The Outlook

CIPH & HRAI Quarterly Economic Review Vol. 6 No. 1 July 2018

What's Next for Canada's Housing Market?

Housing policy interventions in 2017 have seemingly slowed Canada's galloping housing market growth, particularly price and sales growth in Toronto and Vancouver. In this issue, we explore the recent housing market "turbulence" to present a clear-eyed view of the state of Canada's new residential construction market and where it is likely to go next. While there is regional variation, Canada's housing market remains healthy on the whole. A steady pace of housing starts is expected ahead, as housing supply slowly responds to unmet pent-up demand.

What to Watch

While a lot of commentary focuses on high-frequency monthly data, these trends can be deceptive due to the high degree of volatility in housing data. It's more effective to examine trends over longer periods – ignore the noise and look for the signal. Trends in **resale markets**, **employment growth, migration**, and **interest rates** are all useful guideposts for forecasting residential building activity.

"Canada's housing market remains healthy on the whole."

Home Resale Activity

Resale activity is typically not a driver of residential construction as they are both driven by the same factors. Since resale activity reacts more quickly than housing starts it can serve as a helpful predictor. Canada-wide resales were lower in Q1 this year, driven largely by B.C. and Ontario, a trend that began in early 2016. The Q1 Canada-wide decline was broad-based as all but two provinces experienced lower resales. Policy-induced turbulence, slightly higher interest rates, and decelerated employment growth has been a damper on residential housing market activity going into 2018.

Employment

Steady employment growth is expected this year, though slower than the robust growth posted last year, reflective of a slower pace of economic growth this year. Canada's economy is projected to grow at a moderate pace of 2.1% this year, following strong 3.0% growth that was driven by very strong housing market activity, consumer spending and capital investment.

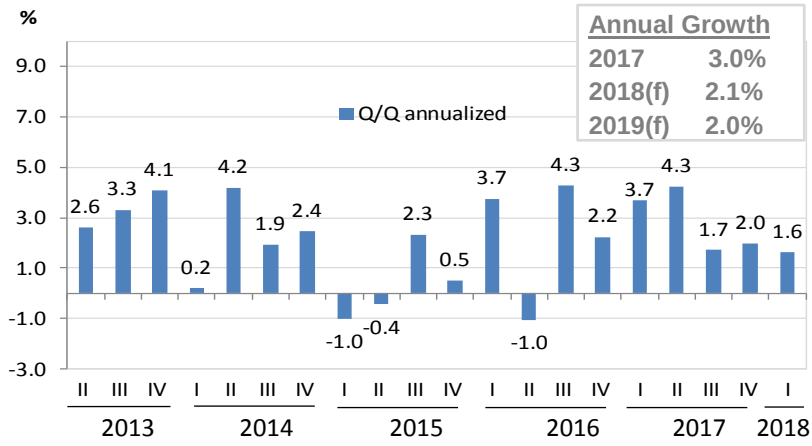
Important Trends

Indicator	Direction		Implication
Residential Permits (3 period moving average, SA)		Increasing	Residential permits accelerated in the first quarter of 2018, suggesting that starts will remain elevated in the coming quarters
Non Residential Permits (3 period moving average, SA)		Increasing	Non-residential permits increased in the first quarter, at a higher level than the annual average in 2017
Housing Resales (Quarterly Total, SA)		Decreasing	Housing resales decelerated sharply in the first quarter of 2018 to a level below the 10-year average
Energy Prices (Y/Y % change, end of quarter values)		Increasing	Energy price growth increased slightly in comparison to the previous quarter, however below the long-term average
Housing Starts (SA)		Flat	Housing starts were relatively unchanged, as they are expected to moderate in 2018 in comparison to the previous year

Slightly elevated interest rates and international trade uncertainty have already begun to create headwinds for consumer spending and capital investment.

All told, Canada is expected to see around 234,800 net new jobs this year, strong but below the robust 336,500 net new jobs created last year.

GDP Growth Expected to Moderate in 2018



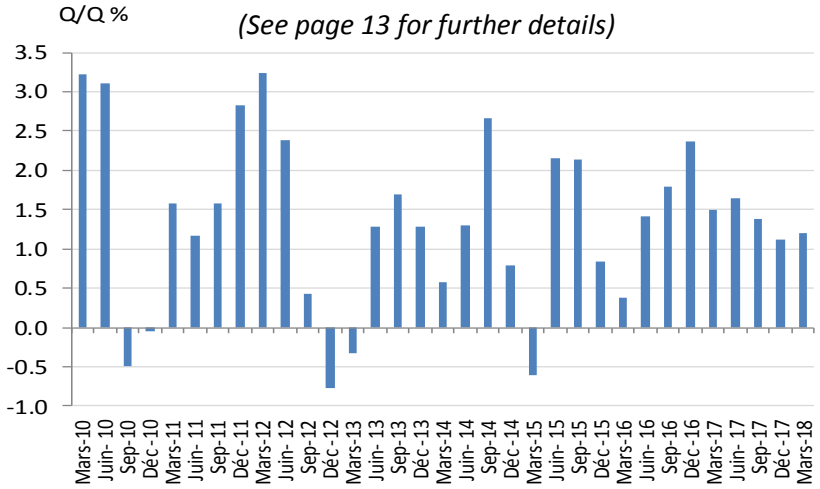
Interest Rates

Interest rates are an important determinant of housing demand, as low rates increase affordability and boost consumer confidence. For almost a decade, demand has been boosted by historically low interest rates, supporting both the resale market and pushing up housing starts. Economic uncertainty arising from a looming a U.S. trade war is tempering interest rate expectations. Going forward, we expect flat or even lower mortgage rates over the near term, driven by moderating bond yield expectations.

Migration

While interest rates and employment growth strengthen housing demand, in the long-run, demand is driven by population growth. In Canada, the majority of our population growth comes from international immigration. Population growth is expected to strengthen in 2018, as firm economic conditions continue to attract international and interprovincial migrants. This is likely to be supported by the federal government's plan to settle up to 340,000 immigrants in Canada a year by 2020. Many of these people will likely settle in Ontario, B.C. and Quebec, and in particular Toronto and Vancouver.

Leading Indicator Accelerates



(See page 13 for further details)

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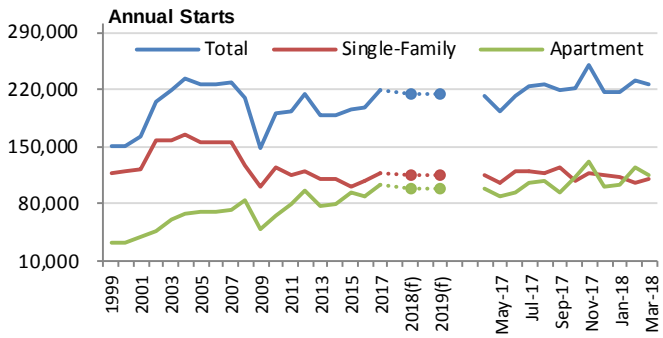
Indicator Accelerates

- The leading indicator increased in the first quarter, after declining in the previous two quarters.
- This suggests a positive near term construction outlook, though not as robust as last year.

