January 2023

A Guide to Recessions and the BC Housing Market

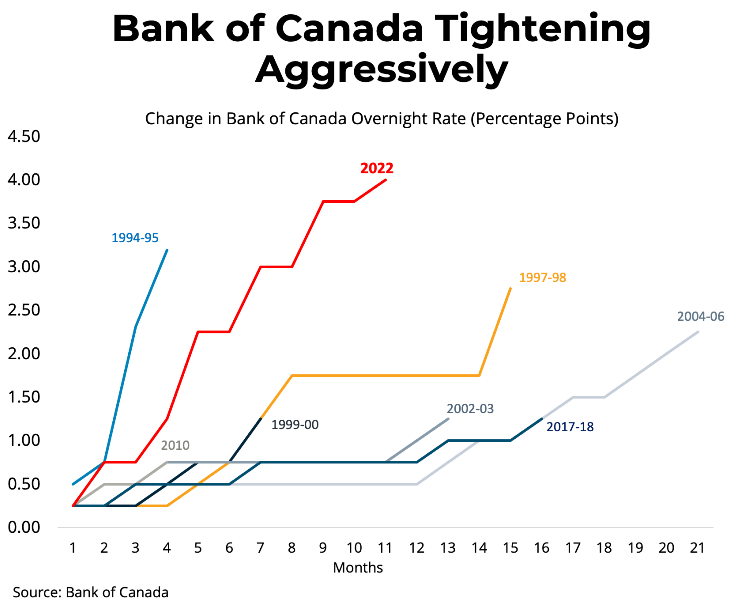
Summary of Findings

High interest rates mean that recession anxiety is mounting.

- Historically, home sales tend to lead the business cycle, starting to decline many months before the start of a recession. By the time the recession begins, sales are typically near their nadir.
- Prices follow a less predictable pattern surrounding recessions. The early 1980s involved a large run up and crash in prices, but subsequent recessions involved a modest softening or plateauing of prices before the ascent resumed.
- Historically, home sales tend to post substantial recoveries following a recession as interest rates are cut to support the economy.
- Strong economic fundamentals and demographics support the housing sector in British Columbia.

Introduction

As the Bank of Canada aggressively raised rates over the past year to fight multi-decade-high inflation, fears are mounting that tighter monetary policy will push the Canadian economy into recession. Indeed, central banks have a poor historical track record in achieving "soft landings" following tightening cycles. That is, amid high inflation, central banks often struggle to "thread the needle" of raising rates enough to bring inflation back down to 2 per cent without tipping the economy into a recession.[1]



[1] David Macdonald, *Canada's fight against inflation: Bank of Canada could induce a recession*, Canadian Centre for Policy Alternatives, July 5, 2022, https://monitormag.ca/articles/canadas-fight-against-inflation-bank-of-canada-could-induce-a-recession

In this Market Intelligence, we summarize how past Canadian recessions have impacted the BC economy and housing market and look forward to how the BC housing market may perform during a potential 2023 recession.

The History of Recessions in Canada

Since 1980, there have been four Canadian recessions, including the most recent caused by the COVID-19 Pandemic. Excluding the unusual COVID-19-induced recession, which was historically deep but thankfully short-lived, the average Canadian recession has lasted between eight and 25 months and is characterized by a contraction of about 4 per cent in real GDP and a jump in the unemployment rate of 4.5 percentage points.

(a) 1980-82 Recession

From 1980 to 1983, Canada suffered a prolonged period of weak or negative economic growth. During this period, Canada experienced a "double dip recession," with growth declining for five months in 1980, recovering, then falling for another 17 months in 1981 and 1982. Recessions in this period were a global phenomenon, with causes primarily outside of Canada. An oil price shock in 1979 contributed to already high inflation. The central bank aggressively tightened monetary policy, bringing its overnight rate above 20 per cent in 1981, to pull inflation down from rates above 10 per cent. At the same time, the United States implemented a floating exchange rate, causing a drop in the value of the Canadian dollar, in turn causing import prices to spike in Canada. The combination of high inflation and weak or shrinking GDP was termed "stagflation," both in Canada and internationally.

(b) 1990-92 Recession

Similar factors contributed to another global recession from 1990 to 1992. Rising inflation in Canada caused the central bank to hike its policy rate above 10 per cent and implement an inflation-targeting regime for the first time. New sales taxes implemented to control the deficit and weakness in Canada's largest trading partner, the United States, also contributed to the recession. Finally, the high Canadian dollar and low productivity amid the introduction of NAFTA caused a slowdown in the large manufacturing sector during this period.

