

A New Risk for Housing Markets

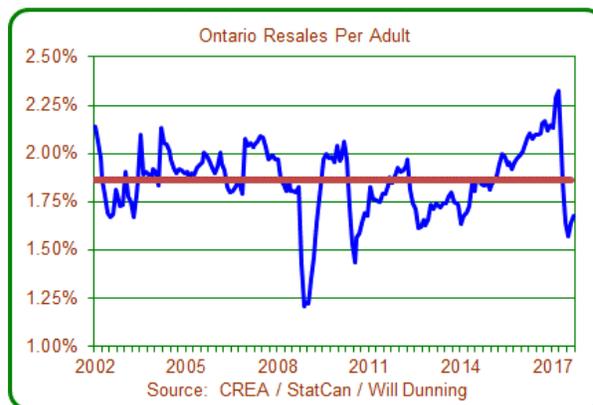
The Office of the Superintendent of Financial Institutions (“OSFI”) now requires that all residential mortgages by federally-regulated lenders must be “stress-tested”, at two percentage points above the contract interest rate (or the 5-year posted rate, if that is higher). In combination with the requirements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

Following a very rapid decline during the spring, the province’s resale activity appears to have stabilized, and may already be in recovery.



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 Ontario, this data shows a period of over-heating that started in late 2015, as the sales rate was far above the long-term average (which is shown by the flat brown line). The current below-average sales rate is payback for that.

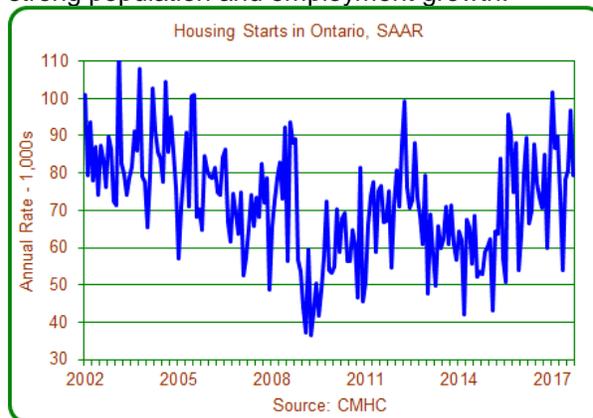


The sales-to-new-listings ratio (“SNLR”) averaged 71% during the over-heating period but is now 54%. This is slightly above the balanced market threshold (which appears to be 50% for Ontario). Looking forward, this should support moderate price growth. But, OSFI’s stress test policy can be expected to reduce sales, raising the risk of price reductions.

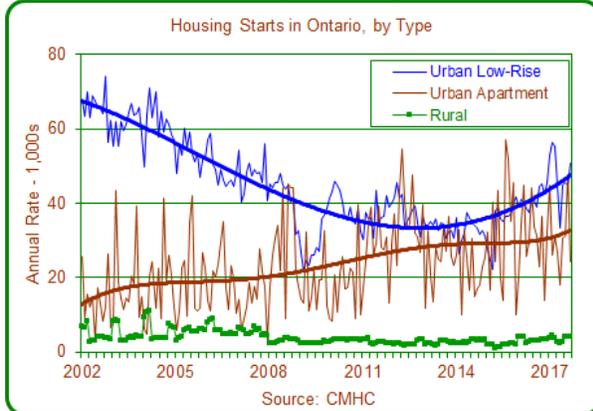


Housing Starts

Housing starts in Ontario are highly erratic, but at present appear to be relatively high, reflecting strong population and employment growth.



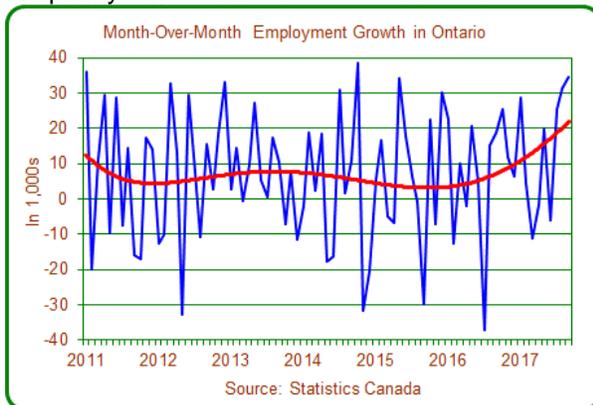
The mix of housing construction by type of dwelling has shifted sharply. While low-rise activity has improved recently, it remains low in historic terms. Apartment activity is strong.



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

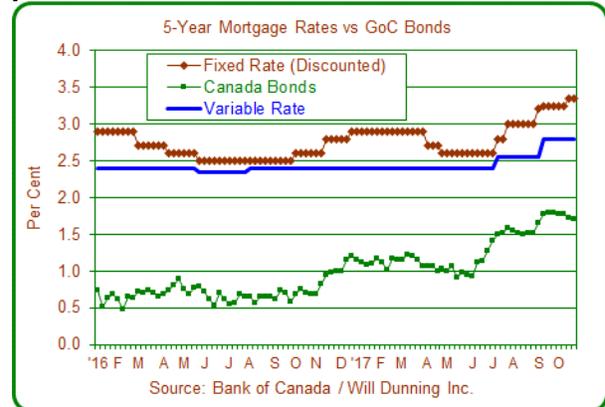
The monthly reports on job growth for Ontario show very wide variations from month-to-month, and these short-term changes are always suspect. Looking at trends over longer periods of time indicates that the rate of job creation had been tepid, but with considerable improvement during the past year.



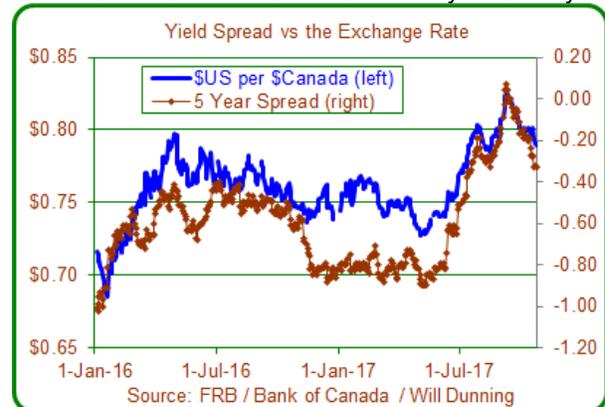
Interest Rates

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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