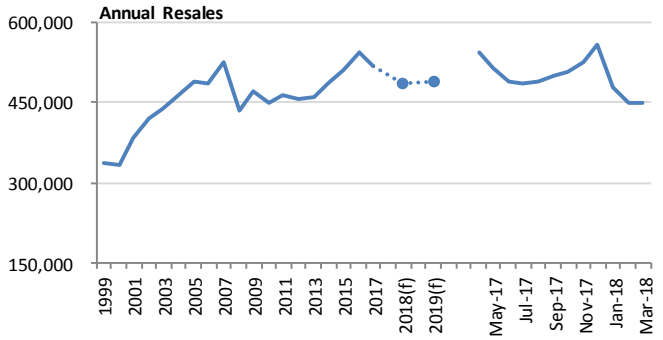
Housing Starts

- In the first quarter of 2018, housing starts decreased 1% from the previous quarter to 226,910 units. Notwithstanding the decrease, apartment starts were positive in the quarter.
- Housing starts are forecasted to decline across most provinces except for Alberta, Ontario, and Nova Scotia, to a total of 217,275 units in 2018.



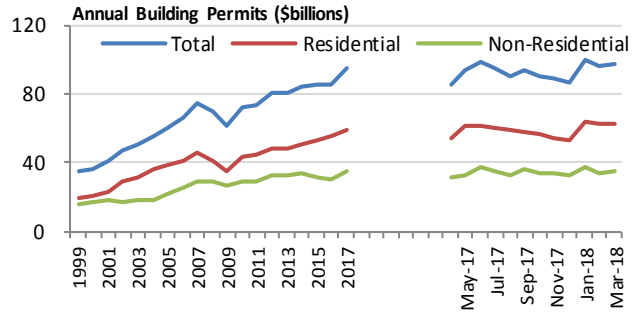
Resales

- 459,036 homes were sold in the first quarter of 2018, a 15% decline from the previous quarter. The average price per household across Canada followed suit, decreasing by 6%.
- Nevertheless, sales are expected to trend lower in 2018 and 2019.



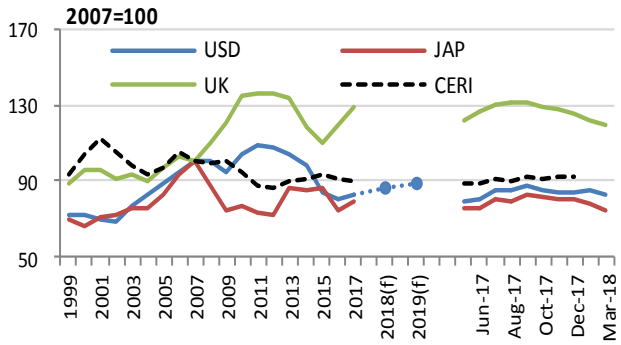
Permits

- In the first quarter of 2018, $25 billion worth of building permits were issued, an increase of 11% over the previous quarter.
- The quarterly gain was driven by the residential and commercial sectors.
- The construction value of permits issued in the first quarter of 2018 was higher than any previous quarter in 2017, signalling an increase in near-term investment.



Exchange Rates

- The Canadian dollar finished the first quarter of 2018 at $0.77 USD, a decrease of 1% compared to the start of the year.
- The Canadian dollar is forecasted to remain competitive in 2018 and 2019, weighed down by trade uncertainty and the lower interest rates relative to the U.S.



Engineering Investment

- Investment in engineering by the business and government sectors increased by 1% from the previous quarter to a total of $127 billion.
- The Q1 2018 increase is 8% higher than the same period in 2017, consistent with the moderate increases expected for Canada's oil and gas sector in 2018.

Non-Residential Spending

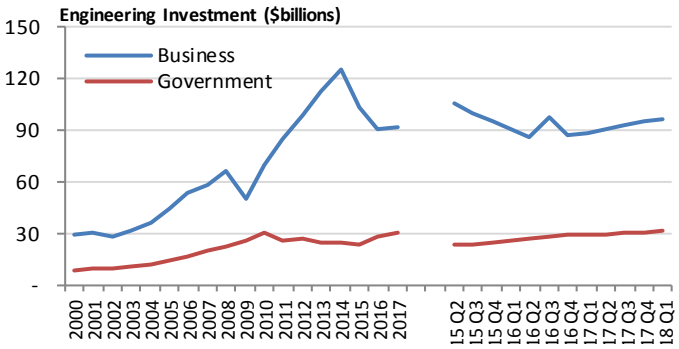
- Non-residential investment (real) rose to $45 billion (SAAR) in the first quarter of 2018, an increase of 3% compared with the previous quarter.
- Non-residential investment is forecasted to grow by 1.6% and 1.4% in 2018 and 2019, respectively.

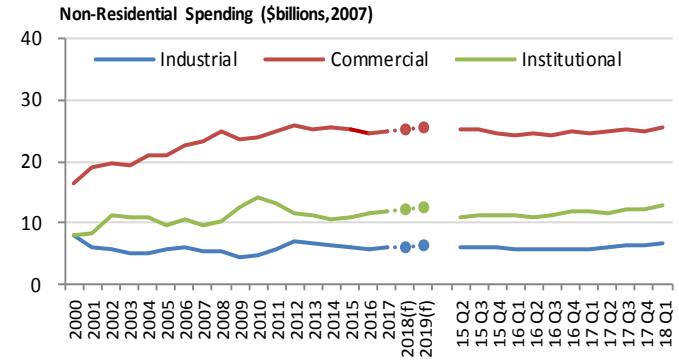
Price Index

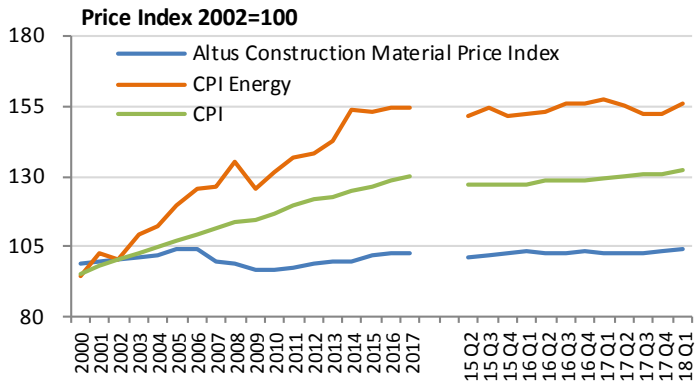
- The Altus Construction Material Price Index was 1.79% higher year-over-year in the first quarter of 2018, faster than the overall rate of inflation.
- Energy prices decreased for the third consecutive quarter in Q1 2018, the overall decrease in energy prices in Canada were driven by a decrease in electricity prices in Ontario.

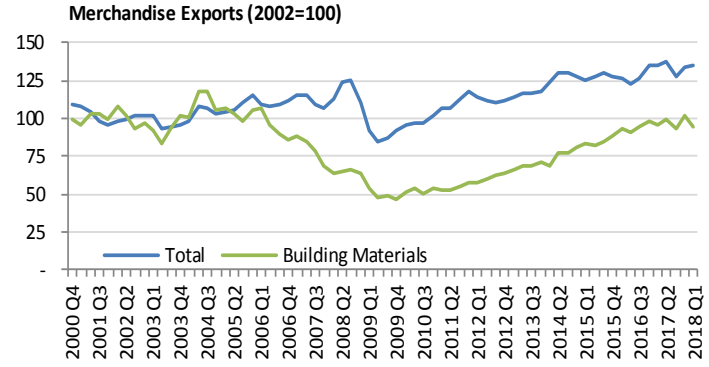
Exports

- Exports of building materials and merchandise exports increased by 1% in the first quarter of 2018 compared to the previous quarter.
- Building materials were down 8% year-over-year.
- Recently announced tariffs by the U.S. on Canadian steel and aluminum products could hurt the positive growth trendline experienced in the last ten years.





