached bottom at approximately 440,000 in the second quarter of this year. In July and August, a modest recovery took place, and August sales were back at 470,000 annualized. The market remains relatively tight, with CREA's inventory-to-sales ratio reaching a cyclical bottom of 4.2 months of sales in March 2017, gradually climbing back to 5.2 months in August.

Data for Québec are more upbeat.[1] According to the Québec Federation of Real Estate Boards, home sales increased 6% year over year in the second quarter and totaled

slightly less than 85,000 from June 2017 to June 2018. Québec's sales were helped by the looser market, with the inventory-to-sales ratio averaging 7.4 months of sales in the second quarter of this year.

The slowdown in house prices has become more evident with each passing month. Only in Toronto have house prices started to increase in the past two months after almost a year of previous decline. For the other large metro areas, prices have been either flat or in slight decline since the imposition of the full-coverage OSFI borrower stress tests (see Chart 1). Overall, national house price growth has been slower since early 2017, when the Ontario Fair Housing Plan moved to restrict housing demand in the face of an insufficient supply of available homes, though British Columbia had intervened in the Vancouver housing market a full six months earlier.

The slowdown is even more evident when examining house price dynamics in the six months between February and the

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1   Because the Québec Federation of Real Estate Boards is not a member of CREA, its housing market statistics are published separately.

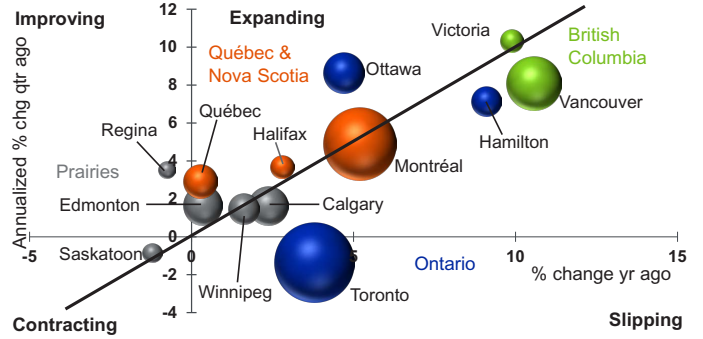## Chart 1: Toronto Starts to Lose Momentum

RPS composite house prices, Jan 2010=100, SA
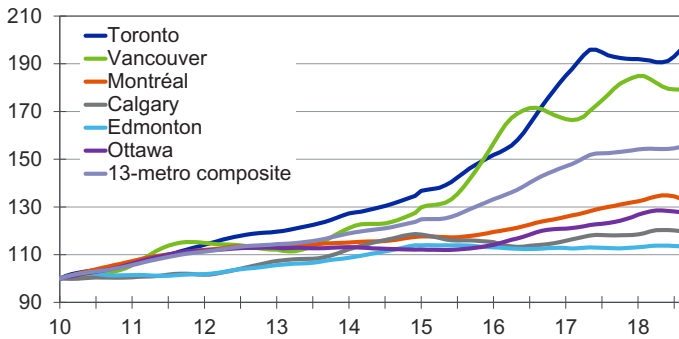
Sources: RPS, Moody's Analytics

Chart 2: Good HPI Growth Early This Year…

Composite index, 1-yr vs. 1-qtr performance, 3-mo MA, Feb 2018

Sources: RPS, Moody's Analytics   * Bubble size indicates # of households

last month of house price data in August, as shown in Charts 2 and 3. In February, several metro areas still had current annualized house price growth that equaled or exceeded year-over-year growth. By August, only Toronto fit that category, while year-over-year house price growth fell to below 5% for all 13 RPS composite index metro areas except Victoria. The Prairie metro areas are now showing flat or declining price growth, an expected consequence of their recent economic slowdown.

Demand is likely to slow in the next one to two years, given that credit is tightening and the cost of homeownership is increasing. The five-year mortgage rate bottomed out at 3.62% in April 2017 but has since gained 81 basis points to end August 2018 at 4.43%. Although the price slowdown has at last caused the national ratio of home value to estimated median family income to peak, the ratio of homeownership costs to average

household disposable income tracked by the BoC is still increasing (see Chart 4).

