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No housing crash for Canada: BMO

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Canada will likely avoid a crash or serious correction in its “somewhat pricey” housing market, with the possible exception of Vancouver, says a new paper from Bank of Montreal.

The analysis by BMO economists suggests alarms about Canada's housing market by international observers, from the International Monetary Fund to The Economist magazine, are exaggerated or simplistic.

“The main takeaway is that the national housing market appears somewhat pricey, but is far removed from a bubble,” said economists Sherry Cooper and Sal Guatieri in the report released Monday.

“In our view, the [market] is more like a balloon than a bubble. While bubbles always burst, a balloon often deflates slowly in the absence of a ‘pin'.”

Even Toronto's hot condo market – one of the subjects of many of the warnings – is more likely to cool rather than collapse, BMO said, noting that a sharp decline in construction for rental units is stimulating demand for condos.

The report estimates that half of new condos in the Toronto area are purchased by investors, and about 22 per cent are rented.

The one exception to the sanguine view appears to be Vancouver and parts of British Columbia, where home prices and demand from an influx of non-resident Chinese investment is elevating prices and construction. Home prices in Vancouver have climbed 159 per cent over the past 10 years, more than 50 per cent higher than the national average.

“Bottom line is, we expect the Canadian housing market to cool down rather than bust over the next couple of years, with the possible exception of Vancouver and parts of B.C. which will likely experience further correction,” Mr. Guatieri said in an interview.

By cooling, he predicted that prices, sales and startups will essentially be flat this year and likely next.

Housing has become an area of concern for policy makers over the past few years as Canadians continued to dip into the mortgage market to take advantage of historically low interest rates. As a consequence, household debt to disposable income has shot to more than 153 per cent, the highest ever and close to the levels reached in the United States before the subprime crash.

Earlier in the month, Finance Minister Jim Flaherty said he was prepared to intervene for the fourth time in six years if there is no let-up in borrowing.

The BMO economists say the government and Bank of Montreal are correct to worry about a continuation of the trend, but that is not likely. In fact, except for a few hot spots, that cooling trend has already begun with prices rising only 0.9 per cent last year. Home starts have also dipped well south of the over 200,000 level.

Nor is it likely that Canada will fall into another recession, or that interest rates would rise so quickly that a significant number of households would be unable to meet mortgage payments.

Canadian households are not as vulnerable as their American counterparts, the economists say.

Canadian home ownership equity is 67 per cent in Canada, compared with 39 per cent in the U.S., and even debt-to-income ratios are far better in Canada when the cost of health care that U.S. households must pay is factored in.

The report argues that many of the measures used by alarmists to suggest housing is due for a severe correction are exaggerated or simplistic.

On the important measures that gauge affordability, households are on firm ground. House prices to family incomes are elevated from 10 years ago, but not excessively so, at a ratio of 4.9 versus 3.2 a decade ago.

The exception again is Vancouver at 10, nearly double what it was a decade ago. Also elevated is Toronto at 6.7 versus 4.3.

“Let's assume the worst case scenario and house prices fall by 10 per cent, would that affect anything?” Mr. Guatieri asked. “There has been such an increase in house values that I don't think it would pose a serious problem for Canadians or the economy.”

Mr. Guatieri said the situation would become a problem if home prices and household debt continued to outstrip income growth, but trends on both fronts are moderating.