

Dodge warns of inflated housing market

Points to easy credit as culprit in 'facilitating a rise in the price of houses that is really not warranted'

HEATHER SCOFFIELD AND PATRICK BRET HOUR

From Wednesday's Globe and Mail

September 26, 2007 at 3:52 AM EDT

OTTAWA AND VANCOUVER — Bank of Canada Governor David Dodge is raising a red flag about housing prices in Canada, saying that increasingly loose lending rules may be helping overheat the country's real estate market.

While Mr. Dodge did not draw any direct parallels with the subprime mortgage crisis that has gripped the economy of the United States and sparked a credit crunch around the world, he signalled that his long-standing concerns about mortgages with increasingly easy terms have not been addressed.

“One worries about the structure of the mortgage market, that we may be actually aiding, facilitating a rise in the price of houses that is really not warranted,” he told reporters after a speech in Vancouver.

In his comments to reporters Tuesday, Mr. Dodge further warned that housing prices outside of the fast-growing cities of Western Canada may be rising too quickly.

Housing prices in Vancouver, Edmonton, Calgary and Regina have soared, but that growth is to be expected from an expanding economy and population. More troubling is the picture elsewhere, Mr. Dodge said.

“But I guess what has worried us a little bit more, is that even if you extract from those centres, what we're seeing is house prices rising faster, probably at up to twice as fast as the rate of inflation,” Mr. Dodge said.

“We're worried about that, and we'll continue to worry about that.”

Mr. Dodge did not name any housing markets, but the most recent figures from the Statistics Canada new housing price index indicate a number of markets are in the range of growth he pegged as problematic: Halifax, with a 6.8-per-cent increase; Hamilton, 4.3 per cent; London, 5 per cent; Greater Sudbury and Thunder Bay, 4.5 per cent; Winnipeg 15.7 per cent.

Last year, Mr. Dodge met with executives from Canadian Mortgage and Housing Corp. (CMHC) to complain about new incentives by the housing agency to encourage interest-only mortgages and mortgages with amortization periods of up to 35 years. CMHC said

at the time that it had addressed all of Mr. Dodge's concerns. CMHC said it had no comment yesterday, but the governor's comments suggest his concerns remain.

Since then, Canadian housing prices have soared, and consumer demand in general has surpassed most analysts' expectations with its endurance.

At the same time, Mr. Dodge says he is re-evaluating his thinking about how risky and sophisticated credit structures affect the Canadian and global economy.

The credit crunch that has seized global markets since August and caused a tightening of credit in Canada was partially caused by a lack of understanding on the part of central bankers, Mr. Dodge said.

The world's central bankers failed to realize the magnitude of the easy money made available over the past few years through sophisticated market structures, and as a result, central banks kept interest rates too low.

For Canada, the too-low rates were offset by the appreciating Canadian dollar, he added.

But going forward, central bankers will have to better take into account the pricing and availability of credit, when setting monetary policy, he cautioned.

Generally, he expressed confidence that the Canadian economy is supple and strong enough to handle a dollar at par with the U.S. currency and tightening credit conditions at the same time.

“The adjustment is continuing, and in the end the Canadian economy will emerge as a rather strong economy, even if there are difficulties,” he told reporters.

“We're in the process of adjusting and the growth of the economy will not necessarily be as strong as it was in the second quarter but it will continue [to grow] rather strongly.”

The Canadian economy grew an annualized pace of 3.4 per cent in the second quarter, but economists have been scaling back their expectations for the rest of this year and next, and warning of a growing risk of recession in the United States.

Within the past year and a half, Canadians have increasingly chosen longer mortgage amortization terms than the average 25 years.

Terms of 30, 35 and even 40 years have become much more popular, particularly among home buyers taking out high-ratio mortgages in which they are putting down less than 20 per cent of the purchase price, according to a recent Royal Bank report.