Housing finance is doing well for now but is also starting to show the first looming danger signs. Thanks to an extended period of low mortgage rates before mid-2017, the national mortgage delinquency rate is lower than at any point since the early 1990s (see Chart 5). However, there are significant regional imbalances: Delinquency rates for Alberta, Saskatchewan and the Atlantic provinces are significantly higher than the national average, while higher incomes make the delinquency rates for British Columbia and Ontario substantially lower. More important, the slow growth of income relative to house prices has led to a steady increase in the ratio of mortgage debt service to disposable income over the past 15 years, and this ratio is likely to keep increasing before the BoC finishes tightening interest rates. Although it is possible to disagree over the merits of the

new mortgage lending stress tests, the move to make mortgage lending more stringent is not surprising, given this 15-year trend.

Residential construction is responding about as expected to the evolution of housing demand. Single-family housing starts have trended flat for the past four years and are now at 70,000 annualized units, much less than last decade's prerecession total of slightly more than 120,000 units. By contrast, apartment construction is still trending slightly upward and is now at 150,000 annualized units compared with the prerecession total of slightly less than 120,000 units. The ratio of residential construction workers to units under construction has fallen to a record low of 3.3, though this is at least as much an indication of the shift to less labour-intensive apartment construction as it is of the construction industry being near full capacity. Overall, the construction focus indicates that the industry sees slowing de-
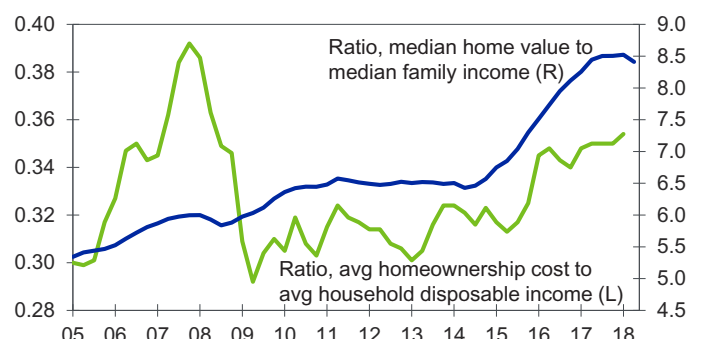
Chart 3: …That Has Now Stalled

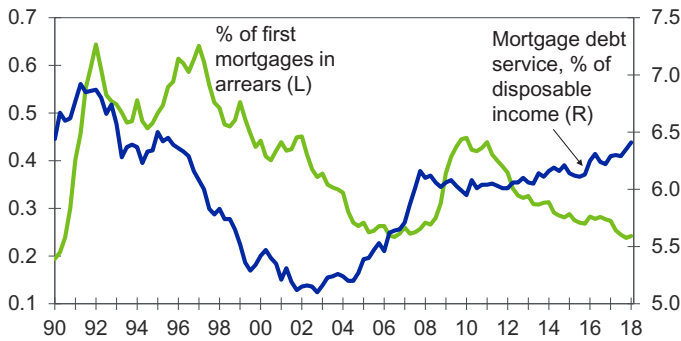Composite index, 1-yr vs. 1-qtr performance, 3-mo MA, Aug 2018
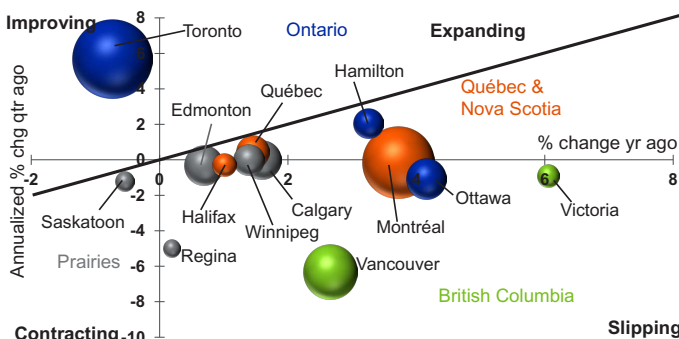
Sources: RPS, Moody's Analytics   * Bubble size indicates # of households

Chart 4: Affordability Is Still Deteriorating

Sources: RPS, Bank of Canada, Statistics Canada, Moody's Analytics

Chart 5: Mortgage Debt Is Good for Now

Sources: Canadian Bankers Association, Statistics Canada, Moody's Analytics

Chart 6: Vancouver and Toronto Hit Ceiling?

RPS median house price, s-f detached, % deviation from trend

Sources: RPS, Moody's Analytics

mand for new single-family home purchases over the next few years, while apartment construction is still a priority, given cyclically low rental vacancy rates in Toronto and Vancouver.

