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VERICO Economic Report
NOVEMBER 2018

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5 *Significant* Numbers You Should Know

4,764,747

The number of mortgages in Canada

0.23%

The percentage of mortgages 90 days or more in arrears (as of Sept 27th)

53.9%

The amount of pre-tax income required to carry a mortgage on a typical Canadian home with 25% down computed by the Royal Bank (highest since 1990)

$64,534

The average owed on Home Equity Line of Credit (HELOC) in Canada

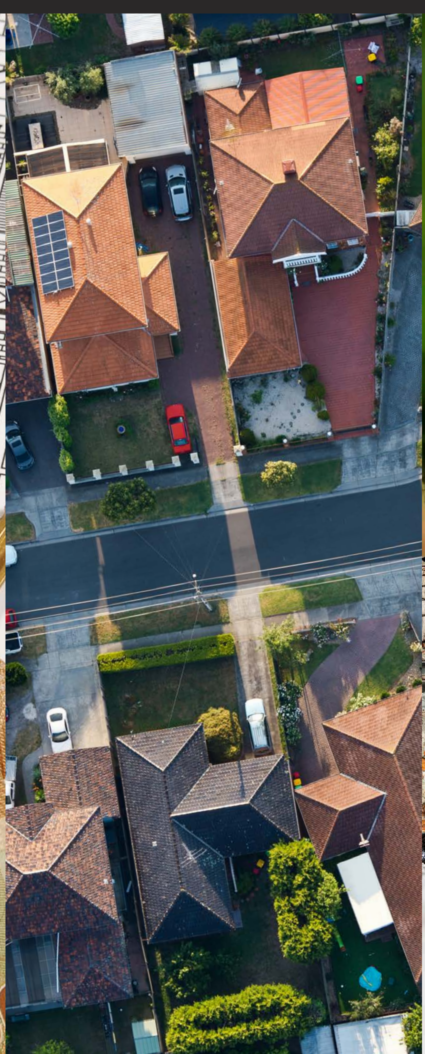
14.2%

The percentage of income in the 2nd quarter that went to debt servicing, the highest since 2008

What's Going On?

- New Trade Agreement
- The Odds On Higher Rates
- What It Means For Real Estate Investment
- What Did We Get For a Slower Market






So What's Going On?

So what does a new trade agreement between Canada, the US and Mexico mean for Canadians? In a nutshell, higher interest rates. When the Bank of Canada met on October 24th, there was a rate hike to 1.75%. And the consensus is that there are at least two – probably three more hikes coming in 2019, which would put rates at the highest level since the 2008 subprime mortgage crisis.

The new USMCA trade deal looks an awful lot like NAFTA and for the overall economy that's good news especially compared to the uncertainty that has been surrounding the talks over the last 18 months. Given over 70% of our exports go to the US and half of Ontario's economy is tied to US/Canada trade, failing to reach a deal was not an option.

Arguably Canada's greatest economic advantage internationally is access to US consumers and businesses, which has become even more important given the current protectionism impacting global trade. Now the uncertainty for Canada surrounding access to the US is over.

The Bank of Canada has specifically cited the ongoing uncertainties surrounding the NAFTA negotiations as the most important obstacle holding a rate hike back but with the new agreement the vast majority of analysts believe that Bank will act.

Canada's bond market has also seen rates move higher recently in anticipation of a rate hike, which will put significant upward pressure on mortgage rates and in turn price some people out of the market.

Why's This A Big Deal

Make no mistake the changing interest rate environment is a monster story. Say goodbye to zero interest rate car loans. The stock market finally has competition from the bond market for investors' cash. Some real estate developments don't look quite so promising with carrying costs rising.

For the past ten years record low interest rates have been the predominate driver of major financial decisions and now those record lows of the summer of 2016 are a thing of the past. (The good news is that you can tell your grandkids that you were there for the 5,000 year low in interest rates in July, 2016.)

But now that's clearly in the rear-view mirror – and so much will change as a result.

Despite the new trade deal, it's not all smooth sailing for the Bank of Canada. Canadians are carrying a record amount of debt so any interest rate increase will hit disposable income and in turn could lower consumer spending and economic growth.

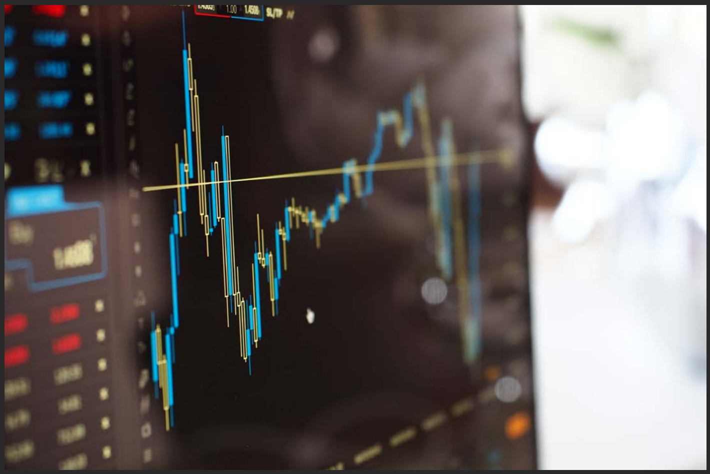
In 2017 according to a recent Environics study, Canadians paid on average $9 billion more in interest charges compared to 2016 due to the rate increases. That's works out to about $554 more that the average Canadian household is spending on interest than on other goods and services.

