Housing Market Digest – British Columbia

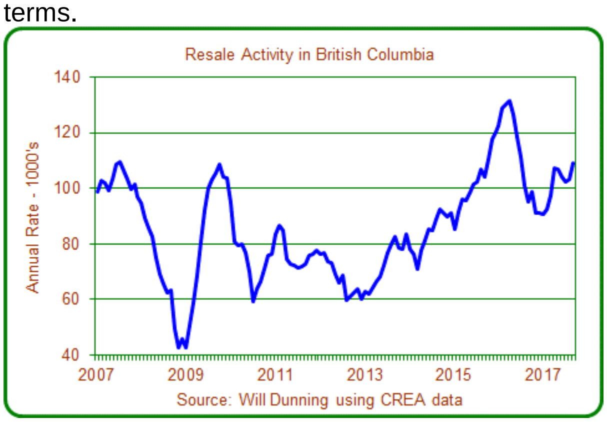
Third Quarter 2017

A New Risk for Housing Markets

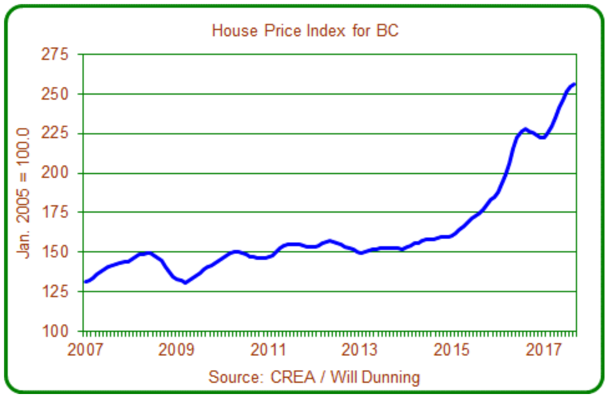
The Office of the Superintendent of Financial Institutions ("OSFI") now requires that all residential mortgages by federally-regulated lenders must be "stress-tested", at two percentage points above the contract interest rate (or the 5-year posted rate, if that is higher). In combination with the requirements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

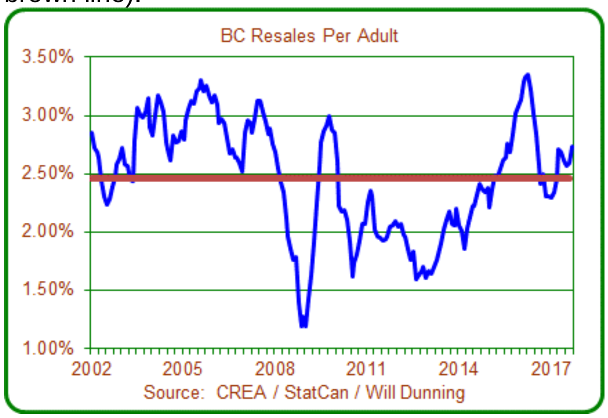
Resale activity has gyrated in BC. While sales are weaker than before the foreign buyers' tax was introduced, activity is relatively strong in historic terms.



The sales-to-new-listings ratio ("SNLR") for BC is now 68.7%, far above the balanced market threshold (in the high 40s for BC). The very tight market is resulting in rapid price growth. CREA does not publish a house price index for British Columbia, but combining the available indexes I have created a composite. It shows year-over-year growth at 12.9%. The SNLR points to further rapid price growth. However, OSFI's stress test policy is likely to result in deceleration in BC.

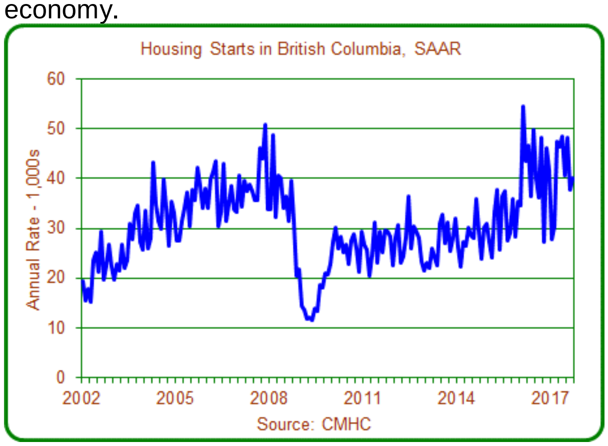


We should, in general, expect that resale activity will trend upwards over time, because the population is growing and the housing inventory is expanding. Therefore, it is useful to look at sales on a per capita basis. For all of BC, recent activity is slightly above the long-term average (the flat brown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