Valuation

The Moody's Analytics forecast model for the RPS house price indexes compares current house prices to long-term trend prices. These trend prices are less sensitive to business cycles and are determined by local household income, population size, the overall new house and land price index, and, for a few metro areas, the deflated stock market price index—a proxy for national wealth—interacting with metro area population dynamics. The divergence between the current price and this long-term trend price determines the degree of over- or undervaluation, which is an important driver of the house price forecast.[2]

In addition to standard mechanisms by which an overvalued housing market tends to move into correction territory—reduced demand due to low affordability and increased supply due possibly to resurgent construction—direct policy interventions such as the new stress tests and provincial transfer taxes are also part of what might be called the error correction mechanism by which house prices in a region return to their long-term trend values.

Since the last Moody's Analytics Canada Housing Market Outlook report published in May, the valuation situation of the Canada metro areas has improved slightly. Single-family house price overvaluation is still at a critical point for Toronto and Vancouver (see Chart 6) but has improved perceptibly since mid-2016, when the first sale restrictions on the Vancouver market were imposed. More important, the reductions in overvaluation accomplished so far in both markets have come with only a minimum of depreciation and with as yet no deterioration in mortgage debt performance. Of the other four large Canada metro areas, Montréal, Calgary and Ottawa are approximately correctly valued and only Edmonton is now undervalued, an unsurprising result, given that its economy slowed with the late-2014 oil price decline, and this slowdown drastically reduced house price growth.

Since the new-home market definitely influences the resale market, and residential construction is one mechanism by which house prices can be pushed back toward being correctly valued, a brief look at the new-home market is warranted. If examined using a simple ratio such as inventory
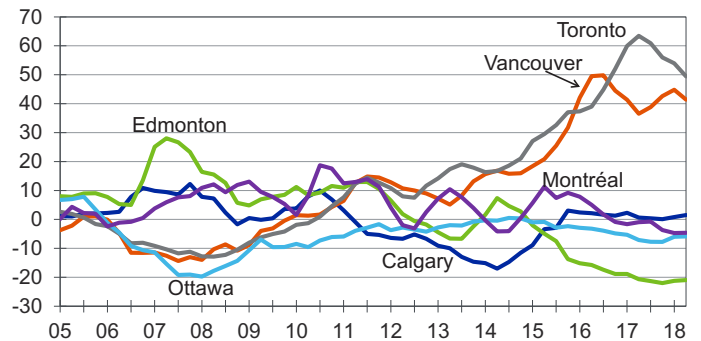
to sales, the new-home market is at first glance quite tight, enough so that one might expect upward drag on existing homes. However, over the past 10 years, the balance between inventory and sales has on average improved, with a recovery in construction between 2011 and 2013 and the more recent decline in sales being important landmarks.

Chart 7 tracks the size of new single-family home inventory relative to national new-home sales for the six largest metro areas and the remaining 27 metro areas as one group. Some metro area new-home markets look deceptively tight because developers seldom pull the trigger on construction without immediate sales prospects. Toronto, for example, has much less new-home inventory, resulting in very little, if any, time spent on market; most single-family homes are sold before construction is started. Vancouver has a larger inventory, possibly because its low affordability re-

Chart 7: New-Home Market Loosens…

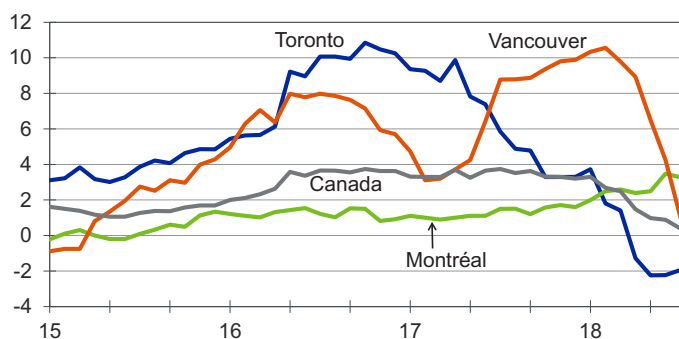Ratio, new single-family inventory to total absorptions*, 3-mo MA
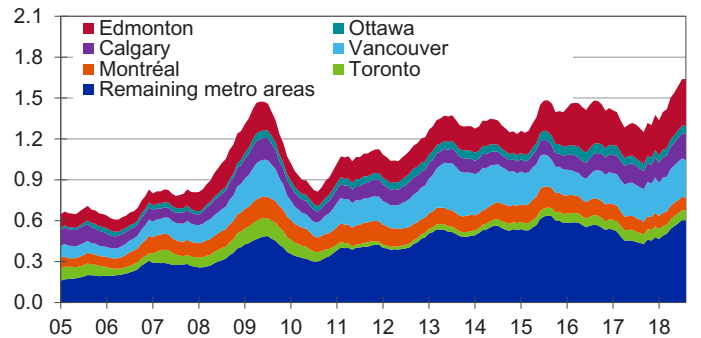
Sources: CMHC, Moody's Analytics   * Total for 33 census metropolitan areas