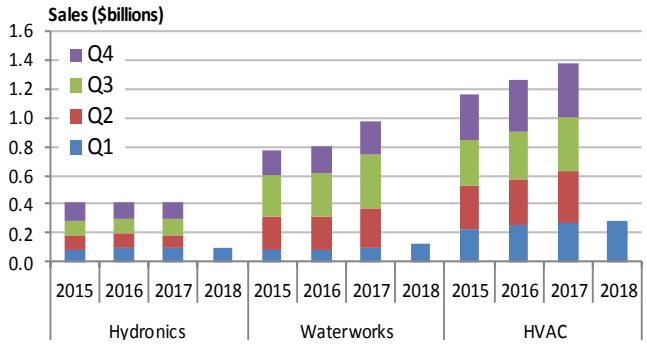




CIPH Member Sales

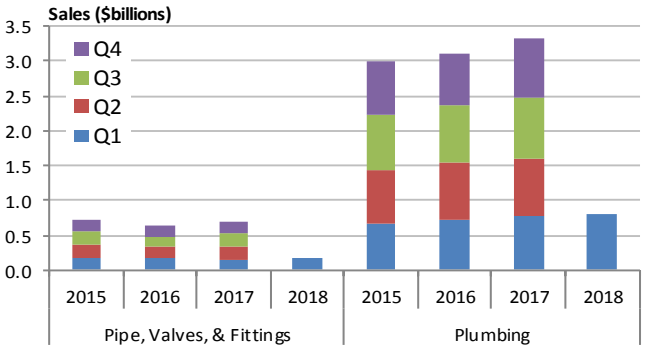
HVAC & Hydronics & Waterworks

- In the first quarter of 2018, the volume of HVAC sales totalled $291 million, a 7% year-over-year increase, and well above the 5-year average.
- Waterworks sales continued at the strong pace seen in 2017, increasing 29% year-over-year in the first quarter of 2018. Hydronics sales grew by 8% year-over-year.



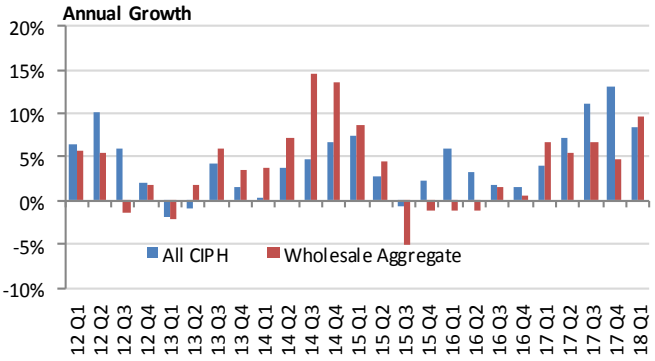
Plumbing & Pipe, Valves, Fittings

- Plumbing equipment accelerated 4% higher in first quarter of 2018, just below the 5% average annual Q1 growth rate in the last five years.
- Pipes, valves and fittings sales increased by 17% in the first quarter of 2018 to a total of $184 million, 29% above the 5-year average level of Q1 sales in the quarter.



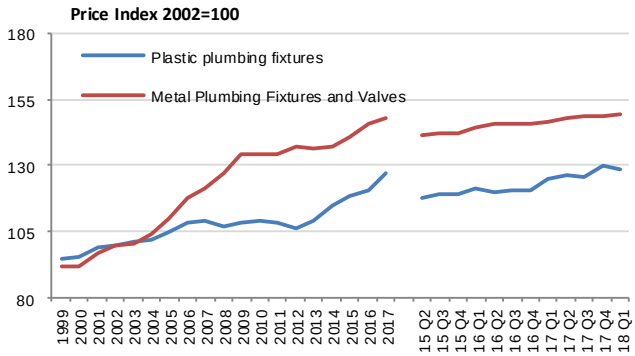
Total Sales

- Combining all of the above sales into an aggregate, CIPH members sold a total of $1.5 billion in the first quarter of 2018, 8% higher on a year-over-year basis.
- A comparable aggregate of sales totalled $7.8 billion in the first quarter of 2018, a growth of 10% year-over year; 2% higher than the pace of CIPH member sales.



Prices

- Price growth for metal plumbing fixtures and valves accelerated by 2.1% year-over-year in the first quarter of 2018.
- Prices for plastic plumbing fixtures increased by 2.4% in first quarter year-over-year, higher than the rate of inflation.

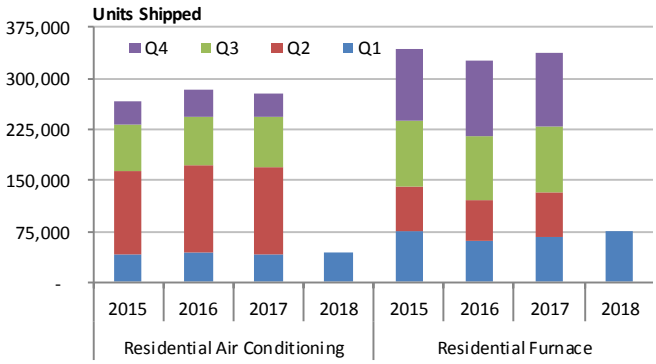


Source: CIPH, Statistics Canada

HRAI Member Shipments

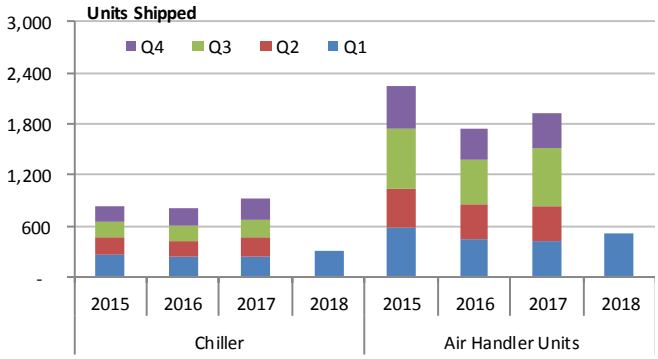
Residential A/C & Furnace

- 44,616 residential air conditioning units were shipped in the first quarter of 2018, an increase of 8% year-over-year.
- Residential furnaces increased in Q1 2018, up by 16% year-over-year to a total of 76,105 shipped.



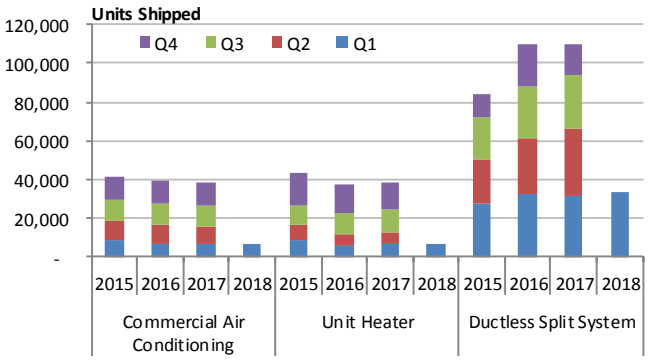
Chiller and Air Handler Units

- The number of air handler units shipped increased by 24% year-over-year in the first quarter to a total of 508 units.
- The number of chillers shipped increased by 32%, an increase of 73 units sold compared with the same period in 2017.



