Housing Bubble: Will it Pop Soon?

Description

Speculations are rife not only of another stock market crash but also a housing bubble popping soon. In May 2020, Evan Siddall, CEO of the Canada Mortgage and Housing Corporation, told the House of Commons's finance committee that home prices could fall by between 9% and 18% from their pre-COVID-19 levels over the next 12 months.

Data shows that Canada's real estate prices have grown at almost triple the pace of any G7 country since 2005. From 2005 to 2020, the increase was 88%, whereas home prices in the U.S. grew by only 3% over the same period. Germany posted the second-highest growth (32.3%), which is just one-third of Canada's very high gain.

Rapid increase

The acceleration started around 2015 when Canada recorded a 50.5% price growth from 2005 to 2015. After the 2008 global financial crisis, the country leaned toward non-productive investment. In terms of residential investment to GDP, the rate more than doubled from 2000 to 2020.

Real estate transactions in 2019 were generating roughly over 50% of all GDP growth. It appears the government is allocating a considerable amount of resources to shore up home prices during this recession. However, the global pandemic might bring prices down. In Q1 2020, real estate price growth at the national level was 3.39%.

Potential impact

If the coronavirus shakes up the housing market, it will impact Canadian retirees and new home buyers. Some retirees are planning to fund their sunset years with equity in their homes. New home buyers will end up with depreciated real estate properties.

Furthermore, many businesses rely on home purchases. If home sales and prices drop, the collateral damage is on banks, construction firms, and furniture stores, among others. Meanwhile, people are waiting for home prices to fall. For first-time home buyers with the fear of missing out, a housing market crash is the perfect moment. They can purchase their unaffordable dream house.

Profitable investment

Investors are wary of banks in the stock market, including **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), because of high exposure to the mortgage market.

CIBC's CFO Hratch Panossian, assures the bank has adequate credit provisioning for souring loans. Chief Risk Officer Shawn Beber adds that an increase in mortgage delinquencies will not translate to material losses. CIBC's mortgage portfolio was stagnant in the last two years, but the balance rose 3% to $207 billion in the most recent quarter.

In Q3 fiscal 2020 (quarter ended July 31, 2020), CIBC reported solid financial results. The total revenue of $4.7 billion and $1.17 billion net income fell short by only 0.5% and 16.16%, respectively, versus the same period in 2019. The capital markets division recorded a 67% increase in net income (from $157 million to $392 million) year over year.

CIBC remains a profitable option for would-be investors. The fifth-largest lender in Canada pays a high 5.61%. Also, the bank stock's dividend track record of 152 years should lend comfort.

No bubble burst

The housing bubble isn't about to pop as people would expect. Both supply and demand are declining together due to COVID-19. With many Canadians still unemployed, potential home buyers will not risk incurring added expenses on land transfer taxes, movers, and furniture.

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