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2   For full details on the Moody's Analytics forecast model for RPS house price indexes, see "Moody's Analytics Canada RPS House Price Index Forecast Methodology", available from Moody's Analytics or RPS.
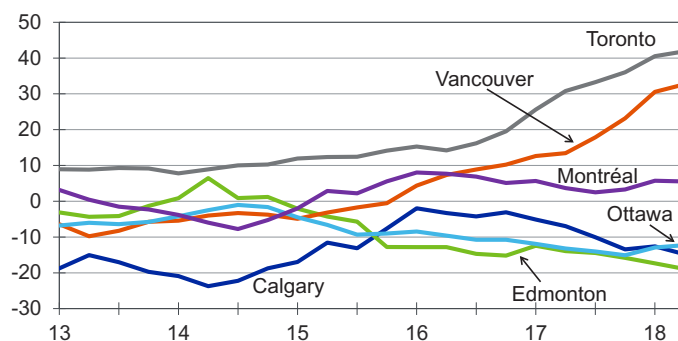
Chart 8: …And New-Home Prices Slow

New-home price indexes, % change yr ago

Sources: Statistics Canada, Moody's Analytics
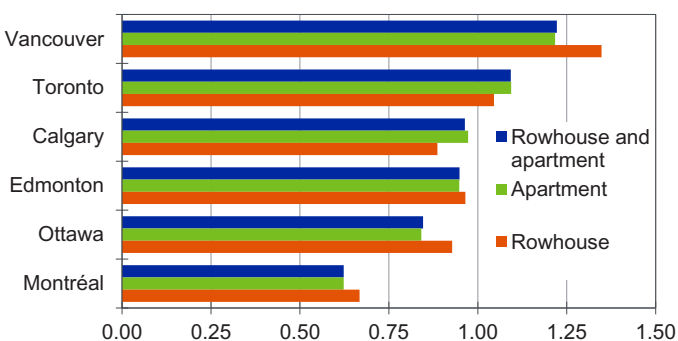
Chart 9: Condos Are Still Climbing

RPS median condo apartment price, % deviation from trend

Sources: RPS, Moody's Analytics

stricts the new-home market to the upper income tiers, where there is less total demand. Lastly, since mid-2017 the combined new-home inventory-to-sales ratio has increased mainly because of a slowdown in sales in the small and medium-size metro areas, with metro areas around Toronto being likely candidates; inventory for Edmonton has also increased somewhat.

Overall, despite the relatively low national inventory-to-sales ratio, the new-home market now faces weaker demand than at any time since the 2009 downturn, and this is showing in the price indexes for new homes, where first Toronto and then Vancouver new-home prices have slowed drastically and dragged the national price index down with them (see Chart 8). So the new-home market can hardly be said to be adding upward price pressure on the resale market and may in fact be doing the reverse.

There is now much more demand pressure and overheating in the national market for condo apartments, and again the greatest pressure is in Toronto and Vancouver, with most other metro areas having apartment prices that are either correctly valued or moderately undervalued, as shown in Chart 9. Tight demand relative to supply for condo units is only the start of the story. An important reason for the tight supply of condo apartments is that, in Toronto and Vancouver at least, apartments have a relatively more profitable use. Apartment rents are significantly higher for these two metro areas compared with others, even when deflated by their respective province's CPIs

(see Chart 10).[3] The rental market also affects the market for single-family homes, given that a significant share of the supply of row-houses and other attached single-family homes is also rented out rather than being listed for sale. In contrast with Toronto and Vancouver, rents in Calgary, Edmonton and Ottawa are more moderate, and are even lower in Montréal, which now seems to enjoy a housing affordability advantage relative to the other large metro areas in Canada.

