Submission by:
Canadian Association of Accredited Mortgage Professionals ("CAAMP")
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CAAMP ACCHA

"The impacts of the decline in the global price of oil on the Canadian economy, including impacts on the value of the Canadian dollar, energy and manufacturing sectors, and the labour and housing markets."

At the request of the Clerk, Standing Committee on Finance, the Canadian Association of Accredited Mortgage Professionals is pleased to present the following statement.

Due to its interests in the housing finance system, CAAMP's comments will be largely focused on housing market impacts.

Impacts on housing markets will arise primarily due to changes in job creation and consumer confidence, and due to any changes in mortgage interest rates.

There are several direct and indirect channels through which job creation and consumer confidence will be affected by the reduction of oil prices. While many of the anticipated impacts are negative for job creation, there are significant positive impacts. Needless to say, the relative impacts of these factors will vary across regions, and thus housing market impacts will vary across the country.

- Fewer jobs will be generated by new investment in productive capacities (exploration and drilling, as well as construction of processing facilities and associated infrastructure).

  The largest negative impacts will be experienced in the provinces and regions in which the resources are situated. However, negative impacts will also occur throughout the rest of Canada, due to reduced demand for goods and services that are used in the exploration and construction processes. Announcements by producers already point to very substantial reductions in investment, which will have negative spin-off effects among associated producers of goods and services.

  These impacts are negative for housing activity.

- On the other hand, lower energy costs benefit many industries.

  Industries that utilize oil-related products will see cost reductions, which in competitive markets are expected to result in price reductions for the goods and services that they produce. Reduced selling produces will support increased sales. Benefiting industries include: transportation services (passenger and freight services), chemicals and plastics, farming, and various resource producing industries. In turn, these price reductions will have subsequent benefits for large swathes of the Canadian economy.

  These impacts are positive for housing activity.

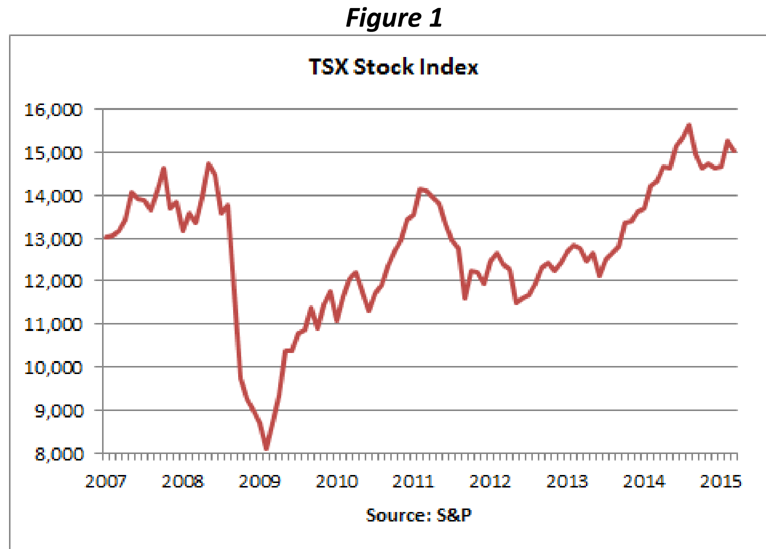
- Stock market impacts will occur, through a "wealth effect".

  Wealth arising through changing stock prices affect job creation in several ways: they send a signal to businesses and consumers about the evolving state and the outlook for the economy, which affects confidence positively or negatively; rising stock prices enable corporations to raise

funds that can be used to expand their operations (which creates jobs through the investment activity as well as through expansion of their productive work forces); for consumers the increase in stock-related wealth encourages and supports spending that creates jobs.
At this time, stock prices in Canada (as indicated by the TSX index) are slightly below the record-high level that was seen last fall. At present, the level of stock prices is still relatively high in historic terms (as is illustrated in Figure 1). Stock market wealth is currently a positive factor, although it is less positive than a half year ago.

The future path of stock prices is highly uncertain and therefore it is a major risk factor (positively and negatively) for the Canadian economy and thus for the housing market.

