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Employment Impacts of Housing and Mortgage Activity

Prepared for:

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Executive Summary

The Canadian housing sector is a significant economic driver.

- Housing and mortgage activities create significant employment in Canada. They could account for more than 1.35 million direct and indirect jobs (about 8% of total Canadian employment).
- The housing and mortgage industry has been particularly important to job creation these past five years. From 2006 to 2011, it's estimated that 18% of all job creation occurred as a direct and indirect result of growth in the housing and mortgage sector.
- Rising home values lead to greater consumer spending, and thus, a stronger economy. CAAMP estimates that rising home values from 2006 to 2011 have led to \$17 billion in additional economic activity, or about 1.2% of total GDP in Canada.

The Canadian housing economy is safe and stable.

- At the peak of the US housing boom, approximately 20 to 25% of all US housing sales were for investment purposes. In contrast, CAAMP estimates that 2 to 3% of Canadian home sales nationally are investment properties.
- Home equity is growing rapidly. Canadian mortgage holders are repaying their mortgages more rapidly than is required.

The biggest threat to the health of the Canadian housing and mortgage industry is a recession that results in job losses. The best way to support the housing and mortgage industry and to sustain its positive impact is to pursue policies that continue to create jobs.

At the same time, it is important that qualified buyers have choice when seeking mortgages to finance or re-finance their home.

Employment Impacts of Housing and Mortgage Activity

Housing and related mortgage activities play an important role in the Canadian economy. The activities generate considerable numbers of jobs in construction, real estate, and financial services (this is referred to below as “immediate impacts”). Further impacts occur through a “wealth effect”. This short paper briefly illustrates the impacts.

Immediate Impacts

The most detailed data on employment in Canada is from the 2006 Census. The table below provides key data as of 2006. Later discussion considers growth up to 2011.

- About 280,000 people were employed in “residential building construction”, or 1.7% of total employment (which was about 16 million, according to the 2006 Census).
- Employment in “credit intermediation and related activities” amounted to 327,000. Residential mortgage credit represented 34% of total household and business credit in Canada, implying that employment related to residential mortgage credit was about 111,000.
- About 96,000 persons were employed in “offices of real estate agents and brokers” with a further 47,000 in “activities related to real estate”. Assuming that two-thirds of this employment was related to residential real estate, there were 96,000 jobs involved.

Combining these three industries, almost 500,000 jobs in Canada were directly attributable to housing and related mortgage activity.

Those are “direct” employment impacts. In addition, there is employment in other industries that provide required goods and services for these activities (this is known as “indirect” employment). Moreover, as these “direct” and “indirect” employees receive and spend their incomes they create spin-offs – the employment that results is considered “induced”. The table below provides a set of estimates for the direct, indirect, and induced employment effects of housing and residential mortgage activity¹. It indicates that **as of 2006 the impacts exceeded 1.2 million jobs (about 7.5% of total employment in Canada)**. Clearly, strength of the housing and mortgage markets has a role to play in sustaining the Canadian economy.

<i>Employment Related to Housing and Residential Mortgage Activity, in 2006</i>				
	<i>Residential Building Construction</i>	<i>Real Estate Offices and Related Activities</i>	<i>Credit Intermediation and Related Activities</i>	<i>Combined</i>
Direct Employment	280,000	144,000	327,000	751,000
Share attributed to residential activity	100%	66.67%	34%	
Direct Employment	280,000	96,000	111,000	487,000
Indirect Employment	249,000	103,000	73,000	425,000
Induced Employment	173,000	58,000	81,000	312,000
Total Employment	702,000	257,000	266,000	1,225,000
Sources: Calculations by Will Dunning using Statistics Canada data: 2006 Census file 97-559-XCB2006009; National Input-Output Multipliers, 2007 (jobs multipliers). Totals may not add due to rounding.				

¹ Statistics Canada provides estimates of employment multipliers. The table applies the multipliers estimated for 2007 to the Census data on employment.

The previous table provides estimates of employment as of 2006. Other Statistics Canada data (the Survey of Employment, Payrolls and Hours, SEPH) indicates that during 2006 to 2011 total employment in Canada increased by just under 5%. Growth was stronger for residential construction (13%), credit intermediation (11%), and real estate (9%). **Combining the data from the Census and SEPH, the housing and residential mortgage markets may now account for more than 1.35 million jobs, and more than 8% of total employment in Canada, through their direct, indirect, and induced impacts.** These industries, with the addition of their indirect and induced impacts, accounted for about 18% of job creation during 2006 to 2011.

