Is a Housing Market Crash Likely Before 2021?

Description

Despite the global health crisis decimating our way of life and putting everybody in an economically uncertain situation, the markets seem to be faring well. Millions of people remain unemployed, and many businesses are not operating at full capacity. The markets are performing well due to the support offered by the government and the banking sector.

The Canada Emergency Response Benefit (CERB) ensures that unemployed Canadians still have money for monthly expenses. Mortgage and other deferrals offered by banks are further easing the financial pressure on them. While these measures are helping people, they can also turn out to be the reason for a significant crash before 2021.

I will discuss why they might result in a crash and what you could consider as an investor.

The problem with the solution

While the CERB is a fantastic relief for unemployed Canadians, it is also going to enlarge the government's debt as it continues to fund the CERB program. Even if the government decides to continue paying out CERB money, the banks might not feel as generous about the deferrals.

The government already decided to extend the CERB. However, banks offered mortgage and other deferrals to help Canadians when the pandemic was in its earliest stages. For many people, those deferral periods can run out in a few months. If that happens and there are no further deferrals, it can present more substantial challenges for the economy.

A combination of CERB and mortgage deferrals is the only thing helping Canadians. When it becomes time to start paying mortgages again, especially in pricier real estate markets like Toronto, a $2,000 per month CERB will not be enough to help people stay afloat.

Bad news for financial institutions

The inability to pay down debt could spell horrific news for banking stocks like the **Royal Bank of Canada** (TSX:RY)(NYSE:RY). RBC has approved deferrals for residential mortgages amounting to more than $47 billion — almost 20% of the bank's entire mortgage balance.

While significant banks have substantial credit reserves available for challenging economic times, the reserves might not last long if there is an extensive recession.

Economists from the bank took a closer look at the real estate market figures for sales in Canada and understand the bounce of sales could be overstated. The economists from the bank observed that the supply in the housing market could outpace the demand soon and lead to a major crash.

With a few months left for the year to end, a lack of positive development in the situation with dealing with the pandemic could lead to dire economic circumstances. An increase in listings without sufficient buyers coupled with a reduction in overall buying power for Canadians could lead to a massive decline in the housing market.

Foolish takeaway

If you own RBC shares, I would advise carefully recalibrating your position in the stock, depending on your short-term risk tolerance. While it is a well-capitalized financial institution, RBC is likely to see the massive short-term correction with another market crash. You can expect to see double-digit losses to your capital until the economy recovers.

A long-term investor should not have anything to worry about and continue holding the shares. For investors interested in the bank, you might have a fantastic opportunity coming up to buy RBC shares at a low price point in case of a crash.

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