

'Future shocks' forecast for housing market



Hefty debts, rising interest rates threaten to cut homeowner spending and put a drag on the economy, OECD report warns. Will Ottawa have to intervene?

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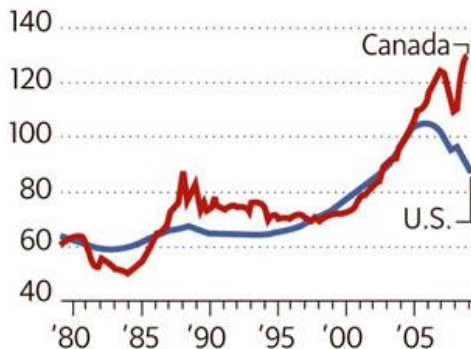
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Bloated debts and rising interest rates threaten to force a growing number of families to cut back and prompt Ottawa to intervene again to cool down the mortgage market. Canadians have spent the past year rushing into a housing market fuelled by low mortgage rates, despite prices many could not afford if rates were to rise to more historically normal levels. About 375,000 homeowners are already being forced to cut spending in other areas, despite ultra low rates, the Canadian Association of Mortgage Professionals said in a recent report. A further 475,000 would find themselves in the same position if rates were to climb to 5.25 per cent.

The rebound in the housing market has been key to Canada's recovery from the recession. But it has left some facing a toxic combination of hefty debts and rising interest rates as the Bank of Canada pulls back from the emergency low rates used to juice the economy back to life. The Organization for Economic Co-operation and Development warned in an annual review of the Canadian economy that record high debt levels have left many vulnerable "to any future adverse shocks." In the report being released today, the OECD said more measures could be taken by the federal government to keep marginal buyers out, suggesting an "overpriced" housing market needs to cool off before allowing more people to plunge in.

Real housing prices

The housing downturn during the financial crisis was short-lived in Canada unlike in the U.S.



THE GLOBE AND MAIL » SOURCE: OECD

Some 7.5 per cent of Canadian households could be “financially vulnerable” by mid-2012 if borrowing keeps up at the same pace and interest rates rise as expected, the report said. Economists have warned that while Canadians aren't likely to default on their mortgages, they are likely to stop spending in other key areas, which would put a strain on the economy. Canada isn't at risk of a U.S.-style real estate meltdown, OECD senior economist Peter Jarrett pointed out. But he said “there's somewhat of an excess” in the market that must be worked off. The Paris-based OECD, a club of wealthy nations that includes Canada and 32 other economies, suggested Ottawa could require home buyers to put up bigger down payments if they want their mortgages federally insured. The government could also consider forcing banks to disclose the “sensitivity” of their mortgage revenues to rate hikes. The organization said Canadians have been taking advantage of low interest rates to pay down their large mortgages, but “this is bound to change” as the Bank of Canada ratchets up rates and the economy begins to normalize. The bank has already raised rates three times this year.

Household debt

Debt-to-disposable income ratio is climbing suggesting a growing vulnerability to additional financial adversity.



THE GLOBE AND MAIL » SOURCE: OECD

If the government were to intervene, it would be the second time this year. In February, it introduced rules that made it harder to qualify for a variable-rate mortgage and increased the amount needed as a down payment if the buyer didn't plan to live at the address. In February some thought the government would raise the amount needed for a down payment to 10 per cent from 5 per cent, but it opted instead to make all applicants qualify for a more expensive five-year mortgage when applying for the cheaper variable rate.

And while the housing market has shown signs of cooling, several markets continue to face what the OECD calls excess demand conditions. Already seeing a slowdown in the housing market, some in the industry do not see the need for further action from Ottawa. "You don't throw a bucket of water on the fire once it has put itself out," said Phil Soper, president of Royal LePage Real Estate Services, Canada's largest residential brokerage.

The warning about the frothy real estate market is contained in a 158-page report that generally lauds Canada's handling of the recession and the financial crisis, but forecasts less prosperous times ahead for the country. **Canada is on track to lead the Group of Seven in growth this year.** The OECD is forecasting growth of 3.5 per cent this year and 3 per cent in 2011. But over the medium term, Canada will likely grow much more sluggishly than it has over the past decade, and slower than some of its key competitors, Mr. Jarrett said. "We're looking at a period when expectations need to be revised down," he remarked.

The main culprit for the predicted slowdown is demographics. Canada is greying at a faster rate than the United States, opening up a hole in the tax-paying working population and increasing demands on government services by the elderly. Mr. Jarrett said the Bank of Canada also must be mindful of not overheating the economy by keeping interest rates too low and that governments will have to rein in their spending to cope with much lower-than-expected tax revenues. "Canada could be in trouble," he said, if policy makers expect the economy to be the same as it was before the recession. Mr. Jarrett likened the current environment to the early 1970s, when many people expected the economy to boom again like it had during the 1950s and 1960s. "We never went back to those growth rates," he said.

The report also touches on the financial health of Ottawa and the provinces. And while the OECD said Canada stacks up well compared to other member countries, the country's fiscal health is deteriorating. The OECD said it's concerned about the deteriorating finances of some provinces, particularly Quebec and Ontario. The report said all levels of government must work to curb spending.

REPORT ON MEDICARE

Canada's medicare system offers "top-notch care," but measures need to be taken to contain costs to ensure the future of the popular program, the Organization for Economic Co-operation and Development warns in a new report.

Among the measures recommended are the introduction of co-payments and deductibles to "encourage more responsible service use" and a need to rein in physician salaries, which are among the highest in the Western world. The OECD also rebukes Canada for its slow implementation of electronic health records, saying it is undermining efficiency, and for the lack of universal coverage of prescription drugs, the norm in many industrialized countries. The OECD also calls for "clarification" of the Canada Health Act, saying "there seems to be confusion about the legitimate role of the private sector" in the health system.

- *André Picard*