Canada Is Due for an Abrupt Housing Crash in 2020

Description

The Canada Mortgage and Housing Corporation (CMHC) issued a letter that encouraged lenders in the country to stop offering mortgages to so many high-risk borrowers. The letter is a reminder that it fears investors in Canada’s housing market could soon suffer the consequences of a major market correction.

Don’t lend so much to everybody

In the letter, CMHC talked to the lenders about the importance of becoming more strict about how much money they are willing to lend for funding home purchases. It also asked them to be more diligent about who they are lending the money to in the first place.

The CMHC does not directly loan out money to buy homes. Still, it has a significant influence on Canada’s housing market. The agency insures a substantial chunk of the loans that lenders give to borrowers. High-risk borrowers with down payments of less than 20% of their purchase price must have mortgage insurance to cover potential losses. The premiums they need to pay can add several thousand dollars to their overall cost for buying a home.

The CMHC raised its standards for giving out insurance by increasing the minimum credit score it will accept and a limit on the gross debt ratio for borrowers to qualify. It also banned using borrowed money for down payments.

The agency tried to make it more challenging to take insured loans so that borrowers would not make reckless financial decisions. Despite the introduction of strict regulations, many Canadians who cannot afford to buy a house are still trying.

Another major crash

COVID-19 devastated every aspect of the Canadian economy, but the housing prices have not yet fallen like other sectors. The average prices remained flat in March and April compared to last year’s prices. However, the prices went up in May and June compared to last year.

The most significant reason that the prices are so high is due to programs like Canada Emergency Response Benefit (CERB) and Canada Emergency Wage Subsidy (CEWS) helping Canadians stay afloat. It is leading to borrowers making bolder decisions without being financially sound. It could lead to a crash, as the programs will eventually expire.

If a major market correction takes place, there is no doubt that the entire economy will feel the effects. Mortgage-heavy companies trading on the TSX could suffer the most losses amid a housing market correction.

A stock to stay away from

If the housing market crashes, it could cause severe short-term problems for Canadian banks that rely heavily on mortgage interest for income. A bank like **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) could take a massive beating if the housing market sees trouble.

While CIBC is a well-capitalized bank, it has the most exposure to Canada's housing market among the major financial institutions. It could be leading the downward charge for banking stocks if the housing market declines. The bank may be a safe long-term investment, but it presents a substantial risk if you have a short investment horizon.

In the last crash, CIBC cratered and fell by almost 40%. At writing, it is trading for $98.99 per share, and it is up 45%. It is offering a juicy 5.90% dividend yield. Its share prices can see another steep fall if the housing market sees a correction.

Foolish takeaway

I cannot predict when the housing market will crash. The conditions look ripe for a significant correction in housing prices. It could lead to an overall decline in the stock market. I would advise reconsidering your position in several companies that rely heavily on the housing market. CIBC could see substantial short-term pain amid a housing crash. It could also be an excellent value buy in the long run.

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