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OPENING THOUGHTS

The Vancouver housing market performed as expected, please go back and read the March Report for my earlier expectations. Sales plunged, dropping 39% on a year-over-year basis. That’s in comparison to April 2019 which was the slowest April in 19 years. So yes, sales were downright terrible, the worst on record. However, new listings were equally miserable. People held off listing their homes for obvious reasons, which prompted new listings to fall by 58%.

So what do we make of these numbers? Well, our supply and demand figures suggest the market took a hard pivot from a sellers market to a buyers market in short order. The overall months of inventory for sale more than doubled in one month, going from 3.9 to 8.4 months of supply. Furthermore, the sales to actives ratio went from 25% to 12%. That is an unprecedented shift. Going back through our models, we have never seen months of inventory come anywhere close to
doubling in one month, not even during the depths of the financial crisis.

Of course there’s no real ability to track and measure prices on a monthly basis, particularly when volumes crash to record lows. What I can say is that for the most part prices held firm, but there appeared to be some minor price discounting. For example, condos that would have got multiple offers before the virus and sold above the asking price, are now seeing a bid slightly below the list price.

It seems logical to expect this to continue in the months ahead, as i’m not convinced sales figures will improve much in May.

While we may have flattened the curve and mitigated the worst of the virus, the economic fallout from putting the global economy on pause will catch many by surprise. Recent figures highlight just how unprecedented the destruction has been. The unemployment rate is expected to jump well into double digits, and remain there for some time. Second quarter GDP is expected to be so ugly that the Bank of Canada, for the first time in recent memory, failed to provide an actual forecast, only suggesting our economy would contract between 15-30%.

Sure, policy makers have been swift to act, but recent stimulus measures are really not “stimulus” and don’t make up for the trillions of dollars in lost revenues that will never be recouped. Though various measures of QE (quantitative easing) may have stemmed a liquidity crisis, we are still facing a solvency crisis as over leveraged households and corporations face contracting cash flows.

There’s been plenty of talk about pent-up demand, but I have not heard anyone even mention the notion of pent-up supply. I will discuss that later on in this report and I highly encourage you to give it a read.

Remember, demand for housing is a function of employment, population growth, and availability of credit. All three of which are contracting.
As always, I'll be the first to admit I don't know what the future holds, however, I believe current probabilities suggest downside risks remain elevated. There will once again become a time to take increased risk, that time is not now.

Stay safe, and stay liquid,

Steve

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Detached sales for Greater Vancouver fell 33% year-over-year in April. It was the slowest April on record. We are a long way from our more recent 2016 highs.

Sales by Month
Source: REBGV, Steve Saretsky
Meanwhile, new listings fell off a cliff. New listings fell 65% year-over-year. Obviously sellers decided they didn’t want strangers in their home during this pandemic.

![Graph of Number of New Listings](image)

However, despite the plunge in new listings, overall months of inventory for sale nearly doubled. The MOI (months of inventory) jumped from 4.7 to 9.7. Anything above 6 is considered a buyers market.
Officially the MLS benchmark price increased 2.3% from last year but that is more noise than anything. Essentially prices are little changed despite the recent volatility. I suspect we will get a more clear direction on prices in the coming months.
CONDO HOUSING
MARKET UPDATE

Condo sales in Greater Vancouver fell 43% year-over-year in April. It was the lowest count since April 2000.

Sales by Month
Source: REBGV, Steve Saretsky

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And new listings collapsed by 57%.

![Number of New Listings](chart)

Months of inventory for sale jumped from 3.6 to 7.9. That’s a buyers market but still way below financial crisis levels which reached as high as 19.4.
After bottoming in June 2019, condo prices were back on the rise. However, they turned back down again in April. I’ll be monitoring this closely in the months ahead.
The condo market was on strong footing before the virus but appears to have been knocked off course. The headwinds of rising unemployment and tighter lending conditions will be difficult to overcome in the near term.
PENT-UP SUPPLY?

