How Will a Housing Market Crash Impact Bank Stocks?

Description

A housing market crash in 2020 is looking increasingly likely. The ongoing pandemic and economic shutdown have devastated Canada's economy. A price war in the crude oil sector simply adds fuel to the fire. Estimates now suggest unemployment and consumer delinquencies could reach historic highs in 2020.

The economic thunderstorm could rattle Canada's most important sector — residential real estate. A housing market crash in 2020 could severely impair the assets of some of our biggest banks. These banks have been the biggest corporations and most generous dividend payers on the stock market for years.

If you're an income-seeking investor, here's what you need to know about the impact of a housing market crash on Canada's major banks.

Housing market crash

For the moment, Canada's real estate market is on pause. Open houses and transactions have declined, as people self-isolate at home. I'm sure renters aren't moving either. So, it's too early to tell if the correction in house prices has started.

However, there are several indications that the price of an average Canadian house could be lower by the end of the year. Half-a-million homeowners have already applied for mortgage deferrals from the big banks. Meanwhile, the government has refused to bail out Airbnb landlords, so these units have flooded the market.

Rent could decline with new units coming onto the market. Meanwhile, banks could be more cautious with lending, as economic conditions worsen in 2020. Finally, consumer confidence and median income is already trending lower. Canadian consumers are already over-leveraged. Household debt represented 102% of national income in 2019.

More supply, lower income, and lower liquidity could trigger a housing market crash.

Banks exposed

Mortgage providers, developers, and subprime lenders are at the epicentre of this crisis. However, Canada's largest banks are also exposed to the residential mortgage sector to varying degrees. The uninsured portion of residential mortgage assets was 60% for **National Bank** and **Socitabank**. In other words, the majority of their mortgage books were vulnerable in a downturn.

Similarly, **TD Bank's** home equity line of credit portfolio was worth $90 billion in 2019. That was 45.6% of the bank's total residential mortgage portfolio.

Better bets

Larger, better-funded banks such as **Royal Bank of Canada** could be safer. It has less exposure to the oil and gas sector. The bank also has the largest asset base and a well-diversified business across the board.

However, it isn't fully immune to a potential housing market crash. 64% of the bank's mortgages are uninsured. Of those uninsured assets, the average loan-to-value ratio was 52%. A double-digit decline in home values will certainly be reflected on RBC's balance sheet. Investors might want to brace for impact.

Bottom line

Canada's over-leveraged real estate market is vulnerable in the ongoing economic downturn. The shutdown and job losses could trigger a housing market crash. This would be detrimental for the nation's largest lenders.

Investors should probably reassess their exposure to vulnerable bank stocks in 2020. There's plenty of uncertainty already. Why take a risk that seems somewhat visible? Stay safe!

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Date
2025/07/27
Date Created
2020/04/08
Author
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