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Why You Can't Afford A House In Vancouver

Brian Chang

There has been no shortage of analysis and commentary concerning the stratospheric rise of Vancouver's real estate market and the near-ruinous consequences that have been brought about by its resulting imbalances. As has almost always been the case over the long history of economic and financial dislocations, the deep-seated socialist affliction has today once more risen from the ashes, renewed and invigorated, laying blame for the current housing crisis squarely at the feet of the free-market and decrying the renewed displacement of the middle-class as a gross injustice perpetuated by nothing more than the complete and abject failure of capitalism.

While it is certainly true that in its many forms, speculation, corruption, and foreign capital have played a large part in the seemingly unstoppable increase in Vancouver housing costs, these symptoms are only the most visible manifestations of the larger problem at hand, not the problem in and of itself. The principal cause of the current affordability crisis is not a failure of the free-market as is so frequently cited, but a failure of the free-market price-signaling mechanism that is so critical to proper economic calculation.

The unprecedented meddling in the natural pricing of investment capital by central banks has created a condition where there is today no free-market in housing in any true sense of the word, only market prices dictated by central bank decree. Contrary to the claims of our socialist critics, the growing impoverishment of society resulting from the meteoric rise in Vancouver house prices is not a consequence of the free-market, but a consequence of interference with the free-market. It is not a failure of capitalism which is to blame, but a failure of policy.

Central Bank Price-Fixing

What, then, the reader is undoubtedly asking, is the true and underlying source of our present-day ills, for monetary policy touches in some way, shape, or form, nearly all aspects of modern-day life. While it is true that central bank interference in the free-market has led to innumerable distortions which have each served to undermine the structure of production to varying degrees, the overriding problem we are faced with today lies in the insidiousness of central bank price controls—not simply price controls of a single consumer product or service, or even the price of Vancouver housing itself, but rather the price of the most widely used and important commodity in circulation today: the price of money.

In the common vernacular, the "price" or "cost" of money is often referred to as the cost of capital and constitutes the interest rate paid by borrowers seeking access to loans, or capital, for the purpose of investment. In an economy free from modern-day fractional reserve banking, capital would be no different from any other commodity in that it too, is comprised of both a supply and demand which is, over time, brought into equilibrium through its free-market price. As capital is drawn from the store of society's pooled savings and lent at interest for the purpose of investment, savings comes to represent the "supply" of capital, investment the "demand", and the prevailing rate of interest the "price". Just as any good or service decreases in price when the supply is expanded, so too should the prevailing interest rate fall when the societal pool of savings increases. As the stock of available funds to be lent out for investment grows, banks must necessarily lower the prices they demand on loans, which lowers interest rates for borrowers as they bid on an increasingly abundant pool of capital. Conversely, when savings are in short supply, borrowers have increasing difficulty accessing loans for future ventures, and the price of capital—the interest rate—correspondingly rises to reflect this scarcity of supply.

But if the presence of low interest rates is meant to represent an abundance of savings available for lending to borrowers, why then do we not find today's market interest rate significantly higher to account for society's overt lack of real savings? This discrepancy between interest rates and legitimate savings, we will see, is due to no other reason than central bank price-fixing of the cost of capital. In their rush to drive down the market interest rate to some pre-determined level which they proclaim necessary to "stimulate" economic growth or facilitate "the dream of home ownership", the central bank's unprecedented suppression of interest rates has correspondingly driven down the cost of capital to the point where it no longer has any real-world relationship to the level of real savings in the broad economy. In the current environment, savers no longer set interest rates in the loan market as a function of their productive capacity and relative preferences towards savings versus consumption but have instead been relegated to the sidelines by central bankers as they are ultimately crowded out by the long arm of government.

The Road To Ruin

Proponents of these easy-money policies will proclaim both loudly and repeatedly that credit constitutes "the lifeblood of the economy", and that without access to cheap capital for investment, businesses could scarcely hope to subsist, much less thrive and prosper. They are quick to point out that should interest rates suddenly rise to reflect the true level of real savings in the economy, critical investment would be fatally curtailed and the economy would at once fall into a state of stagnation and despair. Infrastructure, they argue, would be allowed to decay and crumble, innovation seize up and die, and rampant unemployment and misery would invariably follow. These arguments, however, while perhaps superficially convincing, conflate legitimate capital formation with the naïve, simplistic, and fallacious corollary that any investment loan, in any quantity and at any price, offers net positive economic value to society.

This is, of course, incorrect for the price of capital exists to ration demand away from wasteful enterprises. In a true free-market absent of central bank intervention, with real savings today in such short supply, conditions of resource scarcity would naturally arise as lenders are driven to extend loans at much higher interest rates to only the most efficient and credit-worthy borrowers. The current shortfall of savings and real wealth in today's economy would at once cause savers to become selective and discerning, for with such a scarcity of societal savings held in reserve to fund investments, savers come to demand more favourable repayment terms they know can only be met by the most efficient and best allocators of capital. Lenders would certainly not provide loans at record-low interest rates to producers engaging in marginal projects of dubious means, nor would they extend million-dollar mortgages to low-income Vancouverites with little in the way of down payments or meaningful equity.

