



Prepare for lower real estate prices

No guarantee that U.S. meltdown won't spread here

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It's hard to find experts in Canada who are concerned that the real estate chaos swirling around next door could hop the border and rattle the housing market here. Well, not yet anyway.

Those who believe the Canadian market is on solid ground will find evidence to support their views when they get a look at housing starts for March (released this morning) and the new housing price index for February (tomorrow). Both are expected to show that Canada's housing market is holding steady amid the downturn to the south.

But if you're the sort of investor who can't help but wonder if Canada must eventually follow the U.S. lead -- a natural instinct given that Canada follows on so many other issues -- you may want to skip the Canadian figures.

Instead, head straight for the words of U.S. central bankers and get their take on housing: The worse it is in the United States, the more reason to worry about the situation here.

This afternoon, the U.S. Federal Reserve releases the minutes from the last Federal Open Markets Committee, on March 21. At that meeting, the committee left short-term interest rates unchanged, but said in its statement that "the adjustment in the housing sector is ongoing."

That is likely code for "quite frankly, the housing sector scares us" -- and the minutes will say more about it.

They have good reason to be scared. In the United States, home prices are tumbling, foreclosures are rising and few are confident the downturn has hit bottom yet. It's a rough time to contemplate buying a home.

Just as worrying, tightening credit conditions and the fact that current homeowners can no longer count on an appreciating market could wreck consumer confidence, which can hit economic growth.

Most Canadians are fully aware of our neighbour's problems. However, the prevailing wisdom is that real estate is a local market and it all boils down to the "location, location location" mantra, which should protect us from any sort of

copycat debacle.

"Can we say that there are ominous parallels between what is happening in the U. S. and what will happen in Canada? I doubt it," said Bart Melek, senior economist at BMO Capital Markets. "It is a fundamentally different market. The structure is different."

U.S. consumers had to ride an upswing in interest rates from 1% in 2003 to 5.25% today, a much more volatile ride than that experienced by Canadian consumers.

At the same time, U.S. loan requirements -- which included 0% downpayments in some cases -- were far looser. And lastly, the Canadian economy is in better shape.

But there's at least one important factor Canada shares with the United States: overvaluation. House prices here have risen to a point where BCA Research believes they are 28% overvalued, based on comparisons with gross domestic product and competing assets, just as house prices were once widely believed to be overvalued in the United States.

With U.S. prices now coming down, it's not hard to envision a similar price-chop here. Few see it now, but that's the best time to prepare yourself.

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