The Impact of Unemployment Rates on Mortgage Payments

NOVEMBER 2020

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INTRODUCTION

1. THE IMPACT OF UNEMPLOYMENT RATES ON MORTGAGE PAYMENTS

The Covid-19 pandemic may have marked a turning point in the world of employment. The International Labour Organization estimates that, during the first wave of the pandemic, as many as 2.7 billion workers worldwide were affected by lockdowns.[1] While many of these workers have returned to work, others have been permanently displaced.

Covid-19 had a dramatic impact on Canada's labour market and overall economy. Gross domestic product (GDP) shrank the most on record in the second quarter as the economy officially entered into recession.[2] With millions of Canadian workers displaced, many feared that the economic downturn would trigger a wave of mortgage defaults and send the housing market tumbling as a result.

Although housing demand weakened at the start of the pandemic, sales and prices surged to record highs in subsequent months, showing once again the strength of Canada's housing market.[3]

With employment and overall economic activity recovering, Canadians are unlikely to be defaulting on their mortgages in huge numbers anytime soon, unless another unexpected disaster strikes. This view is further reinforced by the fact that Canadians have an excellent track record repaying their mortgages—even under the most adverse economic conditions.

2. CANADA'S LABOUR MARKET: BY THE NUMBERS

Like many other countries, Canada's labour market lost millions of jobs in March and April after the provinces implemented strict shelter-in-place orders. The unemployment rate peaked at a record high of 13.7% in May before declining gradually throughout the summer months. By September, the jobless rate had fallen to 9%, which was still well above pre-pandemic levels but nevertheless a marked improvement over the preceding months.

Although the labour force recovery may have slowed after several provinces went back into partial lockdown beginning in August, the worst pandemic-related disruptions appear to have passed. Net employment has been positive for five consecutive months as of September, with most major industries reporting gains.

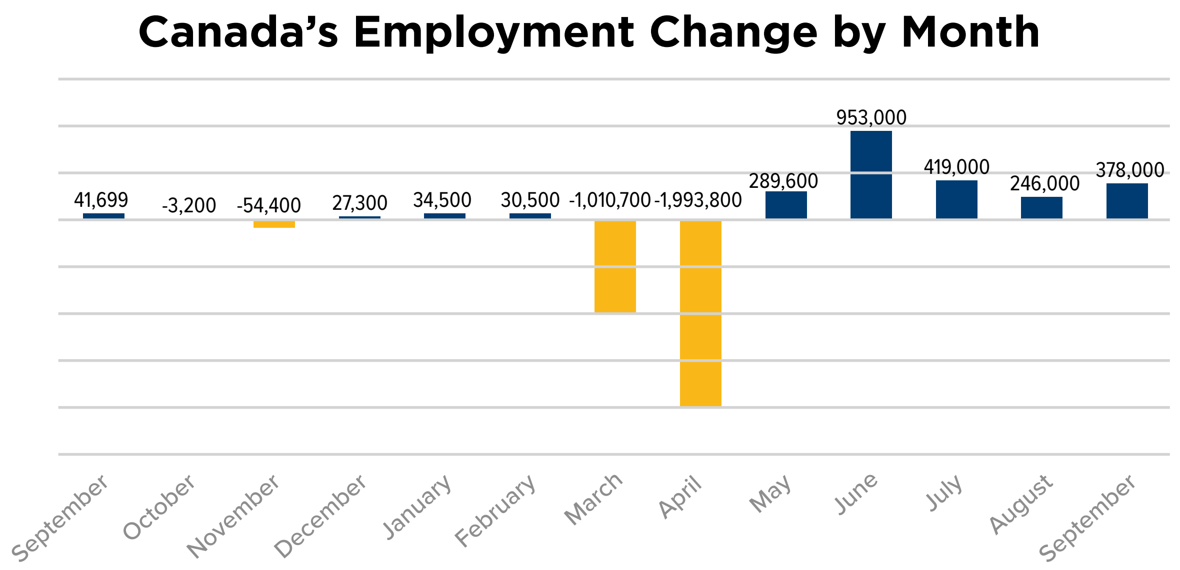

Figure 1: Canada's labour market lost over 3 million jobs in March and April combined. It has since recouped most of those losses following the gradual easing of shelter-in-place orders. | Data Source:. | Source: ▶ Statistics Canada

3. THERE WAS NEVER A DEFERRAL CLIFF

Even if we assume that unemployment is the biggest risk facing the housing market, there are few scenarios that would lead to a serious rise in mortgage defaults.

For starters, many Canadian homeowners have remained gainfully employed during the pandemic, with recent data indicating that younger, low-wage workers were most likely to be affected by lockdowns.[4] Youth unemployment is a serious issue, but this demographic is also least likely to own a home, which lowers the overall probability of rising defaults.

According to TD Economics, the composition of job losses during the pandemic was one of the biggest reasons why the dire housing market predictions never materialized. In fact, housing trends rebounded faster than many had expected due to pent-up demand and a rise in new listings. Ongoing policy support from the federal government also boosted homebuyer sentiment.

Canadians are also notoriously good at paying their mortgages—a fact that remains true regardless of the business cycle. Long before the pandemic, in early 2019, research from Statistics Canada showed that Canadians are putting a near-record amount of money towards paying off their mortgages.

At the time, Statistics Canada said borrowers were spending 14.9% of disposable income on debt servicing, which includes interest and capital payments.[5] It was estimated that 92% of Canadian homeowners have at least 25% equity in their property.[6] With so much equity, many homeowners seek refinancing or home equity loans to access cash. But this trend is not synonymous with rising defaults.

