How simple mathematics can predict the coming crash in the Canadian property market

I say this is simple mathematics so, in keeping with the premise, let me spell this out in short bullet points for you:

In June 2022 Manulife Canada published a debt survey in Canada in which they asked Canadians from across the country questions about their debt and specifically their mortgage debt. The survey found that:

- 18% of Canadian homeowners already can not afford their homes and can't keep up with their mortgage payments.
- 23% of homeowners would have to sell their homes if interest rates rise any further.
- Almost 50% of Canadians say that debt is impacting their mental health and that they are struggling to handle any unexpected expenses.

Knowing this, let us firstly consider the likelihood of further interest rate increases and inflation-fuelled 'unexpected expenses.'

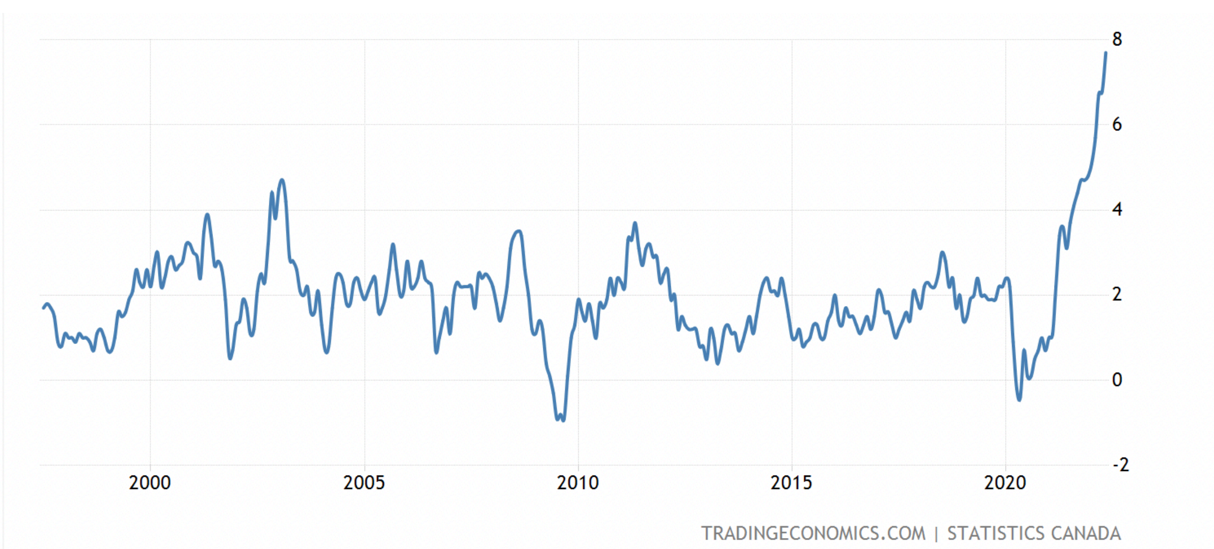
- Inflation is currently at a 40 year high in Canada. The official rate is about 8%, but this excludes food and fuel, so the real rate of inflation is estimated to be closer to 15%.
- This rate of inflation is likely to continue to grow as so much extra money has been put into circulation in Canada over the last two years.
- The Bank of Canada has openly said it remains on a prime rate "hike path" in an attempt to control this surging rate of inflation.
- The retail cost of gasoline has doubled in price over the last year. Although fuel is not included in the inflation index, this is having a significant knock-on effect across the supply chain driving up the price of everything that needs to the delivered.
- The supply chain issues (and looming diesel and diesel exhaust fluid shortage) are also beginning to be felt, adding scarcity and panic buying to upward price pressures.

Considering the above, it is inevitable that prime rate in Canada will continue to increase, likely to somewhere between 10 and 15% (as it was back in the 1980's). Currently the Central Bank prime lending rate is 1.5% (having just been increased by half a percent at the beginning of June). The problem is that the rate of interest has been at historic lows for the last decade and people have become conditioned to relying on 3 to 5% commercial lending interest rates, which are rapidly coming to an end.

Now just step back for a moment and think about what I've said.

Prime rate in Canada is currently 1.5%, yet inflation is at a 40-year record high, likely in the 15% range!?? Anyone, with the slightest bit of common sense knows that that doesn't add up - or at least it can't for very long.

CANADIAN INFLATION 1997 TO 2022



It is inevitable that either inflation will quickly settle back down to that 4 or 5% range, or prime rate will shoot up to 12 to 15% to better match inflation. Considering how the national economy has been bungled since the launch of Covid, which of these options do you honestly think is more likely…? Yeah…

Anyway, lets get back to the housing market in Canada:

- The ratio of homes to people in Canada is 424 homes per 1,000 people.
- Canada has a population of 38.4 million people.
- Therefore there are 16.28 million homes in Canada (being 424 x 38,400)
- 68% of homes in Canada are owned.
- Therefore the total number of owned homes in Canada is currently 11 million (being 68% of 16.28 million which is 11.07 million).
- According to the last census in Canada 43% of owned homes have been paid off. This means that approximately 57% of the above 11 million homes are still mortgaged.
- This means that there are 6.3 million active mortgages out there.

What this tells us is that if (or should I saw when) there is the next interest rate hike in Canada, which some predict could happen in early August, the above 23% of mortgage holders will have to seriously consider selling their homes.

This means that likely sometime over the next three months 1.45 million homes (being 23% of 6.3 million) will be added to the housing market. This means that on average almost one in every ten houses on every suburban street across the entire country could be going up for sale in the very near future, and many of them will be desperate sales needing to liquidate quickly as they have already been carried for too long.

This flood of inventory will inevitably drive down the cost of residential property in Canada, and the current wave of new builds also coming onto the market will only add to the over-supply.

In June 2022 the Canada Mortgage and Housing Corporation said that Canada needs an additional 3.5 million more homes to be built over and above all those that are already being planned or are under construction by the end of the decade for housing to become affordable again. The CMHC' definition of 'affordable' is for housing not to cost more than 40% of a family's disposable income. Currently housing in both Ontario and British Columbia accounts for closer to 60% of a family's disposable income.

So what will all this likely result in? I personally think:

- The average price of family homes in Canada will peak in about mid/end July 2022.
- But when the next prime rate hike is announced in August we will see the volume of houses for sale increase on the market and the overall price will start to drop.

- When the next prime rate hike comes along, likely in late September 2022, a lot more houses will be added to the market which will accelerate the drop in price.
- As the cost of home-ownership comes down, so we will see a proportionate increase in the cost of rentals, particularly lower cost rentals, as everyone who is forced to sell their homes due to economic hardship will need to find an affordable rental. That will become a rapidly overheated (and potentially very lucrative) market.
- Personally I think we could see a drop of up to 30% in the cost of house and a corresponding increase in monthly rental of upwards of 30%.
- By mid-October as the ice and snow of the Canadian Winter start to drag the temperatures down to the minus thirties of January, so a large chunk of the formerly middle class will start to suffer in ways not seen in this country since the 1940's.

I hope I am wrong about all this, but when you consider everything else that has been thrown at us over the last couple of years, is it really so outrageously unrealistic…?