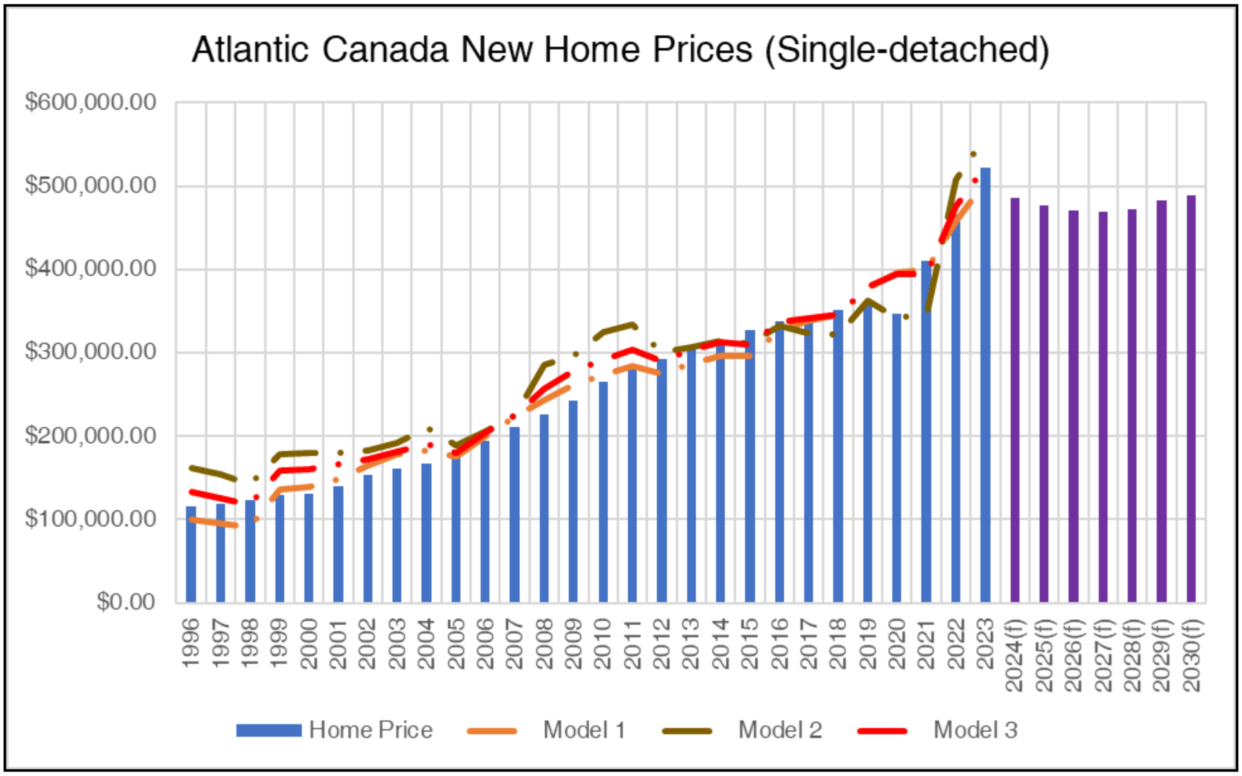
What Goes Up: May Come Down!



Source: CMHC Actual Median Prices (blue); TDP Forecast (purple).

Atlantic Canada house prices have consistently been in the news since 2021. That year *new* house prices increased by 18.2% year over year, the largest annual increase ever recorded in the region. 2022 saw an increase of 13.5%, followed by a further increase of 11.8% in 2023. But these increases were anomalies: in the two decades pre-2021 *new* house prices increased at 4.9% per annum on average. So, is the party over or can we expect the current trend to continue and for how long? We thought that you would like to know so we whipped out our crystal ball (actually three econometric models) and found out.