(c) 2008-09 Recession

The 2008-09 recession, also known as the global financial crisis or "great recession" was the most recent economic crisis before COVID. The causes were once again international, beginning with the burst of a housing bubble in the United States, continuing with a subprime mortgage crisis and subsequent crises across the financial systems of developed economies. Canada was less impacted than other economies, particularly the United States, due to its well-capitalized and conservative banking sector. Falling exports largely drove the negative impacts in Canada due to recessions among its major trading partners.

(d) 2020 COVID-19 Recession

The COVID-19 recession in Canada differed from prior recessions as it was mainly the consequence of public health measures needed to reduce viral spread. Large parts of the economy were shut down, with borders closed and factories and ports temporarily locked. While the economy had already been weak in late 2019, the onset of COVID had already begun moderately hampering growth in early 2020 before stock markets crashed in late February. Canada's GDP contracted by about 5 per cent in Q2 of 2020, total employment plunged 15 per cent from pre-pandemic levels in April of 2020, and the unemployment rate jumped nearly 9 percentage points in BC. Many observers feared that Canada could enter the worst economic crisis since the great depression.

In response to the unprecedented economic crisis, substantial fiscal support through the Canada Emergency Response Benefit (CERB) was provided to Canadians, and the central bank aggressively lowered interest rates and engaged in a program of substantial asset purchases (quantitative easing). These policies contributed to a significant and unusual spike in disposable income and savings. Amid a locked-down economy and scrambled supply chains, these actions helped prevent the economy from dipping back into a recession (remarkably, the COVID-19 recession lasted just 2-3 months). Instead, these policies precipitated the strong (or perhaps overheated) economy we find ourselves in today, with record-low unemployment rates and substantial price inflation. These fiscal and monetary policies, in combination with other effects such as a preference shock as buyer demand shifted to large single-family homes, also likely contributed to the record-setting and unanticipated boom in the housing market during and following the COVID-19 crisis.

Provincial economic data is only available annually, making it much harder to track the duration of recessions. We know that during the 1981-82 recession, the BC economy contracted by 6.4 per cent, and the unemployment rate jumped nearly 10 points. This arguably remains the worst recession on record for British Columbia. However, by our estimates, there were months during the 2020 pandemic-driven recession in which the economy had contracted by more than 10 per cent. The provincial economy performed much better in the 1990-92 recession, with real GDP eking out meagre growth over that period, though the provincial unemployment rate did spike to nearly 11 per cent. During the 2008-09 Financial Crisis and recession, we estimate the BC economy peaked in November of 2008 and contracted 3.7 per cent over the following 12 months, while the unemployment rate rose more than 4 points.

Table 1: Historical Recession Characteristics

Recession Dates	Duration (months)	Decline in Canadian Real GDP (Peak to Trough)	Peak Unemployment Rate		Rise in Unemployment Rate (percentage points)	
		Canada	Canada	BC	Canada	BC
1981/82	16	-4.50%	13.10%	15.70%	6	9.8
1990/92	25	-3.40%	12.10%	10.90%	4.8	3.1
2008/09	8	-4.40%	8.70%	8.30%	2.9	4.2
2020	2	-17.50%	13.40%	13.30%	7.8	8.7

The Historical Impact of Recessions on the BC Housing Market

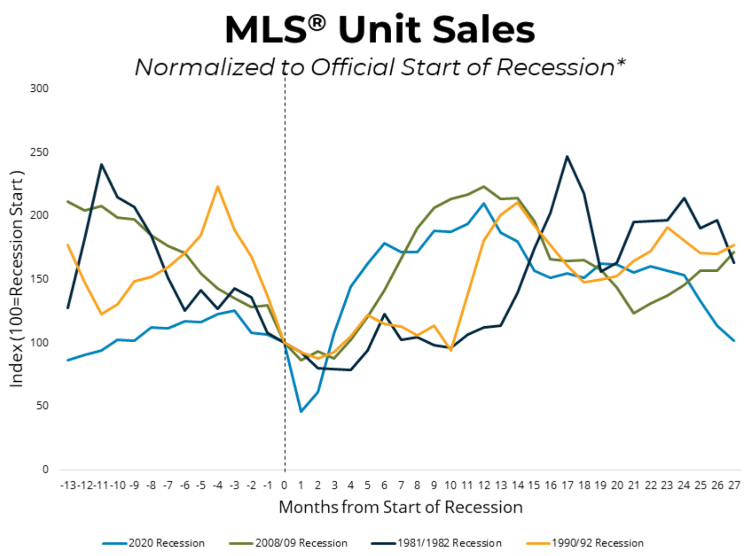
The renowned economist Edward Leamer once wrote that housing is the business cycle, showing in his empirical work that new home construction tends to lead the wider economy. We find that the same is broadly true for the resale housing market.

