Take it to the limit: Canada, we have a debt problem

By Michael Babad
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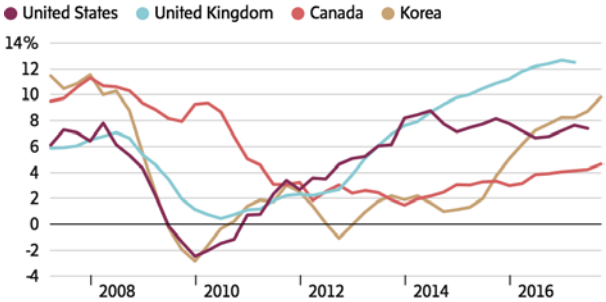
We're going to hear that popular refrain again this week - we're borrowing too much to buy ever-more expensive homes - and how higher interest rates might be affecting that.

Last week, Canadians were warned yet again by the Organization for Economic Co-operation and Development that our debt burdens rival the highest in the world.

The Bank of Canada will shed more light on that Tuesday when it releases its semi-annual review of the financial system. On top of that will be the latest quarterly financial results from some of the country's major banks, which should give us the latest on the mortgage market.



THE GLOBE AND MAIL, SOURCE: THOMSON REUTERS; BLOOMBERG; FEDERAL RESERVE

To recap: The Bank of Canada raised its benchmark overnight rate twice this year, to a still-low 1 per cent, promising to watch for the impact on consumers. Separately, Vancouver's housing market slumped in the wake of a provincial tax on foreign buyers, and is now rebounding. The Toronto area's housing market suffered a similar slump after a similar tax, but it, too, is expected to perk up again.

Also playing into all this are new mortgage rules from the commercial bank regulator, the Office for the Superintendent of Financial Institutions, that will make it harder to qualify for a mortgage.

Which is why markets will be watching closely when Governor Stephen Poloz and his central bank colleagues release the financial system review, followed by a news conference, Tuesday morning.

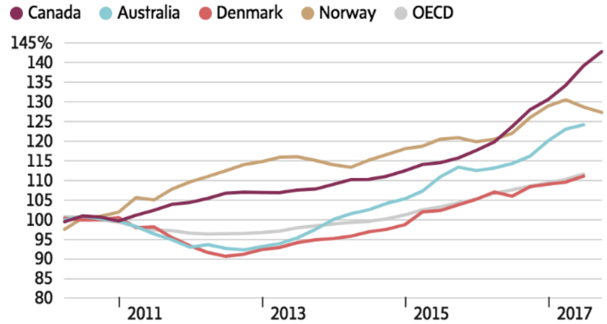
"Look for household indebtedness and housing to again be listed as key vulnerabilities," said Benjamin Reitzes, the Canadian rates and macro strategist at Bank of Montreal's economics group.

This is a popular refrain from the central bank and others.

"There's much more uncertainty around the outlook for both of these after the BoC's 50 basis points in hikes and the coming OSFI mortgage rule changes," Mr. Reitzes added in a lookahead to the review.

"That's especially the case with the Greater Golden Horseshoe still working through the impact of the Ontario government's Fair Housing Plan. We'll be looking for the Bank of Canada to provide a bit more clarity on how many households could be impacted by the new OSFI measures (e.g., how many households were stretching to the limit to purchase a home)."

Royal Bank of Canada economists noted in their lookahead that home resales in the



THE GLOBE AND MAIL, SOURCE: OECD ANALYTICAL HOUSE PRICE DATABASE

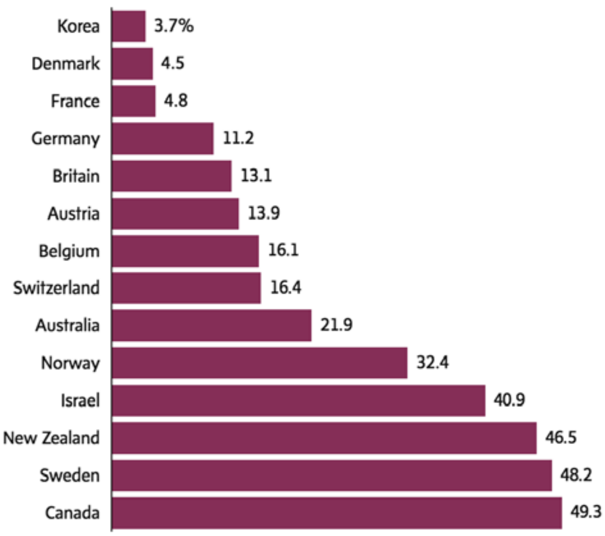
Toronto area tumbled 27 per cent from a year earlier in the May-to-October period, with prices slipping 6.5 per cent.

"Contrasted with this is a resurgence in Vancouver prices/activity after late 2016 declines and some modest pick-up in other major urban centres," RBC said.

"Recent BoC statements on the housing market have emphasized that they expect supply and demand dynamics to dominate over the medium-term."

Price to rent ratios , select OECD nations*

Deviations over long term average



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*2017Q1 OR LATEST AVAILABLE DATA

Mortgage borrowing growth has eased somewhat, but other consumer credit has picked up. And the ratio of debt to disposable income among Canadian families has been running at or near record levels.

We'll hear more about mortgages, too, when Canada's big banks begin reporting quarterly results Tuesday. As The Globe and Mail's James Bradshaw reports, there are risks heading into next year given that mortgage growth is expected to slow, among other things.

Still, the banks will no doubt cap a strong year when they release those fourth-quarter earnings.

Based on what's publicly known, the mortgage books of the six major banks increased by 1 per cent, or an annual pace of 7 per cent, during the first two months of the fourth quarter, those being August and September, driven by the rise in uninsured mortgages, said National Bank of Canada analyst Gabriel Dechaine.

"More important than the upcoming quarterly growth rate, though, is what banks have to say about their 2018 mortgage growth expectations ahead of revised … regulation," Mr. Dechaine said in a report on what he expects the results to tell us.

"We forecast 2018 asset growth of 4 to 7 per cent in Canadian [personal and commercial] banking segments, which implicitly includes a similar growth rate for domestic mortgages," he added.

"We believe many investors view revised … rules as a trigger to cause mortgage growth to tumble, which would have important implications for the Canadian economy as a whole. We believe this issue (along with pricing data in Toronto, in particular) could act as an overhang on the sector to start the new year."