Macroeconomic outlook

Two macroeconomic projections now dominate housing markets in Canada. The first is that the BoC will continue to tighten short-term interest rates through 2020 in order to head off inflation and also maintain the value of the Canadian dollar relative to its U.S. counterpart. With some lag, monetary tightening will pull up mortgage rates. The five-year mortgage rate is now at about 4.4% after bottoming out at 3.6% in mid-2017; the Moody's Analytics baseline projection is that it will continue to increase

Chart 10: Rent Advantage for Montréal

2017 rent for 2-bedroom dwellings, 2002CAD ths*

Sources: CMHC, Statistics Canada, Moody's Analytics   * Structures with 3+ units

until it levels off at about 6% by late 2020. This projection is subject to risks on both sides. With unexpectedly strong growth, BoC tightening might lead the mortgage rate to top out at slightly more than 6.6% by late 2020. By contrast, an extended slump caused by an unexpected financial crisis and mishandling of monetary policy would pull the mortgage rate in reverse, possibly bottoming out at 3.5% by the end of 2020.[4] In the baseline case, the two-year upward trend in mortgage rates, combined with the parallel and higher posted mortgage rate used for OSFI stress tests, will perceptibly reduce the pool of potential mortgage borrowers in the next two years.

One projection that will counteract this effect is that wage income growth is now

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3 Following usual practice, rents are deflated by the ex shelter CPI rather than the full CPI, so as to give something similar to a rental price relative to nonrental prices.

4 The two cases are the Moody's Analytics S0 and S4 scenarios, respectively. In terms of probability, either scenario has only a 4% probability of taking place, as opposed to more moderate outcomes.

kicking into gear and will be strong for the next year before the BoC's tightening clamps down on inflation and wage growth. The current baseline projection is that, thanks to stronger wage growth, per capita disposable income growth might peak at almost 7% per year in early 2019 before receding (see Chart 11). To the extent that monetary tightening can pull back on house price growth while a tight labor market leads to a temporary surge in income growth, housing affordability in Canada should at last start to improve by the end of the monetary tightening period.

Table 1 presents the current macroeconomic outlook, starting with the RPS house price indexes. In addition to the previous discussion, another aspect of the outlook is that whatever downward pressure residential construction has exerted on house price growth so far will no longer be present as interest rate tightening continues: Housing starts most likely have peaked and will continue to fall for the next four years, so that more existing-home listings will have to fill the supply gap. Even so, house prices on average will fall slightly this year and will subsequently grow at only a fraction of the feverish pace of 2015-2017.[5]

Other items in Table 1 are as expected. Thanks to interest rate tightening, the unemployment rate may already have bottomed this year and will peak at around 6.6% in 2021 before it starts to fall. While affordability will improve, the ratio of outstanding mortgage debt to total disposable income will increase slowly but steadily; most likely, this ratio would have increased perceptibly faster without OSFI's intervention to slow mortgage originations.

The regional outlook

The regional outlook for house prices has not changed drastically since the May report. In particular, income growth will continue to be slower in the Prairie and Atlantic provinces, whereas Toronto and British Columbia will lead, and Québec will be in between. In addition, the Atlantic provinces also have to cope with much slower demographics—Moody's Analytics projects that, out of the four provinces, only Prince Edward Island will have any population growth in the coming five years. Also, the effects of the late-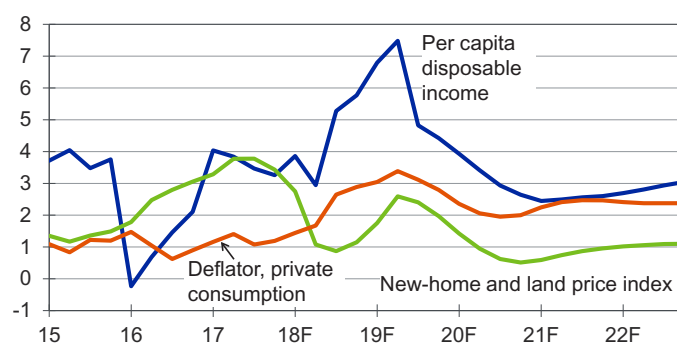2014 oil price shock are still evident in the Prairie provinces, where slow house price growth has resulted in some metro areas, notably Edmonton and Saskatoon, being undervalued.

Table 2 shows the short-term dynamics of the single-family house price forecast. The first column shows over- or undervaluation. As in the May Housing Market Outlook report, most Ontario metro areas are still significantly overvalued, but this overvaluation has on average started to decrease; Toronto is 51% overvalued now but was 53% overvalued in the May report.[6] Thanks to slower house price growth, larger decreases in overvaluation include Barrie, Guelph, and Brantford.

