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Is Canada in a Housing Bubble?

A Quantitative Analysis of Speculative Risk and Structural Realities



Introduction

In recent years, Canada's housing market has become one of the most debated topics in global economics and financial markets. Two main narratives divide the current sentiment toward the Canadian real estate market: *"Canada is in a massive bubble, and it is about to burst soon,"* and *"Canadian home prices have always been increasing due to its structure, and they will continue to rise."*

Before evaluating either claim, it is necessary to establish what a real estate bubble means and what it does not.

According to EBSCO (2023), a real estate bubble occurs when house prices rise significantly without aligning with fundamental economic indicators such as wages, employment, construction costs, land value, or interest rates. This misalignment creates a market that is increasingly susceptible to a sharp correction. When a bubble is inflating, homes are not purchased for the shelter or long-term yield they provide, but because buyers are speculating that a future buyer will pay an even higher price. However, when the market sentiments shift or when credit conditions change, the real estate market becomes fragile, home prices start falling, and the bubble bursts.

The core indicators of a real estate bubble are as follows:

- 1) Home prices increasing at a faster rate than wages or rent.
- 2) Speculative market behaviour - rapid flipping, fear of missing out (FOMO), bidding wars, and/or multiple offers on the same property without standard closing conditions such as financing approval and inspection.
- 3) Increase in credit risk - high LTV mortgages, and an increase in household debt.

It must be noted that there are indicators that can cause an upward pressure on the real estate prices, but are not directly linked to a real estate bubble. Structural supply shortage, increase in cost of raw material, conservative lending practices, restrictive zoning, etc., are a few examples. Higher prices must not be considered in isolation when predicting a real estate bubble. A broader view of the Canadian economy and policy environment is a more reliable guide.

Finally, the purpose of this paper is not to sensationalize, predict a crash, or minimize affordability issues. Instead, the goal of this paper is to evaluate the Canadian housing market in detail and assess whether the current conditions are predictors of a classic

bubble or whether the high real estate prices are due to long-standing structural and institutional choices.

Bubble Indicator 1: Home Prices vs Income.

In a healthy real estate market, over the long term, house prices generally rise at roughly the same rate as household income, since buyers base their investment decision on their income. When home prices deviate upwards from the household income for an extended period of time, housing becomes unaffordable, household debt increases, and the leverage-to-income ratio increases, which increases the probability of a market correction.

The Indexed house-price-to-income is a metric used to compare the rate of growth of the median house price in a given nation to its median income. A higher metric indicates that house prices have grown faster than household incomes. According to Statista Research Department (2025), Canada ranked second in the world for the highest house-price-to-income index.

The average house price to income index for all the OECD (Organisation for Economic Co-operation and Development) nations stood at 116.2 index points, while for Canada it was at 137.1. The index for house prices relative to income grew to 137.1, indicating that the gap between housing costs and earnings widened by 37.1% compared to the 2015 baseline. Moreover, the median house prices have outpaced the median incomes in Vancouver and Toronto by 11.8x and 8.4x over the past decade, respectively, making Vancouver fourth and Toronto thirteenth severely unaffordable housing markets in the world.

The house-price-to-income ratio is where the math for the average Canadian really falls apart. Nationally, this ratio has climbed past 5.4x, meaning the median home now costs more than five times what the median household earns in a year. To put that in perspective, economists generally consider a ratio of 3.0 to be 'affordable.' By doubling that

benchmark, Canada has moved past simple 'unaffordability' and into a territory where homeownership requires either extreme debt or existing wealth. This is a classic symptom of a market that has outrun its fundamental base. The house-price-to-income ratio shows the average Canadian is facing a severe affordability crisis.

While this indicates a possible bubble-like behaviour, this does not necessarily confirm a real estate bubble on its own. Historically, Canada has faced long-standing supply shortages of raw materials, restrictive zoning policies, and high population growth rates, which push prices upwards independent of income growth. A widening house-prices-to-income gap does indicate a potential bubble-like situation, as well as draw serious affordability concerns, but it does not guarantee a real estate bubble.

Bubble Indicator 2: Home Prices vs Rent.

In a balanced market, house prices and rents move in tandem. If buying becomes too expensive, people choose to rent, which in turn pushes rent costs upward until buying becomes more attractive. However, when home prices skyrocket, and rents stay almost flat, this is a huge red flag. It indicates that people are not buying homes for the yield but to speculate. This is a prime example of the Greater Fool Theory, which suggests that one can profit from buying an overvalued asset by selling it to someone else (a "greater fool"), for an even higher price, regardless of the intrinsic value of the underlying asset.

In the real estate market, the price-to-rent ratio is one of the best ways to track this disconnect. According to Trading Economics, Canada's ratio stood at 125.5 in Q3 2025, down from a peak of 134.6 in 2024. This means that home prices are finally falling after hitting the ceiling because rent income just does not justify the huge, massive mortgage costs.

For years, the Canadian real estate market was known to be a "sure thing." Phrases like "Houses always go up" or "Real estate investing is the safest investment there is" were not uncommon. However, in 2025, the math (and the sentiment) flipped. In cities like Toronto,

many condo investors found themselves in a negative carry. The income (rent) was not even able to cover interest, maintenance, and property taxes, let alone the principal.