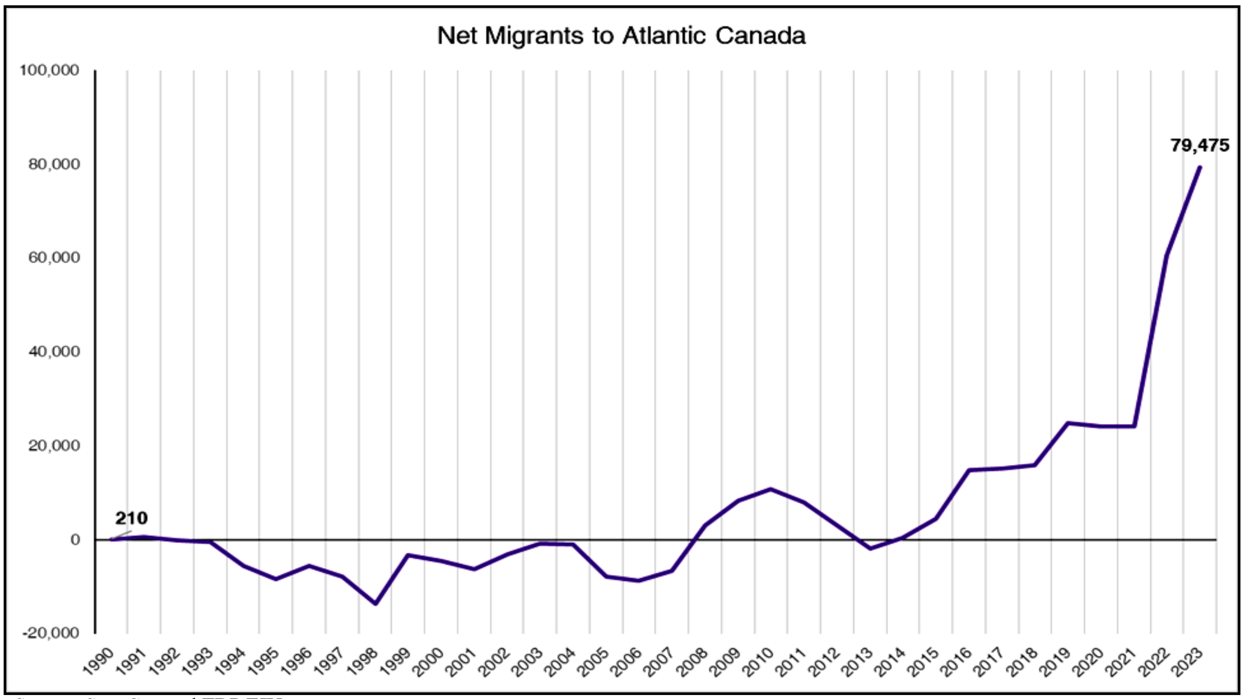
Background

We have utilised *new* home prices because that data is available from CMHC. *Existing* house price sales data is not available in the public forum. It is collected by the various real estate associations but is privately held and is often not even shared between the associations themselves, making it difficult and expensive to aggregate. For example, we have access to the data for Nova Scotia because we belong to the Nova Scotia Association of Realtors and for Prince Edward Island because we purchase it from the single real estate association in that province. However New Brunswick has five associations and Newfoundland also has its own real estate body. It would be in the public interest if the associations pooled their data; and real estate sales licensing credentials in each province were recognised in the others; ensuring sales person mobility and the free flow of knowledge for consumers throughout the Region. After all, in aggregate the Atlantic Region has about half the population and land area of most, if not all, of the remaining provinces in Canada. However, there does not appear to be much industry appetite for that type of co-operation so it would have to be a political initiative. It is what it is, so we have to rely on *new* sales prices as a surrogate for used home prices as well. The two are a function of supply and demand and are correlated, so reliance on *new* home prices is adequate for the purpose of this exercise.

Why is it important to look ahead? If you intend to purchase or sell a home the answer is obvious, but it has much wider implications. Every municipality relies on property taxes as their main source of revenue. They are usually the second largest stakeholder in any property, after the mortgagee, and well ahead of the freeholder. Property taxes are a function of property value (price) and the mill (tax) rate. If prices are increasing municipalities have more political room for budgeting purposes… and suffer the reverse if prices are falling. For most municipalities, future expansion or contraction in their tax base focuses on the amount or decline in building activity rather than the performance of their existing inventory. Yet addition to, or decline of, building stock pales by comparison to existing inventory.

House prices are determined by the interaction of supply and demand. Because single family homes are a capital good, supply takes a long time to adjust to changes in demand so prices are relatively price inelastic. In other words, supply cannot respond quickly to changes in demand so prices can be volatile. In this article, we attempt to rationally list some variables in the economy that could have an impact on home prices, weed out any correlation among them, and try to identify some variables that have a significant effect on median new home (single-detached) prices. Basically, we developed three econometric models to predict home prices, and then used the average to forecast prices out till 2030 (purple bars on the New Home Graph Page 1). Each of the models has been compared to the past home price data (blue bars on the New Home Prices Graph Page 1) to determine their "degree of fit" and are shown as orange, red and gold lines. All three models fitted the past data very well. Model 1 explained 97% of the variation in prices, Model 2, 95% and Model 3, 98%. We have developed forecasts for all four Atlantic provinces, but for brevity focus on the entire region, with references to the individual provinces where necessary. Since our price projections are based on assumptions with respect to variables in the economy we have detailed those assumptions in the article.

