Banks spot evidence of a housing bubble. What took so long?

By Ian McGugan
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So all of us can finally agree: Toronto's home prices constitute a ticking time bomb. The question is, how do you defuse that high explosive?

Over the past couple of weeks, economists for major banks have lined up to offer their ideas. Their flurry of suggestions provides a stirring display of public-spirited ingenuity – although observers might be tempted to ask where all that mental acuity has been lurking.

Just a few months back, bank economists were still ferocious contenders in an unofficial contest to offer the most reassuring voice on soaring Canadian housing prices. They may now profess to be shocked – shocked! – at evidence of speculation in the Toronto real estate market, but they cannot say they were not warned.

Outside observers such as the International Monetary Fund and the Organization for Economic Co-operation and Development have sounded the alarm for years about surging Canadian real estate prices.

Despite those warnings, Canada's own financial-industry experts remained steadfast believers, until now, in the unfettered market. They argued that stratospheric prices in centres such as Toronto and Vancouver were amply supported by strong population growth, low interest rates and limited supply.

If it was not for the well-established fact that Bay Street economists are all scientists engaged in a clinical pursuit of truth, one might have been tempted to wonder if their employers' huge mortgage businesses were a motivational factor in their opinions.

Such slanders, of course, would be just silly. As bank economists tell it, it was not them who changed. It was the data.

Even the most ingenious economist can find it challenging to explain how real estate prices might rationally jump 23 per cent in a year, as Toronto's just did, according to the most recent data from the Teranet-National Bank House Price Index.

"Something happened in 2016," as Benjamin Tal of CIBC puts it in a recent note. There might now be – brace yourself – "some evidence of speculative activity," according to Jean-François Perrault and Adrienne Warren of Bank of Nova Scotia.

As a result of the past few months' data, bank economists have been flipping their opinions on the Toronto housing market. Remarkably, though, they offer little consensus about what to do next. It was as if this is the first time they have considered the possibility that a market might be overvalued.

Warren Lovely of National Bank Financial argues that it is time to look at a tax on transactions by foreign buyers as well as a levy on empty homes.

For their part, the Scotiabank duo favour boosting supply through a streamlined approval process for developers, as well as crimping demand by imposing heftier taxes on all housing speculators, domestic or foreign.

In contrast, Mr. Tal of CIBC disagrees with proposals for a foreign buyers' tax, but sees a case for greater incentives for building rental units. The team at Toronto-Dominion Bank, meanwhile, proffers a myriad of possible policies, ranging from a foreign-buyers' tax to higher requirements for down payments.

The range of proposals shows how tough it is to tame a runaway housing market in which buyers have been conditioned to expect strong gains, year after year. "If anything, Vancouver's housing market has regained its footing surprisingly fast" after the imposition last year of a foreign buyers' tax, Mr. Lovely of National Bank observes.

Still, it seems clear Canada could be doing some things far better. Most notably, it could improve its tracking of the real estate market. "There is no solid data on the number of foreign buyers in [Toronto]," the Scotiabank team writes. That is rather shocking after years of international warnings about the dangerous state of the Canadian housing market.

Just as shocking is the evidence that banks are only now starting to worry about the possible after-shocks from soaring home prices.

"Historically, it's difficult to find a period across U.S. and Canadian markets where sustained home price growth of this magnitude was not followed by a period of contraction," the TD Economics team concluded on Monday in a report about the Toronto housing market. "The longer the cycle runs, the greater the risk of contraction."

Well, yes, exactly. But that warning might have sounded even better a couple of years ago.