Chart 11: Stronger Income Growth Ahead
Macroeconomic indicators, % change yr ago, baseline forecast

Sources: Statistics Canada, Moody's Analytics

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5   Starting in April 2018, Moody's Analytics also re-specified the forecast equation for the RPS national composite house price index. Both in this and the May report, projected house price growth is significantly stronger than in previous reports.

6   The usual caveat for measuring overvaluation continues to apply: A high degree of overvaluation is not a surefire guarantee that house prices will start to correct in the near future, especially if wealth inflows affecting local housing markets continue unabated.

Table 1: Canada Housing Market, History and Baseline Forecast

	Most recent	2016	2017	2018	2019	2020	2021	2022	2023
Detached single-family house price index, % change *	1.4	13.4	7.7	-1.9	0.5	0.8	2.5	3.4	3.4
Condo apartment price index, % change *	9.9	10.0	13.6	5.0	0.6	0.3	1.9	2.6	2.7
Composite house price index, % change *	1.8	10.6	5.9	-0.6	2.0	1.8	3.6	4.2	4
Real per capita disposable income, % change	2.4	0.0	2.4	2.3	2.7	1.1	0.1	0.5	0.7
Unemployment rate, %	5.9	7.0	6.3	5.9	6.2	6.5	6.6	6.5	6.6
Avg mortgage rate, 5-yr, %	4.3	3.7	3.8	4.7	5.2	5.8	6.0	6.0	6.0
Housing starts, ths	219.8	198.7	219.2	218.8	206.4	188.3	180.6	180.7	177.4
% change	7.2	2.2	10.3	-0.2	-5.7	-8.8	-4.1	0.0	-1.8
Ratio, median dwelling price/median family income	8.4	7.8	8.4	8.3	7.9	7.8	7.8	7.8	7.8
Ratio, outstanding mortgage debt/disp. income	1.1	1.1	1.1	1.1	1.2	1.2	1.3	1.3	1.3

*Fourth qtr, yr over yr
Sources: RPS, Statistics Canada, CMHC, Moody's Analytics

Table 2: Canada Subnational Forecast, Median Detached House Price

	% deviation from trend price, 2018Q2*	% change annualized, 2018Q2	Avg annualized house price growth, %, 2018Q3-2019Q2	Avg annualized house price growth, %, 2019Q3-2020Q2
Canada		**-2.5**	**-1.4**	**0.9**
Alberta		2.4	-1.9	-1.5
Calgary, census metropolitan area	1.8	3.8	-2.9	-3.6
Edmonton, census metropolitan area	-20.4	2.9	-1.0	0.4
British Columbia		-7.6	-2.1	3.1
Abbotsford, census metropolitan area	29.7	-4.9	-3.6	2.5
Kelowna, census metropolitan area	13.8	-0.5	-1.3	3.6
Vancouver, census metropolitan area	41.4	-11.3	-2.9	3.4
Victoria, census metropolitan area	20.8	4.6	1.6	1.0
Manitoba		5.1	0.7	-0.4
Winnipeg, census metropolitan area	7.6	5.6	0.8	-0.6
New Brunswick		2.0	0.3	1.1
Moncton, census metropolitan area	-6.3	9.4	0.8	1.9
Saint John, census metropolitan area	-6.1	11.0	2.0	1.2
Newfoundland and Labrador		2.8	-1.7	0.4
St. John's, census metropolitan area	6.4	3.1	-1.8	0.2
Nova Scotia		2.0	0.1	0.8
Halifax, census metropolitan area	-6.1	1.8	1.0	1.2
Ontario		-0.6	-2.9	0.9
Barrie, census metropolitan area	36.4	-6.3	-5.6	1.1
Brantford, census metropolitan area	35.0	1.1	-3.3	-1.1
Greater Sudbury, census metropolitan area	8.7	14.4	1.6	0.6
Guelph, census metropolitan area	28.1	0.4	-2.4	2.1
Hamilton, census metropolitan area	42.0	4.0	-2.3	-0.2
Kingston, census metropolitan area	-7.1	1.6	-3.4	-0.7
Kitchener, census metropolitan area	36.5	4.3	-2.3	-0.8
London, census metropolitan area	13.2	9.8	-0.1	0.2
Oshawa, census metropolitan area	43.4	-3.8	-3.4	2.3
Ottawa-Gatineau, census metropolitan area	-5.0	4.6	-0.6	2.2
Peterborough, census metropolitan area	23.7	4.6	-1.8	0.9
St. Catharines-Niagara, census metropolitan area	31.4	3.3	-2.7	-0.4
Thunder Bay, census metropolitan area	22.5	3.1	-3.3	-0.8
Toronto, census metropolitan area	51.6	-3.5	-3.6	1.4
Windsor, census metropolitan area	-0.2	4.5	-0.9	-0.3
Prince Edward Island		9.6	-4.3	-2.0
Quebec		4.4	1.3	2.2
Montréal, census metropolitan area	-3.8	6.0	2.8	3.1
Québec, census metropolitan area	24.8	2.1	-1.2	0.2
Saguenay, census metropolitan area	8.8	3.2	-0.1	0.5
Sherbrooke, census metropolitan area	7.5	1.1	-0.4	1.4
Trois-Rivieres, census metropolitan area	5.3	3.2	0.0	1.6
Saskatchewan		-1.1	-4.3	-2.7
Regina, census metropolitan area	12.1	0.2	-7.5	-7.8
Saskatoon, census metropolitan area	-7.2	-1.1	-2.0	1.3

