Will Canada's Housing Bubble Finally Pop in 2020?

Description

Canada's housing bubble has been ready to burst for quite a while now. Even when no one knew the full economic repercussions of the pandemic, how thoroughly it would trample on the economy, people were talking about Canada's housing bubble bursting, and it's easy to see why. Canada's housing prices have grown at a monstrous rate.

To get the full picture of Canada's housing bubble, let's compare it to G7 countries, not only with the U.S. Between 1996 and 2005, there has been a lot of overlap in relative housing prices among the G7 countries, especially between the U.S. and Canada. But after the converging point in 2005, the trends differ significantly. Canada's housing prices started to grow exponentially, and apart from a small correction in 2008, and another in 2017, the prices have grown.

The disparity between Canadian prices and the rest is simply stunning. From 2005 to 2020, Canadian prices have risen by 88%. The only other G7 country that even comes close to this is Germany that saw 32.3% growth during the same 15-year period. Prices in the US are rising at a much steadier pace.

Will the housing market crash this year?

In 2020, the pandemic haven't done a lot to contain the roaring monster that is the Canadian housing market. July 2020 saw more residential sales than any individual quarter since 2015. Consequently, the average prices rose by 14%, compared to July 2019 prices. Quebec and Ontario took the lead in the highest rise in average prices, while the average price in Newfoundland and Alberta barely budged. The inventory has fallen to its lowest levels since 2016.

Understandably, Canadians would want to jump on the low interest rates, but the sales in July were still quite unprecedented. Many people assume it's because the season started relatively late during the COVID-19. But just because the housing market hasn't crashed yet, doesn't mean it won't anytime soon.

Toronto-Dominion Bank has forecast that Canadian home sales will take a deep nosedive. The bank predicts that in the next two or three quarters, home sales might drop to one-third of what it is now. The recovery would be V-shaped. If this comes to pass, it would the bubble burst that many Canadians have been waiting for.

Should you invest in real estate?

While having a tangible asset would be advisable, it requires a massive amount of capital. And in the current situation, you might be better off with an aristocratic REIT like **SmartCentres REIT** (TSX:SRU.UN). In the second quarter, the REIT suffered a loss of $133 million, mostly because of the fair value adjustments of investment properties. NOI and FFO decreased by $19.9 and $16.5 million, respectively.

The losses are justified, mostly because of the nature of SmartCentres retail tenants. The retail business suffered a lot during COVID-19, due to minimal foot traffic. But the company has a strong balance sheet, and it's likely to recover once the fear of the pandemic starts receding. It has 166 properties, 115 of which are anchored Walmart.

Foolish takeaway

If you had plans of buying your first home and take advantage of the current interest rates, you might be better off waiting for a while. The bubble will most likely burst within a couple of years. It may not be as soon as TD predicted.

Still, the full blow of an economy recovering from the pandemic and other factors like lower immigration numbers, purchasing power, and defaulting mortgages because of income loss will contribute to the downward motion of housing.

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