HOUSING MARKET DIGEST CANADA

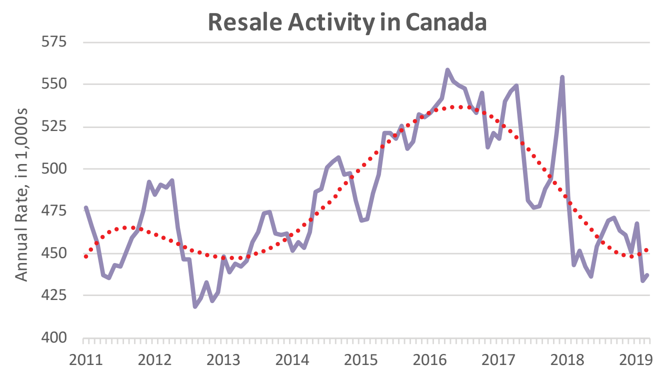
MORTGAGE PROFESSIONALS CANADA

Resale Market

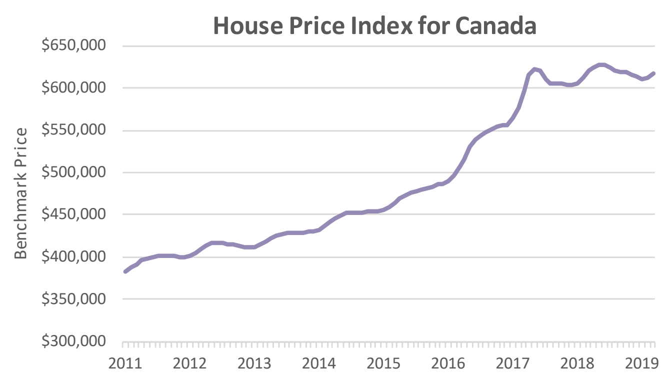
Following unusually harsh weather that caused very weak sales in February, activity should have rebounded in March. But there was only a slight recovery, to an annualized rate of 437,600. With employment growing strongly, and the rate of population growth at one of the highest levels in a generation, sales should be strong. Instead, the March sales rate is 15% below average (after adjusting for population growth). The mortgage stress tests continue to weigh very heavily on home-buying. In addition, we may now be seeing a "second round effect": if consumers become fearful that prices will fall, some of them will decide to delay buying, which can turn those fears into reality. A senior federal government official has stated that the stress tests have caused prices to be 3.4% lower than they would be otherwise. Falling house prices is one of the most dangerous things that can happen in a modern economy, because of the negative effects on consumer confidence, which can generate a downward spiral. There are some major market areas in western Canada where prices have already fallen enough to signal significant economic risks.

House prices in Canada are roughly flat, as the House Price Index from the Canadian Real Estate Association ("CREA") was 0.5% lower than a year earlier. But, the national index masks that there are large variations across the country. Several major market areas now seeing notable (and economically worrisome) rates of price reduction. More discussion of these trends is provided in the regional editions of Housing Market Digest.

The sales-to-new-listings ratio ("SNLR") was 54.1% in March, which is slightly above the threshold (52%) for a "balanced market" (this is the level at which prices are expected to rise by 2% per year). As noted, there are wide variations across the country.



Source: CREA / The Author



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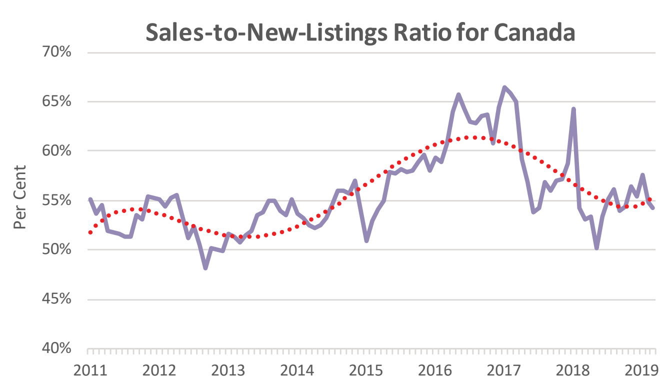

