The fever breaks: Canada's housing market will cool but stay strong in 2022

January 27 2022

Even after shattering all sorts of records in 2021—for high sales and prices and low inventories—Canada's housing market isn't about to buckle. Plenty of unmet demand remains and will continue to fuel tremendous activity across the country. Still, we expect the Bank of Canada's rate liftoff to turn down the market's heat in 2022 as deteriorating affordability sends buyers to the sidelines. Higher interest rates and the likelihood of new anti-speculation measures will also prove a tougher proposition for investors. In all, we expect 579,600 existing Canadian homes to change hands this year. Though down 13.1% from the astounding 667,000 transactions in 2021, that's still the second-highest amount in history. The ongoing construction boom will bring much needed new supply to the market, helping to ease severe shortages.

Home prices will keep climbing, though at a slower pace

Most of that increase in supply and cooling of the market will take place in the second half of this year. We expect demand-supply conditions to become much less favourable—though still broadly positive—for sellers by then, reducing upward pressure on prices. We think this will slow the pace of price appreciation, but not alter the direction (with some possible local exceptions). We project Canada's benchmark price to rise 6.2% in 2022 or nearly a third of the record rate of 17.8% last year. The momentum will be even slower in 2023 with most markets returning to better balance.

Sellers will keep a tight grip on the market amid record-low inventories

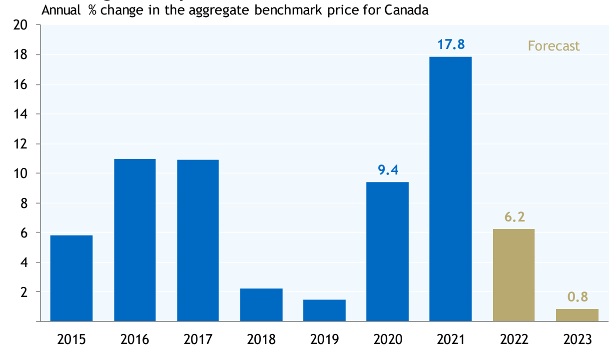
In the near-term however, the outlook for prices remains super strong. Sellers ended 2021 in full control of virtually every local market. That's bound to keep property values rising rapidly in the initial months of 2022. Demand-supply conditions were so tight in parts of B.C., Ontario, Quebec and Atlantic Canada at the end of 2021 that we wouldn't be surprised to see prices accelerate even further at first. More moderate gains will set in once extreme tightness starts to unwind by mid-year.

The supply side will continue to be crucial to Canada's housing story. So far in the pandemic, supply has been dwarfed by supercharged demand. Inventories of homes for sale have plummeted to historical lows as a result, leaving few options for buyers. We estimate the Canadian market was short 180,000 to 250,000 listings at the end of 2021. To reach a better balance, with exceptionally strong demand, active listings would need to at least triple.

Brace for more bidding wars in 2022

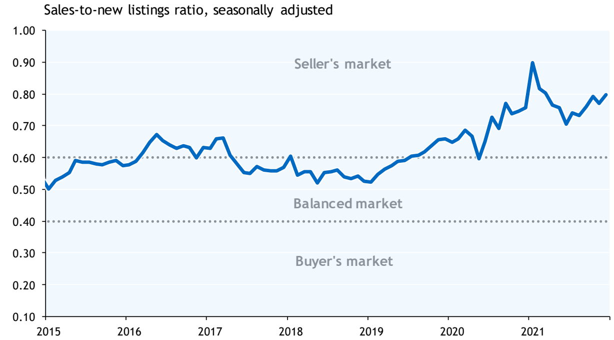
Competition between buyers will remain fierce beyond the always-hot Toronto and Vancouver markets. Inventories were at all-time lows in provincial housing markets accounting for 80% of activity in Canada at the end of last year—with only the Prairies, and Newfoundland Labrador seeing a milder scarcity of listings. Many smaller markets saw bidding wars for the first time. We expect this to continue in the near term.