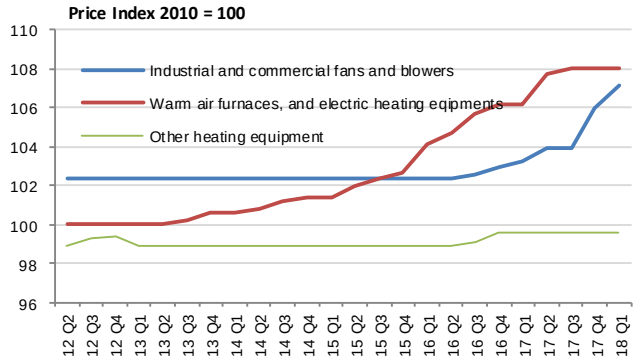
Commercial A/C, Unit Heater & Ductless Split System Units

- Commercial air conditioning units shipped in the first quarter of 2018 increased to 7,014 units, up 4% compared with the same period in 2017.
- Sales of ductless split systems increased by 9% in the first quarter of 2018, well above the five year average. Sales in the first quarter have grown by 13% on an average annual basis in the last 5 years.
- Unit heater shipments totalled 6,397 in the first quarter, up 2% year-over-year.



Prices

- Prices for industrial and commercial fans and blowers accelerated by 4% in the first quarter of 2018 year-over-year.
- Warm air furnaces and electrical heating equipment prices increased by 1.8% year-over-year, while other equipment was unchanged.



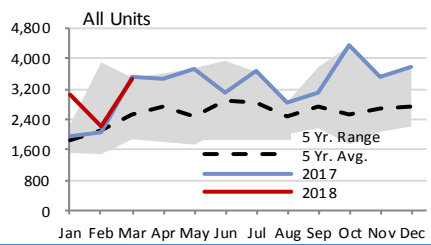
Source: HRAI, Statistics Canada

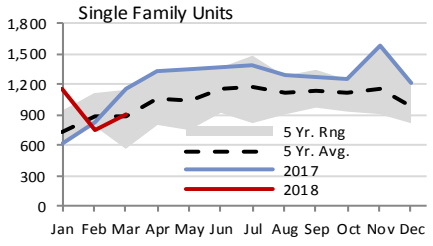
Regional Insights

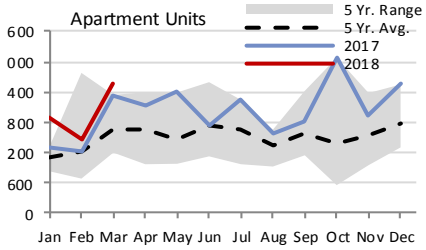
With growth projected at a pace of 2.8% in 2018, B.C. is expected to continue along its strong growth path, supported by strong consumer spending, solid population growth, and softer but firm government spending. From 2018 onwards, growth is expected to moderate from its very strong pace. In the near-term, downside risks to growth include slower exports growth due to the looming threat of tariffs imposed by the United States, and a deceleration in mortgage growth.

However, the Site C hydroelectric dam project despite recent delays, and the eventual construction of the Trans Mountain pipeline should represent a significant tailwind to growth over the next four years.

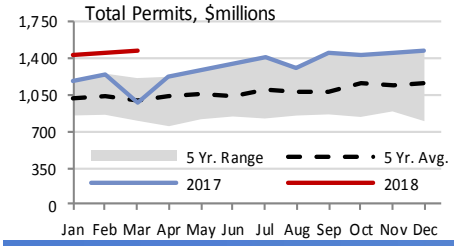
Housing Starts

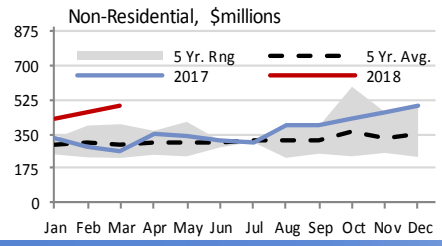


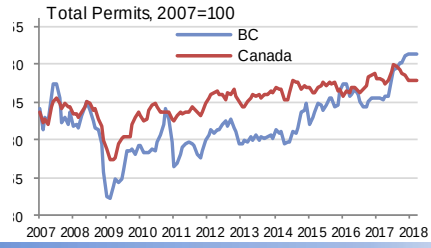




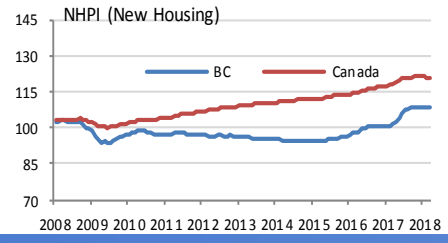
Building Permits

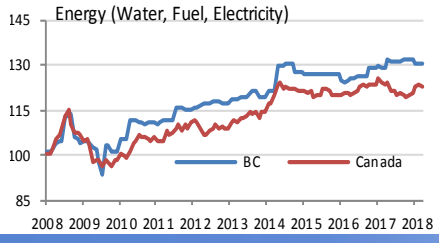


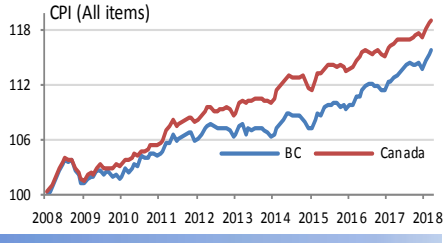




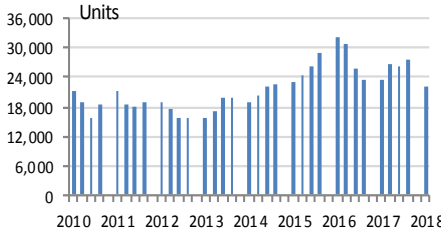
Prices, 2007=100



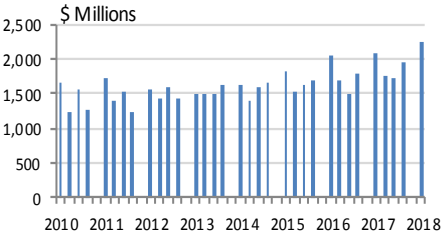




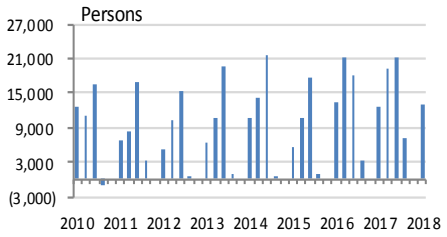
Existing Home Sales



Renovations



Net Migration

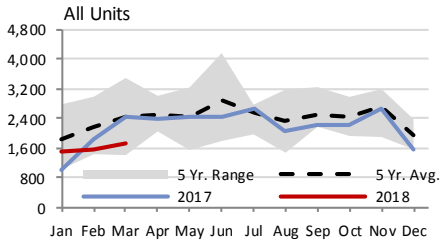


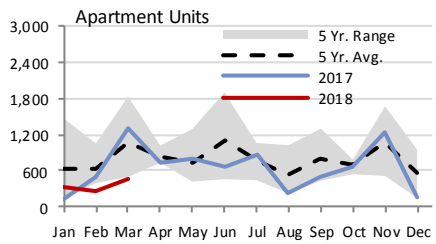
Regional Insights

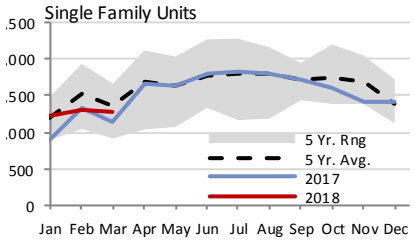
Alberta's economy rebounded in 2017 from two years of economic recession caused by plunging crude oil prices in 2014. The economic resurgence was characterized by a blistering 4.0% growth rate, exceeding all expectations. Growth was broad-based with notable gains in oil production, exports, housing starts, and consumer spending. The labour market also improved considerably as all of the jobs lost during the recession were recovered by the end of 2017. Increased provincial government spending and the rebuilding of Fort McMurray after the wildfires in 2016 were also catalysts for growth.

