Housing Market Digest – Alberta

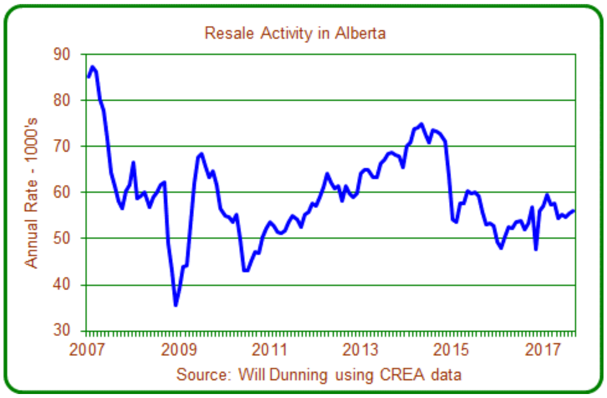
Third Quarter 2017

A New Risk for Housing Markets

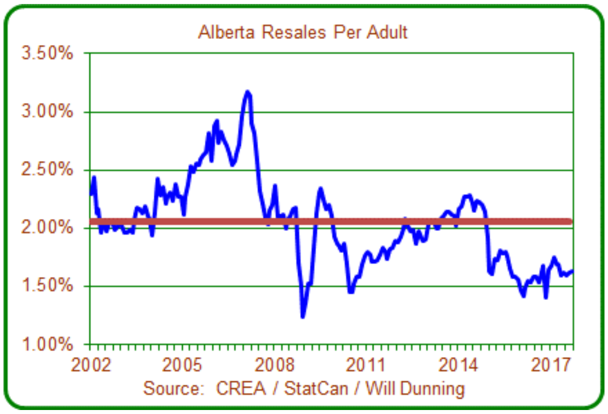
The Office of the Superintendent of Financial Institutions ("OSFI") now requires that all residential mortgages by federally-regulated lenders must be "stress-tested", at two percentage points above the contract interest rate (or the 5-year posted rate, if that is higher). In combination with the requirements 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 (for all of Canada) could be 150,000-250,000 lower than it would otherwise be. There is a risk that house prices will fall in some communities. 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 has shown some recovery in Alberta during the past year, but remains low in historic terms.



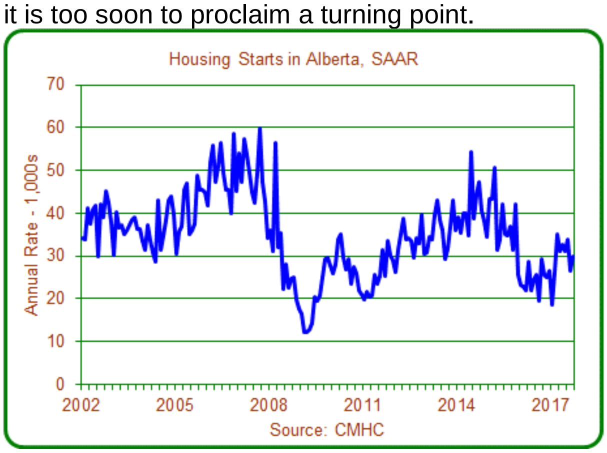
We should, in general, expect that resale activity will trend upwards over time, because the population is growing and the housing inventory is expanding. Therefore, it is useful to look at sales on a per capita basis. In Alberta, activity has been far below the long-term average (the flat brown line)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