Soaring home prices to slow their ascent
Annual % change in the aggregate benchmark price for Canada



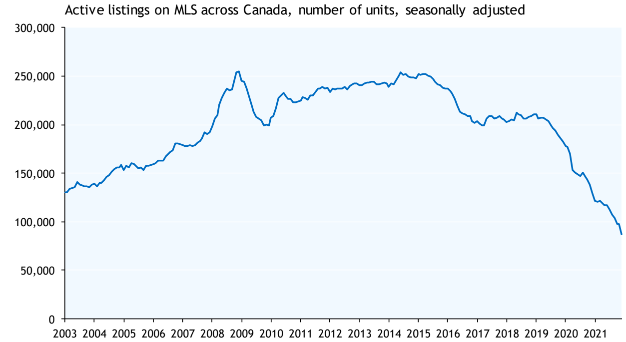
Source: RPS, RBC Economics

Sellers keep tight grip on Canada's housing market
Sales-to-new listings ratio, seasonally adjusted



Source: Canadian Real Estate Association, RBC Economics

Housing inventories fall to historic lows in 2021
Active listings on MLS across Canada, number of units, seasonally adjusted



Source: Canadian Real Estate Association, RBC Economics

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Demographic factors will keep the fire burning

The changing housing needs of Millennials will continue to generate substantial activity in the market, especially for homes suited to families. Millennials (in their mid-20s to early-40s) have swelled the ranks of Canadians in their prime home-buying stage of life in recent years. There were 10.5 million people aged 25 to 44 in Canada in 2021. That's up more than 800,000 (or 8.3%) in the past five years. If historical ownership patterns hold, Millennials will remain a major force in the housing market in 2022 and beyond. Ownership rates typically rise significantly between the ages of 25-29 (40%) and 40-44 (63%). Millennials will remain the biggest source of first-time home buyers and an increasing source of move-up buyers.

The immigration factor

Against all odds, the Canadian government met its ambitious target of welcoming 401,000 new permanent residents in 2021. To do so, though, it heavily recruited migrants who were already in the country on a temporary basis. We expect the government to draw more immigrants from overseas to achieve this year's target of 411,000. This means the number of newcomers actually setting foot on Canadian soil and looking for housing is set to jump. We believe this wave of immigrants will impact the rental market first—as newcomers most often rent in their first few years in our country. But we also see a boosting effect on the ownership market, with some economic-class immigrants (mainly skilled workers, entrepreneurs and others coming to address labour shortages) ready to enter the market from day one. We expect the vast majority of newcomers to settle in Canada's larger urban areas—Toronto, Vancouver and Montreal—further intensifying pressure on housing stock.

Gigantic savings to gradually normalize, leaving less for housing

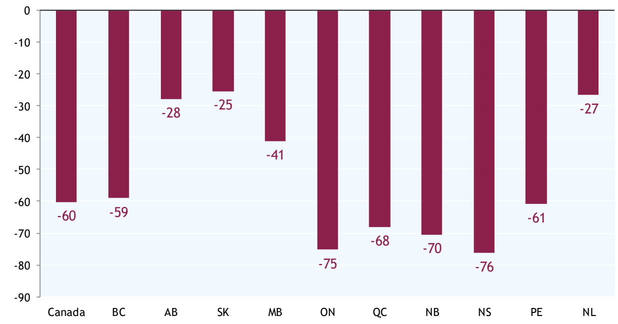
Canadians on the whole are in remarkably good financial shape considering the severity of the pandemic's economic shock. While mortgage debt is rising fast (by more than 10% y/y most recently), mortgage delinquency rates remain historically low. Households' net worth is at a record high and savings have been massive in the past two years thanks to government support and fewer places to spend. Some of those savings flowed into the housing market. But we expect there will be less extra cash available in the year ahead as restrictions ease and spending patterns normalize. Many Canadians will want to reallocate budget room on things like travel and dining out at the expense of housing investment.