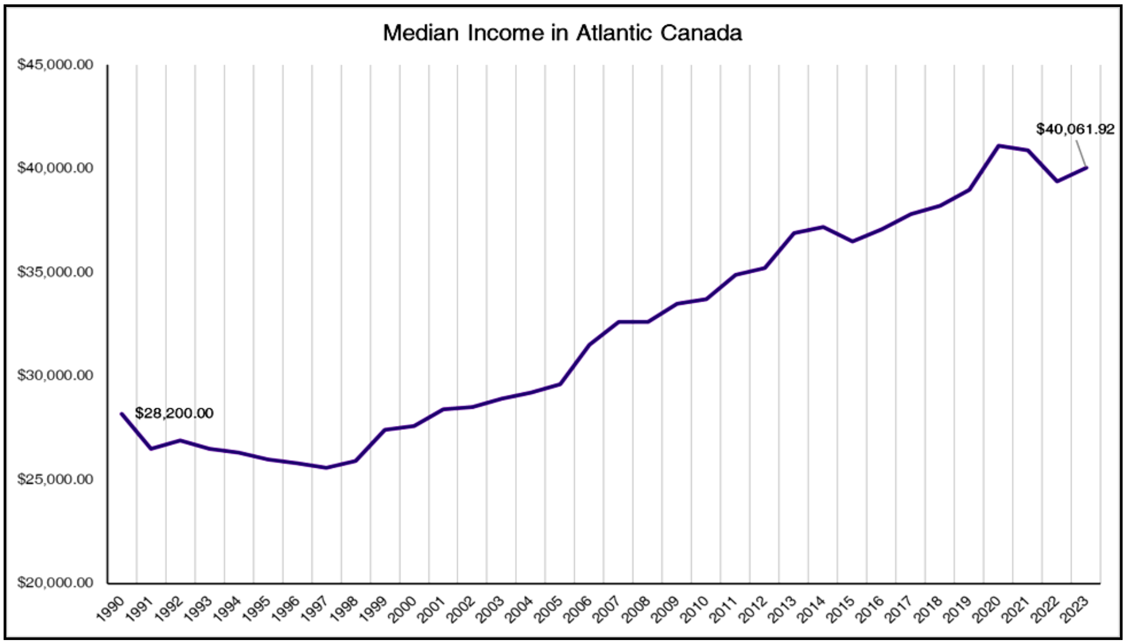
Population



Source: StatsCan and TDP EIU.

First of all, when we talk about demand for homes we have to speak about the population. Atlantic Canada has been the go-to place for Canadians from other provinces, and people from around the world, ever since the pandemic-induced travel restrictions were lifted. The onset of Covid-19, and the Region's success in containing it, initiated migration from other provinces by people able to work from home who were no longer bound to a particular location. Substantially lower home prices than Toronto and Vancouver meant that property owners relocating to Atlantic Canada could purchase a home with a substantially reduced or no mortgage. During the pandemic many bought homes here sight unseen. The Region had the infrastructure for remote working, offered a more relaxed life style, beautiful scenery and was a great place to raise a family. As the pandemic passed, immigration from abroad which had been on-hold during the lock down, also contributed to the rapid increase in net migration (the total of people who came here minus those who left). Immigration from abroad to the Region had increased prior to the pandemic as provincial governments petitioned the Federal Government for a greater share of the pie to combat their rapidly aging population. The combined result of the foregoing is shown on the Net Migrants Graph above. Since all of these people had to be accommodated it resulted in a large increase in demand for all types of housing.

