CAMERON STEPHENS
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CAMERON STEPHENS ECONOMIC UPDATE:
THE OUTLOOK FOR REAL ESTATE IN CANADA'S MAJOR MARKETS

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Good afternoon! Thank you for the warm introduction. And to all of you for coming.

Setting the scene

At a time of great flux and uncertainty, it's a privilege to have the chance to be here to help you navigate what could lie ahead—for the Canadian economy and for real-estate markets more specifically.

This analysis is grounded in my perspective from nearly 30 years of work across financial markets, international public policy, and academic research.

But also, some modesty. I'm reminded of the views of two US Presidents on the value of contributions from economists.

- Harry Truman noted that economists too often say "on the one hand, and on the other" when asked for their forecasts. "Give me a one-handed economist!" he pleaded.
- Lyndon Baines Johnson noted that a speech about economics feels a bit like wetting one's pants: it feels really hot for the speaker when it's happening, but no one else thinks so.

This will be a distinctly one-handed set of remarks.

I'm going to convey three clear positions—all firmly rooted in the developments of the last four decades, current fundamentals, and forward-looking indicators.

And my hope is that this will leave you feeling kind of hot—or at least pleasantly warm—about the outlook for Canadian real estate.

There are three important headlines to take away from today:

- Canadian and global macroeconomic prospects remain solid: while recession risks are rising, my base case remains a soft landing. It doesn't appear that we're on the cusp of stagflation.
- Canadian real estate fundamentals remain strong.
- Investors can usefully look through the recent volatility in residential real estate markets.

A. THE CANADIAN ECONOMY HAS A WIDE RANGE OF STRENGTHS.

There are five critical sets of data on which I'd like to focus.

1/ Canadian economic growth is slowing from 2021's blowout 4.7% y/y, but its set to remain strong compared with the last two decades. Consensus anticipates it remaining well above Canada's underlying 1.75% potential growth rate at 4.0% y/y in 2022 and 2.5–3.0% y/y in 2023.

2/ Labour markets are the strongest they've ever been. And the return of greater immigration and higher temporary foreign worker numbers will help relieve bottlenecks. Canadian job numbers are above pre-pandemic levels; in fact, the highest-ever share of Canada's core working-age population is now employed. US jobs numbers are near to pre-pandemic numbers. Unemployment rates in many parts of Canada and the US are at all-time lows.

3/ Households are seeing rising wages amidst strong balance sheets with still-large savings cushions. Corporate balance sheets remain solid with low debt-to-asset ratios and good interest-coverage ratios. Consumer demand is set to remain stronger in Canada than the US. But it's shifting from goods to services as re-opening continues in this less-acute phase of the pandemic. Consumption accounts for around 60% of Canadian and US GDP, respectively. Savings ratios are still far higher than pre-pandemic levels: this leaves ample dry powder to draw down to sustain consumption and cover liabilities. Canadian personal debt-income ratios are still high, but below or on-par with pre-pandemic levels—and some of this debt has been restructured to take advantaged of the low emergency rates prevailing in 2020–21.

4/ Inflation is undeniably high, with some strong momentum and breadth. But, consensus has it coming back into BoC target range next year as supply chain bottlenecks and labour market kinks continue to work their way out, and more energy supply comes online. Remember that an enduring challenge for Canada in the past has been too little inflation, not too much.

5/ Interest rates are expected to keep going up—but to levels similar to, though above, those prevailing during the pre-pandemic period. Markets have been pricing the Bank of Canada policy rate going to around 3.25% over the next year and staying there—higher than the 2.00% we had in February 2020. But remember that growth was only 1.9% y/y in 2019. The Bank of Canada's hiking path would take real policy rates only narrowly into positive territory. Rates may go higher, though, if expectations keep edging up.

B. CANADIAN REAL ESTATE HAS SOME ENDURING FUNDAMENTALS UNDER CURRENT VOLATILITY.

1/ We have a massive structural housing shortage. Canada has lowest per capita housing stock in the G7 at 464/1,000 residents versus the G7 average of 471.

Getting to the G7 average would require about 1.8 million more homes. Consensus forecasts expect only about 700,000 new home completions in all of Canada over the next three years.

Ontario has the lowest per capita housing stock—by far—of all the of the provinces at around 400/1,000 people, with Alberta and Manitoba also well below the Canada-wide average. BC's per capita housing stock sits right on the Canadian average.