When it comes to stocks, money managers will be watching the bonds rates very closely. Record low interest rates drove stocks to record highs because investors, pension funds and other pools of capital had little alternative in a bond market that offered 1.5% on a ten year government bond. The trillion dollar question is at what interest rate on the 10 year bonds does it become more attractive than taking on the risk inherent in stocks? The consensus seems to be that in the 4% to 5% range significant amounts of money will move from the bond to stock market. It's already started as rising bond rates have been the catalyst for some sharp sell-offs. Even more money will move in the next year if the US Federal Reserve goes through with its plan to raise rates at least three times next year.

One area of the stock market that's sure to be impacted is the record amount of companies buying back their own shares, which in turn push share prices higher. So far this year companies have taken advantage of low borrowing rates to buy back a record $835 billion US in shares. Higher interest rates will reduce that number significantly.

The bottom line is that stock market investors should be on their guard. (No kidding.) The question is how will a correction in the market influence consumer psychology. So far the strength of the market has had a marked wealth effect on everything from consumer spending to home purchases. Let's see what happens if the market enters a correction.

Higher bond yields also impact investment decisions in real estate, as carrying costs for new developments increase and mortgage rates rise for individual investors considering purchases in existing housing stock. It's important to understand that there is a new risk/reward dynamic in play that will see some people opt for the safety of a 5% Triple A corporate bond instead of purchasing a revenue property that has a lower yield along with diminished prospects for capital gain.



Real Estate

The market is slowing down in Great Vancouver while stabilizing in other parts of the country. Just like the residential market didn't go up in unison across Canada over the past eight years, the drop in activity isn't uniform.

Given that Greater Vancouver rose faster and higher than other markets, it's not a surprise that it's now experiencing a more severe downturn. Both listings for single detached houses and condos have risen dramatically while sales have fallen since early spring yet arguably the biggest change is in market psychology. The days of multiple offers and presale condomania are over along with the worry that if you don't buy now prices will be higher next month.

Sales of single detached homes in Vancouver are 36% under the 10 year average, down 40% compared to September, 2017 while 31% more homes are looking for buyers. Condo sales in September are off 44% compared to last year but the bigger story is that there are 75% more condos waiting to be sold.

In Victoria there are 34% more active listings this September compared to 12 months ago while sales are down 17%.

Toronto went through a similar decline that started about 9 months earlier with the introduction of the Wynne government's 16 point plan. The September numbers hint that the market has stabilized with sales up 1.9% and listings down 3.1% from last year.

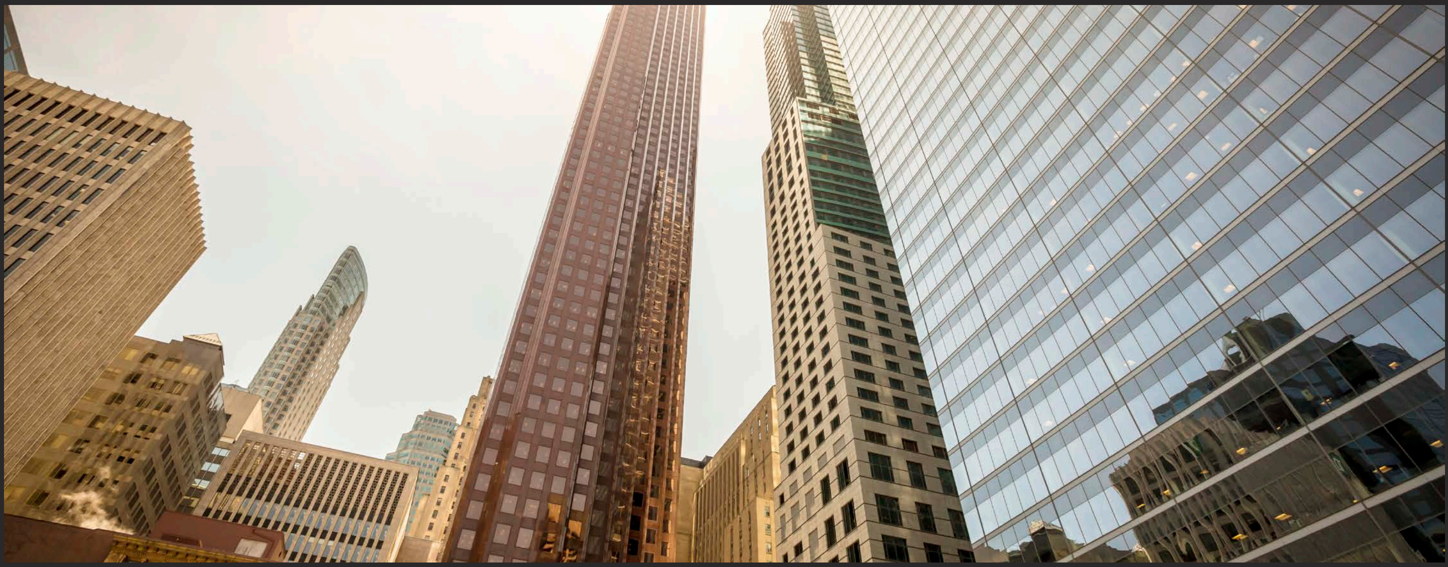
As easily predicted, Montreal outperformed the other major urban centres hitting 9 year highs in sales in September. I say "easily" because both the BC and Ontario government put in regulations designed to slow the market while Quebec didn't. On top of that average prices in Montreal were about 60% below Vancouver and Toronto so guessing where capital might flow didn't take a Phd.

