Testing mortgages against a 4.64% interest rate Reduces one risk but creates another

Toronto (October 18, 2016) – Changes for mortgage insurance in Canada, which were announced on October 3, are intended to reduce housing activity in Canada, with the aim of slowing the growth rates for house prices and mortgage indebtedness.

Many mortgage applications in Canada will be stress-tested using a benchmark interest rate that is currently 4.64%. By contrast, actual rates in the mortgage market are 2.5% or lower.

Opinions on the potential impacts vary, with many economic commentators expecting that the reduction of resale market activity will be in the range of 8% or slightly higher.

Canadian housing market economist Will Dunning explores the housing market and economic issues, in **Slamming on the Brakes**, released today. The report agrees that an 8% initial impact seems realistic, but concludes that there will be subsequent effects. Ultimately, housing market activity will be reduced by at least double (and potentially triple) the 8% factor. There will also be negative effects in the broader economy.

“There is a cliché that it isn’t speed that kills, it’s the sudden deceleration,” said Mr. Dunning. “A drop in housing activity that is larger than the government expects would have further consequences that it does not expect, including falling house prices in many parts of the country and related economic damage.”

In addition to reduced home buying by first-time purchasers, subsequent effects include:

- Fewer current home owners will buy different dwellings (because it will be more difficult to sell their current homes).
- Jobs will be lost due to reduced transactions, which will further reduce housing demand.
- If potential buyers expect that house price will fall, buying will be further deterred.
- Housing starts will be reduced. An 8% drop in housing starts would cost 25,000 jobs. Doubling the impact would cost 50,000 jobs
- Lower housing starts will reduce how much housing will be available in future. Because there will be less movement out of rentals into home ownership, vacancy rates will be reduced and rents will rise more rapidly, aggravating challenges for tenants.

“The government is aiming to reduce the risk of a housing market implosion,” continued Mr. Dunning. “The new policy is based on a future event that is possible, but has a low probability of occurring – that in five years mortgage interest rates could be more than two points higher than they are today. In so doing it is creating a risk that is also possible, and seems to have a higher probability of occurring – that its policy could have severe negative effects for the housing market and the broader economy. It would be useful to have more public discussion on the trade-off of risks.”

Will Dunning consults to a wide range of interests in the housing and mortgage markets, including associations, governments, financial institutions, builders, investors, non-governmental organizations, and the co-operative and non-profit housing sectors.

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