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Postcard from Toronto

Another outpost of the British Commonwealth is showing what a bear market in residential real estate might look like (*Grant's*, Feb. 9). Across the Dominion of Canada, sales dropped by 13.9% year-over-year in April, marking their worst April showing since 2011, according to the Canadian Real Estate Association. As for prices, the Teranet–National Bank House Price Index is up by 5.6% from a year earlier, largely thanks to last summer's outsize gains. Still, that rise is the smallest one since August 2015 and represents the tenth straight deceleration from last June's record year-over-year advance of 14.2%.

The national average obscures big swings across cities and provinces. The Toronto Real Estate Board reports that May's sales declined by 22% year-over-year, with a 6.6% slip in prices to boot. Levitating prices in Vancouver disguised an even greater lag in activity, with sales plunging by more than 35% year-over-year, according to the local real-estate board. The 2,833 transactions in May were almost 20% below the 10-year average for the jewel of British Columbia.

Tightening regulatory and monetary conditions are the cooling agents in Canada's formerly blistering market. Last fall, the Office of the Superintendent of Financial Institutions introduced the so-called B-20 regulations, which subject all mortgages to an interest-rate stress test. Futures markets are projecting a 65% chance of at least two 25 basis-point hikes in the Bank of Canada's overnight lending rate by year-end. That's on top of the three which, since July, have lifted the rate to 1.25%.

Those tightening conditions, slight though they may seem, have already made waves. Christina Kramer, executive vice-president of the Canadian Imperial Bank of Commerce (a.k.a. CIBC; CM on the Toronto Stock Exchange), told dialers-in to the May 23 second-quarter conference call to expect a 50% year-over-year cut in mortgage originations in the next half of the year. More broadly, M-2 money supply, which has grown by 96% over the past 10 years compared with 82% in the United States, has declined in the first four months of the year from December's record C$1.6 trillion. Household credit growth, which has generally remained over 5% on a three-month annualized basis throughout the decade, has rolled over, falling to well below 4%.

Via email, Hilliard MacBeth, author of *When the Bubble Bursts: Surviving the Canadian Real Estate Crash* (the second edition of which will be released on June 23) and paid-up subscriber to *Grant's*, tells colleague Phil Grant:

> When debt is created by commercial banks to finance housing, the money supply expands. Loan growth at a 7% per annum average over 18 years backed by residential real estate has been a major contributor to Canadian GDP growth, allowing Canada to experience a very mild recession in 2008–09. Since the GFC Canada's debt growth has been exceptional among developed countries, especially in the private sector, the BIS singled out Canada as the country most at risk of a financial and banking crisis due to this rapid growth.
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> When growth in debt slows, it has the opposite impact, putting the economy at risk of a recession, or worse. The coming slowdown in the Canadian economy will be much worse than in 2009 as credit will be contracting and debt levels are at unprecedented levels. We would have to look back to the early 1990s or even the 1980s to find a comparable period. And the housing and debt bubbles are much bigger than [they were] prior to those downturns.

Evidence of a broader slowdown is beginning to appear. First-quarter real GDP rose at an annualized 1.3%, well below the consensus 1.8%, as household consumption growth dropped to 1.1% from 4.0% in the first period of 2017. Last week, the annual CIBC Home Renovation Poll found that Canadian homeowners plan to spend C$11,000 on renovations this year, down from C$11,800 and $13,000 in 2017 and 2016, respectively. In addition, just 44% of the respondents said they planned to pay for the improvements in cash. Last year, 67% so indicated.

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