Housing Market Digest – Canada

October 2017

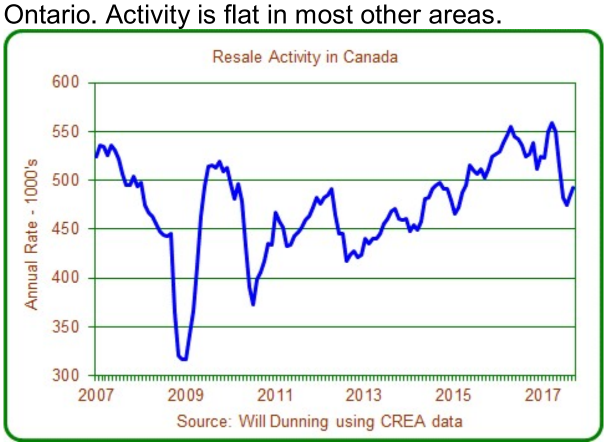
MORTGAGE PROFESSIONALS CANADA

A New Risk for Housing Markets

The Office of the Superintendent of Financial Institutions ("OSFI") now requires that all residential mortgages by federally-regulated lenders must be "stress-tested", at two percentage points above the contract interest rate (or the 5-year posted rate, if that is higher). In combination with the requirements for mortgage insurance, about 90% of all new mortgages will be tested. This can be expected to reduce housing activity by 10-15%. It is on top of the impact from recent rises for mortgage interest rates (another 5-10% drop in activity). The combined 15-25% drop in housing activity will affect the broader economy. In two years, employment could be 150,000-250,000 lower than it would otherwise be. There is a risk that house prices will fall. In a modern economy, a sustained drop in house prices is one of the most dangerous things that can happen: as happened in the US a decade ago, falling house prices can turn into widespread economic decline.

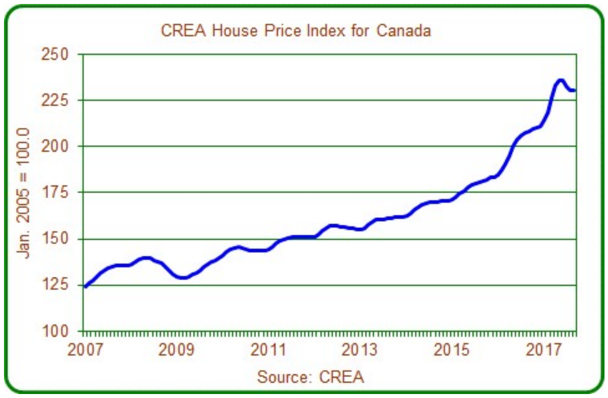
Resale Market

Resale activity recovered a bit more in September, to 492,900, due to partial rebounds in BC and Ontario. Activity is flat in most other areas.

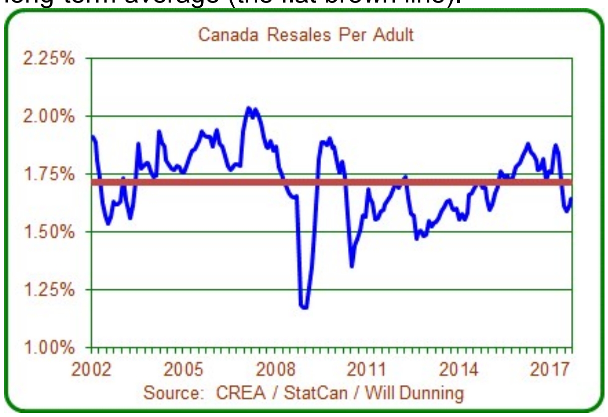


CREA's House Price Index was flat in September. The year-over-year change is now 10.7% (down from the peak of 19.7% that was seen in April).

The sales-to-new-listings ratio ("SNLR") was 55.7% in September, slightly above the balanced market threshold of 51%. This indicator points to an outlook for stable prices (at worst). But, as noted, OSFI's stress test policy creates a risk of falling prices.