Italicizedmetro areas are part of the RPS 13-metro-area composite index.

*Census metropolitan areas only

Sources: RPS, Moody's Analytics

Vancouver's overvaluation also decreased slightly, but is still at more than 40%. By contrast, Montréal's median single-family home price is undervalued by less than 4%; most likely, Montréal's housing market need not worry about insufficient demand or unaffordability for some years to come.

Edmonton remains the most undervalued metro area, according to Table 2. After the period of mortgage rate increases is over, Edmonton should experience faster house price growth thanks to a combination of reduced listings and increased opportunistic purchases. Saskatoon and the Atlantic metro areas other than St. John's are moderately undervalued, but the resulting upward price pull will not fully offset their projected slower income and population growth.

The second column shows annualized second quarter house price growth, which has significant persistence effects on house price growth over the next few quarters. Based on such persistence effects, Toronto and Vancouver house prices will see strong downward pull over the next two to three quarters. By contrast, good house price growth in Montréal in the second quarter will partly carry over into the next two to three quarters. Of the smaller metro areas, the strongest short-term persistence effects will be in the New Brunswick metro areas and in Greater Sudbury, Ontario.

The third column shows projected median single-family home price growth over the coming year. The largest corrections will be in those metro areas that have a combination of recent house price declines, high overvaluation and slower projected income growth—Barrie and Regina lead the list, which can also include Prince Edward Island, though it lacks its own metro area. Because of interest rate tightening and the continuing impact of the mortgage stress tests, there are no metro areas that will have strong house price growth in the coming year.

The fourth column of Table 2 shows average annualized growth for mid-2019 to mid-2020, after current persistence effects and the initial impact of the mortgage stress tests have worn off, but in which rising mortgage rates continue to exert downward drag. Given its current overvaluation and the frag-

ile state of the Saskatchewan economy, Regina will have the largest house price decline during this period. Toronto and Vancouver will join Montréal as having moderate house price growth in those four quarters. Alberta's housing market will be mixed, with prices flat in Edmonton but still falling in Calgary.

Table 3 ranks average annualized five-year house price growth for the current metro area forecasts and compares them with the forecasts from May's Housing Market Outlook report. Of the 13 metro areas in the RPS transactions-weighted national composite house price index, Saskatoon, Edmonton, Montréal, and Vancouver will have good house price growth due to a combination of better per capita disposable income growth and/or bouncing back after a period of house price declines and resulting undervaluation. Toronto's house price growth will be more moderate because of the combined effects of rising interest rates, transfer taxes on foreign purchases, more stringent stress tests, and overvaluation that has seriously reduced affordability. Metro areas that will have mildly negative average house price growth over the next five years include Calgary and Regina; they

have some combination of house price overvaluation and slow projected income growth in the medium term. The largest change between the May and current reports is Calgary: The Alberta metro area house price forecasts have stronger sensitivity to increases in mortgage rates and, unlike Edmonton, the impact for Calgary was not cushioned by sizable current undervaluation of house prices.