Figure 1



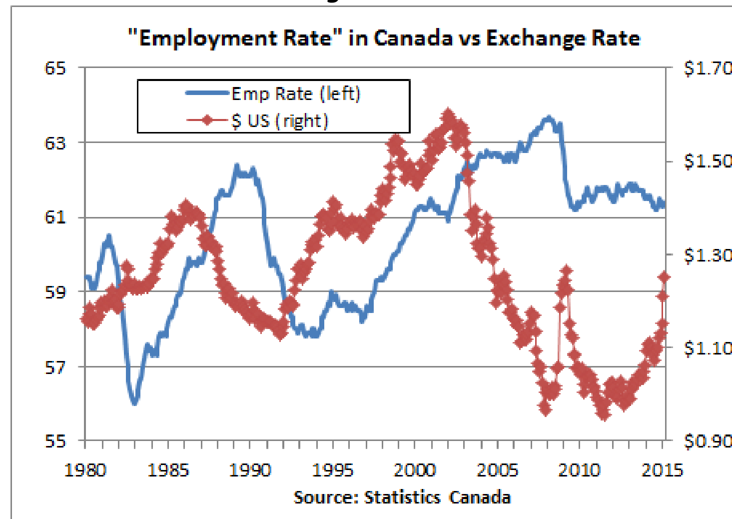
- A weaker dollar benefits all regions.
  The value of the Canadian dollar (especially relative to the US dollar) is highly correlated with the prices of the raw materials that we produce (especially including the price of oil). The sharp drop in oil prices has contributed to the weakening of our dollar.
  Changes in the dollar have historically been associated with changes in job creation: a weakened dollar brings a shift in relative labour costs compared to our major trading partners and our competitors in other countries, and thus makes us more competitive for goods and services. Historically, this has meant that a weakened dollar causes us to import less (this includes goods and a wide range of service industries, such as out-of-country tourism by Canadians, and myriad business and personal services). A weakened dollar also results in increased exports (goods and services, which include increased tourist visits to Canada, business services, and film production, etc.).
  However, the rapidity of these various impacts varies widely. Some are quite rapid. But, the biggest impacts – which occur through the creation of new industrial capacity in Canada – take considerable lengths of time. Historic data hints that it takes five to six years for the impacts of a changing dollar to have its full effects on job creation in Canada. The chart below illustrates this by contrasting the Canadian employment-to-population ratio (the percentage of adults who are employed) versus the exchange rate (expressed as how many Canadian dollars it takes to buy one US dollar). In this chart, key events for the employment rate occur a long time after the changes in the exchange rate. For example, the exchange rate was at a peak at the start of 2002

(meaning the dollar was at its weakest). A peak followed for the employment rate, at the start of 2008 – six years later.

The upshot of this discussion is that while the Canadian dollar has weakened during the past three years, and especially since the price of oil began to tumble, initial economic benefits will be quite modest. It may be another three years before we see convincing positive impacts on job creation.

This is (very) weakly positive for housing activity.

Figure 2



- Lower consumer prices mean more "discretionary income".

  Reduced spending on energy (gasoline in particular) will leave consumers with more money to save or spend. Some job creation will result, but the initial reaction will be largely cautious as consumers will be uncertain about how long the lower prices will last. For some time, most of the windfall will be devoted to rebuilding personal finances. To the extent that small amounts of job creation result, there will be minor benefits for housing demand.

  This is weakly positive for housing activity.

- Lower inflation rate means interest rates will stay low for longer.

  Bond markets have reacted very strongly to the drop in the price of oil. Presumably this is largely due to reduced expectations about future inflation. Relatedly, it might also reflect expectations of negative economic impacts.

  In the space of two months the yield for 5-year Government of Canada bonds fell by about one-half and are now (as of March 3) at just 0.79%.