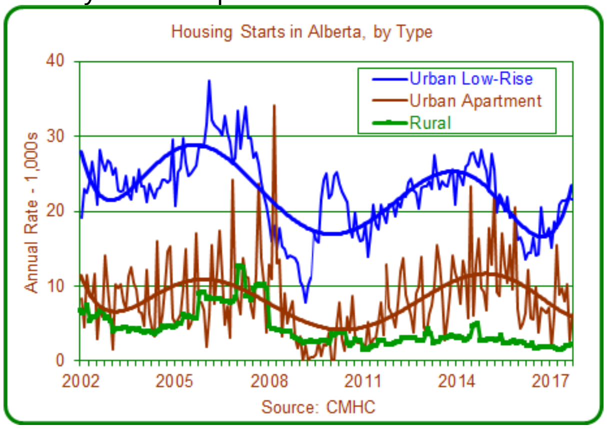
The sales-to-new-listings ratio ("SNLR") for Alberta is now 47%, below the balanced market threshold (55% for Alberta). Due to soft market conditions, the average resale price in Alberta has been roughly flat during the past four years. OSFI's stress test policy can be expected to further reduce sales, raising the risk of price reductions.

Housing Starts

Since the start of 2016, housing starts in Alberta have been weak in historic terms. While there has been slight improvement during the past half year, it is too soon to proclaim a turning point.



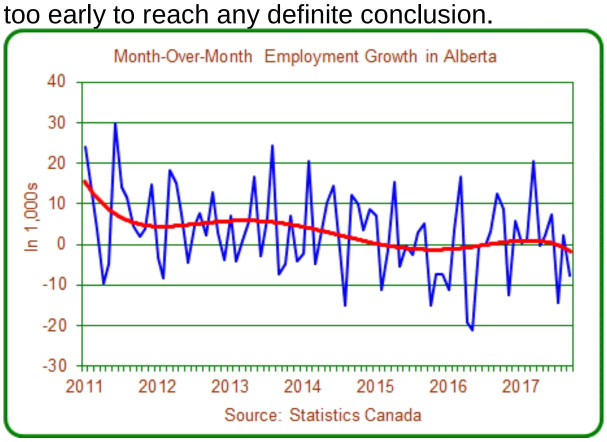
Trends have been broadly similar for low-rise dwellings and apartments. Low-rise activity has recently shown improvement.



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. The magnitude of the economic impacts won't be visible for some time. (This is the main reason that it will take two years for the employment effects to occur.)

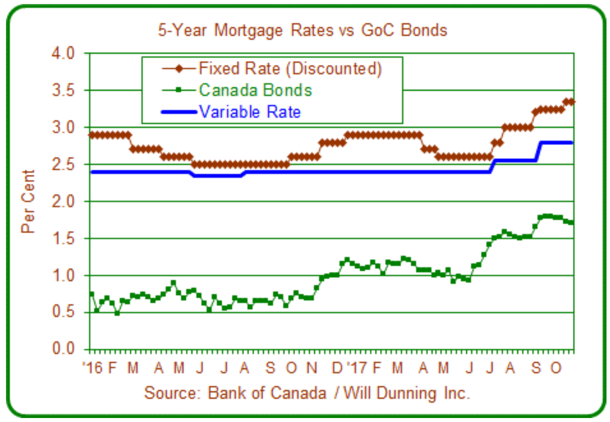
Employment Trends

Alberta has seen little or no job growth during the past three years. Month-to-month changes are always suspect, and it is therefore useful to look at trends over longer periods of time. The most recent data hints at a further slowdown, but it is too early to reach any definite conclusion.

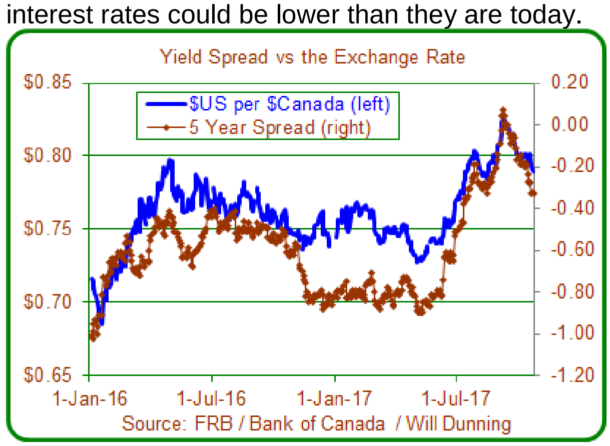


Interest Rates

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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