CONSUMER WATCH

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Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.ca

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.ca

Peter Buchanan
(416) 594-7354
peter.buchanan@cibc.ca

Warren Lovely
(416) 594-8041
warren.lovely@cibc.ca

Emanuella Enenajor
(416) 956-6527
emanuella.enenajor@cibc.ca

Andrew Grantham
(416) 956-3219
andrew.grantham@cibc.ca

http://research.cibcwm.com/res/Eco/EcoResearch.html

Canadian Housing: Demographically Dangerous?

by Benjamin Tal

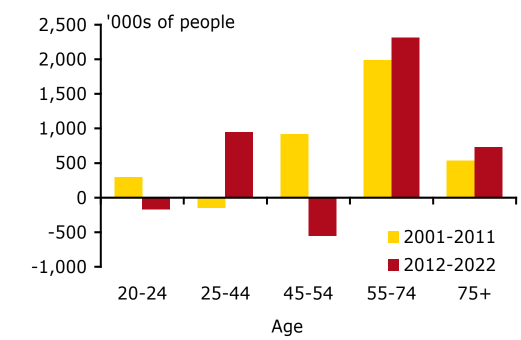
The ongoing softening in housing market activity is hardly a surprise and probably represents the early stage of the highly expected downward adjustment in both volume and prices. But is it just a cyclical correction or the beginning of a real estate bear market? Important here is the role of demographics. How concerned should we be that the falling number of young Canadians, along with the downsizing and increased liquidation of houses by seniors or heirs, will work to exacerbate the adjustment and prevent any subsequent recovery? It turns out that those fears are highly exaggerated and very premature. In fact, demographic forces will be as supportive to real estate markets in the coming decade as they were in the past decade.

Demographics Imply Continued Strong Demand in Coming Decade

A quick glance at Chart 1 puts the demographic picture in perspective. The focus here should be on the difference in population growth between the last and the next decade — using Statistics Canada's medium-growth, medium immigration projection as a benchmark. The chart clearly reveals the well documented expected decline in the number of young Canadians (under 25) and in the 45-54 age group, along with the acceleration in the pace of growth in the 55+ age group.

Chart 1

Population Growth by Age

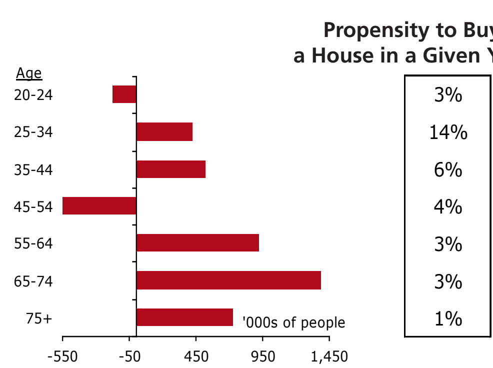


Source: StatCan, CIBC

But from a housing market perspective, what counts is not only the change in population of a given age group, but more importantly, the level of housing market activity among those age groups. Chart 2 presents information on the projected change in the different age groups in the coming decade, alongside their respective propensity to buy a house

Chart 2

Population Growth: The Next Decade



Source: StatCan, CMHC, Harris Decima, CIBC in a given year. While the projected 170,000 decline in the number of Canadians in the age group 20-24 in the coming decade is negative for housing demand, the low propensity to buy among this age group will limit the damage. At the same time, the growth in the number of Canadians in the age group 25-34, which accounts for the vast majority of first-time buyers, is projected to be much stronger. In other words, the group that is most likely to buy a house will grow faster in the coming decade.

What about other age groups? A notable decline (550,000) is projected for the age group 45-54. But note that with a relatively low propensity to buy, this age group accounts for only 12% of total housing demand.

Putting it all together by summing up the change in population growth by age groups weighted by their respective house-buying propensity reveals that the next decade will see an annual average growth of 0.9% in demographically based housing demand — roughly in line with the average growth in demand seen in the past decade (Chart 3).

Beyond the next decade, these demographic forces will start exerting downward pressure on the pace of growth in housing activity as demographically based demand is projected to rise by only 0.5% annually between 2022 and 2032.

