Housing Prices Were up 17% Last Month: Is This a Bubble?

Description

The average price of a Canadian home popped 17% in January compared with the previous year. Since 2005 housing prices in Canada have nearly doubled, while in the U.S., prices are roughly flat. The disparity is huge. The average selling price of Canadian house today is $470,000. In the U.S., its only $260,000.

This gap has caused many analysts to believe that the country is currently in its first real estate bubble in decades. If and when it pops, some fear that big-time lenders such as **Royal Bank of Canada** (TSX:RY)(NYSE:RY), **Bank of Montreal** (TSX:BMO)(NYSE:BMO) and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) may go the way of American banks during the last financial crisis, posting massive losses and watching their stocks sink 50% or more.

Will this possibility become a reality?

A tale of two Canadas

There are a few major differences between the current bubble in Canada and the one that popped in the U.S.

First, the price explosion seems to be happening in only a handful of regions, even down to a specific locale. For example, two cities (Toronto and Vancouver) seem to be skewing the entire market. Without them, the average Canadian home grew in value by only 8% with the average home selling for just $340,000. If you strip out the British Columbia and Ontario provinces altogether, the price of an average Canadian home actually dropped year over year to $287,000.

The issue, however, is a potential spillover effect. Provinces like Alberta and Saskatchewan haven't seen real estate bubbles because their economies are already in decline due to collapsing oil prices. The major regions that aren't reliant on commodities, namely B.C. and Ontario, could by pushed into recession if the real estate market collapsed.

If this occurs, nearly every major metropolitan area in Canada would be experiencing declines in wealth. This could have a severe impact on consumer spending and confidence, which would be more than enough to create a systemic crisis.

Here’s why things would turn messy

Even the Bank of Canada, which has an incentive to downplay a potential downturn, believes things are starting to look overheated.

“Recent momentum in prices in Toronto and Vancouver may increase the likelihood of a correction in house prices, which could affect vulnerable households,” it said. How could a real estate crash destroy the Canadian economy, even if it were contained in just a few areas?

A recent study by the Bank of Canada highlights a big area of concern. While housing prices have doubled over the past decade, so has private debt. For those under 45 years old, houses typically represent 90% of the value of their assets. About 8% of all households are carrying debt that is 350% or more of their gross income. The people with the highest levels of debt also tend to reside in regions where housing prices have exploded, specifically British Columbia and Ontario.

If the real estate market even hiccups there, it could have a domino effect fairly quickly given that homeowners are already stretched. While the big dividend yields are tempting, investing in Canadian banks carries a large amount of risk. Judging by what happened in the U.S., downside of 50% or more is not out of the question.

CATEGORY

1. Bank Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:RY (Royal Bank of Canada)
3. NYSE:TD (The Toronto-Dominion Bank)
4. TSX:BMO (Bank Of Montreal)
5. TSX:RY (Royal Bank of Canada)
6. TSX:TD (The Toronto-Dominion Bank)

Category

1. Bank Stocks
2. Investing

Tags

1. Editor's Choice

Date
2025/08/26

Date Created
2016/02/17
Author
rvanzo