

5 Jul 2016 The Vancouver Sun

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Vancouver's housing bubble will surely burst

It's a matter of when, not if, it happens, Herbert Grubel writes.

All of the public and political discussions about high and rapidly rising house prices in Vancouver are focused on the impact they have on affordability and the problems they cause for young Canadian families wanting to buy a home. This **focus on affordability diverts attention from the fact that the development of Vancouver (and Toronto) house prices has all of the characteristics of a classic price bubble, which will burst and bring hardships to many that could dwarf those arising from the affordability crisis.**

In a well-known study, the late Charles Kindleberger identified **five phases** in the growth and bursting of price bubbles. Applied to the current situation, the **first phase began when low interest rates made larger mortgages more affordable** and increased the demand for houses in Vancouver at the same time that changes in Chinese government policies enabled rich Chinese to invest in Vancouver houses for safety and capital gains. These new sources of demand came on top of the constant demand for over 200 housing units a week brought on by immigrant families settling in Vancouver. This phase brought some unexpected increases in house prices.

A boom is the second phase of a bubble. It started when these modest, but unexpected, price increases attracted smart investors and speculators who believed that low interest rates and high immigration were here to stay and would lead to ever-higher prices. Their belief was strengthened by the very price increases their purchases had created.

Euphoria is the third phase in the life of a bubble. The large and steady price increases seem to make the purchase of homes a sure road to riches. They induce many newcomers to enter the market, and quick-rich deals like flipping and shady market practices are used increasingly. In 2016, the Vancouver market has been gripped by euphoria and prices reached record levels.

Crisis is the fourth phase. It starts when the smart investors realize that the high and rising prices are unsustainable and begin to sell. At first, prices stop rising, but then fall. The decreases accelerate as the lower prices **force highly leveraged speculators to sell so they can pay their mortgages.** Everyone expects even lower prices to come and no one is buying. Panic spreads through the economy.

The final phase is one of revulsion, as the media, politicians, investors and speculators search for someone to blame for the calamity and demand that government provide relief for their problems.

It is a question of when, not whether, the Vancouver housing market will reach the crisis and revulsion phases. But one thing is clear. The longer the bubble lasts and the higher prices go, the larger will be the bang and damage when it bursts.

And the damage will be huge. In 1989, the Toronto bubble burst, and six years later house prices had decreased 50 per cent. Many speculators lost all of their life savings. Financial institutions were in crisis. All home building activities stopped. Unemployment increased. The flow of immigrants decreased sharply. A general economic recession developed.

Governments cannot prevent the bursting of the Vancouver bubble. They can only adopt policies to slow its growth. But these will be opposed by the many who benefit from the price increases and who, as is the case during all euphoric phases, insist that this time, things are different.

There are a few policies that could stop price increases. The most obvious is raising interest rates, but this policy will not be adopted since it threatens to cause a recession. Increasing down payments and taxing empty homes will not deter speculators expecting huge profits. Policies to increase the supply of housing, such as the relaxation of regulations affecting construction, zoning and the use of agricultural land will continue to be prevented by widespread political opposition.

The only policy that could work quickly and reliably is a moratorium on immigration, but such a policy would meet overwhelmingly powerful opposition from the immigration industry and many who believe that only good can come with immigrants.

But there are the usual silver linings accompanying all crises. Housing will be affordable again for young families after the inevitable fall in prices. Immigration will slow, as it did in Toronto after 1989. And the resultant decrease in the demand for housing will usher in a period of price stability — until the next bubble.