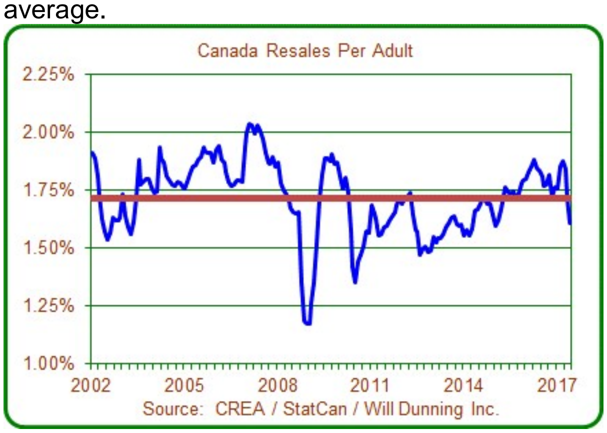
Housing Market Digest – Canada

July 2017

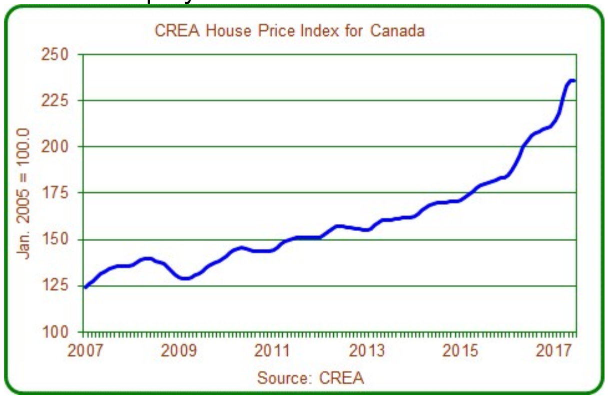
Resale Market

Resale activity fell in June, for the third consecutive month, and has gone from stellar to so-so. The (annualized) sales rate of 479,700 for June is 10% below the average of the prior 12 months. The largest drops have been seen in Toronto and surrounding areas.

It is useful to compare the sales data to the population, because over time we should expect the resale market to expand. This data shows that during the past two years the sales rate was slightly above the long-term average (but was comfortably within the historic range). This was partially due to catch-up from prolonged weakness post-recession. As of June, the sales rate is below average.



CREA data shows that the average price has fallen during the past two months. But, this is influenced by a change in composition (the large drop in sales in Toronto and environs, and in addition, the average price for Toronto is being distorted by composition – a reduced share for high-end properties). CREA's House Price Index for Canada (and the Toronto area) does not (yet) show a downturn. Year-over-year, the index for Canada is up by 15.8%.



Housing Starts

Nothing to see here: housing starts lag behind the resale market and the broader economy, and therefore it will be at least a few months before we see any impacts from the unfolding turmoil in the Toronto area.

Employment Trends

Statistics Canada's Labour Force Survey ("LFS") shows accelerating growth (1.9% over the past year, versus 1.1% growth for the population, resulting in rapid recovery of the employment-to-population ratio). If this is reasonably correct, it is a very positive sign. But, most of the growth is in just two major urban areas (Montreal at 5.8% year-over-year and Vancouver at 4.1%). Excluding them, the rest-of-Canada growth rate is just 1.2% - a neutral performance. Further complicating this, it looks like Toronto is being under-estimated (just 0.6% year-over-year). My life would be a lot easier if I could just accept the data at face value.

