Housing: What the BoC Help Giveth, the BoC Help Taketh Away

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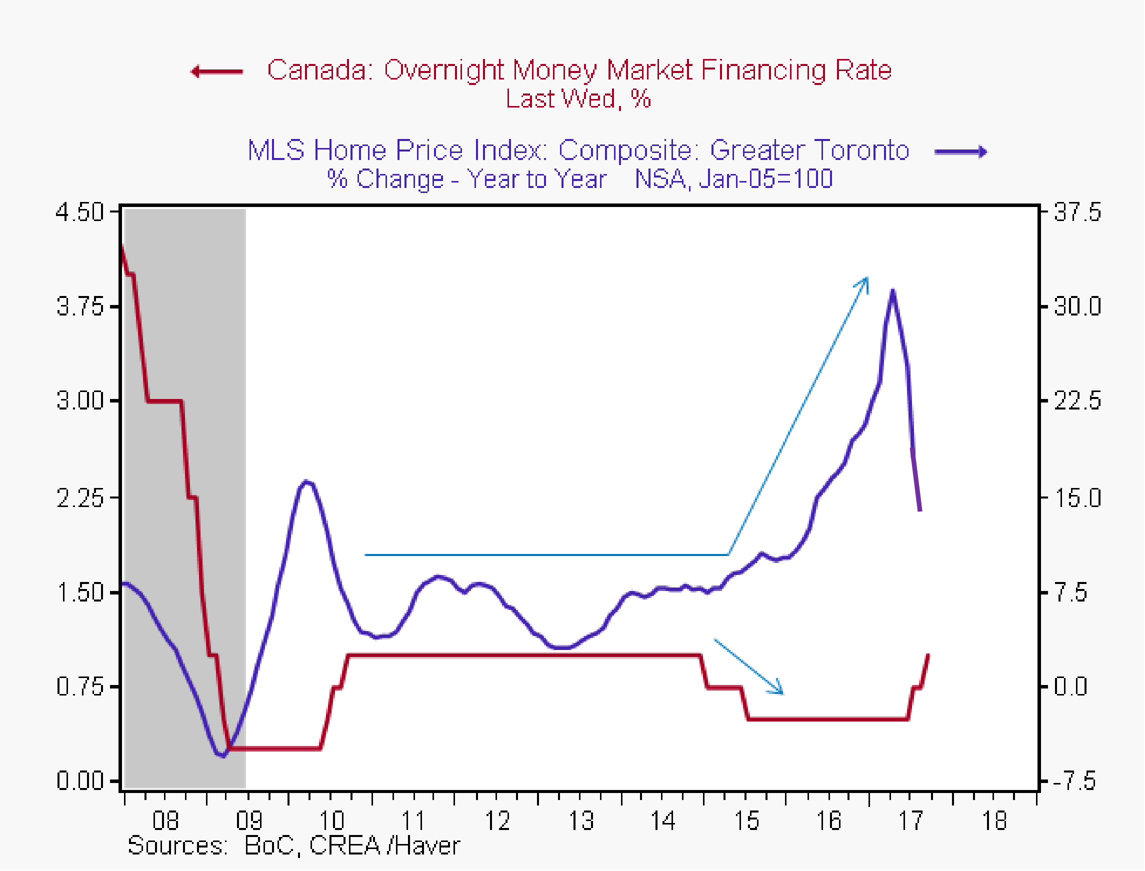
The first impact of the follow-up BoC rate hike might be psychological. It's no coincidence that, after a multi-year period of well-behaved price growth, the Toronto market began to explode after the Bank of Canada cut rates twice in the first half of 2015. While the marginal improvement in affordability helped, it also sent a clear message that, after barely containing their enthusiasm for years as rates were expected to (eventually) normalize, buyers/investors/speculators had a free pass to run amok.

Now, a follow-up rate hike sends an even stronger message that past price growth shouldn't be expected to continue. This could extend the adjustment period that the TO market is currently going through even (as we noted yesterday) if there are signs of a bottom forming.