For perspective, we would need about 650,000 new units in Ontario alone to bring it up to the Canadian average of homes per person. That's the inflow most forecasters are expecting for all of Canada over the next few years.

This isn't set to get better: which means real estate is likely to remain a sector with above-average returns over the medium term.

2/ The number of people we need to house is growing quickly in the cities where the housing stock is the most constrained. Canada has the fastest growing population in the G7 and this has been the case for years—which is a huge cultural, economic, and strategic advantage for us. But it means that our housing shortage isn't set to get better.

Immigration targets are the highest they've been since the early 20th century. About 65% of new arrivals go to Ontario and BC, with most heading to the GTHA and the Vancouver lower-mainland and Victoria areas.

Stocks of new and existing homes, adjusted for population, are coming off 20-year lows in these markets. Calgary and Edmonton are the only major Canadian cities where the population-adjusted inventory of homes is well above its average of the last two decades. But economic growth and population expansion in Alberta are set to lead Canada over the next two years and bring these ratios back into line

Major, sustained corrections in the Toronto and Vancouver markets were accompanied by these ratios sitting well above their decanal averages—situations of substantial excess supply. That's not where we are now. Instead, we're in a persistent case of supply deficits.

3/ We increasingly live alone. Average household size has been gradually going down for 150 years—from over 6 people in 1870 to around 2.4 people today. Rising immigration and renewed interest in intergenerational households hasn't reversed this. These declining household sizes put added pressure on the challenges we face in ensuring everyone has a place to live.

B. CANADIAN REAL ESTATE HAS SOME ENDURING FUNDAMENTALS UNDER CURRENT VOLATILITY.

4/ Housing starts aren't keeping up with our population growth. The ratio of new housing completions to new additions to our population—from both local births and immigration—has been on a steady decline for 40 years—from 0.70 down to 0.40. If the federal government's immigration targets for this year and 2023 are realized, this ratio will hit a new 40-year low this year.

5/ Cities are back. Pandemic outflows are reversing. Foot traffic is increasing. Office life is returning.

In the meantime, affordability isn't set to improve for average Canadians. This is a direct result of the policy failure by all levels of government to coordinate to get more housing built in the areas where it's needed most.

Policies that seek to keep foreign capital out of the market aren't helping—they're hurting. We need more capital—not less—to finance the kind of growth necessary to address our structural housing deficit.

C. WEATHERING PRESENT VOLATILITY.

Fine, you might say, but what about the next few years? We've already seen a softening in many real-estate markets. Where are we going in the short term?

Here's why I think we need to look through the current headlines.

- **As I mentioned, previous sustained real-estate corrections have arrived in response to big supply overhangs—not supply shortfalls.** We still have a major supply deficit in most Canadian markets outside Alberta, but Alberta is set to lead Canadian economic expansion and population growth for the next two years.
- **Canadians can weather higher interest rates. Less than half of Canadian households have a mortgage or a HELOC. The rest own their homes outright or rent.** Rising rates have a more limited impact on these households than headlines imply.
- **Around three-quarters of mortgages remain at fixed rates, despite a recent surge in variable-rate borrowing.** Most are on five-year fixed terms and variable-rate products tend to extend maturity—not raise monthly cash-flow demands—as rates rise.
- **The CMHC says that the average outstanding mortgage balance is around $240k. Five-year fixed mortgages are renewing this year at rates around 75–100 bps higher than previously assessed, or around $100/month.** Strong labour markets and elevated savings provide some breathing room to meet these increased financing demands.
- **Canadians don't default on their mortgages.** Failure rates declined during the 2008–10 financial crisis and have kept edging downward ever since. Our regulatory and stress-testing systems work.
- **Canadian underwriting standards mean that average loan-to-value ratios are lower than in the US and home equity shares consistently higher than in the US.**
- **It's a great time to be landlord.** Rents are rising sharply in cities as potential buyers put purchase plans on pause.

WRAPPING UP: WE'RE NOT GOING BACK TO THE 1980S, SO DON'T START LOOKING FOR A VINTAGE DELOREAN.

- **We're not on the cusp of stagflation: growth prospects remain hopeful, inflation should moderate.**
- **The fundamentals in Canada's housing market remain favourable for investors.**
- **Current volatility is an opportunity.**

That's my one-handed view. I hope it leaves you feeling a little warmer about Canada's economic outlook.

Thank you.

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