Is Vancouver's Housing Illness Contagious?

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Canada's housing market has been on a wild ride this cycle, with many local markets still adjusting to various policy changes and economic conditions. Vancouver is closely watched right now given the widespread correction across that previously-soaring market. This begs the question: Will the decline in Vancouver's market spill over, pulling down the broader Canadian housing market and economy? The short answer is we don't think so.

Vancouver's recent housing market history has been unique within Canada (echoed less extremely in Toronto). Fundamental supply-demand conditions were driving home prices through much of the cycle until around early-2015. At that point, two major factors worked to detach prices (which took off at a 30% y/y clip) from those fundamentals (*Chart 1*). First, **nonresident demand** was pouring onto an already drum-tight market. While the data history is limited, BC Finance figures show that nonresident demand accounted for as much as 15% of residential sales activity in the GVA by mid-2016. Meantime, the Bank of Canada's two rate cuts in the first half of 2015 changed the **psychology** in Canada with respect to rate expectations, opening the door to a flood of speculative buying in hotter markets like Vancouver (and Toronto). Indeed, the share of properties turned over within a 12-month period in the GVA showed a jump in flipping activity shortly after those rate cuts (*Chart 2*)—a classic case of expectations of higher prices driving demand and lifting prices further.

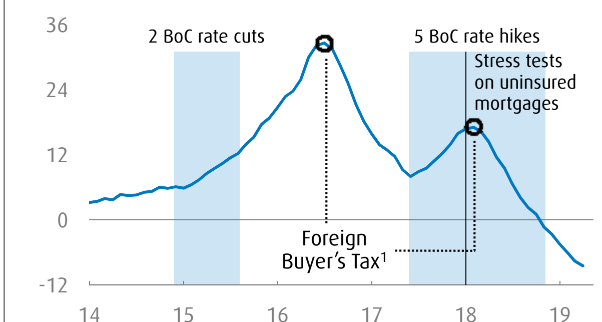
Since mid-2016, however, a trio of policy measures removed the froth, and contributed to the downturn that the market is still enduring today. First, the Province of British Columbia's 15% **tax on nonresident buyers**—implemented in June 2016, then expanded and increased to 20% in early-2018—chilled foreign investment demand. The share of activity is now stable in the 3%-to-4% range at just over 100 transactions per month, down from more than 1,000 per month (15% of activity) at the high (*Chart 3*). Also, five **Bank of Canada rate hikes** not only dinged affordability, but also changed the message on interest rates. This, along with the tax on nonresident buyers, likely contributed to lower price growth expectations and a decline in speculative psychology. Finally, the **OSFI stress test** on uninsured mortgages, introduced in January 2018, further eroded affordability through a higher qualification hurdle, effectively pulling many would-be buyers down the price ladder.

All in, the unwinding of earlier froth has pulled prices down almost 10% overall, with all segments seeing a downdraft (anecdotal declines have been as much as a third in some high-end pockets). While the May sales figures encouragingly showed a solid month-over-month gain, the market balance is still historically loose and FOMO psychology has been replaced by an environment where buyers are holding back waiting for prices to stabilize. And, investors who were banking on price gains to make their calculus

Chart 1
Housing Reacts to Policy

Vancouver (y/y % chng)

MLS Home Price Index

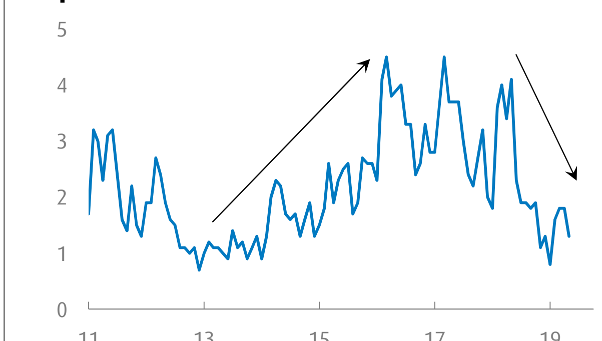


[1] 15% in June 2016; 20% in February 2018
Sources: BMO Economics, Haver Analytics

Chart 2
Speculation Comes and Goes

Vancouver (% of total units)

Properties Sold within 12 Months of Purchase



Sources: BMO Economics, Steve Saretsky Realty work (since positive cash flow was nonexistent at recent cap rates with 20% down) could be selling into any strength or as current development projects reach completion. As such, the market will likely remain soggy for some time still.