News on the Coronavirus front has been getting better, and there appears to be some light at the end of the tunnel. As we brace for a possible re-opening in the next few weeks, there is a lot of talk within the real estate industry about the direction of the housing market. Nearly all of those discussions focus on the idea of “pent-up demand”. This belief that a swarm of eager buyers, finally released from their quarantine shackles, will be tripping over themselves to snatch up condos, thanks to a flood of cheap credit and a lack of supply.

But what if demand remains impaired?

While the virus may be fading, it is still very much with us, and it seems it will be here for the foreseeable future. All this talk about money printing and stimulus saving us all, as if we can simply paper over a wave of insolvencies. The reality is many businesses will not survive, as John Mauldin of Mauldin Economics recently noted, unlike manufacturing, retailing, or agriculture, service businesses can't hold inventory. They can't just close for a few weeks and then make up the lost time. There is no second chance to sell that hotel room night, plane seat, restaurant meal, haircut, Uber ride, or cocktail. Revenue has been vaporized, not deferred. It will take years to make up lost revenue, including all the jobs that have been eviscerated.

The unfortunate reality is we will be stuck with a double digit unemployment rate for quite some time. The real economic...
damage has yet to materialize. Has anyone asked what demand will look like under that scenario?

The demand for housing consists of employment, population growth, and the availability of credit.

We already know employment prospects are bleak. Many businesses won’t survive. For those who do get re-hired, good luck asking for a pay raise. That’s a net negative for rents, or in other words, a landlord’s future expected cashflow.

What does population growth look like in a world of limited travel and weak job prospects? Natural population increase in Canada was near record lows pre virus. In fact, our recent population boom was via non-permanent residents. This cohort is made up of foreign students, work permit holders, and refugees. They were responsible for nearly 35% of our total population growth, a record high. This cohort has proven to be cyclical, mirroring the business cycle.

In BC, we are particularly vulnerable to a reduction of migration flows. Net immigration was 14x as large as the net natural increase in the population (i.e. births less deaths), versus 4.9 for Canada as a whole, per Capital Economics.

**Ratio of Net Immigration to Net Natural Increase in Population**

Source: Statistics Canada, Capital Economics

![Graph showing the ratio of net immigration to net natural increase in population over time for Canada, Ontario, Quebec, British Columbia, and Alberta. The graph highlights a significant increase in immigration relative to natural population growth in recent years, particularly in BC.](image)
Meanwhile the access to credit has slowly tightened over the past few weeks. Banks are becoming more conservative, and for good reason. Refinances and home equity lines of credit have been reigned in. But what did you expect? Their customers are under strain, coming into this crisis with record amounts of debt and a near sixty year low in savings rates. Banks are trying to protect their collateral (your house), and have dished out over 720,000 mortgage deferrals- that equates to 15% of all residential mortgages on their books as per data from the Canadian Bankers Association.

This doesn’t include mortgages at local credit unions or in the private/ shadow banking system. In other words, deferral or no deferral, foreclosures will rise, and probably meaningfully.

Now that we have a somewhat better understanding of demand, lets take a look at the other side of the equation. I have so far heard very few people talking about pent-up supply. Who could fathom such a thing?

What we know is that the Canadian housing market has enjoyed a prosperous few decades. This bull market has been generous, and over the years, has brought on speculation of ever rising prices. Thus it has encouraged many Canadians to invest in additional property. Will some of these investors flinch and try to liquidate if they believe prices may move lower? Do they have the ability to withstand missed rent payments from unemployed tenants? What about AirBnB landlords? Today, we don’t have that answer, but we will soon find out if this results in additional supply.

What we know for sure, is that a wave of new home construction is nearing completion. In Vancouver there is a record 44,000 units under construction today, and in Toronto that number is 73,000. Furthermore, housing starts remain elevated. In other words, the supply is coming regardless of whether the demand is there to meet it. New supply can not simply be shut off.