However, Canada's severe lack of purpose-built rental housing and high population growth have kept rents at historic highs, which supports these inflated prices. If rents stay high, they prevent a total system collapse, but it does create a trap where the only way to keep the market stable is to keep housing permanently unaffordable for an average Canadian resident.

Bubble Indicator 3: Credit Risk

One of the primary concerns in Canada when it comes to a real estate bubble isn't the size of the debt, but its fragility. According to Statistics Canada, credit market debt to disposable income is hovering at 176.66%. This means that for every dollar of take-home pay, Canadians owe \$1.77. Moreover, Consumer credit and mortgage liabilities to disposable income stood at 168.48% in Q3, 2025. This means that for every after-tax dollar a household earns, it owes \$1.68 in consumer credit and mortgage debt combined.

In 2026, a key concern is the upcoming "Renewal Wall." In Canada, typically, most borrowers renew their mortgage rates every five years. Therefore, debtors who borrowed in 2021, when the interest rates were at a record low, must renew in 2026. These homeowners will face a payment shock since the new rates would significantly increase their monthly payment amount due to an increase in interest rates, which started in 2022.

From a credit risk perspective, the most critical measure is the regional delinquency trend. While the national mortgage delinquency rates remain historically low at 0.22%, Ontario (0.23%) and Toronto (0.24%) have recently surpassed the national average for the first time in over a decade. While the delinquency rate for Toronto seems low, this represents a 60% year-over-year surge (from 0.15% in 2024). When debt serviceability is contingent on rate

cuts and extended amortizations, the credit quality of the underlying assets is compromised.

The Canadian housing market's vulnerability stems less from high prices alone and more from its heavily leveraged financial foundation. The intersection of extreme price-to-income/rent ratios and near-record household debt-to-disposable-income creates a fragile environment where the impending "Renewal Wall" transforms a pricing problem into an acute credit risk.

The Structural Counter-Narrative: Why Prices Won't "Burst"

While Bubble Indicators 1, 2, and 3 were pointed towards the idea that the market is primed for a correction and that Canadian real estate might be in a bubble, the structural argument claims that the real estate market in Canada is supported by a foundation of scarcity that a classic bubble definition does not account for.

- 1) The supply productive gap: According to a 2025 Scotiabank Economics report, approximately 27% increase in home prices can be directly attributed to a supply shortage. Here, the emphasis isn't simply on supply - "lack of houses", but a decline in construction productivity. Since 2018, the construction costs - labour, land, and material have risen. Real estate developers are finding it extremely difficult to build new units at a price point that new home buyers can afford.
- 2) Government-induced and closing costs on new homes: According to an Research report (2024) published by the Canadian Centre for Economic Analysis, in Ontario, development charges, levies, and taxes account for roughly 36% of the total cost of a new home. These are "sticky" costs, and unlike speculative sentiment, taxes and municipal fees rarely go down, creating a permanent floor for new construction costs.

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- 3) Zoning and Hammerlock: Historically, Canada's zoning laws have been very strict, which has funneled demand into a narrow band of turnkey properties in established neighbourhoods. However, a recent push in higher-density approvals has been noticed, which could ease supply pressure; the process, however, remains slow and expensive. This hammerlock on developments ensures that even when the demand drops, supply remains so restricted that the total price collapse is prevented due to limited inventory.
 - 4) The population floor: Recent cuts in immigration targets in 2025 and 2026 are a step in the correct direction; however, Canada still faces massive housing gaps. The Parliament Budget Officer (PBO) has estimated that Canada still needs approximately 3.2 million new net units by 2035 just to return to a balanced state. Even a slower population growth rate would still require a constant growth rate in new unit construction. Thus, this would provide a constant baseline of demand, which keeps the market from "popping" in the traditional sense.

Conclusion: A Structural Trap or a Speculative End?

Based on the evidence, it is clear that the Canadian housing market is currently caught between two conflicting realities. On one hand, the price-to-income ratio and price-to-rent ratio indicate a classic speculative bubble where the asset prices have detached from the earnings. On the other hand, the consistent structural deficit in supply and historically high population growth have solidified the floor which, in the past, many economists have predicted can "burst/break" anytime.

However, taking into account the household debt and the delinquency rates has changed the conversation from "affordability" to "solvency." The idea and belief that people will always find a way to pay for a roof over their heads is finally being tested by the sheer math of debt servicing.

The ultimate goal of this paper was to determine if current conditions are predictors of a classic bubble. Again, a bubble usually represents a sudden “pop.” However, Canada’s situation looks more like a puncture. As long as policy interventions continue to protect borrowers from the full weight of their debt, the market does not seem like it would crash in the traditional sense. Instead, it risks entering the “lost decade” - a term used to describe stagnation.

For Canadian investors and policymakers, the risk is no longer just a drop in home values, but it is the long-term fragility of a national economy that has placed far too many eggs in a single, increasingly unstable basket.

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<https://doi.org/10.25318/3810023801-eng>