BoC vs. Housing Affordability

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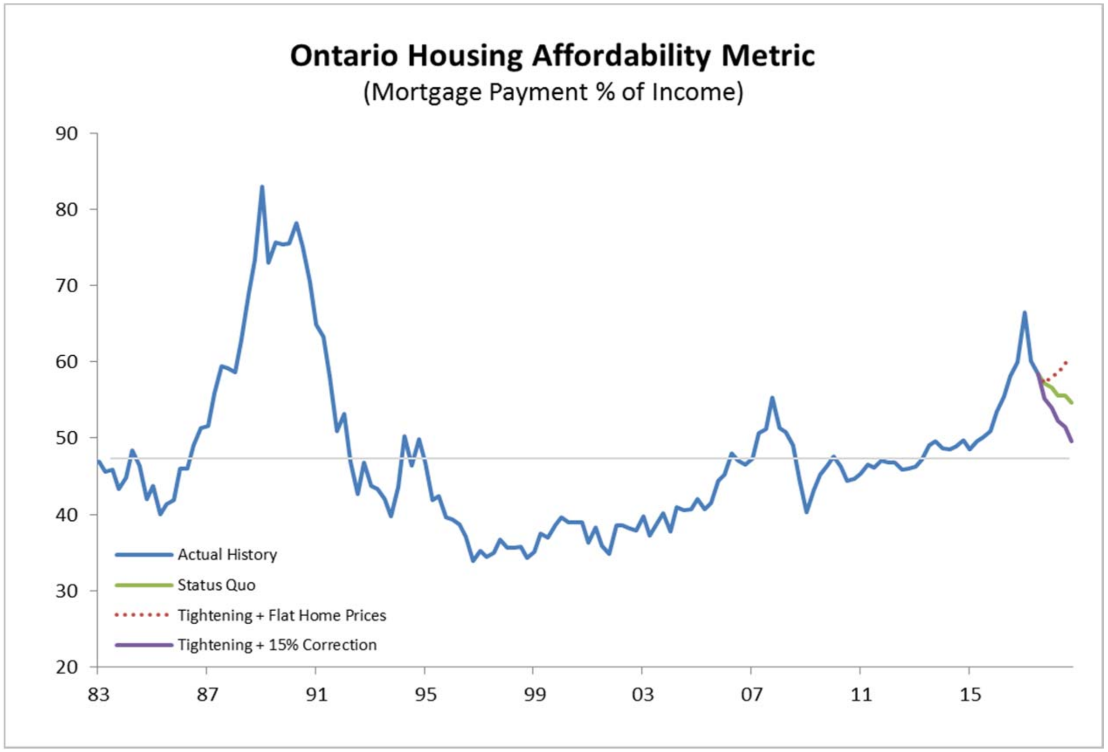
Here are a few rough scenarios that look at how Ontario housing affordability (or valuations, if you will) could evolve. Note how this metric was very well behaved until late-2015, when it began to detach in a big way. Now we pay the piper.

Status quo: The average home price holds steady through the end of 2018, the recent rate hikes (BoC and 5-year yields) are left to do their work, while incomes continue to grow. The adjustment wouldn't go all the way within the short time frame.

Tightening + flat prices: The average home price holds steady, while the BoC raises rates 4 more times by the end of 2018. This actually hurts affordability as incomes can't keep up. Not a sustainable outcome.

Tightening + price declines: Same scenario as above, but prices fall to restore affordability. In this case, it would take a roughly 15% decline in average prices to take affordability back to 'normal' levels.

As always, the truth might be somewhere in between. That is, less tightening, and less of a price decline, or a more drawn-out adjustment.



Based on 25-year amortization, average of 1- and 5-year posted rate, average-priced house, down payment equal to half of annual income. Household income measured as personal income per labour force member.

TSX: Stuck in the Muddle With You

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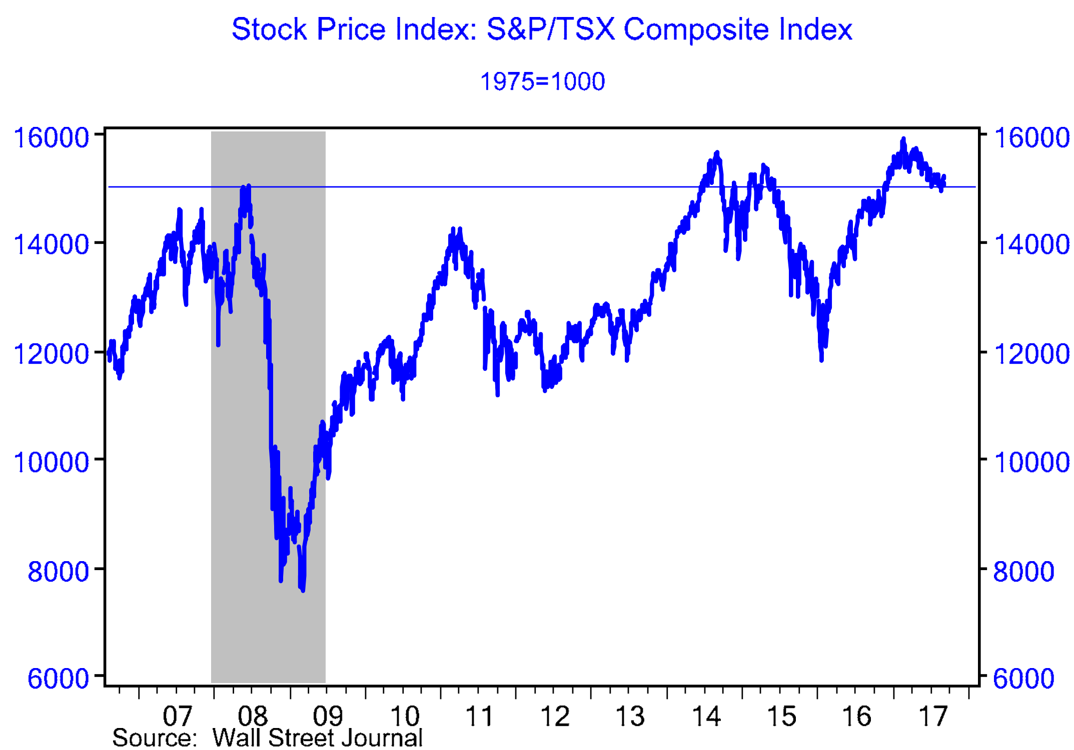
Not meaning to bring everyone down, but the latest slippage in the TSX to just over 15,000 leaves the index barely above year-ago levels. It gets worse. Not wanting to bring up the nasty year of 2008, but the index peaked that year at 15,073 in mid-June.

