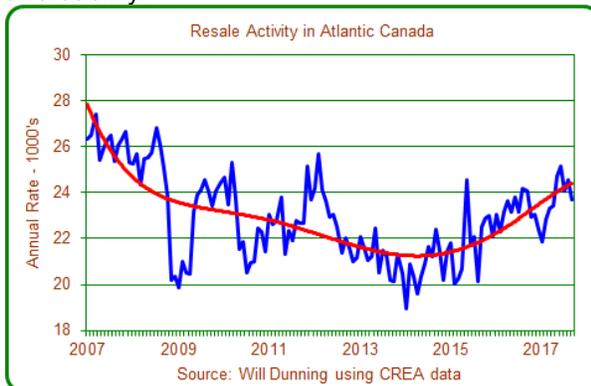


A New Risk for Housing Markets

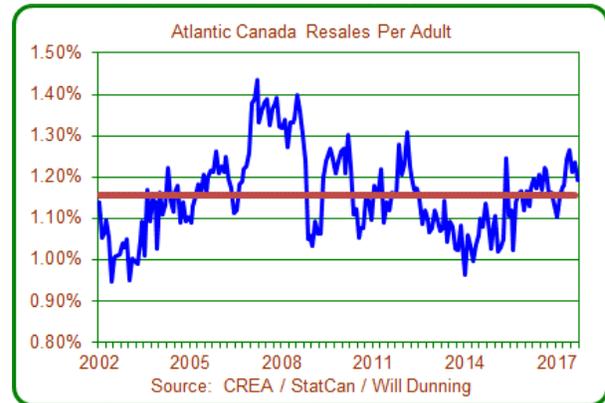
The Office of the Superintendent of Financial Institutions (“OSFI”) now requires that all residential mortgages by federally-regulated lenders must be “stress-tested”, at two percentage points above the contract interest rate (or the 5-year posted rate, if that is higher). In combination with the requirements 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

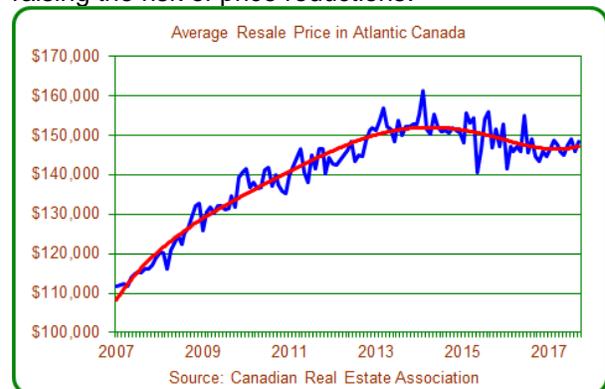
Resale activity has expanded since 2015, in response to low interest rates and excellent affordability.



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 Atlantic Canada, this data shows that activity is currently just slightly above the average level (which is shown by the flat brown line). This is an improvement compared to four years ago, when sales were below-normal.



The sales-to-new-listings ratio (“SNLR”) is currently 52%, well above the balanced market threshold (which appears to be about 45% for the region). However, this has not resulted in any notable price growth: the average price has been roughly flat during the past two years. But, OSFI’s stress test policy can be expected to reduce sales, raising the risk of price reductions.

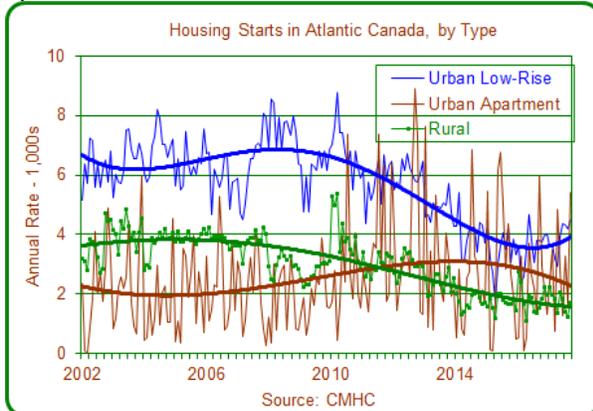


Housing Starts

During the past three years, housing starts in the region have been about one-third lower than they were previously.



The fall in housing starts has been pronounced for low-rise dwelling in urban areas as well as rural areas. On the other hand, construction of apartments has not shown as much variation.



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

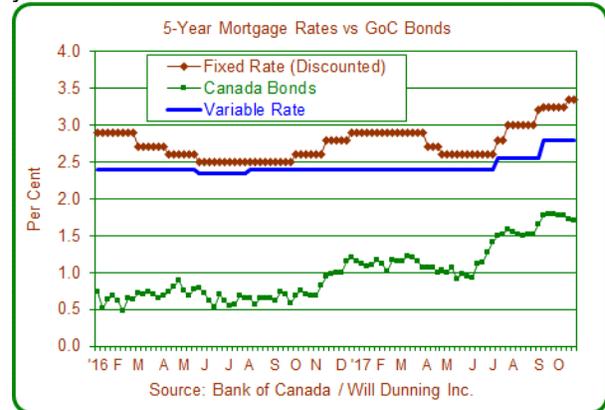
The monthly estimates of job growth show wide variations from month-to-month, and these short-term changes are always suspect. Looking at trends over longer periods of time indicates that in Atlantic Canada employment has been roughly flat for some time, and may have eroded recently. However, it is too soon to draw a definite conclusion on this.



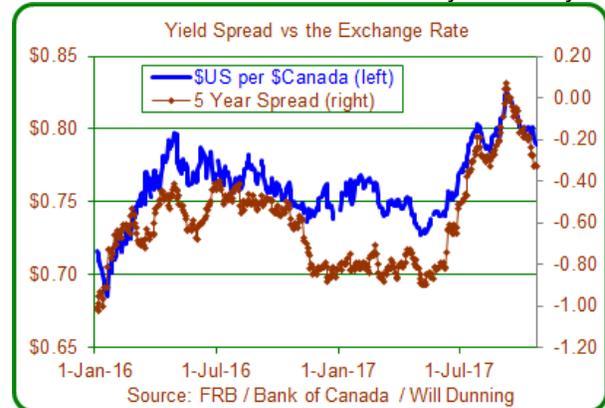
Interest Rates

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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