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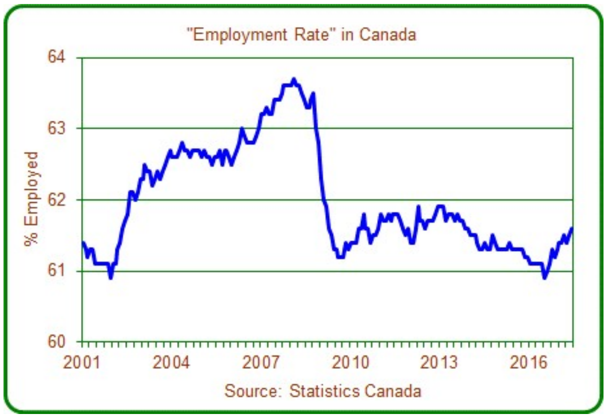
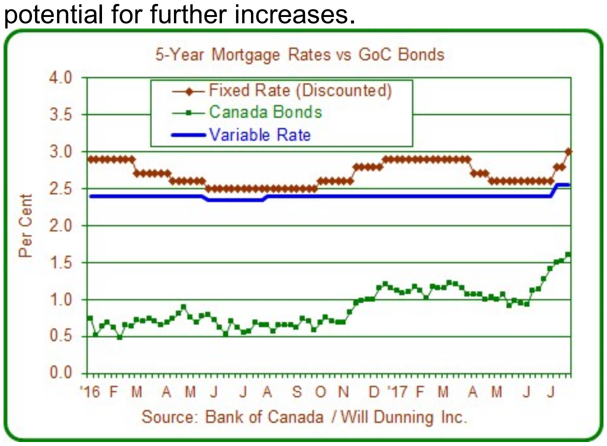


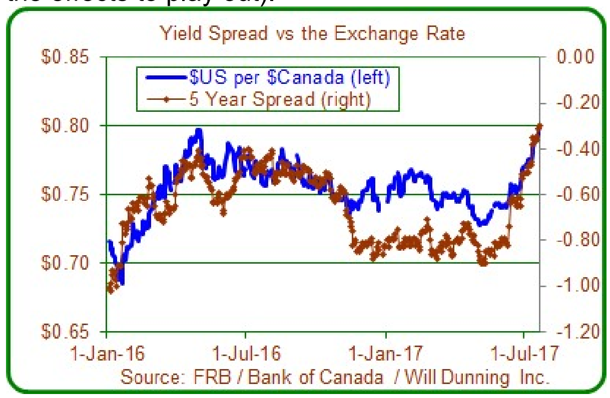
Interest Rates

Bond yields continue to rise. At the moment, the yield for 5-year GoCs is close to 1.6%, up by 80 bps from the average seen during 2015 and 2016 (0.79%). Some increase has been justifiable, given improved economic indicators for Canada. At this point, yields have increased enough, and there should be a pause, but what the market decides could be very different. Mortgage rate adjustments were a bit slow. At this point (with my opinion estimate of a typical 5-year fixed rate from major lenders at 3.0%) the bond-mortgage spread is too low (1.4 versus a normal 1.8) and there is potential for further increases.



The Bank of Canada has raised the 5-year posted rate to 4.84%, from 4.64%, making the mortgage insurance stress test even more ridiculous, punitive, and dangerous than it already was.

The surge in the Canadian dollar is closely related to compression in the spread between Canadian and US bonds. The relationship was interrupted for 7 months in the immediate aftermath of the US presidential election, but it seems that it is now back to normal. The combination of increased interest rates and a stronger dollar is negative for the economic outlook (although it will take time for the effects to play out).



OSFI Proposes Significant Intervention

Based on data from the housing and mortgage markets, combined with a sharp drop for CMHC's mortgage insurance activity, it appears that the mortgage insurance stress test (which took effect late last year) has not achieved its intended effects: the data hint that many home buyers have avoided mortgage insurance and the stress test by increasing their down payments to 20% or more.

In a draft revision of "Guideline B-20", the Office of the Superintendent of Financial Institutions proposes that all new mortgages by federally-regulated lenders must be stress tested at the actual contracted interest rates plus two points. This is highly likely to have a significant dampening effect on housing markets, with non-trivial consequences for the broader economy. In addition, OSFI suggests that in areas with high price growth, lenders should adjust the selling prices for lending purposes. This will make the purchase and borrowing process more complex and uncertain within the impacted communities, which will be a further dampening factor.

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