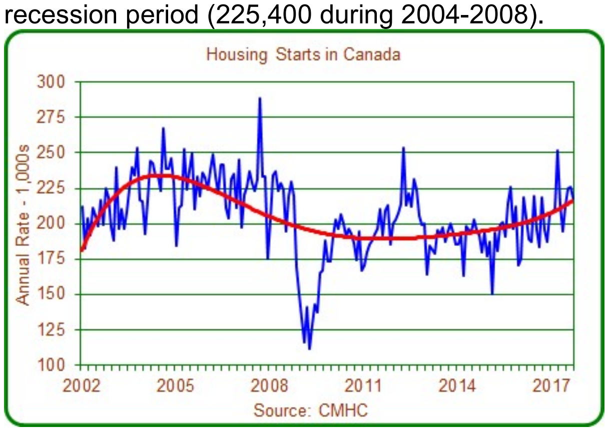


We should, in general, expect that resale activity will trend upwards over time, because the population is growing and the housing inventory is expanding. Therefore, it is useful to look at sales on a per capita basis. Recent activity is below the long-term average (the flat brown line).



Housing Starts

Housing starts have strengthened in Canada. However, the average rate for the past two years (205,000) is still 9% lower than during the pre-recession period (225,400 during 2004-2008).



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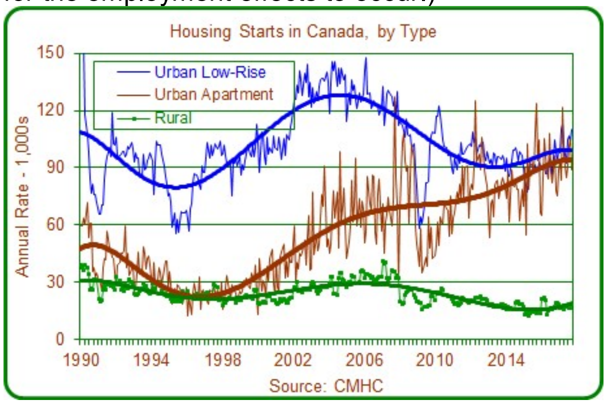
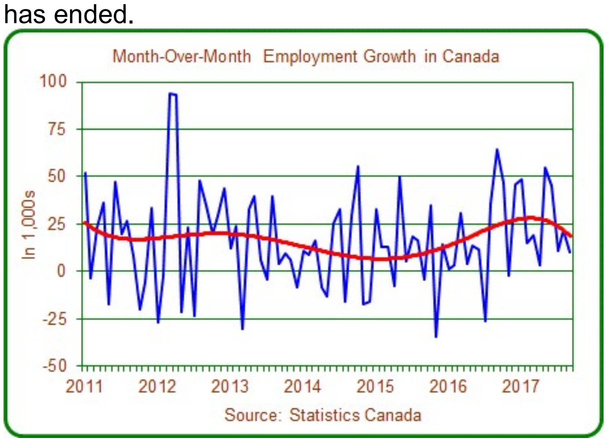
The mix of activity has changed. Urban low-rise activity is 22% below the pre-recession level while apartment starts are up by 28%. Rural activity is down by 44%.

Construction activity is likely to slow in the wake of OSFI, although this will take time, as starts result from sales that occurred in the past. The lags are longest for apartments. Therefore, the magnitude of the impact won't be visible until late next year. (This is the main reason that it will take two years for the employment effects to occur.)



Employment Trends

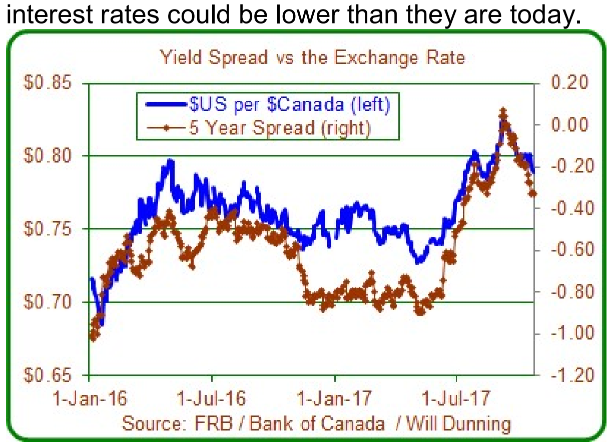
Starting in August 2016, Canada experienced a year of strong job growth. While month-to-month changes are always suspect, the data for the past few months are suggesting that the growth spurt has ended.



Interest Rates

Bond yields (5-year GoC) have eased slightly during the past month. They are now 0.9 point higher than the average for 2015/16. Increases for mortgage rates have more-or-less followed bond yields.

A month ago, 5-year bond yields in Canada and the US were about equal. More recently, the spread has turned negative once again, which has contributed to a weaker dollar. But, the dollar is still relatively strong compared to the past few years. That plus higher interest rates and the OSFI stress test are significant factors that will increasingly weigh on the Canadian economy. Consequently, it is possible that by next spring our interest rates could be lower than they are today.



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