Bank of Canada rate hikes: a turning point

The main event this year for the market will be the Bank of Canada's rate hike liftoff. We expect the central bank to initiate rate increases this spring culminating in a series of six rate hikes totaling 150 basis points in a little more than 18 months. This increase, on its own, will have a significant cooling effect on demand. Exceptionally low interest rates have been a powerful tonic for homebuyer's appetites throughout the pandemic. We expect this to fade after a few rate hikes make buyers' interest payments tougher to swallow. Tremendous price escalation and rock-bottom mortgage rates have rendered mortgage payments twice as sensitive to interest rate changes as they were 15 years ago. The broad increase in

Almost everywhere in Canada, housing inventory is scarce

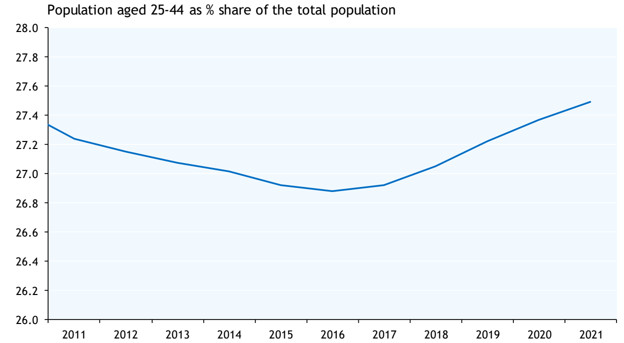
Active listings on MLS at December 2021 vs 10-year average, % change



Source: Canadian Real Estate Association, RBC Economics

Millennials expand the ranks of Canadians in prime home-buying age

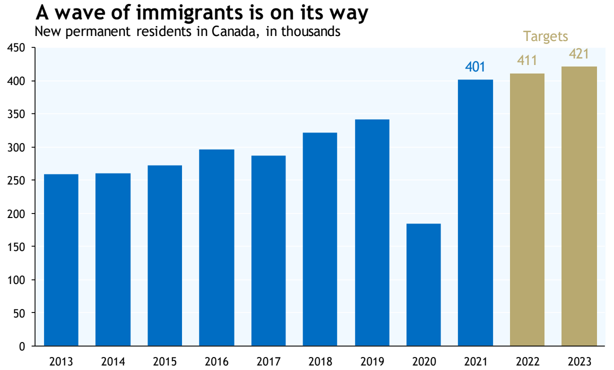
Population aged 25-44 as % share of the total population



Source: Statistics Canada, RBC Economics

A wave of immigrants is on its way

New permanent residents in Canada, in thousands



Source: Statistics Canada, RBC Economics

Canadians ease off record savings streak as pandemic restrictions lift

Household savings, billions of $ per quarter, seasonally-adjusted

Source: Statistics Canada, RBC Economics rates—we expect both variable and fixed rates to rise materially—is likely to pressure up the mortgage qualifying rate at some point in the second half of this year (or possibly sooner). We think that would push some buyers to the sidelines at least temporarily.

Rate hikes will deliver the biggest punch in most expensive markets

Buyers in Toronto, Vancouver and Victoria will feel the pinch of rising rates more intensely than their counterparts in less expensive markets. That's because the larger mortgage sizes—and larger mortgage payments—in higher-priced cities are much more sensitive to a change in rates. We believe a rising rate environment would maintain the appeal of smaller, more affordable markets, if not augment it at the margin.

New policy actions could change the game for investors

A Bank of Canada rate hike will also alter the equation for investors. This category of buyers played a larger role in the market last year, accounting for slightly more than one-in-five purchases. Those considered 'speculators' by policymakers will soon face stricter regulations. The federal government is working to introduce measures that would: ban foreign buyers from purchasing non-recreational properties for two years; tighten down payment requirements for investment properties; tax gains on flipping properties; and curb excessive profits on investment properties. Details on most of these initiatives have yet to be announced though we expect the spring federal budget to provide some specifics. Federal measures would be in addition to plans being pursued at the local or provincial levels—most notably in Vancouver and Toronto—to curb speculative activity. We believe higher interest rates and policy efforts will cool down investment activity by a few degrees.

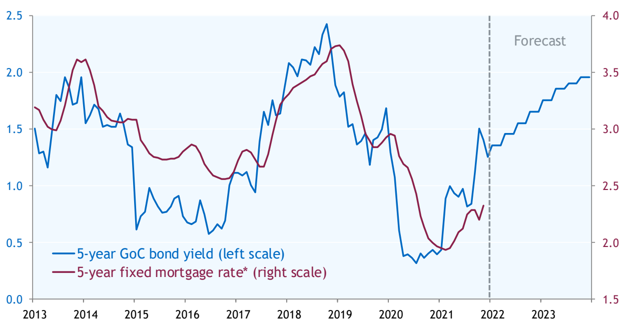
Calming effect will be welcome in frenetic markets

While a less accommodative monetary policy would no doubt deliver a blow to the most stretched prospective home buyers—especially first-time home buyers—the general calming effect on the market will be welcome. We believe this is a key part of what's needed to rebalance the market and tame runaway prices. From a market risk perspective, we don't think the kind of rate increases we're contemplating would derail activity or cause prices to crash. We expect positive demographic factors to largely mitigate such risks, with the net result a soft landing over a two- to possibly three-year period.

