Is a Canada Housing Correction Imminent?

Description

When 2021 started, I'd explained why the Canada housing market was well positioned for yet another banner year. Sales and prices have erupted in the first three months of 2021. Readers have undoubtedly seen extreme examples where some houses are going for more than half a million over asking. Today, I want to discuss whether a correction is coming in the Canada housing space.

Why Canada housing has erupted over the past year

The COVID-19 pandemic had a devastating impact on many economic sectors. Initially, some analysts and economists expected the Canada housing market to suffer a sharp correction due to the crisis. Indeed, sales and prices did retreat in the initial phases of the pandemic in Canada. However, the federal government would go on to provide substantial support to citizens as job losses ballooned. The Canada housing market regained momentum on the back of pent-up demand, historically friendly credit rules, and consistently low supply.

Stocks like **Equitable Group** (TSX:EQB) have flourished in this environment. Equitable Group is one of the largest alternative lenders in the country. Its shares have increased 18% in 2021 as of early afternoon trading on March 31. The stock is up over 110% from the prior year. Equitable Group achieved record earnings in 2020. Diluted earnings per share rose 8% to $12.95. The stock still offers a favourable price-to-earnings ratio of 9.7 at the time of this writing.

What can stop the red-hot market right now?

Top financial institutions have started to sound the alarm as the Canada housing market continues to roar. **Royal Bank** economist Robert Hogue warned of "overheating": "Demand is exceedingly strong, inventories are generally low, and property values have soared to levels far outside historical norms. Making matters worse: buyers and sellers expect prices to continue to escalate."

Hogue has called for the government to step in and introduce reforms. **Bank of Montreal** senior economist Robert Kavcic said that policy makers need to take action to break "market psychology and the belief that prices will only rise further." The report outlined some potential cooling measures. These included taxes, higher interest rates, and making the blind bidding process transparent.

Earlier this month, I'd predicted that the only thing that would stop the red-hot Canada housing market was government intervention. Calls for intervention are mounting, but the Bank of Canada has not been eager to step in. Housing is one of the few sectors that has thrived in the wake of the pandemic. Policy moves to cool the market will require a very delicate touch.

Which way should investors bet?

It is difficult to predict the path of policy makers right now. Raising interest rates appears out of the question as Canadians wrestle with this historical crisis. The introduction of new taxes is always a touchy political subject. Moreover, tweaking the bidding process will do little to sway the conditions that are generating this frothy Canada housing market. High demand, loose credit policy, and low supply are the main factors that are driving this broader increase.

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