Canada could face housing woes, Merrill warns

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TORONTO — Canada could be headed for a housing and mortgage meltdown similar to the one that has devasted the U.S. economy, Merrill Lynch warned Wednesday.

Canadian households are more financially overextended than their counterparts in the United States or Britain, a report issued by Merrill Lynch Canada economists David Wolf and Carolyn Kwan says.

“We're just now starting to see house prices fall in Canada, and sharp rises in unsold home inventories increasingly imply that this will not be a transitory phenomenon ... From this perspective, the absence of a Canadian credit crunch to date may be cause for concern, not comfort,” their report says.

They say it's only a matter of time before the “tipping point” is reached and the housing and credit markets crack in Canada.

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Merrill Lynch Canada acknowledges its analysis is more pessimistic than the prevailing view.

Many economists have said Canada's housing and banking sectors are far more stable than their American counterparts and will likely slow but not crash.

“What worries us is that Canadian households have been running a larger financial deficit than households in either the U.S. or the U.K.,” the Merrill report says. “... After 40 years of net saving, Canadian households moved into sustained deficit in 2002. In 2007, household net borrowing amounted to 6.3 per cent of disposable income, a wider deficit than in the U.K. and not far off the peak U.S. shortfall seen in 2005.”

The economists say the data imply that Canada's household sector is now overextending itself as much as the United States or Britain ever did.

“So why haven't we seen housing and credit markets in Canada crack?” they say. “The market view is that it's not going to, that the household overextension evident in the aggregate data is somehow more sustainable in Canada, to judge from the massive outperformance of Canadian bank shares through the global crisis ... We fear, however, that it may simply be a matter of time.”

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