New supply is already on the horizon

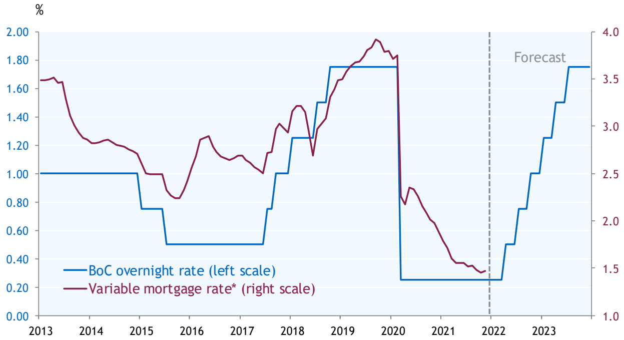
There's reason to believe 2022 will finally be the year more supply makes its way to market. Housing starts have surged in the last year, reaching levels unseen since the mid-1970s. Some of those units have recently been completed and barring prolonged construction delays (supply chain bottlenecks and labour shortages pose significant challenges), we expect builders to boost completions materially in 2022 to nearly 250,000 units. This would be up significantly from an average of 190,000 units annually over the past five years. The increase is unlikely to fully address the supply shortage on its own. But alongside calmer demand, we believe it will noticeably reduce the imbalance.

Fixed mortgage rates are poised to rise



Source: Bank of Canada, RBC Economics * Weighted-average rate on funds advanced by chartered banks.

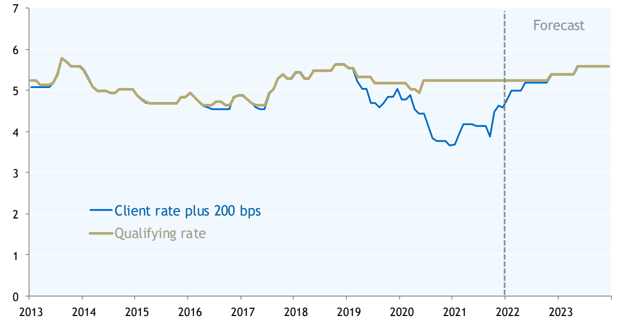
Variable mortgage rates are also on their way up



Source: Bank of Canada, RBC Economics * Weighted-average rate on funds advanced by chartered banks.

