Housing Market Digest

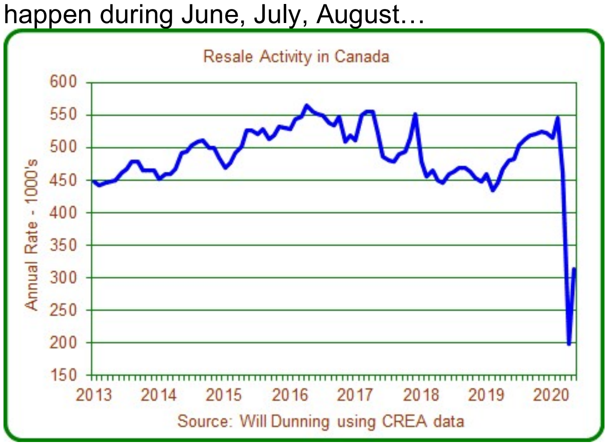
Greater Toronto Area, June 2020

Synopsis: at this point there are no economic forecasts, only assumptions.

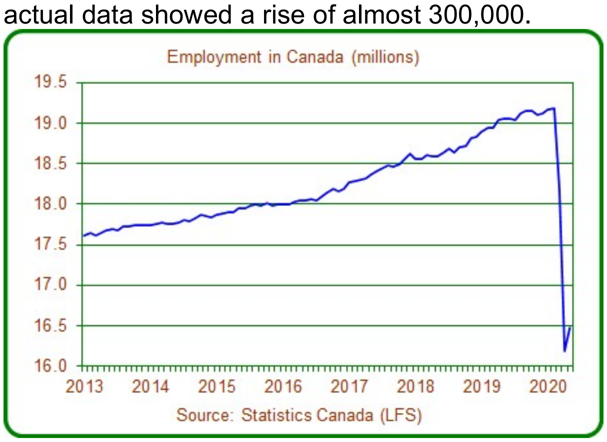
To Start, Some Epistemology?

(I don't actually know what "epistemology" means.)

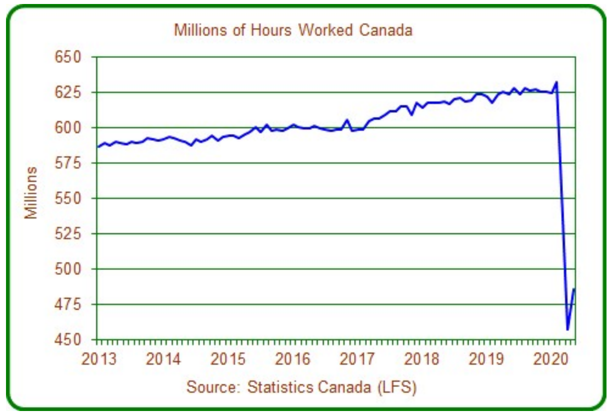
Dissection of recent economic data is most useful in the clues it provides about what might happen in the near future: most of the time, the future is similar to the past. Not now. The data for February, March, and April did not provide us with reliable expectations about what subsequently happened in each of the following months. Similarly, the data we now have for May probably will not do a good job of predicting what will happen during June, July, August…



As one illustration of this: after the loss of three million jobs during March and April, the so-called "consensus" was that there would be a further drop of a half million during May, but then the actual data showed a rise of almost 300,000.



We are in a very deep hole. My instincts and inclinations are shouting at me about what might happen, but I am fighting back against my own opinions. If I state them, I'll only be telling you about what kind of person I am. I won't be giving you anything you should rely on. The only thing I know for sure right now is that I don't know.



Lots of (Very Different) Forecasts

The range of opinions about what happens next is wider than ever. For the moment, I find CMHC's forecasts very interesting.

For one thing, they are showing ranges that are really wide. I am reluctant to call these "forecasts".

