

# Bailout of the Canadian homebuyer



## Hilliard MacBeth

Hilliard's Weekend Notebook – Friday June 9, 2017

Recently an article in Maclean's by Kevin Carmichael appeared: "Why Ottawa should bail out homebuyers if house prices tank". The article reminds me of the controversy that erupted in February 2009 over President Obama's attempts to help U.S. homeowners during that real estate market crash.

If a similar debate happens in Canada, will we hear the same arguments?

Kevin Carmichael wrote that Ottawa should bail out homebuyers that otherwise would lose their houses.

The problem with this proposal is that some people will view such a bailout as unfair to the people who were prudent with their borrowing and spending. Such a bailout also could encourage irresponsible borrowing and "moral hazard".

In 2009 the U.S. faced a similar debate, highlighted by bond trader and CNBC commentator Rick Santelli's rant focused on the "moral hazard" argument. He said "Do we really want to subsidize the losers' mortgages?" That argument goes like this: If we let people off the hook on their decision to borrow lots of money, we foster an irresponsible attitude that one should just borrow as much money as possible and then walk away, if it doesn't work out. Presumably Santelli felt that it's better to let them lose their houses to teach them a lesson. Many, many people agreed with him. He also brought into the argument that taxes incurred to fund the bailout would hurt responsible citizens to help the bankrupts.

As some Canadians continue their headlong rush to the brink of insolvency by borrowing larger and larger amounts, this question could come to a head soon in Canada. The over-extended Canadian debt level is only one significant house price correction or recession away from creating a reality similar to the 2009 U.S. crisis. In that scenario, there would be hundreds of thousands of Canadian households that couldn't pay back their debts. Most of them saddled themselves with these debts while following the existing government rules and under close supervision by Canadian lenders and authorities like the CMHC and Bank of Canada.

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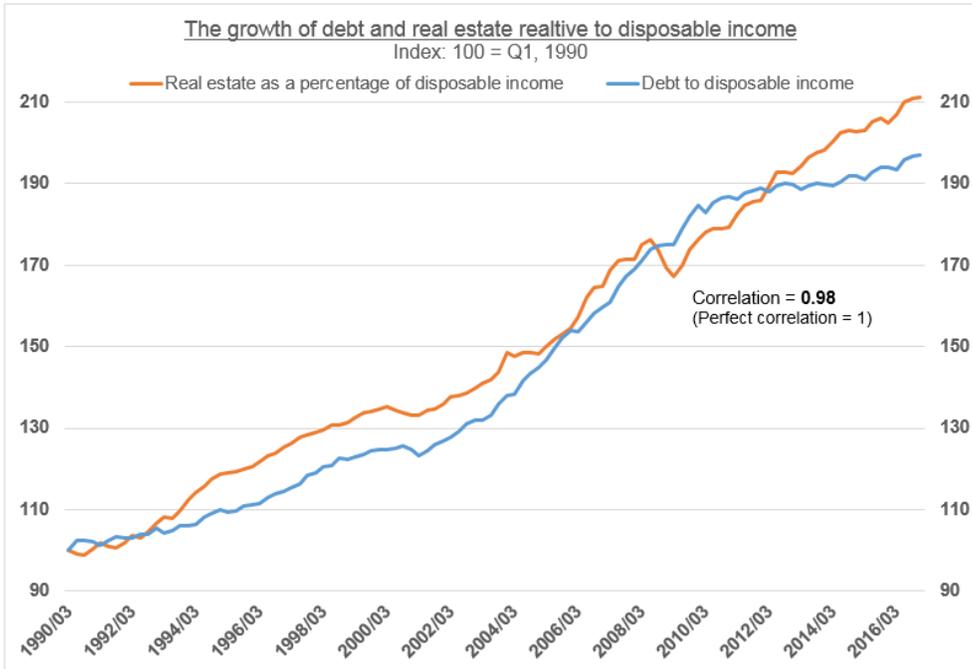
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Source: Statistics Canada, CANSIM Table 378-0123, The MacBeth Group

So who is responsible? Was it really only reckless borrowers?

Were lenders careless too when they allowed people to borrow 5, 6 or even 7 times their household income in Toronto and Vancouver? If the lenders argue that they were just following the existing rules, couldn't Canadian households make the justification?

The borrowers could say, "The bank said that I qualified for the loan, so it's not my fault."

The rules have been modified many times, making it easier for households to qualify to get in over their heads. Authorities such as OSFI, the CMHC and various governments might come in for criticism, recognizing that it took more than two decades to get us into this predicament.

If we suffer a Canadian housing crash and a recession that fosters widespread household and business insolvencies, will we also see significant regulatory reform that would prevent a future household debt crisis? The U.S. experience tells us that reform could be difficult.

It's more likely governments will support the lenders while letting the "foolish and irresponsible" borrowers feel the full weight of the inevitable consequences of their mistakes.

After all, Rick Santelli had the politics right, based on the response to his rant. But Santelli fails to see the bigger picture.

The most important issue is that economic crises are very expensive and rules should be written to avoid them, as the top priority. The debate about where to place the blame after the crisis misses the point.

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