The Impact of Higher Interest Rates

Contrary to what most people seem to believe, it's not automatic that higher mortgage rates are negative for housing activity. There are lots of historical examples where sales and prices rose along with interest rates. For example, between 1978 and 1980 mortgage rates were headed towards 18% yet sales activity and house prices continued to climb. The reason? As long as people perceive that the price increase will be bigger than the cost of borrowing they will continue to borrow. As soon as the price perception changes then the buying dries up.

So where are we now in terms of price perception? Not surprisingly it depends who you're talking to and what neighbourhood you're talking about. In Vancouver expectations are sharply lower compared to the last several years as the short term price pressure is down. In Calgary and Edmonton prices are flat with activity still muted. On average in Toronto, expectations are still in the low single digits. The Canadian Real Estate Association sees average prices sinking just under 3% in the fourth quarter while Royal LePage forecasts a 4.5% average increase.

The bottom line is that in most areas the perception of price appreciation will not be enough to bring speculators into the market with rates rising.



What Did We Get For The Government's Efforts To Slow The Market?

Overkill is a description that comes to mind when it comes to the efforts of the federal and provincial governments in BC and Ontario to "slow the market."

There are many factors that influence residential real estate from employment strength, to population growth, to foreign buying, to taxation but none played a more prominent role in encouraging activity than record low interest rates, especially at the low and mid-price levels of the market.

Once mortgage rates started to rise it was only a matter of time before activity slowed.

That's why the decisions by the feds and the BC and Ontario government to slow the market are highly questionable. The rising rates would be enough to cool the market but they went far further – at just the wrong time – and the consequences will be serious for many people.

The new mortgage stress test has been blamed for new mortgage applications hitting a 17 year low in the second quarter as 18% of potential buyers no longer qualified for a traditional mortgage.

In addition, the BC government put in a new speculation tax that adds to the cost of development while builders wait to get permits. It's estimated to add $8,000 to the cost of a new unit. The slowdown in the single detached market also coincides with new taxes on homes over $3 million, in addition to the government's property purchase tax increase while raising the foreign buyers tax.

In Ontario, the Wynne government's 16 point plan also coincided with a marked downturn in the Toronto market.

The governments got the slowdown they wanted but it begs the question - who benefitted? Certainly not first time buyers or those looking for more affordable housing, especially given that any drop in prices due to reduced activity is being offset by higher borrowing costs.

The government measures obviously impacted demand but they did nothing to address the longer term supply problems in markets like Great Vancouver where population growth is the driving force. Metro Vancouver estimates that it will need 574,000 additional housing units to be built from now until 2041.

If history is any indication, this fundamental long term imbalance suggests that the current slowdown will be temporary until the longer term population trend reasserts itself and demand picks up.

The Last Word

"I can't think of a more stupid or dangerous way of making decisions than by putting those decisions in the hands of people who pay no price for being wrong."

Famed Stanford Economist, Thomas Sowell

Mike's
MINUTE UPDATE

Click to see a short update from Michael Campbell.

About
Michael Campbell

One of Canada`s most respected business analyst, Michael is best known as the host of Canada's top rated syndicated business radio show MoneyTalks, and Senior Business Analyst for BCTV News on Global.

Mr. Campbell is the Economist for VERICO, Canada's most respected network of independent mortgage brokers.

VERICO®

About

VERICO Canada

VERICO was founded in 2005 with a single idea: to unite top mortgage originators in Canada and create additional opportunities for this group of highly driven professionals. Together, we knew we could make a mark on the Canadian mortgage industry.

In 2010, we reached $10 billion in collective loan volume, a number that rivaled the mortgage business of the big 5 banks in Canada.

Operating at the highest degree of professionalism, excellence and ethical standards, we originate over $15 billion by helping 45,000+ families annually with their mortgage needs.

VERICO was named Best Broker Network of the Year in 2009, 2013, 2014, 2016 and 2018.

BROKER NETWORK
OF THE YEAR
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CANADIAN MORTGAGE AWARDS

MORTGAGE
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