Crisis at Canadian subprime mortgage lender

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The deepening crisis at Home Capital, a mortgage lender which provides financing to individuals failing to meet the criteria for loans from Canada's major banks, has exposed the mounting fragility of the country's economy. Despite assurances from government representatives and central bank officials that the difficulties are specific to the company, there are growing concerns Canada's economy could be roiled by a housing bubble, record consumer debt, anemic growth, and the uncertain future of the North American Free Trade Agreement (NAFTA).

The *Globe and Mail* reported in a lengthy article last week that Home Capital came within hours of total collapse on May 1.

The crisis at Home Capital, which holds around 1 percent of Canadian mortgages, began March 27, when CEO Martin Reid was let go. Since then, savers in Home Capital's high-interest savings accounts have withdrawn 94 percent of their deposits, leaving the company with a mere $120 million in deposits. The pace of withdrawals increased dramatically after the Ontario Securities Commission accused the lender on April 19 of providing misleading information about its mortgage business to investors, an allegation Home Capital has rejected. Since then, Home Capital's share price has crashed by 70 percent.

Home Capital executives have repeatedly denied that they will require emergency assistance from the Bank of Canada. At the same time, they acknowledge that the firm only has financing to last several months and that the vast majority of this is drawn from a high interest credit line arranged with the Healthcare of Ontario Pension Plan (HOOPP).

Government officials have sought to downplay the broader impact of the crisis at Home Capital. Federal Finance Minister Bill Morneau said May 15, "We've always seen the Home Capital issue as one that's a Home Capital issue. We don't see a contagion risk here." Bank of Canada Governor Stephen Poloz has insisted that a market-based solution can be found for Home Capital and without the Bank of Canada having to step in.

Whatever transpires in the coming weeks, the rapid development of such a crisis at Canada's largest non-bank mortgage lender has exposed the underlying fragility of the country's economy. No amount of assurances about the circumstances being specific to one company can disguise the fact that Canada's property market is dangerously inflated and could trigger a broader economic collapse. Earlier this year, the *Globe and Mail* compared the situation in Canada's property market to that in the United States on the eve of the 2007-08 crash. Poloz has previously noted that property prices, which were up on average 10 percent annually in April and more than 30 percent in Toronto, are unsustainable.

The percentage of GDP attributable to property sales is currently 1 percent higher than it was in the United States in 2007, on the eve of the subprime lending crisis and the collapse of the US housing market. David Rosenberg, chief economist at Gluskin Sheff, said in an interview with BNN that the two situations bear a striking resemblance. He noted that the price of an average home in Toronto presently absorbs 13 years of family income, adding, "We've never seen this before."

The unsustainability of the housing market is underscored by the surge in consumer and household debt, both of which are at record levels. Average household debt currently stands at 167 percent of disposable income. This was a major factor behind Moody's decision earlier this month to slash the credit ratings of Canada's six major banks. "Today's downgrade of the Canadian banks reflects our ongoing concerns that expanding levels of private-sector debt could weaken asset quality in the future," Moody's said in a statement.

These unprecedented debt levels are linked to stagnant or declining incomes. In 2012, an OECD report noted that among developed countries, Canada had the fifth highest percentage of low-wage workers, earning less than two-thirds of the median income. In 2016, Statistics Canada figures showed that wage growth for salaried workers was zero and there was a decline for hourly workers of 0.4 percent. Such grim figures understate the problem, since they include high-earning positions where incomes have grown significantly.

Home Capital is not the only financial institution to feel the effects of this. Equitable Bank, the country's ninth largest, has also experienced a run on deposits, although of a much smaller scale than Home Capital. It was forced to arrange a $2 billion lifeline with the major banks in early May. Investors have also increased their bets against the major banks themselves. This mounting uncertainty has led to increased pressure on the Canadian dollar, which is the worst performing major currency in 2017.

Canada's sluggish economy has come to rely increasingly on a red-hot housing market to sustain growth. Bloomberg noted that in the provinces with the fastest growth rates, including British Columbia, two-fifths of growth could be put down to the real estate sector and related construction projects.

Canada managed to weather the 2008-09 global economic crisis better than most other advanced capitalist economies. But since the bursting of the China-driven commodity-price boom and especially the collapse of world oil prices in 2014, Canada's economy has performed worse than most of its major rivals. Tens of thousands of relatively good-paying jobs have been wiped out in the energy sector, above all in Alberta, and capital investment has dried up.

The Liberal government of Justin Trudeau promised to increase government spending when it came to power in 2015 to boost economic growth. In reality, its strategy is aimed at placing even more resources in the hands of the financial elite, through privatization and the creation of an infrastructure investment bank dedicated to promoting so-called Private Public Partnerships.

In a recent analysis titled "The worst scenario: What if Canada's real estate bubble bursts?", the CBC considered, not without considerable trepidation, the potential impact on the broader economy. It noted that unemployment would increase sharply, consumer spending would fall as borrowers would no longer be able to use their property as collateral in accessing more credit, and the dollar would drop even further, making imports more expensive.

Experts cited in the CBC report stressed that such a worst case scenario was unlikely, due to the efforts of regulators to deflate the housing bubble. But there are other factors at play.

The Bank of Canada has retained historically low interest rates of 0.5 percent since the 2014-15 oil price collapse. It has been prevented from raising rates by a sluggish economy. According to Canada's central bank the economy will grow by just 2.3 percent this year and the Conference Board of Canada recently projected growth will fall back below 2 percent in 2018.

Meanwhile, the US Federal Reserve has begun what it promises will be a series of rate hikes aimed at returning interest rates to historic levels. A growing gap between US and Canadian rates would further depress the Canadian dollar, fueling inflation and making Canadian companies more susceptible to foreign takeover. This in turn would place pressure on the Bank of Canada to raise interest rates, although this could roil the housing market, resulting in a bursting rather than a controlled deflating of the housing bubble.

The deepening political crisis in the United States will also have major ramifications for Canada. Since Donald Trump won election to the White House last November, the Trudeau government has made its first priority retaining the Canadian bourgeoisie's privileged access to the US market and limiting the fallout from Trump's protectionist, "America First" agenda. Toward this end, the Liberal government has moved to further strengthen Canadian imperialism's military-strategic partnership with Washington, pledging to "modernize" NORAD and increase Canada's support for the military-strategic offensives that the US is mounting around the world to maintain its global hegemony under conditions where its relative economic power has been massively eroded.

Nevertheless, Canada and the US have become embroiled in a series of tit-for-tat trade disputes and this even before Ottawa, Washington, and Mexico City launch negotiations on revising the North American Free Trade Agreement (NAFTA). Uncertainty surrounding the NAFTA talks—Trump has threatened to scrap the deal entirely—could become a significant factor exacerbating any economic downturn in Canada, since Canada depends on the US market for three-quarters of its exports. Bank of Canada Governor Polloz has warned that concerns about NAFTA's future have already led to a decline in business investment.