Hilliard's Weekend Notebook

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The Bank of Canada says housing markets are frothy

The Bank of Canada (BOC) Governor Stephen Poloz spoke on May 6, 2019 to the Chamber of Commerce in Winnipeg. He gave some detailed comments about housing markets in Canada. He called the housing market "frothy", continuing the tradition of refusing to call the housing market a "bubble". But the BOC appears to be concerned.

As Poloz said in his speech, "the most important financial decision most Canadians make is the decision to purchase a home and to take out a mortgage to do so."

Is the Bank of Canada ready to acknowledge the existence of a massive housing bubble? Do the economists at the BOC have a realistic view of housing markets?

Even before this recent speech there were signs that central bankers were waking up to the dire situation that Canadians face in navigating the dangerous waters of a housing correction. The BOC has signaled that it's ready to move quickly with rate cuts, a reversal of their 2017 and 2018 policy.

I wrote about this 180-degree shift in attitude. You can read that here.

Anyone who watched the economy while thinking about the implications of the bursting of the housing bubble knew that the BOC's prediction of more rate hikes was on shaky ground. But mainstream economists working at the central bank are viewing the economy with a huge blind spot.

Believe it or not, economists ignore money, banks and debt in their models.

Here is an interview with Professor Richard Werner, @ProfessorWerner, that explains how flawed those models are.

So, let's look more closely at some things said in Winnipeg, keeping those flaws in mind. You can read the entire speech here.

He said, "we saw housing booms in Toronto and Vancouver, both of which were experiencing strong population and employment growth and supply constraints on new housing." This is the standard explanation of housing market froth.

But that standard explanation is also wrong. Toronto was experiencing steady population growth at 1.0% to 1.5% in the 2016 census, but Vancouver's growth was less than 1%. In contrast, Edmonton and Calgary experienced more than 2%+ annual population growth. And yet Alberta house prices are flat to lower. And, regarding supply constraint, the number of units built and the percentage of GDP devoted to housing construction have stayed elevated, near record levels, for most of the last decade.

But the real causes, such as the generous supply of new mortgage money, the regulatory rules that allowed large mortgages, the subsidy to lenders from mortgage insurers and the encouragement from lenders and others for young couples to take on what will turn out to be crippling indebtedness are not considered in the BOC model, so they must reach for other narratives to explain something their models cannot.

In the speech Mr. Poloz focuses on a change in the public's housing price expectations, and the interaction between the "froth" in the market and lending guidelines and interest rates.

He ends his comments with this; "We conclude from all this that the fundamentals of the housing market remain solid, and growth will resume once the reduced expectations for house price inflation and the new mortgage guidelines have been absorbed."

In other words, a soft landing. But if the "soft landing" camp is right, the housing and debt bubbles will resume their upward trajectory after a short pause, making housing even more unaffordable and debt loads even more dangerous.

The Bank of Canada policy makers are not ready, yet, to accept responsibility for their part in creating and fostering one of the biggest and most dangerous housing bubbles on the planet.

Therefore, Canadians should be aware that their chances of getting rescued are slim. It's likely that Canadians will have to face the housing crash alone.

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