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**WESTERN HOUSING MARKETS ON FIRE, WHILE SOFT-LANDING UNFOLDING IN CENTRAL AND ATLANTIC CANADA, SAY TD ECONOMISTS**

- Canada's housing markets remain robust in early 2006, with prices in the first quarter rising at a year-over-year pace of close to 10 per cent.
- However, the national figures mask a major regional story. In Western Canada, real estate has been on fire, while in Central and Atlantic Canada housing appears to be cooling.
- Sales in Ontario, Quebec and the Atlantic remain high, but the pace of price growth has slowed. This is consistent with the view that a speculative bubble never developed in these regions and the moderation in housing activity is likely to remain orderly.
- Within the West, much of the strength has been supported by strong fundamentals. Although the risk of speculative pressures is present, the prevailing level of affordability does not suggest that housing in Victoria, Edmonton, Calgary, Saskatoon or Winnipeg has become frothy.
- Vancouver has the greatest bubble-like qualities, with prices rising at a 22 per cent annual pace in the first quarter of 2006, average home prices reaching close to half a million dollars and affordability deteriorating to the worst level in the country. The Vancouver real estate market is clearly vulnerable to any deterioration in buyer sentiment, but the good news is that the economic fundamentals for Vancouver are likely to remain solid over the coming years, limiting any softening in the price environment.

**TORONTO** – Like so many other recent economic indicators, the national housing statistics mask a great divide emerging from a regional perspective said TD economists in the latest issue of *Housing Bubble Watch*. The report is available online at [www.td.com/economics](http://www.td.com/economics). “Canada's housing markets remained robust in early 2006, despite slightly higher mortgage rates. However, the dominant theme lurking beneath the national average results is clear signs that speculation has picked up in Western Canada,

while housing markets in Central Canada appear to be coming in for a soft-landing,” remarked Craig Alexander, Vice President and Deputy Chief Economist, TD Bank Financial Group.

With new listings hard pressed to keep up with the elevated level of existing home sales, real estate conditions at the national level remain relatively tight. As a result, the national average price of existing homes continues to climb at a vigorous pace, rising in the first quarter of 2006 at an estimated pace of close to 10 per cent year-over-year – not much different from the experience over the past few years and well above any assessment of a sustainable rate. “Based on long-term factors, including demographics and income growth, the average annual increase in national home prices is likely to be around four per cent in the coming decade, so the recent high single-digit and low double-digit gains cannot persist indefinitely,” remarked Alexander. “But, the key issue is whether the adjustment to a more sustainable trend is gradual. The good news is that this is what appears to be happening in Central and Atlantic Canada.”

East of Manitoba, house prices are now experiencing softer growth than the national average, with the annual rate of appreciation in several markets cooling to the mid-single digits. “But it’s important to note that this is not a reflection of any substantial drop in sales activity. Indeed, with affordability still attractive from a historical perspective, existing home purchases remain near record levels in a number of markets,” observed Alexander. Instead, potential buyers have been given more choice as an increasing supply of product (both from the new and resale housing market) is helping to alleviate the price pressures that hung over the market in the past. “This soft-landing in price growth provides some evidence that these markets did not previously experience a speculative bubble that required a correction – an argument we have been making for more than a year,” stated Alexander.

The outlook for housing in Central Canada and the Atlantic will depend greatly on what happens in the new home market. “So long as developers stay attuned to the softening in demand and do not engage in speculative building, real estate markets should remain

relatively balanced and home prices should not experience a decline,” commented Alexander. And, certain locations should continue to fare better than the average. For example, supply pressures created by zoning/building restrictions are expected to be supportive to parts of the Greater Toronto Area – such as the downtown core and around the ‘Green Belt’.

In contrast to Central and Eastern Canada, housing conditions in Western Canada remain very tight and are showing increased signs of speculation. Activity has become so intense that home price growth has accelerated to over 20 per cent in year-over-year terms in some markets. Much of this outsized growth can be attributed to the high level of commodity prices, which have lit a fire under the economies of the resource-based West, thereby substantially propping up housing demand relative to available supply. Thus, strong economic fundamentals, together with capacity constraints on the supply side, largely explain the lofty price growth in most Western markets. “However, when economic conditions are booming, it can also create the perfect breeding ground for speculative price bubbles to form. That’s because in such an environment, housing market participants are at greater risk of developing a case of irrational exuberance, especially if they expect that such exorbitant price gains will continue indefinitely,” warned Alexander.

The risks appear to be greatest in Vancouver, where average home prices are rising at a 22 per cent year-over-year pace and have now reached close to half a million dollars. This has deeply eroded affordability and it has likely contributed to the decline in the B.C. personal savings rate deep into negative territory.

However, the story is very different in many other Western cities. In contrast to Vancouver, home price growth in Victoria has recently slowed to 13 per cent from well above 20 per cent last year, likely reflecting diminished foreign buying. “Housing in Calgary and Edmonton has also been on fire, but housing affordability has not deteriorated by much in Alberta, suggesting that the rapid ascent of home prices can be

more fundamentally supported,” noted Alexander. The reason for this is that Alberta’s booming economy has also generated significantly stronger income growth.

The bottom line is that there is considerable momentum to the housing markets in the West. It will be important to monitor for signs of any intensification of speculation in these markets. However, strong economic conditions should limit the erosion in affordability and should constrain any softening in home price growth in the future. “The best outcome would be if housing markets in Western Canada in the future can mimic the current soft-landing unfolding in Central and Atlantic Canada,” concluded Alexander.

For more information, please contact:

Craig Alexander  
Vice President & Deputy Chief Economist  
TD Bank Financial Group  
416-982-8064

*Don Drummond (416-982-2556) and Sébastien Lavoie (416-944-5730) sera disponible pour des commentaires en français.*

The report *Housing Bubble Watch* is available in PDF format on TD Economics’ Home Page at: [www.td.com/economics](http://www.td.com/economics).