Table 3: Medium-Term House Price Outlook, Census Metropolitan Areas

Avg annualized projected single-family house price growth, %, 2018Q2-2023Q2

	May 2018 forecast	Aug 2018 forecast
Canada	**3.0**	**1.5**
Kelowna	2.9	3.5
Guelph	3.1	3.0
Saskatoon	4.5	2.9
Edmonton	5.3	2.8
Montréal	4.3	2.6
Vancouver	3.9	2.4
Barrie	2.3	2.3
St. John's	2.4	2.3
Ottawa-Gatineau	3.4	2.2
Halifax	4.3	2.0
Abbotsford	1.4	1.8
Oshawa	3.1	1.8
Victoria	2.9	1.6
Sherbrooke	3.7	1.6
Moncton	-2.0	1.5
Toronto	2.9	1.3
Greater Sudbury	-1.2	1.2
Québec	2.9	1.1
Saint John	-1.5	1.0
Trois-Rivières	-1.3	0.9
London	1.9	0.9
Winnipeg	2.4	0.6
Peterborough	-0.5	0.6
Saguenay	-1.6	0.5
Kitchener	1.7	0.3
Brantford	-0.2	0.2
Kingston	0.5	0.2
Hamilton	1.6	0.1
St. Catharines-Niagara	1.6	0.0
Windsor	2.1	-0.3
Calgary	3.2	-0.4
Thunder Bay	-1.0	-0.4
Regina	1.8	-0.7

Italicized metro areas are part of the RPS 13-metro-area composite index.

Sources: RPS, Moody's Analytics

The overall effect of policy interventions to slow purchase demand—and, if possible, increase the supply—can be seen by comparing the numbers in the second column to house price growth in 2015-2017 before interventions took effect. Compared with Toronto and Vancouver during these years, growth in Table 3 looks downright anemic. But the important points are, first, there is no serious projected house price correction outside of Regina. Second, median family income growth will have a good chance of keeping up with and even outpacing house prices in coming years, improving affordability. Third, the lack of a significant house price decline will prevent mortgage debt performance from deteriorating, especially after 2020, when mortgage rates level off. Such a soft landing is the best one can ask for, given the seriously overheated and regionally imbalanced state of the national housing market two years ago.

Risks

The most plausible risk to this baseline outlook has already been pointed out by CREA and other Realtor and mortgage lender associations. The post-2017 mortgage lending stress tests could be a source of downside risk or possibly of risks that future interest rate tightening will be less effective. Many analysts think that the OSFI stress test for conventional borrowers with 20% down payments is too strong and will reduce actual purchase demand by creating too much financial stringency, especially in lower-income Prairie and Atlantic housing markets. The resulting downward pressure on purchases could weigh on not just home values, but also on the financial balance sheets of real estate developers and on residential construction; by trying to tamp down a housing bubble, OSFI could actually add perceptibly to the drag on Canada's GDP growth.

Conversely, the new stress tests could result in a serious reshuffling of mortgage lending as potential buyers shift from banks toward credit unions and other nonbank mortgage lenders that are not regulated by OSFI. This possibility would result in the stress test being less effective in reducing house prices and purchases. It would also be less effective in its primary goal of preserving mortgage credit quality as interest rates climb, setting the stage for a worsening of mortgage debt performance several years down the line.

Macroeconomic risks are less straightforward, but still easy to describe. A blowup in the U.S.-China trade dispute may well lead to collateral damage for Canada, given the extensive use of Chinese and U.S. components in manufacturing, and would result in slower GDP and income growth, indirectly affecting housing markets.

But monetary policy would have a less roundabout effect and would thus involve stronger downside risks. The key year in the current policy cycle will be 2020, after which BoC interest rate tightening of the gap between long-term interest rates and shorter-term money market rates will be at its narrowest. The narrow gap between short- and long-term interest rates could lead to a tightening of credit that is worse than expected and results in a stronger slowdown in total investment spending.

About the Author

Andres Carbacho-Burgos is an economist at the West Chester office of Moody's Analytics. He covers the U.S. housing market, residential construction, and U.S. regional economies. Before joining Moody's Analytics, he taught economics at Texas State University, where he also researched open-economy macroeconomics and income inequality. Born in Chile, he obtained his PhD and master's in economics from the University of Massachusetts at Amherst and his BA in economics from Carleton College.

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The RPS – Moody's Analytics House Price Forecasts are based on fully specified regional econometric models that account for both housing supply-demand dynamics and long-term influences on house prices such as unemployment and changes in mortgage rates. Updated monthly and providing a 10-year forward-time horizon, the forecasts are available for the nation overall, its 10 provinces and for 33 metropolitan areas, and cover three property style categories, comprising single-family detached, condominium apartments and aggregate, in a number of scenarios: a baseline house price scenario, reflecting the most likely outcome, and six alternative scenarios.

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