Typically, sales activity in the highly interest-rate-sensitive housing sector tends to begin falling months before the official onset of a recession. In the case of the 1990 recession, sales peaked 4 months before the beginning of the recession. By the official start of the downturn, sales were already close to their nadir. Even more extreme, sales peaked 15 months before the onset of the 2008 economic decline. Once again, by the start of the recession, sales were already close to the bottom. The 1980-82 double-dip recession was somewhat of an outlier period, with the most extreme swings in sales activity among recent recessions.

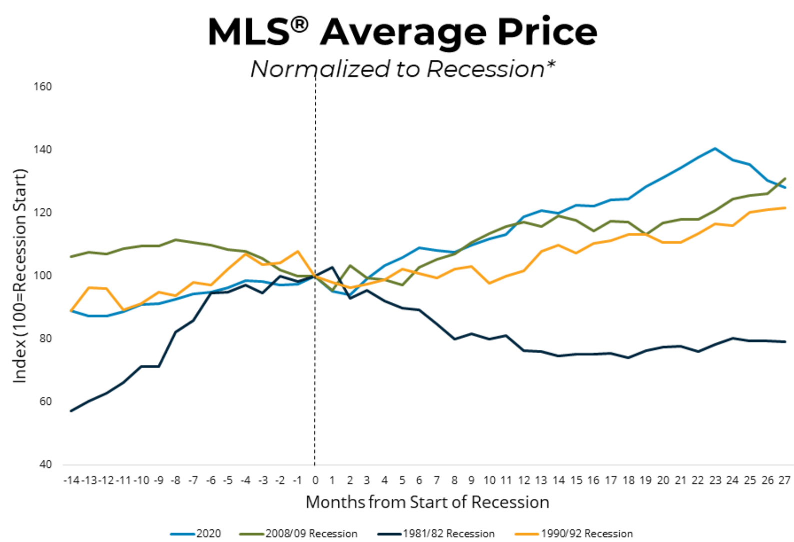
The 2020 recession was notable because sales fell relatively little before booming post-recession. After plunging more than 60 per cent from the pre-recession high by April, sales quickly recovered to their pre-pandemic level. By September, sales were 42 per cent above the pre-pandemic peak in December. Sales peaked at 70 per cent above their pre-pandemic level in March of 2021, almost exactly one year after the onset of the crisis

While there is some variation in response of BC home sales to recessions, sales historically decline 50 to 70 percent from the pre-recession peak and remain in that territory for at least one year before gradually recovering.

The current state of the housing market certainly aligns with what we have seen prior to the onset of past recessions. Home sales have fallen about 50 per cent from a near-record high at the start of 2022 and are currently about 25 to 30 per cent below historical averages.



Prices tend to exhibit a relatively similar pattern to sales in the months before the onset of a recession. In the 1981-82 recession, prices fell for nearly two years following the beginning of the 1981 recession, but this was after a considerable price appreciation just prior to the recession. In the cases of 1990-92 and 2008-09, prices essentially plateaued for one to two years before resuming their ascent. By contrast, following the onset of COVID-19, prices bottomed in May of 2020 just 4 per cent below their February level before beginning their incredible ascent. Prices surged 24 per cent above pre-pandemic levels by March of 2021, declining for several months, then resuming the surge, ultimately reaching a peak in early 2022 that was 46 per cent above pre-pandemic levels. Since then, coinciding almost perfectly with the onset of monetary tightening, average prices around the province have declined from peak levels.



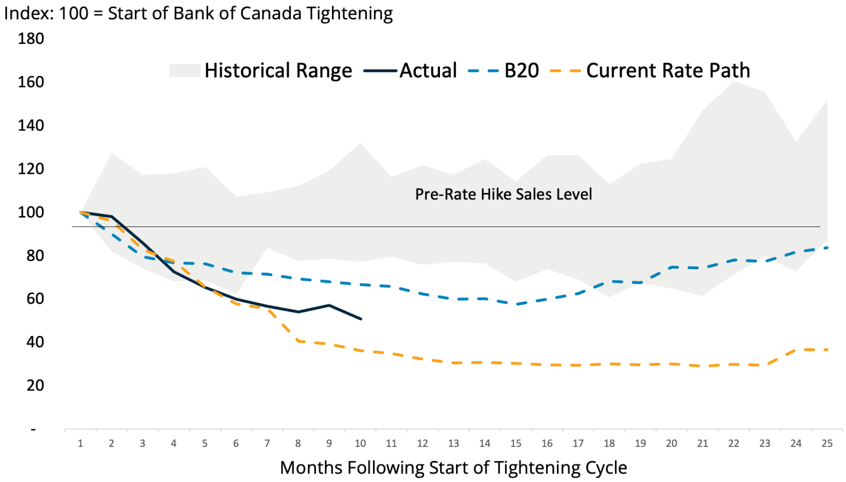
Historical Chronology of Canadian Recessions, CD Howe Institute

Conclusion

BCREA's modelling suggests that if interest rates remain on their current rate path, housing market activity will remain well below its average historical level in 2023. Likewise, our model suggests that prices will trend downward in the coming months, although prices have historically traced various paths following rate tightening.