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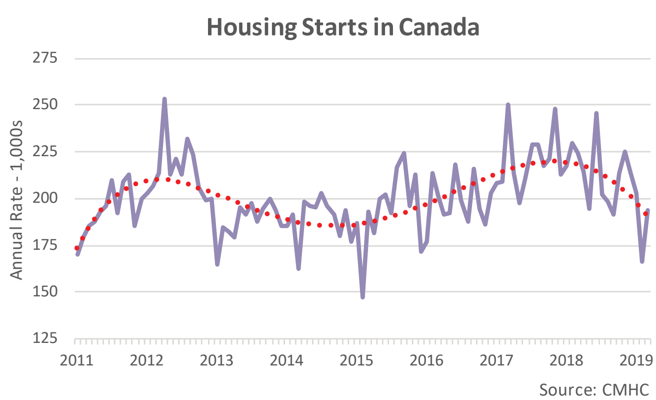
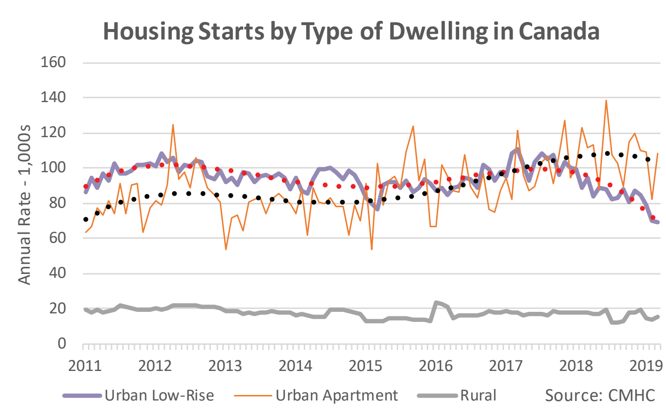
Housing Starts

March housing starts recovered only partially from the sharp reduction seen in February. Volatility of the data makes it difficult to draw a definitive trend line, but it is clear that the introduction of the stress tests is gradually bringing a substantial drop in starts, already by 10-15% from the trend level seen in 2015. Again, population growth has accelerated, and we should be seeing increased starts, not a reduction.

Low-rise activity (singles, semi-detached, and town homes) has clearly dropped sharply, and the drop continues: the trend line is now down by about 25%. Starts of apartments take longer to react to changing conditions. The trend for apartments continues to hint that, at best, activity is at a peak, and it is now increasingly suggesting that a downturn is developing. I continue to expect that apartment starts will trend downwards throughout this year.

Another element of housing activity is renovation. Statistics Canada is now in the process of developing new data on residential construction. It will be another two months before we get enough detailed data to support definitive conclusions. But, but the data that is available so far is hinting that a major downturn is developing for renovation.





Employment Trends

Both of Statistics Canada's surveys of employment show strong rates of job creation: the Labour Force Survey ("LFS") shows year-over-year growth at 1.8% as of March, which exceeds the 1.4% rate of population growth. The Survey of Employment Payrolls and Hours ("SEPH") shows even strong growth, at 2.8% (but as of January).

But, as commented last month, looking at total hours worked, both surveys suggest there has been little change since last fall. Overall, combining this data with other economic indicators, it looks like the Canadian economy has entered a soft patch.

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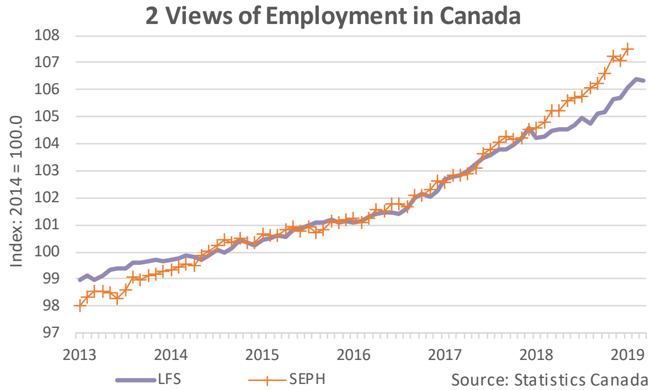
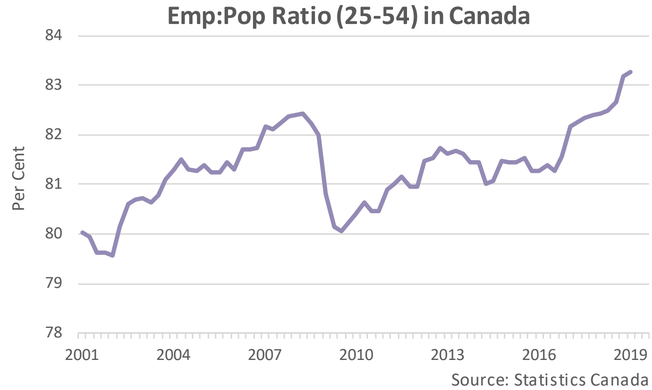
Employment Trends (Continued)

