Bank of Montreal (TSX:BMO) Just Declared a Housing Bubble: Is a Crash Coming?

Description

“Let’s drop the pretense,” says Douglas Porter, the chief economist at **Bank of Montreal** (TSX:BMO)(NYSE:BMO). “The Toronto housing market, and the many cities surrounding it, are in a housing bubble.” Later in the same report, he commented that Toronto home prices have seen “the fastest increase since the late 1980s, a period pretty much everyone can agree was a true bubble.”

Those are some pretty strong words for a well-respected economist who is typically fairly conservative in his predictions. For example, in 2016, a year when many bears were calling for a housing collapse, Douglas Porter was hesitant to call a bubble right then and there. “Da Bears may someday be right, especially on the hottest markets,” he said in a report a few years ago. “But getting the timing down is half the challenge.” He went on to predict continued strength in the housing markets, noting that demand for houses in Canada’s largest cities continued to outstrip supply.

So, after years of remaining skeptical that Canada’s housing market was in bubble territory, what’s made Bank of Montreal’s chief economist change his tune? Should you anticipate a crash in 2019?

Bubbles are appearing in more than Toronto’s housing market

Perhaps if Toronto was the only housing market in bubble territory, the potential fallout wouldn’t be so severe. Unfortunately, it’s looking like Canada’s third largest city, Vancouver, is beginning to show some cracks.

Swiss-based **UBS Group AG** recently released its Global Housing Bubble Index, which ranked Toronto and Vancouver in the top five international cities likely to be in bubble territory. Hong Kong and Munich were the only markets with higher risk ratings. Of major concern, the report noted that these bubbles might be ready to pop. “The first cracks in the boom’s foundation have begun appearing,” the report noted. “House prices declined in half of last year’s bubble risk cities.”

But if you’re waiting for a crash, keep waiting

Clearly, across multiple indicators, the housing markets in both Vancouver and Toronto have been overheated for an extended period of time. But as Douglas Porter noted in 2016, the bears have been consistently wrong for years. A recent report from **Royal Bank of Canada** (TSX:RY)(NYSE:RY) tells housing market bears “don’t hold your breath.” It went on to highlight that whenever stresses were introduced to the market, new buyers quickly “jumped back into the market,” stemming any temporary losses.

Perhaps that type of behaviour can't last forever, and it certainly can't persist at forever increasing prices, but the fact remains that calling a bubble is very difficult to do. But when bubble's pop, they can impact financial returns for long periods of time.

Over the past 60 years, for example, Toronto's housing market has seen three periods of multi-year decline: a five-year decline starting in 1958, an 11-year decline starting in 1974, and a 7-year decline starting in 1989. The most recent Toronto housing bull market has lasted for more than 20 years!

But beware: even small market dips can have outsized effects on Canada's banking stocks. During the 2007 and 2008 turmoil, housing prices were impacted for less than 12-months in Canada's largest markets. Yet the stocks of major banks fell as much as 70%. Bank of Montreal shares fell from $70 to $30, Royal Bank of Canada fell from $60 to $30, and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) fell from $35 to $18.

Bubbles may be hard to predict, but their impact on banking stocks are well-documented. If you're concerned with capital preservation but have investments in Canada's banking sector, now may be a good time to start taking some chips off the table.

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