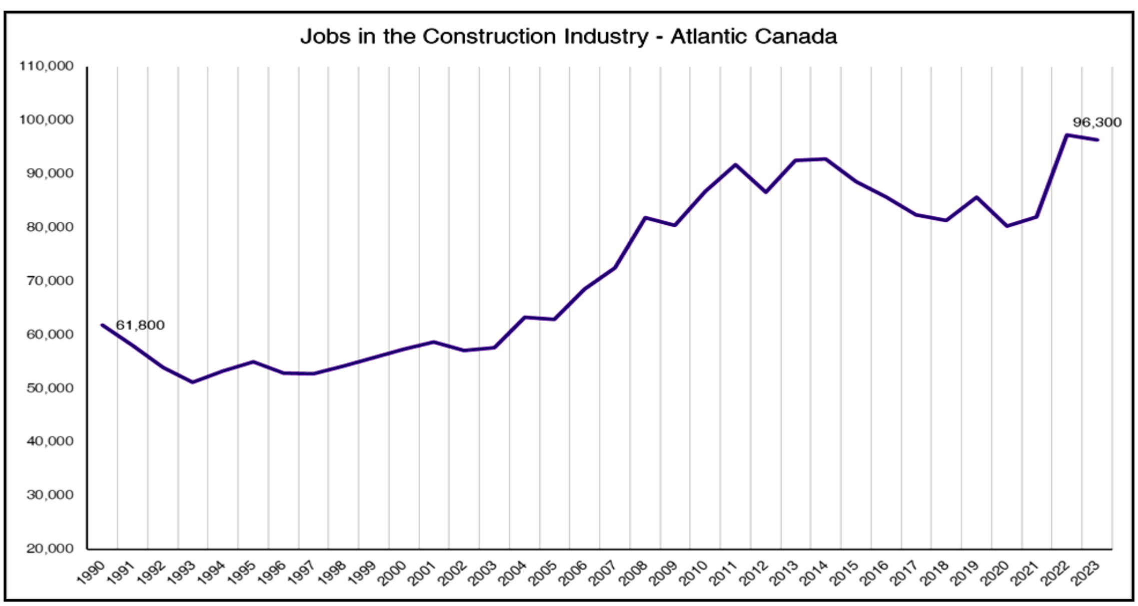
Median Income



Source: StatsCan and TDP EIU.

Median income has increased steadily since 1997 (see Median Income Graph above). Between 1990 and 2023 it grew at an average annual rate of 1.07% with an overall increase of 42.06% ($11,862) over the period. It dropped during the pandemic but is now starting to recover again. Since mortgage availability is based on gross income any increase in the latter will increase home prices (everything else being the same).

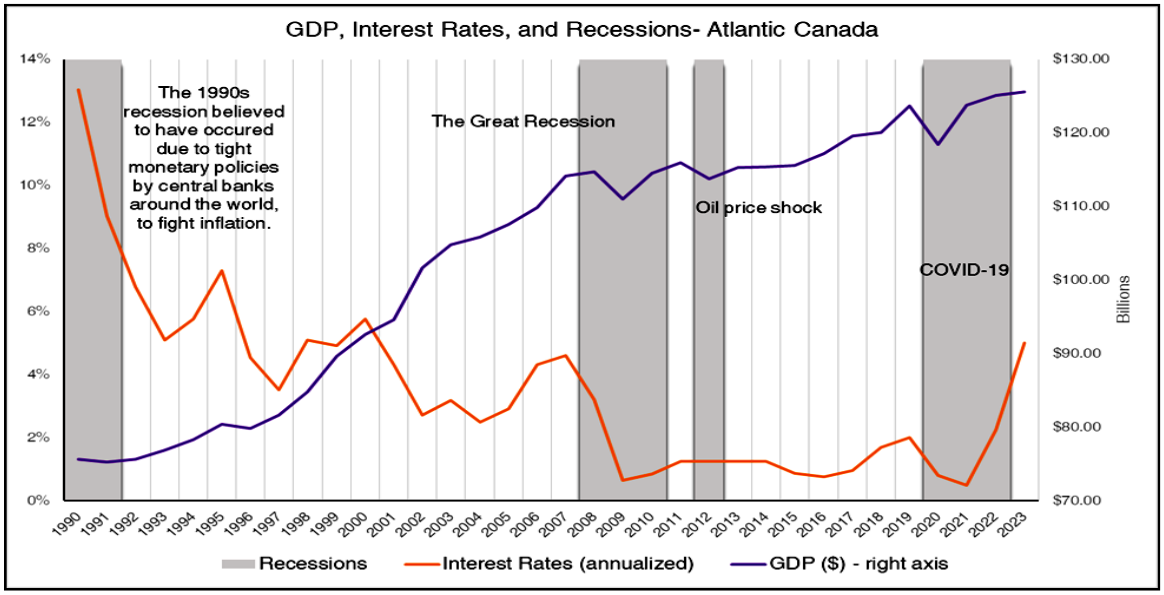
Construction Jobs



Source: StatsCan and TDP EIU.

