Will the Canadian Housing Market Avoid a Crash in 2018?

Description

The housing market in Canada continues to be a riddle for many analysts who are tired of calling it a bubble.

Housing data after the summer lull is still showing a mixed picture, as the nation's two largest markets are moving in different directions.

In Toronto, the benchmark home price index fell for the sixth consecutive month in November, down 0.4% from October. The index has fallen 8.8% since May — the largest six-month decline in the history of data back to 2000.

In contrast, residential home sales in Greater Vancouver jumped ~26% last month compared with the same month a year ago. The Real Estate Board of Greater Vancouver says the number of sales, which saw 2,795 homes sold, is 17% above the 10-year average for the region in November.

Toronto's housing market, viewed by many as a bubble before this spring, when the government's intervention brought prices down more than 20% for the single family segment, has continued its slump. Many analysts citing the new, harsher mortgage rules one of the greatest risks in 2018.

The mortgage rules are coming at a time when the new listings are up 37% in Toronto from a year earlier, and, according to one study, tougher mortgage stress testing could make it impossible for up to 50,000 Canadians to buy a home each year.

Risks for Canadian lenders

A slowing housing market has some consequences for Canadian lenders, especially those companies that heavily rely on housing loans for their lending-book growth.

Canadian consumer confidence is also very much tied to the values of homes; Canadians have taken on a record level of debt through home equity lines of credit.

Canada's largest banks, which announced their fourth-quarter earnings last month, have shown no sign of pain from their housing portfolios.

Canadian Imperial Bank of Commerce (TSX:CM) (NYSE:CM), the most exposed bank to the housing market among the top five lenders, reported a 25% jump in its profit for the period, with its credit losses contained.

But if the market continues to show weakness, especially in the nation's largest market, Toronto, this party is likely to end sooner rather than later.

The biggest risks is for the non-bank lending companies, whose sole business is to fund housing market. In this area, **Home Capital Group Inc.** (TSX:HCG) is particularly vulnerable, as the lender struggles to recapture its market share after facing a liquidity crisis this spring.

The bottom line

Despite the ongoing uncertainty, I think the Canadian home prices won't crash in 2018, as demand dynamics remain strong with robust inflow of immigrants and an improving economic situation.

But investors should tread carefully, especially if they have positions in the alternative mortgage lenders, such as Home Capital Group. Prolonged weakness could affect their bottom lines in 2018.

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