Is the Canadian Housing Market About to Change Course?

Description

The Canadian housing market has been hot for the last several years. Last year, it seemed that the pandemic could be the one factor that would hamper its record run. But the housing market gained momentum due to the pandemic. Concerningly, the Bank of Canada governor has now started seeing this exuberance as excessive.

Canada housing market in 2021

According to a *BNN Bloomberg* article, governor Tiff Macklem said that there are early signs that people are buying real estate solely on the expectations of higher prices in the future.

Interestingly, Tiff Macklem last month said that he is not concerned about the rising housing market. “So far we are not seeing the kind of excessiveness in the housing market that would really get us worried,” he said last month.

Notably, the consistent increase in the Canadian housing market is indeed concerning. Various agencies and analysts gave gloomy views last year. Despite the weakness, the housing market kept heating up from mid-last year and is still going strong this year.

Housing market crash and interest rates

The main reason behind the exuberance is the record-low interest rates. The central bank’s key policy rate is at 0.25% since last year. Notably, when housing markets collapsed in 1990, mortgage rates were close to 13%, significantly higher than current levels.

So, such low rates increased affordability, while people spending more time at home due to closures fueled the demand. Thus, there are fundamental factors that are driving Canada’s housing market this time.

Risks for the Canadian housing market

Indeed, those same factors pose a serious threat too. As we move to normalcy, probably in the second half of 2021, more people will get back to offices and could hamper hosing demand.

If the economy recovers faster than expected, central banks could raise rates earlier. Higher rates will likely dent the affordability. Though the rate hike will be very slow, it will certainly dent consumer sentiment.

Additionally, how debt repayments play out post-pandemic, particularly after government stops stimulus checks, will also be interesting to see.

Bet on diversified REITs

So, if we try and connect the dots, the Canadian housing market seems overheated and could see some weakness later this year or in 2022. However, a crash seems unlikely at this point because of the lower rates and strong demand.

Canadians can consider betting on the real estate sector with some safer options. Consider **iShares S&P/TSX Capped REIT Index ETF** (TSX:XRE). It is a diversified mix of REITs that gives exposure to residential, healthcare, and industrial REITs.

XRE unit is down almost 20% against its pre-pandemic levels. This could be an attractive opportunity for real estate investors, given the impending broader economic recovery. **Canadian Apartment Properties Real Estate Investment Trust** is the biggest holding and forms almost 16% in the fund.

XRE gives you exposure to multiple REITs at once. So, even if the industrial real estate sector underperforms, it should be compensated by other holdings in the fund focused on residential or healthcare real estate sectors. Diversification lowers the risk while increasing your potential for higher returns.

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