Alberta's real GDP is expected to grow at a more moderate 2.2% in 2018. Improvement in the energy sector and capital investment should lead to moderate but sustained economic growth during the forecast period. However, oil prices remain far from levels estimated to be consistent with profitable investment in oil sector capital projects.

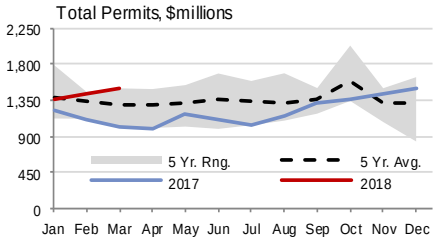
Housing Starts

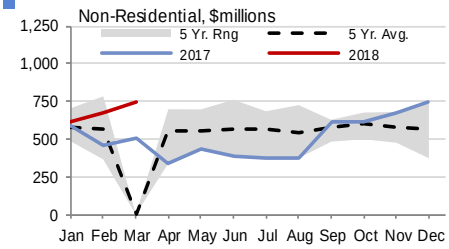


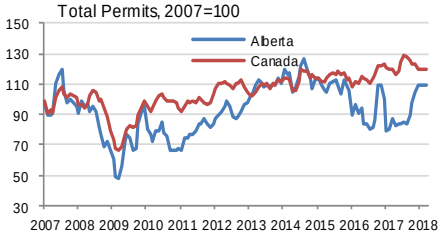




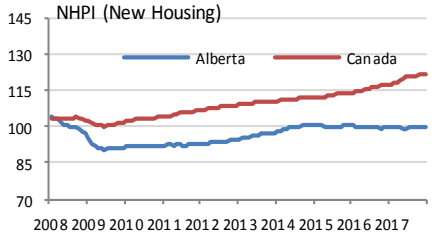
Building Permits

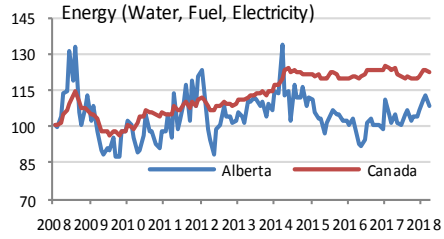


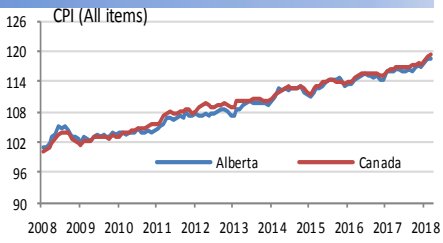




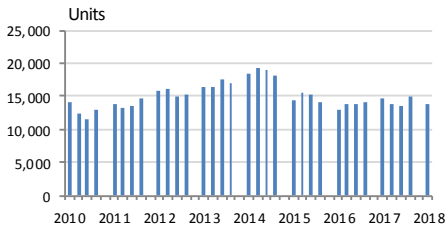
Prices, 2007=100



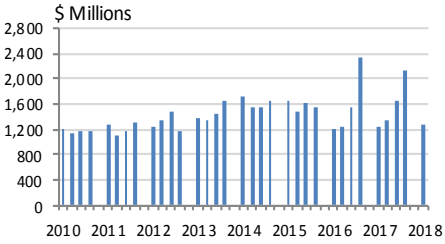




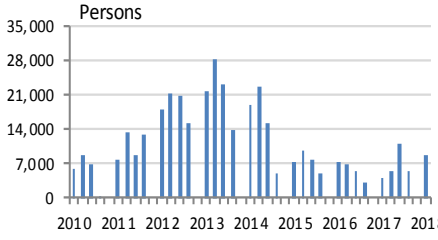
Existing Home Sales



Renovations



Net Migration



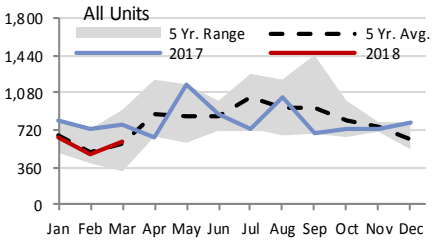
Manitoba/Saskatchewan

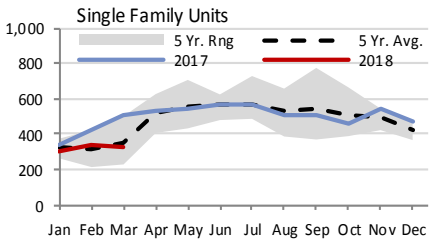
Regional Insights

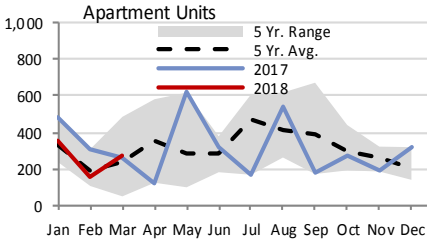
The economies of Manitoba and Saskatchewan grew by an estimated 3.0% and 2.9% respectively in 2017 and are forecasted to grow by 2.1% and 1.3% in 2018. Ongoing U.S. demand and a competitive dollar have increased manufacturing activity across Manitoba and should help support relatively firm economic growth over the forecast period. Saskatchewan's economic growth should benefit from an increase in investment spending and a rebound in the agriculture, oil & gas, and mining sectors. Saskatchewan's economy is expected to improve and maintain a steady pace through the forecast horizon, in tandem with improved activity in the oil and gas sector.

The Manitoba and Saskatchewan manufacturing sectors will likely be boosted by firming U.S. demand, a competitive dollar, reduced import costs stemming from low oil prices and a stronger Alberta economy. Additionally, Saskatchewan's construction sector is expected to receive a boost from non-residential projects.