Despite Vancouver's challenging conditions, there are a number of reasons to believe that the weakness won't spread more broadly across Canada's housing market and economy:

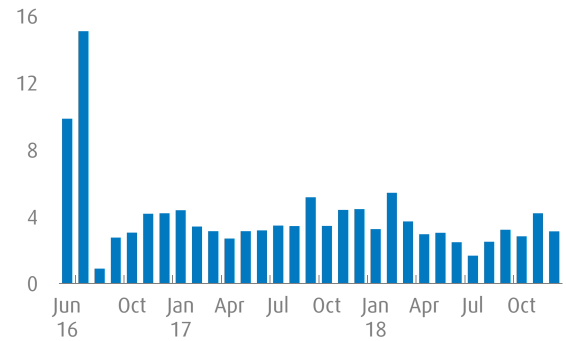
- There is really **no such thing as a 'Canadian housing market'**, but rather a collection of unique and independent markets that run on much different fundamentals. The GVA only made up 7% of Canadian sales volumes on average over the past five years, compared to 19% in Toronto and 15% in Quebec. And, while Vancouver prices are falling, and Calgary and Regina are drifting down because of the oil sector, Montreal and Ottawa are seeing the strongest conditions in more than a decade (*Chart 4*). Combined, this leaves the 'Canadian housing market' still very well balanced.
- The **GTA and Southwestern Ontario** markets carry a much bigger weight, and have also experienced many of the same swings as Vancouver in recent years. But, because the excesses were smaller and demographic and job fundamentals remain strong, the market has already begun to find support. Toronto home sales were up a solid 18.9% y/y in May, and the market balance has almost returned to normal. Single-detached prices have steadied, up 0.8% y/y, and condos (which never corrected anyway) are up 6.8% y/y. In fact, we wouldn't be surprised to see more positive momentum in the GTA market through the summer and into the fall.
- **Credit growth has stabilized**. After decelerating sharply from almost 6% y/y in 2017, growth has stabilized right around 3% annualized (*Chart 5*). This is good news given that an outright contraction in credit would be a major headwind for the economy more broadly. The flip side is that the Bank of Canada is probably quite happy seeing growth steady just below the rate of income growth, thereby tugging down the debt-to-income ratio gradually over time—call it an ideal soft landing at this point.
- Finally, **five-year fixed mortgage rates have fallen** 50 bps since peaking in late-2018, partly because of a more dovish BoC, and partly because of a broader downdraft in global bond yields. This will only reinforce the floor in the Toronto market and, although further down the road, help stabilize Vancouver as well.

The Bottom Line: Vancouver's housing situation is unique to that market, one that is very familiar with big swings. There's little reason to suspect broader contagion and a rate-cut response as a result, even though the best years for credit growth, home prices and consumer spending are now behind us.

Chart 3
Foreign Investment Fades

Vancouver (% of total units)

Nonresident Purchases

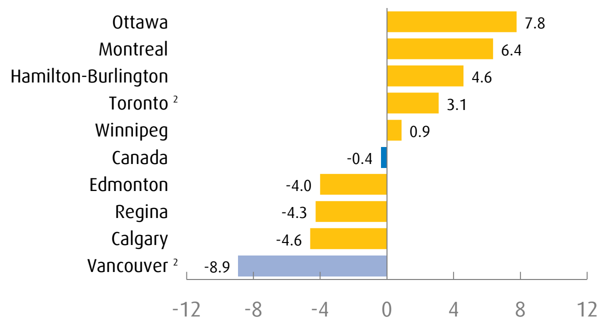


Sources: BMO Economics, BC Finance

Chart 4
Location, Location, Location

Canada (y/y % chng : n.s.a. : as of April 2019)

Existing Home Prices[1]



[1] HPI composite benchmark where available; [2] May 2019
Sources: BMO Economics, Haver Analytics

Chart 5
Credit Growth Stabilizing

Canada

Household Credit

Shading marks periods of Canadian recession
Sources: BMO Economics, Haver Analytics