Editorial – Pop Canada's housing bubble, before it pops the economy

April 15, 2017 – *The Globe and Mail*

History doesn't repeat, but it sure does rhyme.

Revisiting the bubble and bust of the American housing market in the early 2000s, and the financial crisis and Great Recession that followed, doesn't tell us exactly how today's housing bubble will end. And recalling how Toronto's housing prices exploded in the 1980s, and then cratered, doesn't precisely predict what Toronto housing will do in 2017 and beyond.

But there's every reason to believe that, if today's housing bubble is allowed to burst, the sound it makes, and the fallout it leaves, will be familiar. We may not have seen this particular movie yet, but we've seen all the prequels.

Over the past year the housing bubble in the Greater Toronto Area has evolved from a question mark to a flashing, screeching, neon-red exclamation point. It's no longer possible to ignore.

In March, home prices in the GTA – for both houses and condos – were up 33 per cent compared with a year earlier, according to the Toronto Real Estate Board. The Teranet-National Bank index, using a different methodology, has GTA prices up 25 per cent. It also shows the impact spreading through Southern Ontario. In the year to last February, prices rose 29 per cent in Oshawa, 26 per cent in Barrie, 20 per cent in Hamilton and 24 per cent in St. Catharines.

Something similar is happening in British Columbia. Metro Vancouver's housing prices, long the most bubbly in the country, actually reversed course late last year, after the B.C. government brought in a tax on foreign buyers. But due in part to measures watering down and counteracting the tax, Vancouver prices are rising again – and the pace of increases in Abbotsford and Victoria is outpacing those in Vancouver.

National Bank economist Stéfane Marion recently wrote that "close to 55 per cent of regional markets in Canada are reporting price inflation of at least 10 per cent. This record proportion is very similar to that observed in the United States in 2005, at the peak of the market."

No, the Canadian banking system in 2017 is not the U.S. banking system in 2005. There are no "zero income" loans, buyers have more equity in their homes, and Canada does not have "no recourse" mortgages that underwater owners can simply walk away from. No, history is not going to precisely repeat. But every economist and housing analyst is looking for a Canadian phrase that rhymes with "American housing crash."

It's why the ratings agency Moody's describes Canada as being at risk of a housing price correction. It's why Bank of Canada Governor Stephen Poloz this week called Toronto's price frenzy "unsustainable," and described it as being driven by "speculative demand or investor demand, as opposed to just folks that are buying a house."

"There's no fundamental story that we could tell to justify that kind of inflation rate in housing prices," he said. The economy is growing, but hardly booming. Average wages are barely rising. And yet Toronto home prices are on a record tear.

What to do? On Tuesday, federal Finance Minister Bill Morneau is to meet with his Ontario counterpart, Charles Sousa, and Mayor John Tory of Toronto.They've got to take action. And they've got to take the right action.

This is a national issue, threatening harm on the national economy and the national banking system. But the site of the problem is localized in Southern Ontario, and to a lesser extent B.C.

Home prices in Greater Montreal, Canada's second largest city, are up by a mere 3.5 per cent in the last year, according to Teranet-National Bank, and are no higher today than they were in mid-2014. It's a similar story in Calgary and Edmonton: Both cities are cheaper than they were at the market peak of a couple of years ago. Halifax? Prices are below 2013 levels. Ditto Quebec City.

That's why a one-size-fits-all, national policy can't work. Mr. Poloz said this week that higher interest rates, while slowing to an already sluggish Canadian economy, would do little to cool Southern Ontario's speculative frenzy.

"When you're looking at making an investment that you think will make you 20 per cent or more over the next 12 months," said the Bank Governor, "and you have to borrow the money to make that investment, is a quarter point or a half a point (in extra interest) going to make a difference?" No, it isn't.

Toronto and Ontario have to learn from B.C.'s experience – both positive and negative.

Yes to a foreign buyers' tax: This isn't anti-immigrant, since it doesn't apply to immigrants. It isn't anti-foreign investment in productive Canadian assets, like new plant and equipment. But the overheated housing market is already oversupplied with buyers. And B.C.'s foreign buyers' tax did cool overall market psychology, at least at first.

Vancouver also has a tax on empty units, to encourage owners to rent out unoccupied homes. It's a reasonable step.

No to accidentally boosting prices: Politicians love to talk about housing affordability, and those running for re-election love to address it by handing out subsidies to first-time buyers. That's what B.C. did late last year. Problem: Taxpayer subsidies to first-time buyers have the unintended consequence of pushing up home prices.

Don't get bamboozled by developers: Every developer in history wants "less regulation," and sometimes they're even right. But at the moment, there's little evidence that the GTA is undersupplied with new housing construction. There's no shortage of land to build on, and there's been so much new building over the past few years that the ratio of homes-to-people in Toronto has been rising, not falling.

Act now: Toronto is gripped by a speculative frenzy. The frenzied enemy is all of us. Buyers and sellers are behaving as if prices were going to the moon, but they aren't. They can't. Policy has to bring the housing market, and all of us, back down to earth.