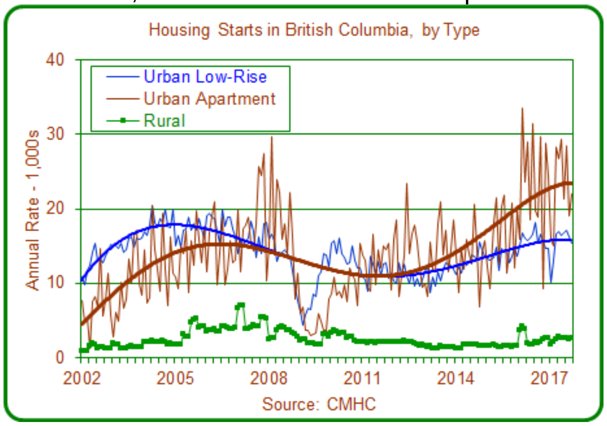


Housing Starts

Since early 2016, housing starts in BC have been at high levels, reflecting a stronger provincial economy.



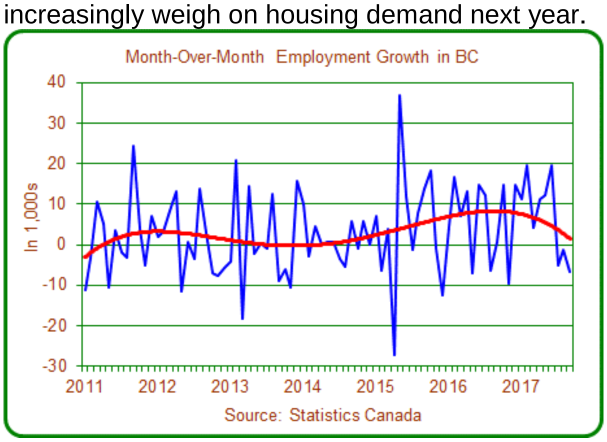
The mix of activity has changed. Low-rise activity now accounts for less than 40% of starts, down from more than one-half in earlier times. On the other hand, 55% of starts are now for apartments.



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 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.)

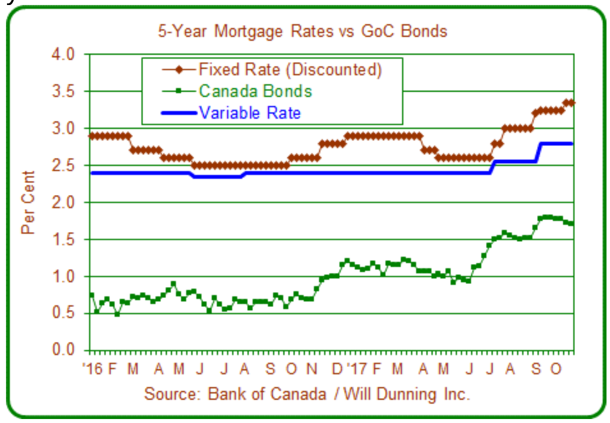
Employment Trends

British Columbia experienced two years of rapid job growth, starting early in 2015. While month-to-month changes are always suspect, the most recent data hints that the growth spurt has ended. If this recent data is accurate, and if the trend is sustained, then slower job growth would increasingly weigh on housing demand next year.

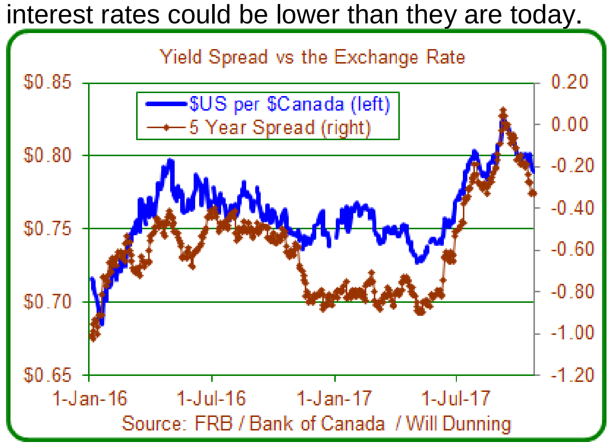


Interest Rates

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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