I also notice that CMHC's forecasts are more pessimistic than most others I've seen. Most noteworthy is the forecast that the average resale price in Canada will fall by 9-18%, and that the period of falling prices will extend into the first or second quarter next year.

I'm not saying that CMHC is wrong, because at this point anything is possible.

What I am saying is that CMHC is, in actuality, giving us a set of assumptions. Some of the assumptions are explicit (meaning they thought about them) and some are implicit. To get to a forecast of large price declines they must be explicitly assuming that the employment situation will remain badly weakened for a prolonged period. As well, there might be an assumption (whether explicit or implicit, I don't know) that there will be a large number of home sales in desperate situations.

Similarly, CMHC has talked about the potential for a large rise in mortgage arrears during the fall. To get to that, they must be assuming (again, I don't know whether this is explicit or implicit) that (1) a lot of mortgage holders will still be suffering from reduced incomes, (2) government income supports will not be available or won't be adequate to help them cover their payments, and (3) there will not be extensions of mortgage deferrals.

So?

Repeating what I've been saying here, I don't find forecasting useful at this time. Instead, there are some other things we should be talking about.

In general, we should currently be talking about *contingencies* for what might happen during the next half year (or so). If, X, Y, or Z happen, how should the government respond?

In particular, what are the implications for mortgage policies?

If employment is still in a big hole, and the end of mortgage deferrals will push many mortgage holders into default, should the deferral period be extended? Would lenders be willing (indeed, would they be able) to accommodate extended deferrals? If it looks like this situation will develop, what new government policies (including financial instruments) would be optimal in the circumstances?

Traditionally, home buying is a leading economic activity in both upturns and downturns. Also, we know that one of the greatest risks in a modern economy is that declines in house prices can result in a "self-reinforcing downward spiral" of the economy. Some of the questions that need to be discussed are: To what extent should the government act to prevent falling house prices? Or, to promote economic recovery by encouraging home buying? What housing and mortgage policies would provide the best balance between stimulus versus risks for future financial stability?

Relatedly, it makes ZERO sense (actually, it makes NEGATIVE sense) for CMHC to change policies and make it harder to buy (as of July 1 maximum debt service ratios will be lower, minimum credit scores will be higher, and there will be more restrictions on down payment sources). CMHC reports to the federal government. If the government does not order a reversal of the new policies, it is endorsing measures that will further weaken the economy.

This discussion brings me, once again, to the mortgage stress tests. The market is providing actual interest rates in the area of 2-2.25%, but the stress tests are currently using a rate of 4.94%. Some of us believe that this is ridiculous, because (1) it is extremely unlikely that actual market rates will be in that area during the next five years and (2) if rates do rise that much, it would be because the economy is very strong, which would also mean that borrowers' incomes are rising and they will have greater capacity to make increased payments. With the pending mortgage policy changes, the CMHC stress test will become even more onerous.

I Did a Video

I'm involved in a 3-country group of academics that is discussing housing post-Covid-19. My video (recorded on May 23) provided some background to a discussion about mortgages. It's 17 minutes long, and if you haven't got anything better to do, you can find it here (some of you might notice that I'm going full-on Mountain Man).
https://www.youtube.com/watch?v=fMcY7CpF3RQ&feature=emb_logo

The first 6 minutes explore an example of why forecasting doesn't work now. Later on, I mention the stress tests and assert that recent events are demonstrating that they are testing the wrong thing.

The new Governor of the Bank of Canada talked to parliamentarians this week, and said something that is related. I know he wasn't actually talking about the stress tests, but his comments are relevant. He declined to comment on what might happen if interest rates rise by 2 points, saying that what determines people's ability to meet their payment obligations is their employment situations. He also said that he doesn't expect a rise of anywhere near 2 points.

So, why are the stress tests based on a rise of almost 3 points?

I'm looking forward to seeing you again.

How to Reach Will Dunning Inc.

Telephone: 416-236-5115
Email: wdunning@sympatico.ca
Web site: www.wdunning.com

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