The mortgage stress tests have contributed to that. One final comment: the employment-to-population ratio (the percentage of people who have jobs) for the "prime working ages" (25-54) is at a very high level. This should be supporting a strong housing market.

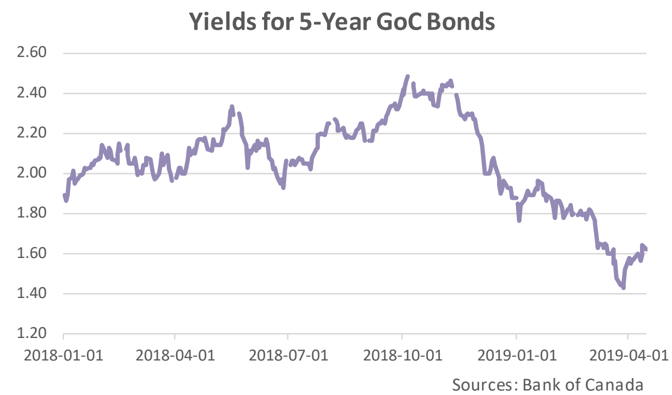




Interest Rates

I commented last month that bond yields might have "overshot" (fallen by too much given evolving economic conditions). Thus, the 5-year yield has partially retraced some of the recent drop. But, at a current 1.6%, the yield is still about 0.8 points above the trough that was seen during 2015 and 2016. I have reduced my opinion-estimate of a typical "special offer" mortgage interest rate (from major lenders) for the third time this year, to 3.1% (versus 3.75% at the start of the year).

Movements in mortgage rates are lagging behind the changes in bond yields. The spread between typical mortgage rates and bond yields is now skinny (1.5 points versus a long-term average of 1.8). I won't be surprised if 5-year fixed rates are a bit higher during the second half of this year (say 3.25% to 3.5%).



Comments on Federal Mortgage Policies

Some thoughts on the federal government's proposed First-time Home Buyers Incentive (FTHBI):

- The $1.25 billion budget allows for about 10,000-15,000 users per year, which is only 3-5% of the 300,000 first-time buyers we should expect each year.
- Therefore, if (and I emphasize if) the program become highly popular, interest will exceed the available funding and a lot of the potential clients will be disappointed.
- Anyone who qualifies for the FTHBI would be able to qualify for the mortgage they need even without it. Therefore, the incremental home buying that results will be even lower than the 10-15K.
- CMHC's own analysis agrees that the impact will be very small. It expects prices to rise by 0.2-0.4% as a result of the program. It says that the price impact of either 30-year amortization or a 1 percent stress test would be five to six times greater. Therefore, CMHC's estimates imply that the FTHBI will be only 1/5th to 1/6th as effective at supporting home buying compared to either of those alternative measures.
- Similarly, CMHC estimates that the stress tests have reduced prices in Canada by 3.4% (compared to what would have happened otherwise). This is 10 times larger than the expected impact of the FTHBA. Therefore, CMHC's analysis implies that the program will reverse only 1/10th of the damage done by the stress tests.

The federal government needs to act on the two major negative effects of the stress tests:

- The negative effects on the long-term financial well-being of middle-class Canadians.
- Negative economic impacts, which will unfold very gradually. At this time, at most 1/10th of those effects have occurred. By the second half of 2021, employment in Canada will be about 200,000 lower than it

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