Bank of Canada gets blunt about real estate prices in Vancouver and Toronto

By David Parkinson
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It's been a long time since a Bank of Canada governor gave Canadian households a stern talking-to. But that's what Stephen Poloz just did – at least to the good people of Vancouver and Toronto.

The Bank of Canada used its twice-a-year Financial System Review to seriously step up its game on addressing the housing problem, or, more specifically, the Vancouver and Toronto housing problem. Because the rest of the country doesn't have a housing problem. But given the central bank's new elevated tone on the issue, maybe Vancouver and Toronto's problem is big enough for all of us.

In both the FSR and in his own comments at a press conference Thursday, Mr. Poloz said the pace of surging prices in Vancouver and Toronto "is unlikely to be sustained." In the central-banking world, where every new choice of words is significant, that is positively seismic. It's as close as you may ever get to hearing this central bank say "bubble."

If that was all of it, this FSR would have represented a substantial elevation of the bank's position on the housing situation. But Mr. Poloz didn't stop there. Not even close.

He stressed that the price increases in Vancouver and Toronto far outstrip any underlying fundamentals – things such as population growth, wage growth, economic expansion and housing supply restrictions – that might justify higher prices.

He said both buyers and lenders in those two markets are increasingly using the accelerated pace of prices as the basis for their expectations for future gains – and pointedly warned them against continuing to do so. "We think that those expectations are probably not going to be realized."

It's a rare and unmistakable shot across the bow. The Bank of Canada has seen all it cares to see of the real estate frenzy gripping the country's two biggest housing markets.

You have to go back to 2009 and Mr. Poloz's predecessor, Mark Carney, to find the last time a Bank of Canada chief launched a public scolding campaign at Canadian households over their imprudent debt levels. Throughout his tenure that began in 2013, Mr. Poloz has been consistently concerned about high household debt levels, fuelled largely by rising mortgage debt, but he has typically been understanding. After all, the bank's years of a low-interest-rate policy not only encouraged all that debt growth, but has kept it largely manageable for most Canadians.

But the madness in the Vancouver and Toronto markets in recent months has raised the stakes. Since the last time the central bank issued an assessment of the housing market risks in its December, 2015 FSR, the year-over-year gains in house prices in Ontario and British Columbia have risen from less than 10 per cent to nearly 20 per cent. Greater Vancouver's year-over-year pace is a head-spinning 30 per cent, double what it was six months ago.

Thursday's report even included a special explanatory box outlining the central bank's analysis of what the fallout would be if housing prices suffered a serious downturn, testing scenarios of a 15-per-cent and a 25-per-cent drop. (Bottom line: Both the financial sector and most households would be able to weather it.) Mr. Poloz later stressed that the bank isn't predicting an outright downturn in prices, only a slowdown in price increases, but the mere fact that it is now publishing analyses on how a price slump would play out tells you all you need to know about the bank's rising concern on the housing front.

"It's our perception that [the risks] are growing," he told reporters, in case you needed it spelled out.

Mr. Poloz will now have to hope home buyers, real estate speculators and lenders heed his strong message. Because, frankly, there's not much else he can do at this point to influence the pace of those housing markets.

Much like Mr. Carney in 2009, Mr. Poloz is handcuffed by a fragile economy that is in no position to absorb increases in interest rates, which would be a very effective tool in slowing the housing sector but would also choke off growth in a wide range of other sectors. Besides, higher lending rates would also affect housing markets in all the other parts of the country that aren't in need of taming at all.

So Mr. Poloz is hoping to use his powerful office to adjust the thinking of housing market participants. It's not the first time a central bank has turned to moral suasion as a form of soft policy to try to slap some sense into overheated markets.

Will it work? The collective shrug in the bond and currency markets on Thursday suggests that few participants read Mr. Poloz's words as a prelude to more concrete policy action. But the risks Mr. Poloz is talking about aren't just rhetoric, they're real. Unless something persuades Vancouver and Toronto to cool their heels, this isn't likely to end happily.