In other words, here we are, a bit more than nine years later, and the index has made precisely no progress. Yes, it has managed to recoup all the devastating losses from 2008/09, but no more. Thankfully, there have been decent dividends, so the total return over that period has been running at nearly 3.5% per year even as the index has done a great circle route to nowhere.



ECB ... Getting There .....

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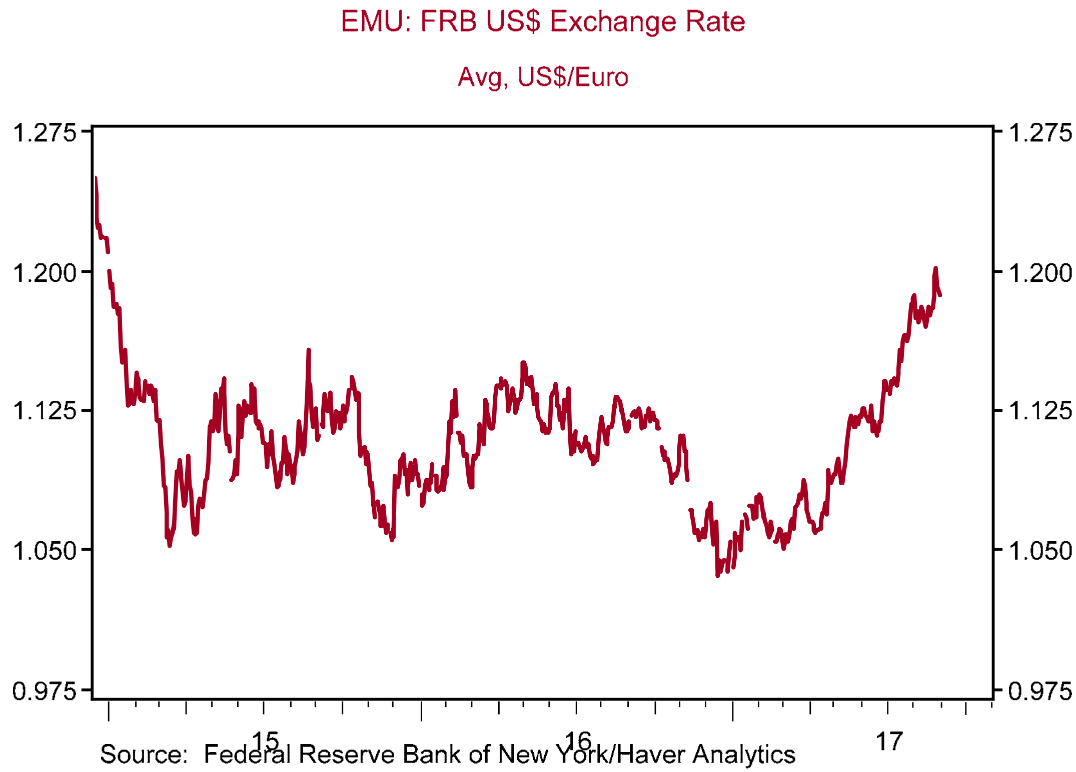
Another ECB meeting came and went, with still no news on what the central bank has planned for its bond buying program (scheduled to run until the end of December, "*or beyond, if necessary*"). They're close to making a decision, though. In fact, "*the bulk of these decisions will be taken in October*", so there is light at the end of the very long tunnel. The Governing Council is clearly nervous about the euro's strength and volatility, which has implications on when the ECB's mandate will be met. Inflation forecasts were marked down over the next two years because of the strong euro.

So now, markets cool their heels ahead of the October 26th announcement. We look for the QE program to be extended by another six months (minimum), but for the monthly purchases to be reduced to €40 bln from €60 bln, currently. Fewer purchases reflect the Euro Area's "*robust*" and "*broad-based*" growth and, perhaps, a possible scarcity of bonds, although that is something that was not discussed today, according to President Draghi.



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