

REAL ESTATE: CANADA LESS VULNERABLE

## Housing markets on shaky ground

Prices don't reflect economic fundamentals in most developed countries, IMF warns

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There's no shortage of housing markets that look like bubbles waiting to burst, but economists say Canada has become one of the safer places in the developed world to own residential real estate.

In the aftermath of the global credit crunch Canada is less vulnerable to a large drop in house prices than any other major advanced economy except Austria, according to the Washington, D.C.-based International Monetary Fund's World Economic Outlook.

"I'd be much more worried if I was from Barcelona than if I was from Toronto right now," said Roberto Cardarelli, senior economist at the IMF. "The dynamics of house prices in Canada are in line with what we would expect based on the fundamentals of the economy."

Canada and Austria were the only two of 17 countries included in the study in which house prices appeared to be at or lower than where they should have been at the end of the period from 1997 to 2007, Mr. Cardarelli said. His study was based on growth in house prices as a function of macro-economic issues including income growth and interest rates.

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For each country in the study, house price growth was modelled as a function of the following: an affordability ratio, growth in disposable income per capita, short and long-term interest rates, credit growth, changes in equity prices and changes in the working age population. The study used data from 1997 to 2007.

A "gap" occurred when house prices were higher or lower than where these economic fundamentals suggested they

should be.

Canada is in better shape than many other countries and home prices here aren't expected to drop this year, said Benjamin Tal, senior economist at CIBC World Markets Inc. But that doesn't mean home owners should expect, or want, to see the big gains of past years, Mr. Tal said.

"If we see continued double-digit price growth in Canada over the next two or three years then we would enter bubble territory, but this is unlikely," Mr. Tal said. "I believe this spring, for the first time in seven years, there will not be a sellers' market in Canada."

In the first quarter of 2008, home prices rose in every major Canadian market except Edmonton, according to recent data from Royal LePage Real Estate Services. The average price of a detached bungalow was \$336,836, up 8.3 per cent from the year before. Two-storey homes rose 7.1 per cent to \$400,647, and standard condo units by 6.9 per cent to \$240,423.

Ireland, the Netherlands and the United Kingdom fared the worst in the IMF study, with house prices at the end of 2007 sitting about 30 per cent higher than what economic fundamentals would suggest. House prices have already started to fall in Ireland and the U.K., and other vulnerable countries identified by the study include France, Spain and Norway.

A decline in interest rates is part of the reason Canadian home prices haven't shot past the country's economic fundamentals, Mr. Cardarelli said. Canada was also in the bottom five countries in the study in terms of real house price growth over the past 10 years, he added.

The U.S. came out better than many countries in the study, but that was partly because a correction was already under way there and this was captured by last year's data.

Fewer speculators and more conservative lending practices have helped protect Canada from a big housing market downturn like that in the U.S. and some European markets, said Sherry Cooper, chief economist at BMO Nesbitt Burns Inc.

"There's been a real market for flipping homes [in those countries]. We just haven't seen that develop at all in Toronto or even out West, where we have seen big increases in house prices," Ms. Cooper said.

In 2004, the U.S. was in the same state of "equilibrium" Canada is now in, but blew it when banks started providing exotic mortgages, creating an artificial demand for houses, Mr. Tal said.

Canadians should take this lesson to heart when considering products such as longer amortization mortgages and those with lower down payments, which add flexibility to the market but shouldn't be abused, Mr. Tal said.

"Remember that things were fine there [in the U.S.] in 2004. Then rates went up, and bankers with imagination created this bubble," he said.

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### **What \$750,000 will get you**

#### **In Toronto**

4-bedroom detached home on a 51- by 93-foot lot

#### **In Dublin**

4 bedroom semi-detached home in Clonsilla

#### **In London**

A three-bedroom 1930s property in Neasden, England.

**In Barcelona**

An apartment

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