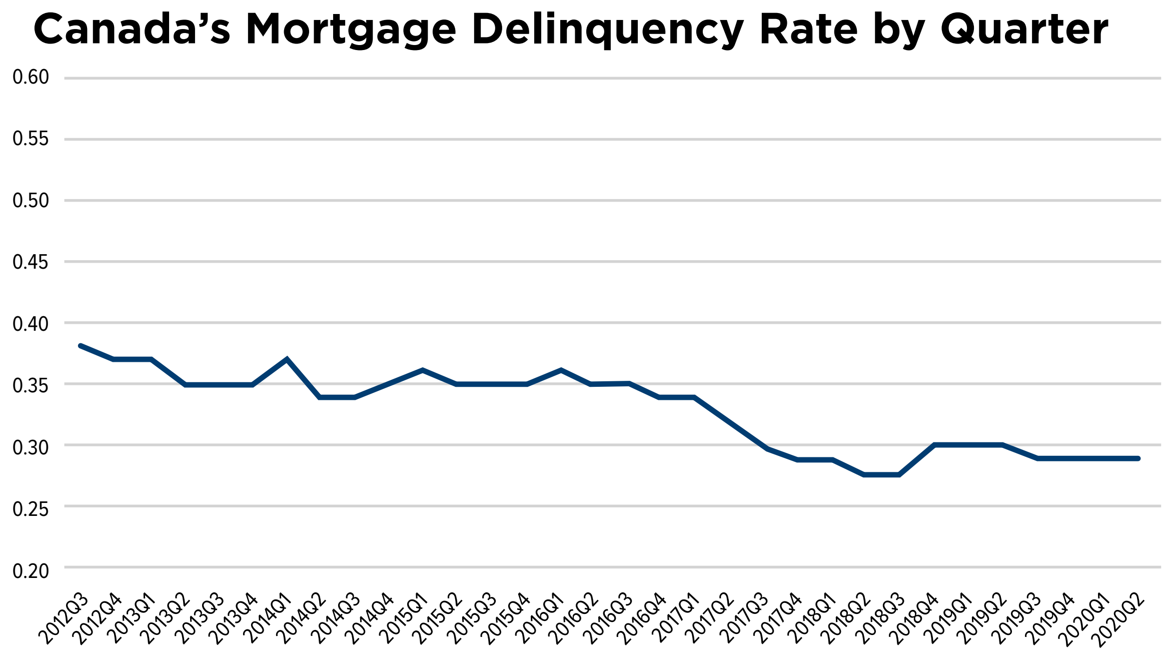

Figure 2: Canada's mortgage delinquency rate has remained well below 0.4% for the past seven years. | Source: Canada Housing Mortgage Corporation

Although many borrowers took advantage of deferral relief programs during the 2020 pandemic, they resumed their payments as normal when the programs expired. Scotiabank, for example, says 99% of mortgage borrowers whose deferrals have expired are current on their mortgage payments.[7]

During the height of the pandemic, mortgage defaults remained at just 0.28% of all loans at the major financial institutions.[8] As the following chart illustrates, the mortgage delinquency rate is generally very low in Canada.

4. WHAT THE PRIVATE MORTGAGE MARKET TELLS US

The private mortgage market provides another potential indicator of the financial health of Canada's average homebuyer. Private mortgages are funded by individuals and businesses who expect to generate a return on their investments.

A 2019 report from CIBC found that private lenders such as Mortgage Investment Corporations are one of the fastest growing segments of the mortgage lending market.[9] These lenders have identified a large addressable market for non-bank loans and are lending to people who may not qualify for traditional "A" or "B" mortgages from the top-six banks.

Even among what some have identified as "riskier borrowers," the delinquency rate was around 1.73% in 2019.[10] Defaults, which typically refer to mortgages that are more than 90 days past due, are significantly smaller. Mortgage Investment Corporations with lower risk profiles and greater portfolio diversity may experience even smaller incidences of defaults.

With that said, the value of residential mortgage loans extended by private lenders grew by 25.4% to $41.1 billion in the second quarter of 2019, according to Statistics Canada. In actual numbers, that's 166,482 private mortgages—an increase of 34.1%. The same data set showed that the number and value of residential mortgages in arrears over 90 days decreased by 9.4%. In fact, these mortgages represented just 0.3% of the total value and 0.2% of the total number of outstanding non-bank mortgages.[11]

If defaults among Canadian homeowners were a major risk like some have been suggesting, the cracks would have first appeared among these so-called "shadow lenders" due to the higher risk profile of their borrowers. But that trend hasn't materialized and seems unlikely to do so as the economy heads for recovery.

5. CANADA'S ECONOMY: THE FUTURE

Canada, like the rest of the world, faces a long path to recovery following the pandemic. Organizations and consumers have used the current crisis to make gradual changes to their business and lifestyle, respectively. According to Deloitte, economic activity could return to pre-pandemic levels as early as the second half of 2021. Once again, consumer spending and housing activity have been the main drivers of that growth.[12]

> *"The good news is that the recovery has been stronger than many forecasters anticipated, particularly with respect to retail spending and real estate activity." – Deloitte (2020)*

A broadening economic recovery bodes well for the average Canadian homeowner. It also dampens the risk of a major default crisis in the country's mortgage market. As the data show, Canadians continue to prioritize mortgage payments and homeownership, and have done so repeatedly amid crises.

Endnotes

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10 Statista. Delinquency rates of lenders in Canada in 2019, by type.

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info@thecmigroup.ca
1 (888) 465-8564
cmimortgageinvestments.ca