The Housing Wealth Effect

Beyond the impacts on employment through the direct, indirect, and induced channels, the housing market has the potential to affect consumers' decisions and behaviours and therefore has further consequences for the economy and the level of employment.

The chief stimulant is rising values for housing, for the following reasons:

- Rising housing values provide a positive signal about the state of the economy and raise confidence.
- Backed by rising housing values, homeowners may decide to reduce their other forms of saving and spend more. Secondly, they may decide to borrow against their housing equity.

A rigorous study of the impact of wealth on consumer spending completed by three of the most respected housing market economists² estimated an impact of about 4% across the United States. This strikes this author as "about right". A 10% rise in housing values might cause consumer spending to rise by 0.4%.

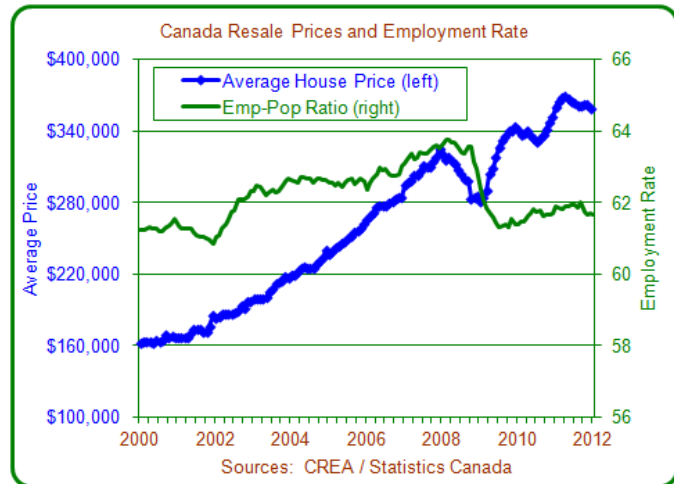
According to the 2006 Census, there were about 8.38 million owner-occupied dwellings in Canada, with an average value of about \$263,000. The aggregate value was just over \$2.2 trillion. Since then, the average home value in Canada has increased by about 31% in actual dollars and about 19% in inflation-adjusted dollars. **On this basis, "real housing wealth" per homeowner has increased by slightly more than \$50,000.** At a 4% impact, this would support a rise in real consumer spending of about \$2,000 per household. **Applied to 8.38 million homeowners, the impact on consumer spending is about \$17 billion.** This theory implies a 1.2% addition to GDP in Canada, with a corresponding impact on job creation.

CAAMP's consumer research is consistent with the academic research. In the fall of 2011, CAAMP's research (published in "Annual State of the Residential Mortgage Market in Canada") estimated that equity take-out by Canadian homeowners had amounted to \$28.5 billion in the prior year. However, about \$11 billion was for debt consolidation and \$3.5 billion was for investments. This left about \$14 billion for spending.

The next chart illustrates the relationship between employment and housing values in Canada. Employment is illustrated using the "employment-to-population ratio" (the percentages of adults who have jobs). In examining the data, it is also clear to the writer that there is a two-way relationship: rising housing values are good for the economy and a strengthening economy is good for the housing market. This "two-way causality" can sometimes result in instability: the interactions can add to the strength of an expansion or the severity of a downturn.

² Karl E. Case, John M. Quigley, Robert J. Shiller. "Comparing Wealth Effects: the Stock Market versus the Housing Market". 2005. Available here: <http://urbanpolicy.berkeley.edu/pdf/cqsadvmacro2005web.pdf>

This chart clearly shows a strong relationship between housing wealth and the employment-to-population ratio, through all phases of the chart. Housing wealth has demonstrably important impacts on the Canadian economy. This is especially noteworthy during the recession and in its aftermath. Canada experienced a drop for the average house price (about 10%), but it was short-lived. The less severe drop for house prices and the prompt return to price growth meant that the recession in Canada (based on the employment-to-population ratio) was only one-half as severe as in the US.



Moreover, the subsequent rise (albeit slight) of the Canadian employment rate illustrates that the economic recovery here has been stronger than in the US. However, the rate of recovery in Canada is more modest than we would hope for, pointing out that we face economic headwinds, including the impacts of a weak US economy on our exporters, a strong Canadian dollar (which makes it more difficult to compete internationally), and high prices for oil and other commodities (which negatively affect consumers and manufacturers of finished goods, although they are beneficial to producers of the commodities).

