



Bank of Canada's Warning to Potential Homebuyers: You're About to Go Into a Tonne of Debt

Description

Notwithstanding the inflated prices of homes, many Canadian homebuyers seem undeterred in their mission to buy a house.

But the Bank of Canada, along with many of Canada's top banks, are clear: if you buy a house now, you're taking a big risk. That's partly because houses are absurdly expensive right now. And it's partly because an expected rise in interest rates may leave Canadians more indebted than they thought.

If you're thinking about buying a house, let's look at two stern warnings issued by the Bank of Canada at the end of last year, suggesting why now is not the best time to buy a home.

Warning #1: Homebuyers' expectations are extrapolative

In his speech to Ontario, Deputy Governor of the Bank of Canada Paul Beaudry gave a stern warning to homebuyers: certain regions of Canada, he said, could experience a market correction sometime in the near future.

Though he didn't give any dates, he did point to a concerning phenomenon: the extrapolative expectations of homebuyers.

Recall that "extrapolative expectations" means that a consumer or investor uses an asset's recent past to predict its performance in the future. In the context of home buying, this means that homebuyers believe the last two years of real estate appreciation will continue into 2022.

As Beaudry points out, this leads homebuyers to fear they're "missing out" if they don't jump into the real estate market today. Prices could go up indefinitely, they think. By not buying today, they could curse themselves for waiting.

Though some surveys do suggest prices will go up this year, it's not guaranteed that they will grow at the same rate they did last year. In fact, research suggests that the rate at which prices are growing

will no longer accelerate in 2022 but rather decelerate: prices may climb, but they'll climb at a slower rate.

And then there's the crediting agencies, **Fitch** and **Moody**, that have long warned Canada's hottest market are severely overvalued. Could homes really climb to higher levels, becoming even more overvalued? Beaudry seems to think *no*.

Warning #2: Indebtedness

Beaudry issued a second warning, one that was perhaps more stern than the first. Canadian homebuyers, he warned, risk going into deeper into debt.

Canadians who stretched their budgets to buy a house in 2020 and 2021 may now be exposed to rising interest costs. "The debt that households accumulated at unusually low interest rates will stay with them well into the future," Beaudry said. "In the meantime, interest rates can be expected to rise as the effects of the pandemic dissipate and excess capacity in the economy is fully absorbed."

Beaudry is also worried that Canadians will have little to fall back on should an unexpected event derail their finances. He cites a "job loss" as a primary concern. If you bought a house under the expectation — extrapolative, perhaps — that you will have the same income in the future, what happens if you *don't*? The same could be said for Canadians who rely on a second job, passive income, or investment earnings to supplement their primary pay. Any kind of disruption in the market could leave cash-strapped Canadians in a precarious position, at least with that massive mortgage attached to their ankle.

These warnings were issued in 2021: Are they still relevant?

Though, yes, Beaudry gave these warnings in a speech at the end of 2021, they are still relevant in 2022 — even more so, in fact, than they were before.

Most of Canada's top banks have warned homebuyers now is not the best time to buy a house. Let that sink in for a second. The people who are making money off your decision to buy a home are telling you not to do it.

Imagine if you went to a car dealer, and the dealer told you the car you wanted to buy was going to depreciate by 25% the moment you drove it off the lot. It's not a good decision, they tell you, but if you want it, you'll have to pay the full price. Contrary to what we might hope for ourselves, if we *really* wanted that car, we'd probably pay more than the asking price.

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