At the end of the day, I’ll be the first to admit I have no idea how this will all play out. The Canadian housing market has proven time and again to be incredibly
resilient. I can merely assess probabilities, and I think the probabilities suggest supply will outpace demand over the coming 12 months. Is anyone prepared for that? I am confident we must continue to ask the hard questions, even if they may be uncomfortable.
CREDIT CONDITIONS

With over 700,000 mortgage deferrals and counting, the banks are under pressure. They’ve had plenty of help so far from policy makers, and without their help things would look a lot worse. In fact, if there was one reason to maybe be bullish on the property market its the amount of intervention and support it gets from all levels of Government. They are certainly doing their best to support the banks assets (your house).

Here’s a look at some of the policy measures so far.

- OSFI lowers capital stability buffers from 2.5% to zero.

- CMHC launches the IMPP (insured mortgage purchase program) which will acquire up to $150B in insured and uninsured mortgages off the banks balance sheet for securitization purposes.

- Bank of Canada targeting purchases of $500M per week of Canada Mortgage Bonds.
I’m not sure what happens when mortgage deferrals expire. Although I’m pretty confident the banks won’t be able to continue deferring 700,000 mortgages (15% of their book) while also continuing to payout dividends. At some point a decision will have to be made, and either they’ll sacrifice retirees depending on the dividend income or the overleveraged homeowners. We are entering a new bull market for social unrest.

Mortgage lending has gotten much tighter, obviously. From what I’m hearing refinancing and accessing home equity lines has become extremely difficult. Furthermore, banks are assessing the sustainability of your employment, particularly if you are in more vulnerable industries or self-employed.

More importantly, some lenders are requesting copies of your pay stub sometimes a week or two before closing. In other words, even if you have a firm approval from the bank, if you lose your job in between the time of your purchase and your closing date, your mortgage approval will be redacted. This puts buyers in a very unpleasant situation, and they will risk losing their deposits.

Private lending has tightened immensely, and loan to value ratios are becoming much more conservative.

Suffice to say, the lending environment has changed significantly.
The economic impact from the Coronavirus will be one for the ages. The International Monetary Fund expects the global economy to shrink 3% this year, far worse than its 0.1% dip in the Great Recession year of 2009. Some estimates are pointing towards a $10 trillion hit to economic output, that's more than the economies of Germany and Japan combined.

The obvious reaction from policy makers has been to spend. Governments across the globe have already committed $8 trillion in spending to help patch the hole in the sinking ship. And that number will be much higher when all is said and done.

In order to support government spending, central banks have put their foot on the accelerator. Global Quantitative Easing (QE) asset purchases are likely to reach USD $6 trillion in 2020 alone, Fitch Ratings says. That's in addition to the $17 trillion of existing assets The ECB, Fed and Bank of Japan have...
accumulated over the years.

There are many sane and rational pundits arguing against government action, on the basis that it will cause hyperinflation, and/or give our children an unsustainable burden of government debt to carry in the future.

However, as the eloquent professor Steve Keen has articulated, forget inflation, it’s all about debt deflation. For those who are unfamiliar with professor Keen, his work on articulating the fallacies of mainstream economists and their failure to understand the modern banking system and credit creation have become popular reading.

Today, Keen argues, in the absence of government rescue, the likely outcome of this crisis is serious deflation. This will be caused by a mechanism called “Fisher’s Paradox”, in honour of Irving Fisher, who first identified it as the primary cause of the Great Depression.

Fisher argued that the Great Depression was caused by the twin coincidence of too high a level of private debt, and too low a level of inflation. In this situation, debtors resorted to distress selling, cutting their prices in order to attract a cash flow to themselves rather than their competitors. But because everyone was doing it, prices fell across the board, taking GDP down with it. Debts therefore fell less than GDP, and the private debt ratio actually rose.