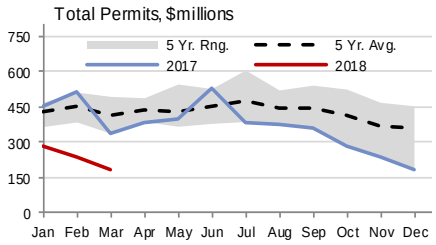
Housing Starts

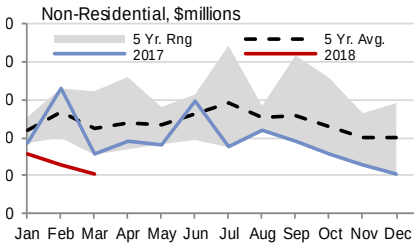


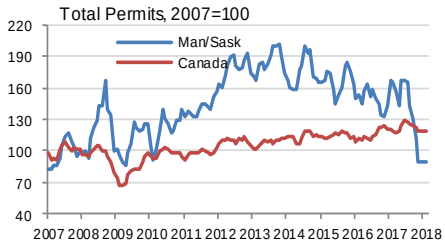




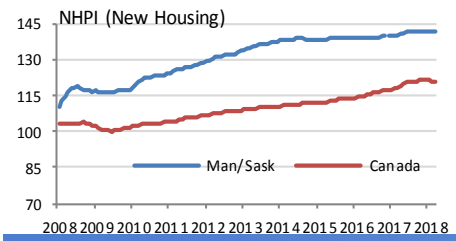
Building Permits

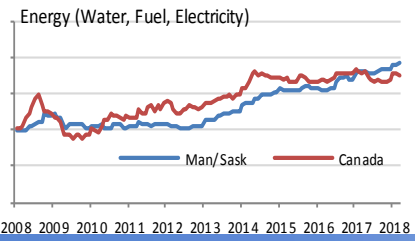


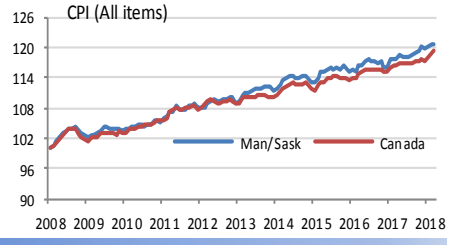




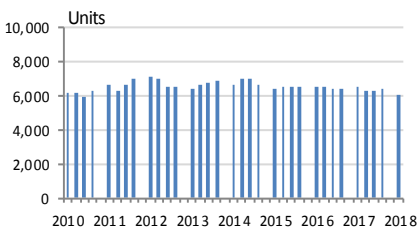
Prices, 2007=100



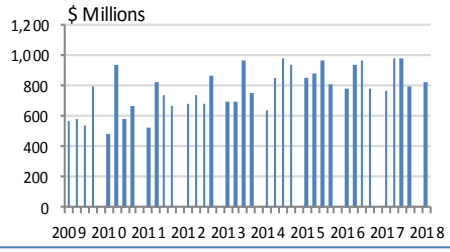




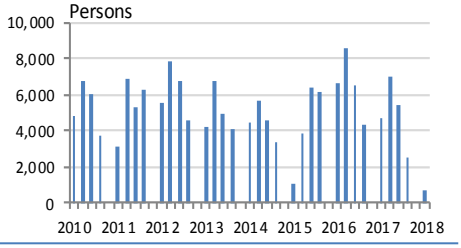
Existing Home Sales



Renovations



Net Migration

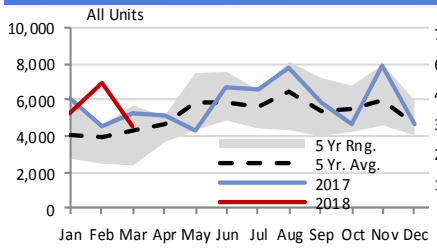


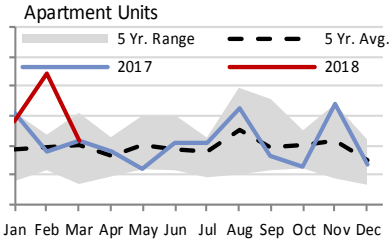
Regional Insights

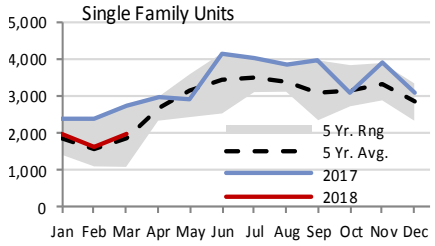
After leading Canada's growth along with B.C., and growing at a moderately strong pace from 2014-2016, Ontario's growth accelerated slightly in 2017. However, economic growth is expected to moderate in 2018, as rising interest rates, market-cooling measures in housing, and a looming trade war with the United States dampen the outlook.

Ontario can expect economic growth to remain relatively firm over the forecast horizon. Consumer and government spending, ongoing population growth, stable U.S. demand and a competitive dollar will support growth. However NAFTA renegotiation uncertainty a looming Canada-U.S. trade war, and policy uncertainty associated with the newly elected provincial government, will likely cause some near-term weakness in the economy. Higher interest rates could also dampen growth somewhat going forward.

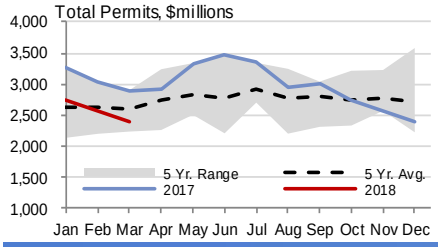
Housing Starts

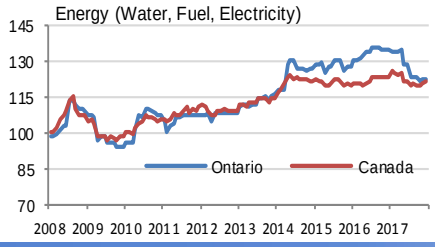


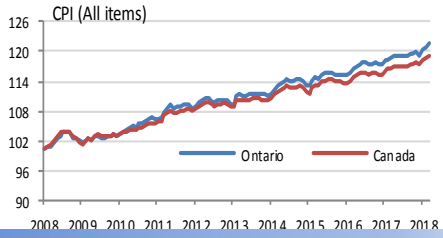




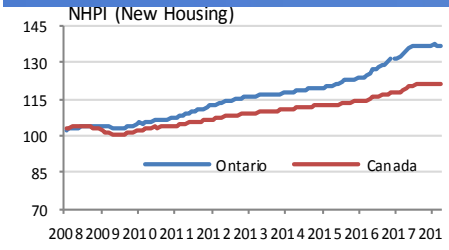
Building Permits

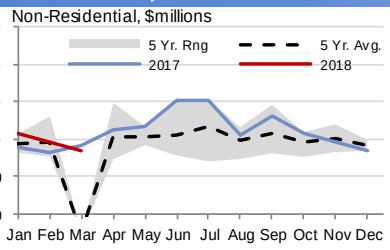


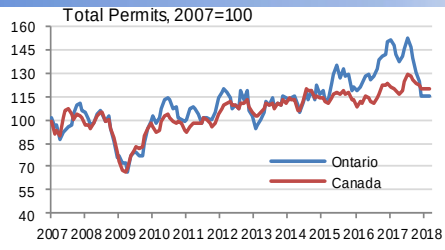




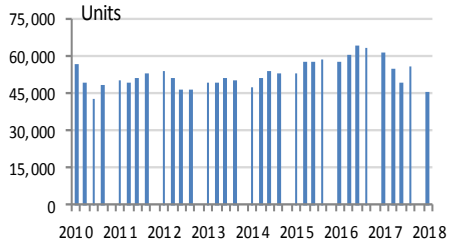
Prices, 2007=100



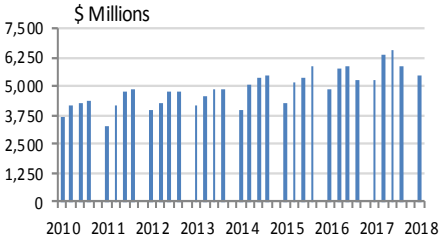




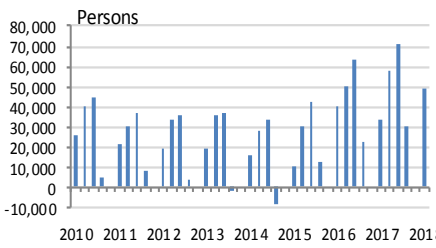
Existing Home Sales



Renovations



Net Migration

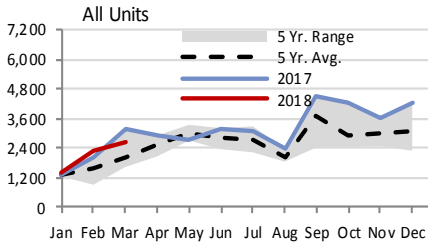


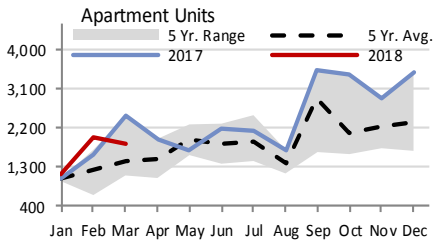
Regional Insights

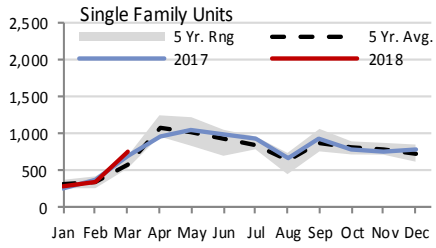
Quebec's economy, fueled by strong consumer spending, firm population growth and very strong in-migration, experienced a solid growth of 3.0% in 2017. Fiscal and political stability also promoted increased provincial spending while U.S. demand helped boost exports. Growth will remain above-average over the forecast horizon, supported by healthy domestic activity and ongoing foreign demand.