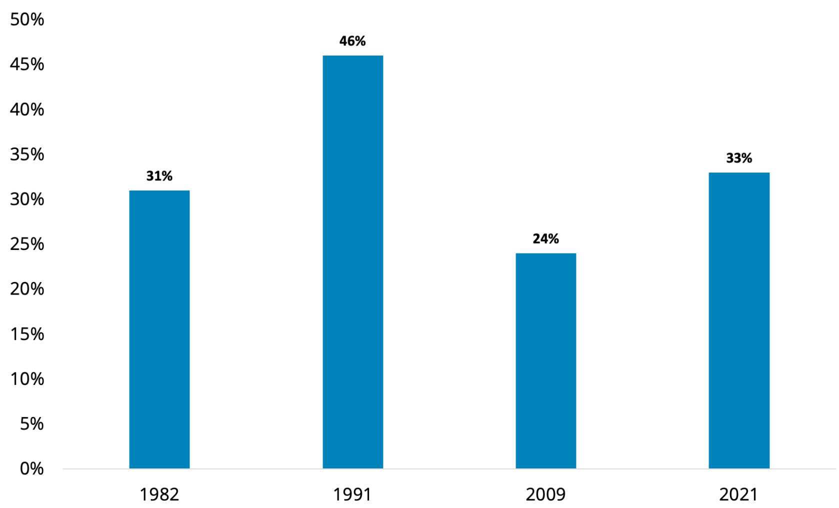
However, If the Canadian economy finds itself in recession this year, it may come at a time when the BC housing market is already at a low point. Indeed, because the housing market historically tends to lead the business cycle, if the same historical pattern holds this time, the onset of a recession could roughly coincide with the start of the recovery in the housing market.

Simulations: Rising Rates and BC Home Sales
(MLS® Unit Sales)



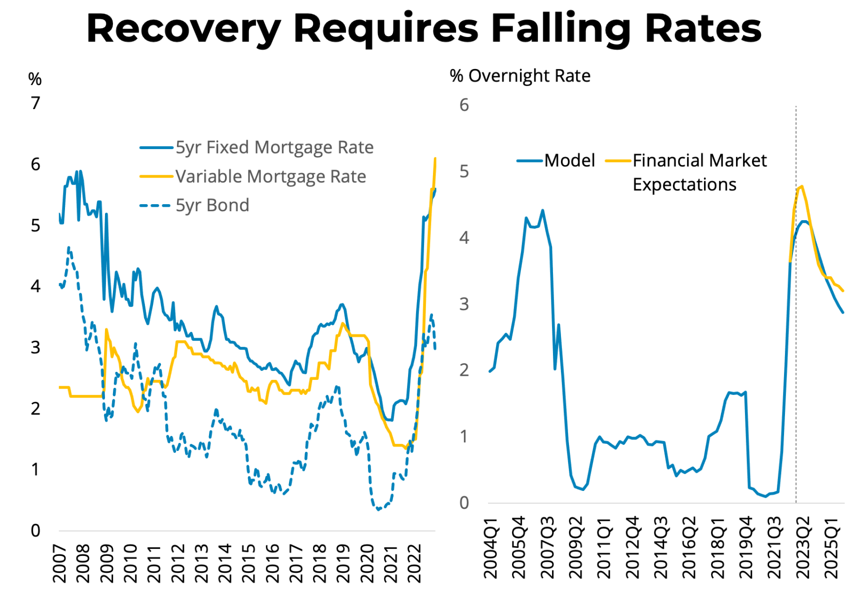
Source: BCREA Economics; Shaded area is the historical range of sales following past tightening cycles

Increase in Home Sales Year Following Start of Recession



Source: BCREA Economics

We know from history that home sales post strong recoveries in the year following the start of a recession as the economy heals and the impact of falling interest rates unlocks demand. Importantly, any recovery is predicated on a continued decline in bond yields and fixed mortgage rates through 2023 in anticipation of the Bank of Canada easing monetary policy.



Source: Bank of Canada, Chatham Financial

We also know the BC economy is blessed with highly favourable demographics as the large cohort of millennials age into their prime household-forming years. While the housing market and the economy may experience a temporary downturn over the next year, there will be no shortage of demand for housing in the future.