Canada's Slowing Housing Market: Which Stocks You Should Avoid?

Description

Rising interest rates and tighter mortgage regulations are slowing down the Canadian housing market, which has been the main growth driver for the economy for almost a decade now.

According to economists, the housing market will hit a slow patch as early as the first quarter of 2018, as buyers feel the impact of regulatory measures and higher mortgage rates.

Even before the Bank of Canada raised its key interest rate for the third time in six months on January 17, the nation's top lenders began to charge more on their mortgages.

The five-year fixed-rate mortgage offered by the top banks surged to 3.49%, according to ratehub.ca. This rate is more than one percentage point higher when compared to the rates offered during the last summer.

These cost pressures are certainly going to force some buyers to put on hold their home-buying decisions, especially when the outlook for the housing market is uncertain, following a sharp correction in some categories since the last spring.

Highlighting the risks to Canada's housing market, the Bank of Canada, in its latest rate decision, said that the engines of growth for the economy will be business investment and exports going forward, rather than consumers and home construction.

Stocks vulnerable to slowing housing market

If Canada's housing market enters a slow patch the way I'm expecting, then this situation has some implications for Canada's alternate mortgage lenders, which heavily rely on borrowers who are unable to get mortgages from regular banks.

Some of the biggest non-bank mortgage lenders, **Home Capital Group Inc.** (TSX:HCG), **First National Financial Corp.** (TSX:FN), and **Equitable Group Inc.** (TSX:EQB), have had their share prices come under pressure for the past one month on these concerns.

The stakes are particularly high for the Home Capital Group, which, after avoiding a bankruptcy last year, is struggling to regain the market share. A robust housing market is a precondition for the company to see a revival of the normal lending activity.

Its share price has lost about 9% during the past one month, while Equitable Group is down about 10% during the same period.

The bottom line

Investors who are long on these companies should be careful going forward and be ready to adjust their portfolios if Canada’s housing market enters a prolonged correction. Though I don’t see a crash scenario developing, as housing demand remains strong from increasing population and supply shortages, this uncertain outlook warrants a note of caution. Investors are better off to adopt a wait-and-see approach, at least for the first quarter of 2018.

CATEGORY

1. Bank Stocks
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TICKERS GLOBAL

1. TSX:EQB (EQB)
2. TSX:FN (First National Financial Corporation)
3. TSX:HCG (Home Capital Group)

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Date
2025/08/25
Date Created
2018/01/17
Author
hanwar