Mortgage qualifying rate could be pushed higher

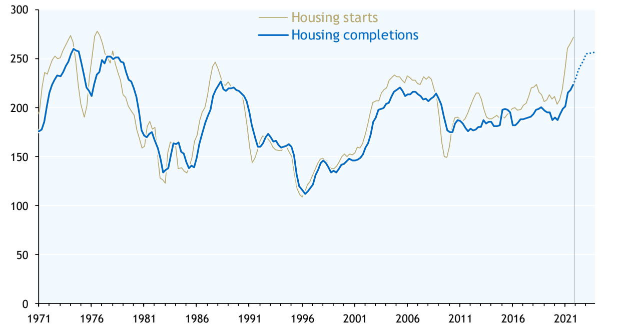
5-year fixed mortgage rate, Canada, %



Source: Bank of Canada, Royal Bank of Canada, RBC Economics

Exceptionally high housing starts will boost supply

Thousands of units in Canada, trailing four-quarter total



Source: CMHC, RBC Economics

And Canada's builders aren't done yet

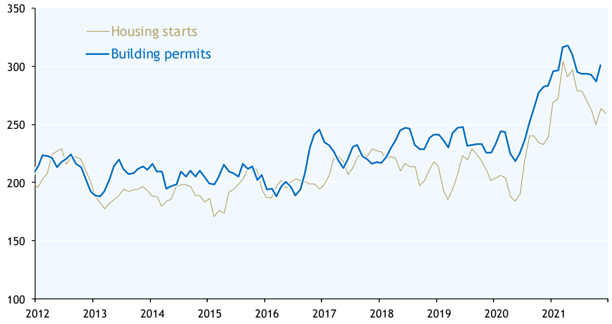
There's scope for completions to rise even more in 2023 and possibly beyond. Municipalities have considerably ramped up building permit issuance in the past year and this will keep the residential construction boom going. We're glad to see all levels of government recognize the need to build more housing to tackle the affordability crisis. Many (including the federal government) have pledged more resources or incentives to municipalities to speed up project approval processes and rethink zoning regulations. This would allow medium-density development (the so-called missing middle) in exclusively low-density areas.

A year of transition, not transformation

The overall landscape for housing will begin to shift in 2022 but we don't expect abrupt changes. These will be the first steps on a long road to normalization. We do expect 2022 will be a remarkable year by almost any standard... unless you compare it to 2021.

Municipalities have turned on the permit tap

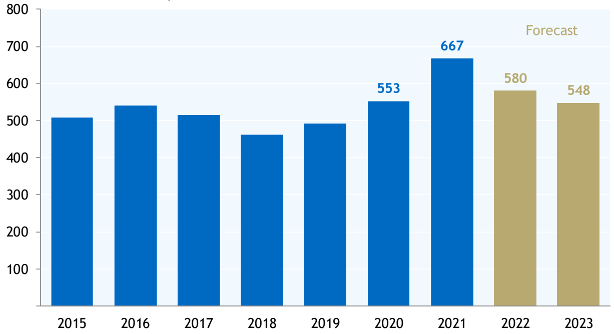
Thousands of units in Canada, trailing 3-month average, seasonally-adjusted and annualized



Source: CMHC, Statistics Canada, RBC Economics

Home resales to slip from historic highs

In thousands of units, Canada



Source: Canadian Real Estate Association, RBC Economics

Home resales forecast (units)

	2014	2015	2016	2017	2018	2019	2020	2021	2022f	2023f
Canada*	482,400	508,100	540,800	515,300	461,000	491,300	552,600	667,000	579,600	547,600
	5.8	*5.3*	*6.4*	*-4.7*	*-10.5*	*6.6*	*12.5*	*20.7*	*-13.1*	*-5.5*
British Columbia	84,200	102,700	112,400	104,000	78,500	77,300	94,000	124,900	109,700	97,800
	15.3	*22.0*	*9.4*	*-7.5*	*-24.5*	*-1.5*	*21.6*	*32.9*	*-12.2*	*-10.8*
Alberta	75,400	59,600	55,200	57,300	53,000	53,100	55,100	84,600	77,500	62,900
	11.4	*-21.0*	*-7.4*	*3.8*	*-7.5*	*0.2*	*3.8*	*53.5*	*-8.4*	*-18.8*
Saskatchewan	14,500	12,900	12,200	12,000	11,100	11,300	14,100	17,500	14,000	12,400
	3.6	*-11.0*	*-5.4*	*-1.6*	*-7.5*	*1.8*	*24.8*	*24.1*	*-20.0*	*-11.4*
Manitoba	13,700	14,000	14,500	14,400	13,500	14,700	16,800	19,700	17,200	15,400
	0.0	*2.2*	*3.6*	*-0.7*	*-6.3*	*8.9*	*14.3*	*17.3*	*-12.7*	*-10.5*
Ontario	202,400	222,100	243,600	219,700	192,500	209,900	228,300	270,800	226,600	230,600
	4.1	*9.7*	*9.7*	*-9.8*	*-12.4*	*9.0*	*8.8*	*18.6*	*-16.3*	*1.8*
Quebec	70,600	74,100	78,100	82,500	86,500	96,600	112,200	110,500	101,300	97,700
	-0.8	*5.0*	*5.4*	*5.6*	*4.8*	*11.7*	*16.1*	*-1.5*	*-8.3*	*-3.6*
New Brunswick	6,500	6,900	7,700	8,200	8,300	9,400	10,600	13,100	11,400	10,200
	-1.5	*6.2*	*11.6*	*6.5*	*1.2*	*13.3*	*12.8*	*23.6*	*-13.0*	*-10.5*
Nova Scotia	9,100	9,400	10,100	10,600	11,100	12,300	14,000	15,900	13,200	13,300
	-1.1	*3.3*	*7.4*	*5.0*	*4.7*	*10.8*	*13.8*	*13.6*	*-17.0*	*0.8*
Prince Edward Island	1,400	1,700	2,100	2,200	2,100	1,900	2,100	2,400	2,200	2,200
	-6.7	*21.4*	*23.5*	*4.8*	*-4.5*	*-9.5*	*10.5*	*14.3*	*-8.3*	*0.0*
Newfoundland & Labrador	4,100	4,200	4,200	3,900	3,700	4,100	4,700	6,800	5,700	4,400
	-4.7	*2.4*	*0.0*	*-7.1*	*-5.1*	*10.8*	*14.6*	*44.7*	*-16.2*	*-22.8*

