Canadian Homeowners Are in Trouble

Description

For years Canadian home prices experienced consistent growth, especially in major cities such as Toronto and Vancouver. It seems that the period of perpetual price growth is over.

In September, the Canadian Real Estate Association lowered its forecast for 2017, projecting a 0.6% decline in national home sales and a 0.2% drop in prices. In June, it had forecast sales to *rise* 0.2% and for prices to *rise* 0.1%.

This reversal could be catastrophic

Canada has seen the largest increase in household debt relative to income of any major developed country since 2000. This summer, Statistics Canada reported that the debt-to-disposable-income ratio for the average Canadian is 165%. That's a record high.

More worrisome is that up to one million Canadian borrowers may not be able to absorb the increase in their monthly payments if interest rates rise by just one full percentage point. The parliamentary budget office released a report warning of dire consequences to come if rates start rising.

"Household debt-servicing capacity will become stretched further as interest rates rise to 'normal' levels over the next five years," its report said. "Based on PBO's projection, the financial vulnerability of the average household would rise to levels beyond historical experience."

Bank of Canada governor Stephen Poloz has said that over 720,000 households could struggle to make debt payments during a downturn. That could start a credit crisis quickly with a risk on contagion for a Canadian economy still reeling from a weak loonie and collapsing oil markets.

It looks like those gloomy predictions are becoming a reality.

A reason to worry

On November 15, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) decided to raise its key interest rates for Canadian mortgages. Unfortunately, Royal Bank of Canada isn't alone. Earlier this month, **Toronto-Dominion Bank**

(TSX:TD)(NYSE:TD) bumped its prime rate to 2.85%.

CBC News outlined the effect:

"For someone who owes $300,000 on a 25-year mortgage locked into a five-year term, under the old rules, they would have paid $1,364 per month. Under the new rules, their monthly payment jumps to $1,425—an extra $61 every month. But over the entire life of the loan, that adds up to an extra $18,000 in added interest costs."

While the increase may seem small, it represents yet another headwind for real estate prices.

In October the Canada Mortgage and Housing Corporation (CMHC) revealed strong evidence that multiple Canadian real estate markets are facing major risks. "Canada now shows strong evidence of problematic conditions overall due to overvaluation and price acceleration," it said, raising its overall risk rating for the national housing market to "strong" for the first time.

Trouble may be coming for the Canadian economy.

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Author
rvanzo