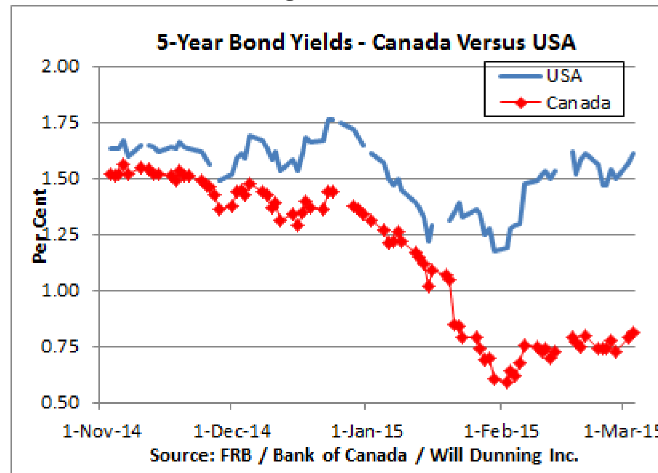
  The drop in Canada has been much larger than in the US, with the consequence that the yield spread is now unusually large.

  Mortgage rates for the most popular mortgage option (5-year fixed rate mortgages) generally follow yields for the corresponding government bond. This time, however, mortgage interest rates have only partially followed the drop in bond yields: a typical rate (after lender discounts) is now about 3.0%, which is a drop of only 0.2 points from prior levels: market rates for mortgages have only partially followed the drop of 0.7-0.8 points for bonds. This has several probable causes, including lenders' difficulty in attracting deposits at very low interest rates. It may also indicate that lenders (and/or depositors) expect bond yields to rise.

Bond yields do seem unnaturally low: recent yields at just 0.75%-0.80% for 5-years are lower than the inflation rate we should reasonably expect over the coming five years.
The upshot of this discussion is that to this point, we have seen only moderate reductions in the cost of mortgage finance and therefore we should expect only a modest positive impact in the housing market.

On current trends, this is weakly positive for housing activity. There is positive and negative risk related to interest rates.

Figure 3



- Reduced taxes and royalties will constrain government spending.

  The magnitude of the negative impacts on government revenues is unclear, and budgetary responses are still being developed. Based on pre-budget commentary, we can expect major spending cuts in Alberta, which will add to the negative consequences within that province. Elsewhere, fiscal responses will be neutral at best. To varying degrees across provinces there will be negative consequences for employment.

  This is negative for housing activity, to varying degrees.

- Feedback between housing and the economy.

  Housing activity is strongly affected by the state of the economy. In turn, housing market conditions affect the economy. Jobs are created directly by housing construction (in the construction industry and in other industries that provide goods and services to the construction process). Resale market activity creates jobs in the real estate industry and the other industries that participate in the transaction process (eg. finance, legal services), as well as in other industries (such as moving, furniture and appliance sales).
  There is a further indirect effect, which in fact may be the most powerful driver of job creation in Canada: changes in housing prices have a "wealth effect". Rising prices encourage consumer spending and job creation (through their impact on confidence and because the improvement in personal finances allows them more discretion). Similarly, falling house prices inhibit job creation.
  The discussions above indicate that in most regions of Canada (the regions that do not produce oil and gas), the economic and housing market impacts will be moderate (most likely slightly positive), and consequently there should be little change in the impact of housing wealth.

But, in the producing regions, substantial alteration of the economic environment will disrupt trends for house prices. It is highly likely that reductions of house prices will add to the negative economic effects (the feedback process will worsen the economic conditions in these regions).
This is negative for housing activity, to varying degrees.

- The intangible factor of consumer confidence
  While housing market activity is largely driven by tangible economic factors, primarily job creation and mortgage interest rates, the market can depart positively or negatively from fundamental conditions, due to changes in consumer confidence.
  Housing markets in Alberta and Saskatchewan have slowed very substantially (the seasonally-adjusted rates for resale activity for January are down by about one-third compared to the levels see during the summer and fall of 2014). It is clear that the drop in oil prices has produced a very sharp change in confidence and expectations that is deterring potential buyers. Elsewhere, trends for sales have not been materially changed, indicating that housing consumers have not become more concerned about risks.

Asymmetry in Responses

In assessing the likely evolution of impacts on the economy and housing market, we need to be aware that responses tend to be gradual when positive changes occur (when job creation picks up, sales increase gradually) but in the face of negative changes (especially strongly negative changes), responses can be very rapid and very strong. We are already seeing this in the disruption of housing market trends in Alberta and Saskatchewan (where there are expected to be strongly negative economic changes). Elsewhere, economic impacts are expected to be positive (albeit gradual) and we cannot discern any substantive disruption to housing market trends.