Importantly, note that the correction and subsequent stagnation in the housing market in the 1990s was accompanied by a notable softening in demographically based housing demand with average annual growth in demand slowing from well over 2% in the late-1980s to an average of close to 0.2% during the 1990s. That reflected the impact of the recession and the jobless recovery on population growth mainly via out-migration and a notable reduction in the number of new immigrants during that period. Assuming that any upcoming adjustment in housing market activity will occur in a non-recessionary environment, demand for housing in the coming decade should be more than four times stronger than it was during the dreary market of the 1990s.

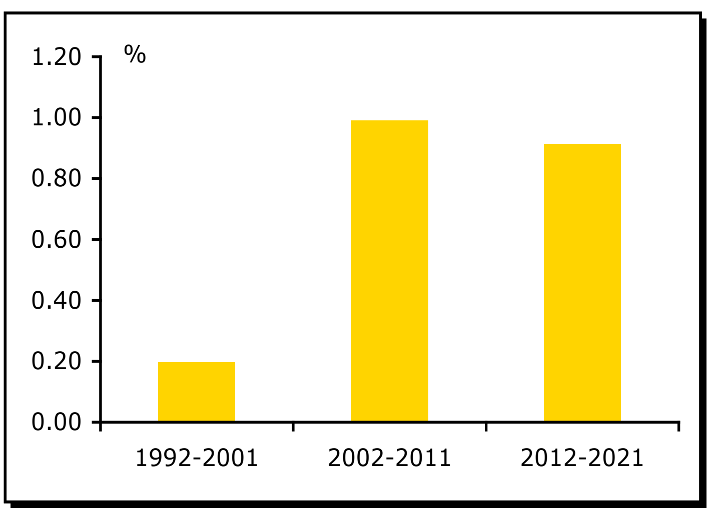
The Immigration Factor

And that demand can be even stronger than currently projected. Given that mostly all the growth in population is now due to immigration, it is clear that public policy on that front will be a major force that will impact housing demand. While recent changes to the Immigrant Investor Program will act as a negative here, this will be more than offset by an acceleration in the pace of immigration growth due to expected changes in immigration policies. Note the significant jump in the home ownership rate among immigrants as they pass the three-year mark. In fact, after ten years in Canada the propensity among immigrants to own a house is higher than among native-born Canadians (Chart 4).

By province, British Columbia is projected to enjoy the strongest increase in housing demand over the coming decade, a fact that might limit the degree and duration of the projected correction in housing activity in the province.

Chart 3

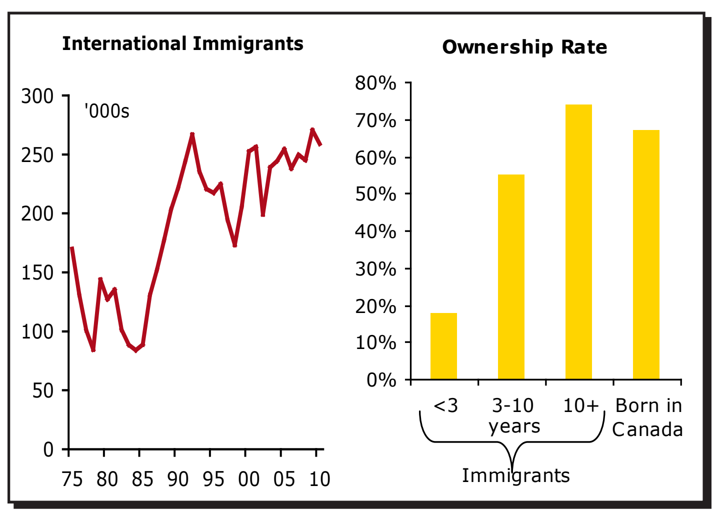
Average Annual Change in Demographic Based Household Demand



Source: StatCan, CIBC

Chart 4

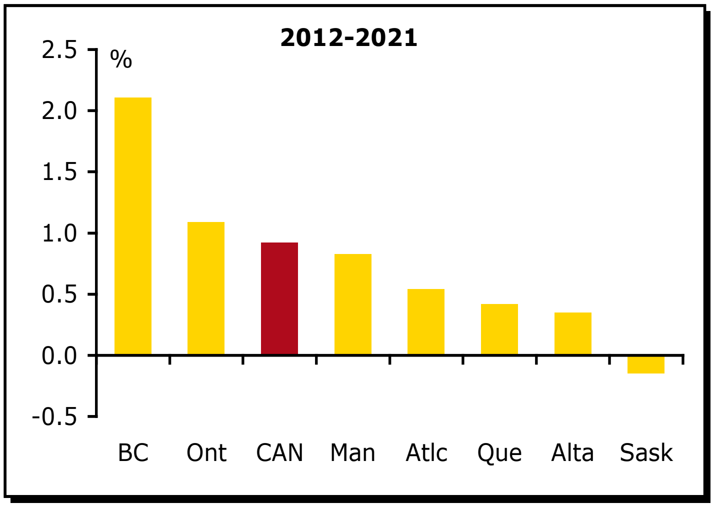
Increase in Immigration Supported Housing Demand