The number of construction workers is both a cause and effect. Lack of workers constrains construction activity, whilst lack of work results in fewer employment opportunities. There were 93,000 people employed in the construction industry in 2023, 1,000 less than in 2022 but 10,700 more than in 2019. The dip in 2020 and 2021 was due to the pandemic. However, during period 2014 to 2018, 11,500 people left the industry.

Interest Rates and GDP



Source: StatsCan and TDP EIU.

To represent the condition of the whole economy, we have chosen the **interest rate** and the **GDP**. We should expect to see a negative relationship between the interest rate and home prices (meaning a decline in home prices as interest rates increase), and a positive relationship between GDP and home prices (meaning home prices go up as GDP goes up). GDP and interest rates should have a negative relationship with each other since the Bank of Canada increases the rate to slow the economy down, and lowers it for expansionary purposes.

The relation between GDP and interest rates is demonstrated quite clearly in the GDP/Interest Rate Graph above. GDP increases when the economy is producing more to feed the strong demand in the economy. Somewhere along the line, prices start increasing because supply becomes unable to meet demand. When prices grow out of hand, the central bank can act to set a new, higher, target interest rate, which sends ripple effects throughout the credit market sector of the economy. With higher interest rates, investment levels fall, and savings increase, which in turn means lower spending (lower demand). The lower demand should lead to lower prices. However, overdo the manipulation of the interest rate and the economy craters. The chart above describes this phenomenon quite well. If you look at the last few years of the chart, you can see why the talk about a hard or a soft landing has been going on in Canada since last year. The Bank of Canada has really shot up target interest rates, but that hasn’t yet had a detrimental effect on GDP. However, the fact that annual GDP has not yet declined shouldn’t be taken as an excuse to delay rate cuts.

Forecast (2024 – 2030)

Our forecasts for the Atlantic Region are shown as purple bars on the New Home Prices Graph (Page 1). The individual provinces are shown in the following table:

Median Single-Detached Home Prices (Actuals & Forecasted) - 2020 to 2030

	Atlantic Canada	Nova Scotia	New Brunswick	Prince Edward Island	Newfoundland & Labrador
2020	$347,371.25	$432,500.00	$300,000.00	$321,985.00	$335,000.00
2021	$410,625.00	$485,000.00	$350,000.00	$450,000.00	$357,500.00
2022	$466,250.00	$630,000.00	$430,000.00	$420,000.00	$385,000.00
2023	$521,297.75	$700,000.00	$500,000.00	$435,191.00	$450,000.00
2024(f)	$486,364.42	$625,913.94	$477,460.26	$393,172.52	$428,802.54
2025(f)	$477,148.51	$640,195.48	$446,287.71	$385,851.46	$444,785.58
2026(f)	$471,165.75	$636,859.38	$434,013.42	$375,005.41	$445,904.36
2027(f)	$469,619.08	$625,099.57	$440,144.90	$377,139.24	$447,808.73
2028(f)	$471,801.74	$637,000.38	$428,937.53	$386,688.09	$451,031.25
2029(f)	$482,685.97	$649,024.51	$451,413.66	$391,405.61	$453,786.50
2030(f)	$488,338.57	$661,394.39	$456,672.97	$396,475.19	$455,246.99

Source: Actual median prices from Canada Housing and Mortgage Corporation; Forecasts from TDP

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Our projections of new house prices (period 2023 to 2030) are based on a decline in net migration (from 79,475 to 46,100 annually), a decrease in the interest rate (from 5% to 1.0% - almost back to pre-pandemic levels), a gradual increase in median income (from $40,062 to $44,547), an 11% increase in GDP, and a 4% increase in number of construction industry jobs.

In summary, the consensus of our models is that new home prices are going to fall in Atlantic Canada in 2024, 2025, and 2026. In 2027, they may pick up steam again and keep rising till 2030. Again, remember that there are quite a few variables whose movements these forecasts rely on. If we are wrong and migration figures don't decline as much as we expect them to, then that will add an upward pressure on home prices; if we are wrong and the interest rate is not lowered, then that will put downwards pressure on home prices; if the GDP and median income falls, so will home prices. There are sure to be many other factors that we have not accounted for, and it will never truly be possible to quantify all their effects. However, we believe that home prices will decline in the near future, but not to the level of pre-pandemic times. They will drop to the point close to the new equilibrium price and remain in that vicinity, until a new external shock is experienced.