The implication is that while the economic impacts of lower oil prices are expected to be mildly negative overall, there is likely to be a disproportionately negative change in housing markets: rapid and strong negative impacts in some areas will exceed the slow and moderate positive effects elsewhere.

Summarizing expected housing market impacts:

- Job growth and low interest rates are positive for Ontario, Quebec, Manitoba, Nova Scotia, New Brunswick, PEI.
- In Alberta, Saskatchewan, and Newfoundland the negative consequences of job losses will not be offset by lower interest rates.
- The outlook is roughly neutral in British Columbia
- For Canada – the net housing market impact is for negligible change.

Inconsistent Expectations about Policies

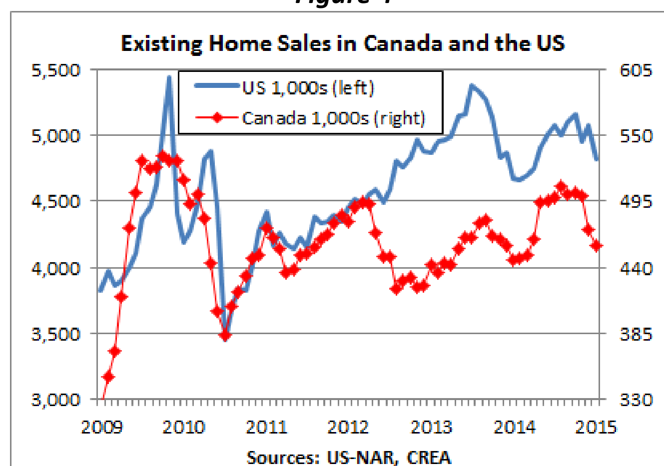
Interest rates have been at exceptionally low levels since the recession, in an attempt to stimulate a stronger economic recovery. Since housing is a very interest rate sensitive part of the economy, the greatest positive impacts of these low interest rates have been seen in the housing arena.

Strong housing demand has resulted in rapid growth of mortgage credit, to the point that the federal government and the Bank of Canada have expressed concerns. The federal government has acted four times to tighten the criteria for mortgage insurance, in order to dampen the growth of mortgage credit.

As a result, the stimulative effects of low interest rates have also been diminished. Because of the power of the housing sector to create jobs, a further consequence of the policy changes for mortgage insurance is that job creation in Canada has also been dampened.

A comparison of resale activity in Canada and the US illustrates that there was a disruption in Canada at the time the fourth of the mortgage insurance changes was implemented (July 2012). Figure 3 contrasts resale activity in Canada and the US on a proportional basis (reflecting that the population of Canada is roughly 11% of the US population). Up to July 2012, the trends in Canada and the US were very close (sales in Canada were very close to 11% of US levels). This makes sense, because economic influences were very similar (trends for interest rates were similar and in both countries job creation was close to the rate at which the population was growing). The policy change caused Canadian sales to fall to about 9% of US levels. Subsequently, the gap has been closing, but even now sales in Canada are only about 10% of US levels. In short, the policy change continues to limit housing market activity in Canada and in consequence to constrain job creation.

Figure 4



During the post-recession period, two sectors have been responsible for most of the job growth in Canada: housing (including related industries) and investment in natural resource industries (especially oil and gas). With the first sector now under-performing due to a set of government policies and the second sector now commencing a rapid deceleration due to market forces, Canada faces a difficult economic test.

About the Canadian Association of Accredited Mortgage Professionals

CAAMP is the national organization representing Canada's mortgage industry. With 11,500 mortgage professionals, its membership is drawn from every province and from all industry sectors. This diversified membership enables CAAMP to bring together key players with the aim of enhancing professionalism.

Established in 1994, CAAMP has taken a leadership role in Canada's mortgage lending industry and has set the standard for best practices in the industry.

In 2004, CAAMP established the Accredited Mortgage Professional ("AMP") designation to enhance educational and ethical standards for Canada's mortgage professionals.

CAAMP's other primary role is that of consumer advocate. On an ongoing basis CAAMP aims to educate and inform the public about the mortgage industry. Through its extensive membership database, CAAMP provides consumers with access to a cross-country network of the industry's most respected and ethical professionals.