In 2018, economic growth may decelerate to a moderate 2.2%, supported by solid consumer spending, non-residential investment, and firm population growth. Economic growth is expected to continue to slow after 2018, but remain relatively firm, weighed on by softer government spending and the winding down of the Champlain Bridge and Romaine River hydroelectric projects.

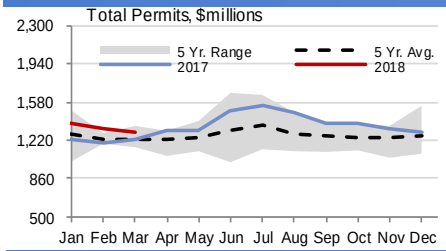
Housing Starts

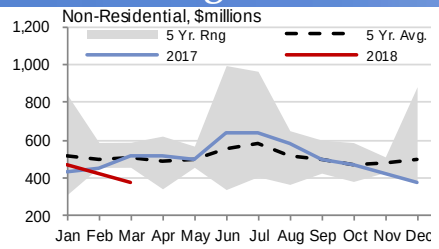


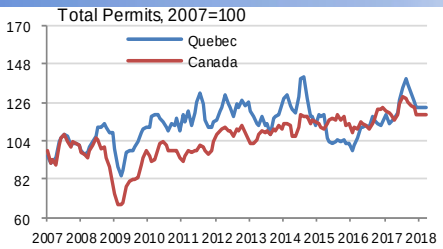




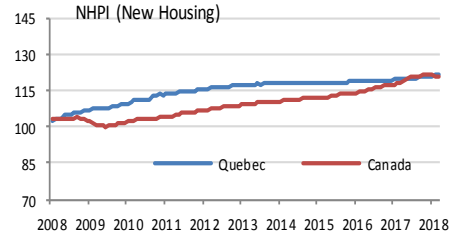
Building Permits

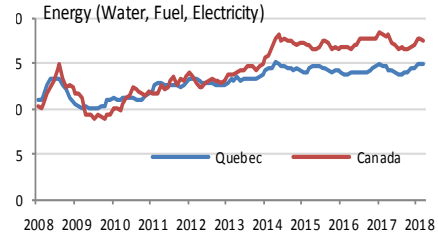


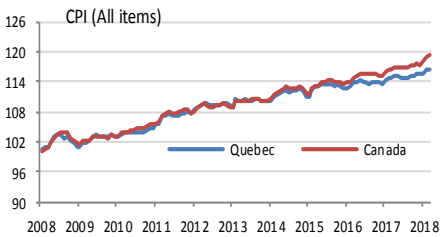




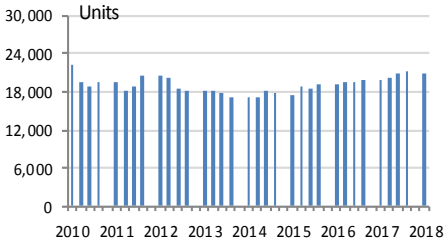
Prices, 2007=100



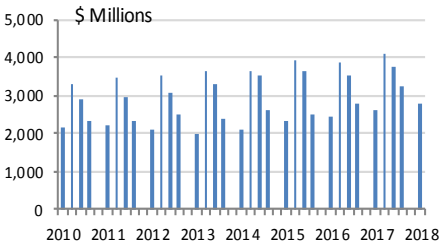




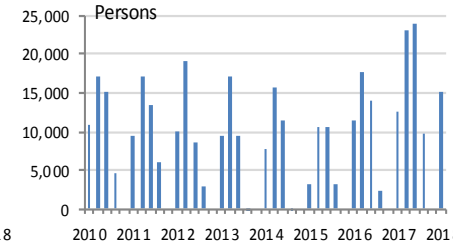
Existing Home Sales



Renovations



Net Migration

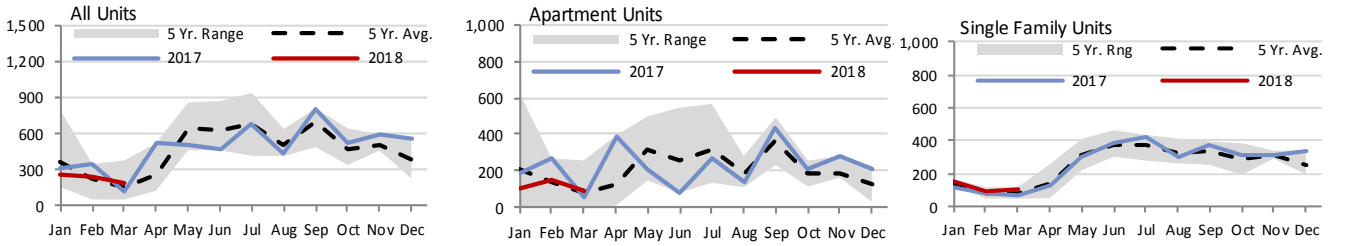


Regional Insights

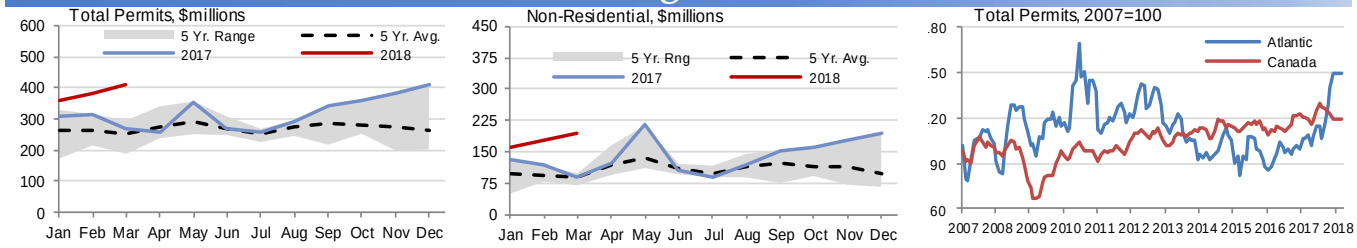
Economic growth in Atlantic Canada was a modest 1.6% in 2017. This relatively slower growth was supported by increased exports, a pickup in housing starts and solid consumer spending. Growth was also supported by manufacturing and construction growth in some Atlantic provinces.

In 2018 and beyond, Atlantic Canada is expected to experience slightly weaker economic growth in the range of 1.0% to 1.2%, supported by provincial government spending, exports, tourism, the Charlottetown Airport upgrade, as well as federal shipbuilding procurement that will buoy Nova Scotia's manufacturing sector. This positive outlook will be supported by export growth (namely oil), ongoing construction of Newfoundland and Labrador's West White Rose offshore project, and less fiscal austerity. Population growth driven by the surprisingly strong migration to the Atlantic Provinces in 2016 and 2017 is also expected to continue to provide support to economic growth going forward.