Source: StatCan, CIBC

Chart 5

Change in Demographic Based Household Demand by Province



Source: StatCan, CIBC

Ontario is also expected to see above-average housing demand in the coming decade followed by Manitoba (Chart 5). While the current demographic population projection by Statistics Canada suggests a relatively mild demand for housing in Alberta and Saskatchewan, there are many reasons to believe that net migration to those provinces will be stronger than currently projected — leading to stronger housing market demand.

Housing Supply — Not a Major Negative

What about the supply of housing? After all, the aging population also means that at some point a larger number of Canadians will start downsizing, as empty-nesters move to smaller houses and apartments, and older Canadians sell their properties due to declining health and related difficulty in coping with the upkeep of their homes.

Directionally, of course, these concerns are legitimate. But again, it is important to also assess the magnitude of this potential change in supply. Chart 6 illustrates the propensity to move among Canadian households — and naturally, the propensity to move declines with age. Our main focus here, however, is in the age group 55-75 (empty-nesters), and from the chart we learn that on a regular basis less than one-third of those households actually move.

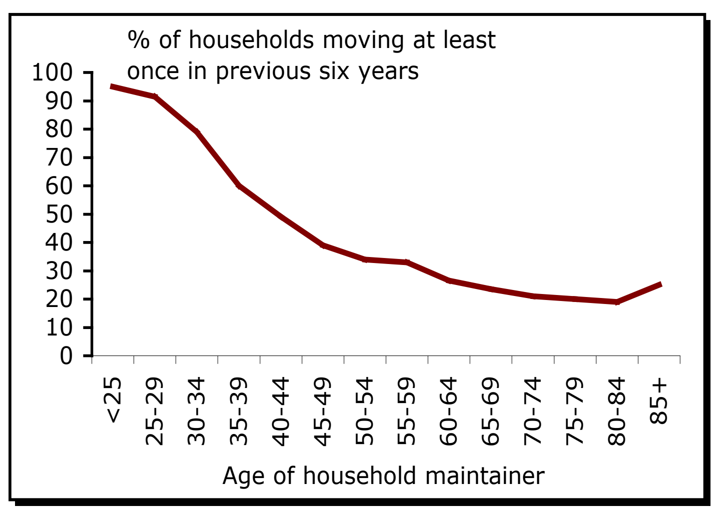
What's more, this low proportion might be even lower in the coming ten years as those baby boomers have more financial assets and are generally in better health than previous generations. The downsizing by empty-nesters will clearly impact the composition of new homes. Even if we assume that a full one-third of Canadians age 55-75 will move to condominiums/apartments (a very strong assumption), this means that, relative to the last decade, builders will have to increase supply by only 15,000 multi-units a year compared to the previous decade in order to eliminate all the potential price impact of that extra demand. This implies limited demographically driven price adjustment to both condominiums and single family housing in the coming decade.

As for the age group 75+, a second look at Chart 1 suggests that the projected 700,000 increase in their number is only 200,000 larger than the increase seen in the past decade. It is simply not large enough to flood the housing market with extra supply, after converting this figure into the number of households and adjusting for the roughly 10 percentage point reduction in homeownership rate among this age group relative to the 65-75 age group.

Putting all this information together (little in demand relative to the past decade and the extra supply due to downsizing and liquidation), it appears that any extra supply of housing due to demographic forces will be trivial at best and can be easily dealt with through a marginal reduction in housing starts. So, while housing market activity is projected to soften in the near-term, the good news is that any adjustment will not be aggravated by negative demographic forces. In fact, at least for the next decade, demographic forces will be strong enough to mitigate the damage and probably shorten the duration of the upcoming market adjustment.

Chart 6

Resident Mobility of Households, Canada



Source: StatCan, Financial Monitor, CIBC