The Investment Motive

A further effect in the housing market is an “investment motive”. When housing values are rising and it is believed that there will be further rises, there is incentive to buy more housing. This applies to investors whose primary (and sometimes sole) motivation is future capital gains. But it can also include owner-occupants who decide to buy homes that are more expensive than they might otherwise. It can also affect lenders, who might become more confident about lending to buyers with marginal qualifications.

This author’s estimates suggest that at the peak of the US housing boom in 2006 about 20-25% of US home sales were attributable to the “investment motive”. Clearly, this was excessive: when a strong investment motive was inserted into the circular relationship between house prices and employment, a bubble resulted in many areas of the US. After the housing bust, the investment motive turned negative. Sales remain far below where they should be based on economic fundamentals: consumers have become reluctant to buy because they fear additional losses of value; lending criteria have become very tight, which has limited buying.

Among commentators whose expectations about the US are on the pessimistic side of the scale, the state of the housing market is frequently cited, including the negative wealth effect, the disincentive to buy an asset that might lose value (a negative investment motive), and excessive caution among lenders, which is keeping some potential buyers out of the market.

For Canada, it appears that there is a mild investment motive in many parts of the country. It might account for 2-3% of home sales nationally. This is not a dangerous level. Home buying in Canada is consistent with the state of the economy and with the very positive effects of record low interest rates. Moreover, as CAAMP’s research has found repeatedly, mortgage borrowers and lenders have acted prudently.

Owner-occupied housing represents a considerable pool of savings in Canada. **CAAMP estimates that total home equity in Canada (net of mortgages and home equity lines of credit) was slightly more than \$2 trillion in the fall of 2011.** Home equity is growing rapidly due to rising housing values plus pay down of mortgage principals (CAAMP's research finds that mortgage holders are making considerable efforts to repay their mortgages more rapidly than is required).

Conclusion

In Canada (and around the world) interest rates have been reduced to exceptionally low levels, in attempts to promote economic recovery. In Canada, much of the impact of low interest rates has been in the housing arena. Jobs have been created, through the immediate impacts of housing and mortgage activity (and ancillary activities). In addition, the stimulation of housing markets has brought growth of housing values at rates more rapid than would have occurred otherwise. This, through the wealth effect, has further contributed to job creation in Canada.

At the same time, the growth of house prices and an associated increase in mortgage indebtedness has led to concerns about risks to the economy. Fears are expressed that large numbers of Canadians will be unable to meet their mortgage obligations when interest rates "inevitably" rise. CAAMP has used data (from consumer surveys and from extensive databases of actual mortgages) to simulate the consequences of higher interest rates. These analyses indicate that borrowers and lenders have exercised foresight and there is considerable room to tolerate higher interest rates. One of the risks in the mortgage market can be characterized as "an unaffordable rise in payments". This is a negligible risk in Canada.

A more important risk is "reduced ability to pay". This arises from the broader economy: in the event of a recession that resulted in job losses in Canada, there would be an increase in the number (which is currently quite small) of Canadian homeowners who struggle to make their mortgage payments.

A housing market downturn, if and when it occurred, would affect the economy through direct job losses in construction, lending, and real estate services, plus the associated indirect and induced job losses. Moreover, in the event of a severe housing market downturn that brings substantial price reductions, losses of housing wealth would further impair the economy. Given the two-way relationship between housing values and the economy, there is a risk of a downward spiral similar in character to what the US has experienced. However, given the modest investment motive in Canada (in contrast to the US), the severity of a Canadian housing-induced downturn should be much less than in the US.

The best ways to support the housing market and to sustain its positive impacts on the Canadian economy are to pursue policies that create jobs. Secondly, we must avoid any policy changes that would artificially constrain housing activity or reduce the ability of lenders to provide mortgages to qualified buyers. The last thing Canada needs is a policy-induced housing market downturn.

About CAAMP

CAAMP is the national organization representing Canada's mortgage industry. With over 12,000 members representing 1,600 businesses, 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.

About the Author

Will Dunning is an economist (BA, MA), and has specialized in the analysis and forecasting of housing markets since 1982. In addition to acting as the Chief Economist for CAAMP he operates an economic analysis consulting firm, Will Dunning Inc.