* Includes sales in the Territories.

Annual percent changes are in italics.

Source: Canadian Real Estate Association, RBC Economics

Home price forecast

Aggregate price	2014	2015	2016	2017	2018	2019	2020	2021	2022f	2023f
Canada	419,400	443,800	492,600	546,400	558,400	566,700	620,000	730,600	776,200	782,700
	4.8	*5.8*	*11.0*	*10.9*	*2.2*	*1.5*	*9.4*	*17.8*	*6.2*	*0.8*
British Columbia	565,500	610,000	717,600	775,300	816,300	785,200	848,100	985,600	1,043,700	1,054,900
	5.5	*7.9*	*17.6*	*8.0*	*5.3*	*-3.8*	*8.0*	*16.2*	*5.9*	*1.1*
Alberta	426,900	432,800	425,900	429,800	428,600	420,900	420,800	441,400	456,000	463,800
	5.3	*1.4*	*-1.6*	*0.9*	*-0.3*	*-1.8*	*0.0*	*4.9*	*3.3*	*1.7*
Saskatchewan	332,400	332,600	332,700	329,900	326,400	321,800	323,800	335,900	343,700	345,600
	1.7	*0.1*	*0.0*	*-0.8*	*-1.1*	*-1.4*	*0.6*	*3.7*	*2.3*	*0.6*
Manitoba	279,900	283,000	288,800	297,500	300,000	305,100	314,500	345,200	360,000	367,700
	3.0	*1.1*	*2.0*	*3.0*	*0.8*	*1.7*	*3.1*	*9.8*	*4.3*	*2.1*
Ontario	423,700	454,900	515,200	600,200	606,600	630,600	705,600	853,300	911,400	916,600
	5.3	*7.4*	*13.3*	*16.5*	*1.1*	*4.0*	*11.9*	*20.9*	*6.8*	*0.6*
Quebec	301,200	305,700	316,000	327,900	341,000	359,600	396,700	465,500	494,600	499,900
	1.7	*1.5*	*3.4*	*3.8*	*4.0*	*5.5*	*10.3*	*17.3*	*6.3*	*1.1*
New Brunswick	198,300	199,800	207,900	208,200	214,900	218,200	223,500	261,000	280,600	282,500
	2.6	*0.8*	*4.1*	*0.1*	*3.2*	*1.5*	*2.4*	*16.8*	*7.5*	*0.7*
Nova Scotia	253,100	256,300	261,800	272,100	275,800	282,600	306,000	377,600	413,100	415,600
	1.2	*1.3*	*2.1*	*3.9*	*1.4*	*2.5*	*8.3*	*23.4*	*9.4*	*0.6*
Prince Edward Island	197,500	204,500	214,800	240,300	266,300	277,200	313,600	362,800	381,400	388,600
	-0.3	*3.5*	*5.0*	*11.9*	*10.8*	*4.1*	*13.1*	*15.7*	*5.1*	*1.9*
Newfoundland & Labrador	295,400	299,400	298,800	295,100	285,200	273,200	272,300	288,400	294,400	294,800
	2.6	*1.4*	*-0.2*	*-1.2*	*-3.4*	*-4.2*	*-0.3*	*5.9*	*2.1*	*0.1*

Annual percent changes are in italics.

Source: RPS, Statistics Canada, RBC Economics