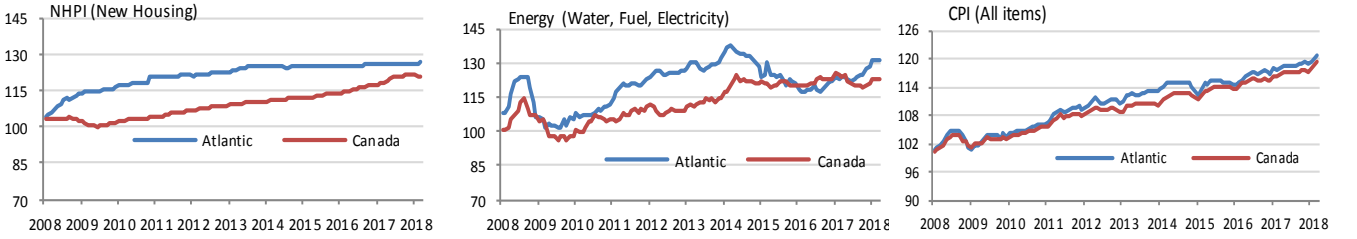
Housing Starts



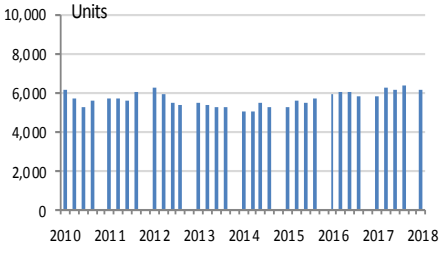
Building Permits



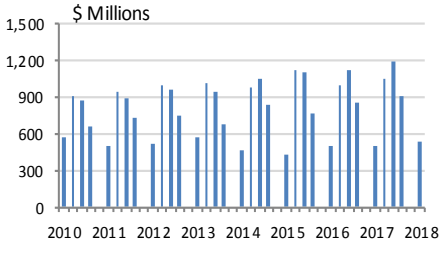
Prices, 2007=100



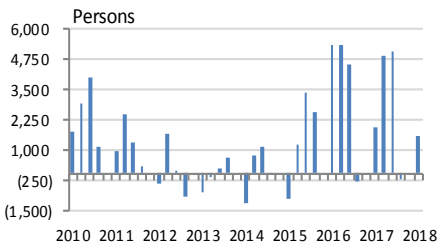
Existing Home Sales



Renovations



Net Migration



Continues from Page 2…

Solid economic growth should support population growth from 2018 onwards. Risks to the population growth forecast include the effects of housing shortages and deteriorating affordability in major markets.

On the whole, net migration to Canada is running above its long-term average and will continue to support steady housing starts and renovation activity.

Condos – A Calibrated Boom Supported by Fundamentals

While some have expressed concern over the pace at which condos are increasingly dominating the landscape and ambience of major cities across the country, production has been well paced and responsive to underlying demand, particularly in Toronto, and presale levels continue to insulate the market from overhang risks.

There are no signs of an oversupply of condos. Record high condo sales are in many instances a reflection of record low single-family housing supply.

After falling since 2016, compared with the same period last year, inventories are up so far this year, particularly in Toronto, Vancouver, Calgary and Edmonton. Slightly higher inventories in Toronto and a slowdown in the pace of Toronto's new condominium apartment sales will mean a more moderate pace of apartment starts in 2018.

Concluding Remarks

The fundamentals of Canada's housing market remain strong. All told, our forecast is for 217,274 housing starts in 2018, and 211,450 units in 2019.

Altus Construction Materials Price Index – A price index of construction materials. Components are weighted to reflect the percentage of total material cost.

Annualized – Periodic trends (monthly or quarterly) expressed as if they continued for a full year.

CERI – (Canadian Dollar Effective Exchange Rate Index) a trade-weighted average of bilateral exchange rates for the Canadian dollar against the currencies of Canada's six largest trading partners. An increase in the index represents an appreciation of the Canadian dollar.

Consensus Forecast – The average forecast of major Canadian financial institutions that have updated their forecasts within the last 40 days. The consensus forecasts for currency are end of period.

CPI – (Consumer Price Index) The cost of a fixed basket of goods in Canada, measured in a constant quality and quantity, re-indexed to 2007.

Engineering Investment – Includes all capitalized costs: legal fees, engineering and architectural fees, capitalized interest and work completed for the business by its own employees. It includes items such as bridges, roads, highways, waterworks, sewage systems, airports, seaways, power line construction, oil well drilling, mine development, dams, street lighting, railway tracks and pipelines. The data is expressed in current dollars.

Exchange Rate – Exchange rates are expressed in terms of foreign currency relative to the average exchange rate in 2007. An increase in the index represents an appreciation of the Canadian dollar vis-à-vis that currency.

FIRM – (Financial Industry Research Monitor) An on-going, quarterly survey of 12,000 Canadian households per year undertaken by Altus Group in conjunction with Ipsos-Reid. Topics range from personal finance, to renovation intentions.

Intentions – Surveyed investment intentions for both public and private entities. The survey is conducted in November of each year by Statistics Canada and is subject to the market outlook at that time.

Leading Indicator – A composition of several data series that are correlated with future construction spending; including: residential and non-residential building permits, housing starts, existing home sales, employment, NHPI, and the money supply.

Money Supply – (M2 Gross) Currency outside of banks and chartered bank demand, notice, and personal term deposits.

Definitions

Net Migration – Includes both international and interprovincial net migration.

NHPI – (New Housing Price Index) The price of constant quality, newly constructed, single-detached homes built by general contractors, indexed to 2007.

Non-Residential Spending – The spending value for enterprises and governments for industrial, commercial and institutional buildings. The data is expressed in 2007 constant dollars.

Plastic Piping – Polyethylene plastic pipes and tubes (excluding flexible)

Realnet – A subsidiary of Altus Group, Realnet is a leading real estate information services company. Realnet tracks new home sales, and land transactions in several markets across the country

Renovations – Includes additions, alterations, conversions, and new installation or replacement of built-in appliances and equipment.

Single Family – Includes single-detached, semi-detached, and townhouse units.

(SA)– (Seasonally Adjusted) Data is adjusted to remove variations attributable to the time of year. This allows for better comparison of periodic changes

SAAR – (Seasonally Adjusted Annual Rate) – Seasonally adjusted data expressed as an annual total.

Q/Q – The change in a variable from one quarter to the next.

Wholesale Aggregate – Sales by wholesalers of electrical, plumbing, heating and air-conditioning equipment and supplies

About Us

HRAI

HRAI is a national association that represents more than 1,400 heating, ventilation, air conditioning and refrigeration (HVACR) manufacturers, wholesalers and contractors, who provide the products and services for indoor comfort and essential refrigeration processes.

HRAI offers leadership and training programs for the advancement of its members' business and technical excellence, promotes a code of ethics for consumer protection and safety, and provides consumers with useful information and a database of members in good standing to support an informed buying process. Through its membership requirements and consumer feedback processes, HRAI is committed to a safe, responsible and fair industry that is environmentally-responsible and sustainable.

CIPH

The Canadian Institute of Plumbing & Heating is a not-for-profit trade association. Founded in 1933, the Institute is a vibrant organization committed to providing members with the tools for success in today's competitive environment. More than 250 companies are members of this influential Canadian industry association. They are the manufacturers, wholesaler distributors, master distributors, manufacturers' agents and allied companies who manufacture and distribute plumbing, hydronic heating, industrial waterworks and other mechanical products. CIPH wholesalers operate more than 700 warehouses and showrooms across Canada. Total industry sales exceed $6 billion annually.

Altus Economics

Altus Group Economic Consulting has been providing both public and private sector clients with strategic advice on topics such as real estate market and forecasting analysis to expert witness testimony to building product and technology analysis since 1972.

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