The central bank's extraordinary intervention in lending markets has today enabled fringe borrowers and businesses to acquire capital that they would otherwise be denied in a properly functioning market. The prolonged and unprecedented artificial lowering of interest rates has, as a consequence, circumvented the natural checks and balances of the free-market as capital is no longer predominantly allocated to those who are best able to employ it. Central bank price-fixing has thus served to impede the process of capital formation through the diversion of credit towards speculations in financial assets and real estate funded by record-low interest rates. It causes speculators to bid up the prices of the existing capital stock while failing to add to the productive capacity of the nation. It has redirected savings away from the most efficient investments yielding the highest long-term returns on invested capital. It is a policy of chronic mal-investment, leading to immeasurable financial distortions. It has impaired economic calculation. It has laid waste to the real wealth of society.

From Boom To Bust

But it would be a mistake to believe, as some professional economists do, that central banks can seamlessly turn a lever and re-institute higher interest rates once they deem the economy to be sufficiently "stimulated". Rising interest rates would inevitably force default and bankruptcy on marginal investors engaged in wanton speculation and questionable enterprises, exposing the initial investments as wasteful and ill-advised misallocations of capital and setting in motion the beginning of the economy-wide bust that must necessarily follow the boom (for an example of this process, see *Inflation, the Disease of Money*, from the January 2018 edition of *Canadian MoneySaver*.)

Yet inasmuch as central banks cannot simply reverse their current interference in lending markets without adverse economic consequences, nor can they continue down the reckless path of interest rate suppression in perpetuity. For an economy of unending interest rate suppression is one of rising inflation, and in the face of continuous increases to the money supply, consumer prices must ultimately rise to reflect the perpetual debasement of the currency. The spectre of runaway inflation forces the central bankers of the day, supported by their mandate of "price-stability", to eventually raise

interest rates in order to gradually curtail the money supply. But we have already seen that central bankers cannot materially raise interest rates without bursting the very bubble which they themselves helped to create.

At this late stage in the scheme, then, there are in fact no good options left, for as the economist Ludwig von Mises noted in 1949 in his book Human Action: "There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved." True free-market economists have clearly recognized for well over half a century that the artificial lowering of interest rates by central bankers serves as the primary catalyst for financial speculation and the birth of the bubble economy. What Mises discerned above, taken in today's context of Vancouver housing, is that either the central bank will eventually begin a rate hiking campaign to stamp out rising inflation and subsequently burst the economy-wide bubble of which Vancouver real estate is but one example, or house prices will retain their value in nominal dollars only to collapse in real inflation-adjusted terms as interest rates are held artificially low and the currency is ultimately driven to worthlessness.

Why You Can't Afford A House In Vancouver

While it is true that we have so far paid short shift to the topic of Vancouver real estate specifically, we can see more generally that it is merely a microcosm of the near-synchronous rise in global asset markets of which Vancouver real estate is but one of its many travesties. The reason that the average citizen can scarcely hope to afford a house in Vancouver is the same reason they cannot afford a house in Toronto, Sydney, Seattle, Auckland, or San Francisco, and it is the same reason that stock and bond markets globally are at, or approaching, all-time highs. The current global liquidity glut caused by the easy-money policies of central banks world-wide is the central catalyst of the recent global economic expansion that has led to the explosive rise in Vancouver real estate; but it is an expansion based on the unsustainable foundation of false price signals and mal-investment which is destined to come to a ruinous end.

Contrary to the persistent and unending claims of real estate lobbyists and other special interests, local housing supply constraints have never been the central policy failure underlying the current housing affordability crisis in Vancouver. The supply-side argument, taken in the context of the current unprecedented global liquidity, while amusing in its naïve simplicity, is rendered largely irrelevant to the matter at hand. And yet the persistent cries of the real estate industry that all would be solved if we simply "build more houses" conveniently ignores the more important and nuanced question of where this demand comes from in the first place. When challenged, they retort obtusely and unwittingly that society at large "isn't making any more land", as if such simplistic utterances pass for the sagest of advice and the most enlightened and expert policy analysis on offer today.

And yet the artificial suppression of interest rates has similarly distorted the stock of available housing supplied by industry, causing builders to incorrectly expand inventory they had mistakenly believed to be legitimately demanded by the free market. What policy analysts are today decrying as an unprecedented housing deficit will instead ultimately come to be recognized as a crisis of housing over-supply, once the mal-investment is, at last, exposed and non-economic demand evaporates in lockstep with the artificial bid emboldened by global liquidity. This restriction of money and credit will inevitably turn boom into bust, engendering the collapse of sky-high Vancouver real estate prices, and, ultimately, the overall economy.

The above argument has, of course, been routinely criticized by certain left-leaning commentators for being callously malicious in tone, or somehow even "defeatist", for it appears to offer no real solutions to the problem at hand other than to permit both real estate and household net-worth to collapse in bitter disillusionment and chaos. Rather, the argument set forth should instead be taken as a cautionary note to those harboring unacceptable exposure and risk to the bubble-markets of the new economy. The inevitable rate hiking campaign by central bankers will eventually bring to an end the "everything bubble" of ever-rising asset prices on which investors have today become so reliant. The end result will be a punishing collapse of those asset markets most overvalued on a global basis, among which we would include equities, and both Vancouver and Toronto real estate. And yet even at this late hour, it remains possible for investors to take action to insulate themselves from the gathering storm through a proactive process of deleveraging and diversification. It is not too late to take protective measures. Still, the time grows short.

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