Canadian House Prices Fell 2 Months in a Row: Is the Correction Here?

Description

This year, the average price of a Canadian house fell twice in a row. In April, the quoted value of an average Canadian home hit $746,000, down from $796,000 in March and $816,000 in February. Although housing is still up on an annualized (year-over-year) basis, the sequential decline is beginning to look significant. The percentage point change from $816,000 to $746,000 is 8.5%. If things keep up this pace all year long, we'll be at $570,000 by the end of the year.

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The question investors need to ask themselves is whether these price declines will continue. If you already own a home, you may be sitting on losses and/or negative equity. If you're planning to buy a home, you may have a better opportunity now than at any other time in recent memory. In this article, I will explore a few reasons why house prices are going down and ask whether now is a good time to buy.

Why house prices are falling

Most experts studying Canada's housing market agree that prices are going down for two main reasons:

1. Higher interest rates
2. Overvaluation prior to this year

Higher interest rates make buying a house more expensive. When the central bank hikes rates, commercial banks soon pass it on to customers in the form of higher mortgage rates. This makes housing more expensive with the price held constant. So, higher rates tend to reduce demand.

The second factor is a little bit less straightforward. For years, many economists had been saying that Canada was in a housing bubble. For the longest time, the ensuing correction didn't come to pass. Today, it just might be happening. Not only are interest rates rising, but Canada's house price to income ratio is very high. Canadian houses cost more than seven times the average Canadian's income, while most aim to pay four times their income or less. So, perhaps this year's dip in prices isan inevitable consequence of overvaluation in the prior year.

Is now a good time to buy?

It's one thing to note that house prices are falling but quite another to say that you should go out and buy a house right now. Certainly, list prices are falling, but interest rates are rising. It's not clear that houses are becoming overall cheaper for all Canadians. If you have enough money saved to buy outright, now is certainly a better time to buy than last year was. Otherwise, you might want to wait for prices to come down a little more.

What about the banks?

No discussion of the housing market is complete without at least mentioning the banking sector. Banks like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) are big players in the mortgage market, and their behaviour dictates who can get loans. With interest rates going up, banks like CIBC might become more conservative about who they lend to. Mortgages are big money makers for banks, but higher interest rates make loans riskier holding the amount constant.

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CM's shareholders are going to be keeping a close eye on default rates and other key metrics through this bear market we're entering. If defaults rise, investors may want to see CM become more defensive in its lending, which could make mortgages harder to get.

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