Mortgages Are Declining: Is a Crash Around the Corner?

Description

A concerning report out of Statistics Canada recently could turn investors bearish on lending companies. According to the agency, during the first three months of 2018, mortgage activity had declined to lows not seen since 2014.

While this shouldn't come as a surprise given that new stress tests are now in place for mortgages, and interest rates are higher than last year, it's confirmation that we are seeing fewer borrowers, and that could have a negative impact on bank stocks if this proves to be part of a longer trend.

Things could get very ugly in the next few years

Astronomical housing prices, particularly in Vancouver and Toronto, still have a long way to go and a bigger correction may be well in the works, particularly as borrowers that signed up for mortgages during lower interest rate periods come due for renewal over the next few years and are in for a big sticker shock.

And while Statistics Canada may show that overall debt levels for Canadians have actually dropped from the previous quarter, at 168% of after-tax income, those levels are still nowhere near manageable, and we could be on the verge of our own housing crisis.

The bubble we are seeing form in housing is concerning and could be setting the stage for a big correction. While there is no discernible reason why houses in the suburbs of Vancouver should be priced anywhere near $1 million, consumers continue to buy because the expectation is that prices will only continue to rise, which is a very dangerous assumption.

The problem is that when a correction hits, it could be sudden and come at a surprise to many. While this may seem like just doom and gloom, consider the dot com crash of the early 2000s and the financial crisis a decade ago, when many successful people were wiped out entirely.

There won't be big warning signs or flashing lights to prepare consumers for the impending doom; it'll just hit, and those unprepared for it will stand to lose the most.

Bank stocks today

While there are plenty of reasons to be bearish on mortgage issuers for the above reasons, we're still likely a few years away from seeing the true fallout of what's happening today.

Banks in Canada are also governed a bit more tightly than banks in the U.S. are, particularly when it comes to mortgages, so while we may see a correction happen, it likely won't be nearly as severe as what happened south of the border.

In the short term, the big question is whether interest rate increases will be able to offset the drop in new mortgages. Investors will recall that earlier this year, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) led the charge as it raised its rates, a move that was soon followed by other big banks and lenders.

Bottom line

While the long-term economic outlook may be troubling, bank stocks are still appealing investments to hold for many years, even decades. TD in particular is well diversified and offers investors a safer investment than other bank stocks might. The company is also coming off a terrific quarter and is still showing great prospects for future growth.

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