Fisher’s Paradox was ignored by mainstream economics, because they subscribe to the fantasy model of banking known as “Loanable Funds”, in which banks are simply intermediaries between savers and borrowers.

As Fisher argued, the fall in the price level amplified the impact of the decline in real output. Falling prices combined with falling output to mean that the fall in nominal GDP was actually bigger than the fall in real (inflation-adjusted) GDP. Since debts are also measured in nominal terms, the fall in the price level made the rise in the private debt ratio worse: “the more debtors pay, the more they owe”.

This is why reflation, by Roosevelt’s New Deal (and also his “Bank Holidays”, which allowed insolvent banks to be wound up and their depositors funds transferred
to solvent ones), was so important. If the injection of new money by the government hadn't happened, this private sector chain reaction of liquidation leading to falling prices and an ever-rising debt level could have continued unabated.

What’s the relevance of this historical story to today’s situation? It is that the Coronavirus crisis has hit when we still haven’t addressed the run-up of private debt that caused the Great Recession in 2007. Private debt today is higher than it was at the peak of the Great Depression. With the Coronavirus smashing both wages and profits in the US and global economies, the last thing we need is for workers that can’t pay their rents and mortgages, and firms that can’t pay their rents and service their corporate debts, to go bankrupt now. Inflation, which is already low, will turn negative, and the private debt ratio will explode once more, as it did in 1930-1933. Bankruptcies would cause a chain reaction of further failures, taking the banks down as well as the debtors.

Private Debt and Change in Private Debt, 1920-1940

Source: US Census Data
The solution? Keen believes a modern debt jubilee is necessary.

He continues...

We therefore need a way to short-circuit the process of debt-deleveraging, while not destroying the assets of both the banking sector and the members of the non-banking public who purchased ABS (Asset backed securities). One feasible means to do this is a “Modern Jubilee”, which could also be described as “Quantitative Easing for the public”.

The current form of Quantitative Easing was undertaken in the false belief that this would “kick start” the economy by spurring bank lending.

Instead, its main effect was to dramatically increase the idle reserves of the banking sector while the broad money supply stagnated or fell, for the obvious reasons that there is already too much private sector debt, and neither lenders nor the public want to take on more debt.

A Modern Jubilee would create fiat money in the same way as with Quantitative Easing, but would direct that money to the bank accounts of the public with the requirement that the first use of this money would be to reduce debt. Debtors whose debt exceeded their injection would have their debt reduced but not eliminated, while at the other extreme, recipients with no debt would receive a cash injection into their deposit accounts.

The broad effects of a Modern Jubilee would be:

1. Debtors would have their debt level reduced;
2. Non-debtors would receive a cash injection;
3. The value of bank assets would remain constant, but the distribution would alter with debt-instruments declining in value and cash assets rising;
4. Bank income would fall, since debt is an income-earning asset for a bank while cash reserves are not;
5. The income flows to asset-backed securities would fall, since a substantial proportion of the debt backing such securities would be paid off; and
6. Members of the public (both individuals and corporations) who owned
asset-backed-securities would have increased cash holdings out of which they could spend in lieu of the income stream from ABS’s on which they were previously dependent.

Sure these concepts are controversial and unlikely to be implemented as policy makers despite change. However, they should absolutely be on the table for further debate. Again, our current debts will never be repaid, and suggestions of further taxation to pay off the debt will only cause further damage to consumer spending and economic growth. After all, you can not borrow your way to prosperity, nor can you tax your way to prosperity.
ABOUT STEVE

Steve Saretsky is a Vancouver residential Realtor and author behind one of Vancouver’s most popular real estate blogs. Steve is widely considered a thought leader in the industry with regular appearances on BNN, CBC, CKNW, CTV and as a contributor to BC Business Magazine. Steve has advised developers, hedge funds, and fund managers on the Vancouver housing market and is a regular speaker at industry events.

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