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October 1, 2026

Greater Victoria Chamber of Commerce and

CFA Society Victoria

Victoria, British Columbia

Canada's housing affordability dilemma

Introduction

I'm very happy to be giving this speech in Victoria today. This city is home to me. I spend most of my time in Ottawa now, but Victoria has been my home base for more than 20 years.

I also started my public sector career here about 15 years ago, so this feels like a professional homecoming too.

It also feels fitting to talk about Canada's housing affordability dilemma here because this is where I first faced it as a public policy problem. It has followed me for the last 15 years through different jobs, different cities and provinces, and even to another country.

Housing affordability remains one of the most pressing economic issues facing Canadians today. It affects both the people trying to buy a home and those trying to rent one.

And affordability is not just about whether people can get into the market. When more household income goes to rent or mortgage payments, families have less room to spend, to save and to absorb an unexpected expense. Over time, that weighs on growth and makes the economy more fragile.

More recently, house prices have come down. That can bring relief for some buyers. But it can also reduce household wealth, weaken spending and slow home sales activity and new construction.

I would like to thank Brian Peterson, Bradley Howell and Charles Gaa for their help in preparing this speech.

Not for publication before October 1, 2026

3:05 pm Eastern Time

It feels a bit like a trap. Higher prices make housing less affordable and leave many households with less room for everything else. Lower prices weigh on consumer confidence, wealth and economic growth. This is the heart of the housing affordability dilemma and why it's so hard to fix.

Housing and house prices have become about far more than just the cost of shelter. They are now deeply intertwined with household wealth, the stability of our financial system and the strength of our economy.

Mortgage debt makes up the largest share of household borrowing, and home equity underpins much of household net worth and access to credit. This shapes how Canadians spend, save and borrow.

Canadian banks are also heavily exposed to residential mortgages. About half of all bank lending is tied to residential real estate. That means movements in house prices can affect lending across the economy and closely tie the health of our banks to the health of our housing market.

And housing has become a much larger part of our economy. In 2000, residential investment accounted for 4.3% of gross domestic product, while overall business investment on machinery, equipment and innovation accounted for 8.3%. Today that relationship is reversed. Canada is investing more in residential housing than in the tools, technology and ideas that grow our economy and increase our standard of living. In other words, housing sits at the heart of our productivity challenge too.

My speech this afternoon won't deliver a solution to housing affordability. If there were an easy solution, the problem would be fixed by now. The policy levers that affect the housing market aren't concentrated in the hands of any one decision-maker. They are spread across different levels of government and many different agencies and regulators.

I'm also not going to assign blame. Our housing affordability problem is not the result of one decision, one policy or one institution. It reflects years of choices and constraints across governments, regulators, borrowers and lenders. Each was responding to the problem in front of them, often with solutions designed for a narrower purpose.

What I will do today is illustrate this problem, drawing on my own experience over the last 15 years. I will share what that experience has taught me about policy trade-offs and how it has shaped my view of the housing market. And then I will end by talking about the implications for our job at the Bank of Canada.

The view from British Columbia

My experience starts here in British Columbia, with a weekend all the way back in February 2016 when *The Globe and Mail* ran an investigative piece titled "The real estate technique fuelling Vancouver's housing market." It described a practice it

called *shadow flipping*. Essentially, a buyer would enter into a contract to buy a home and then assign their right to purchase to a new buyer before the original sale even closed. That new buyer could, in turn, assign the contract to yet another buyer.

Each time this happened, the price was bumped up and the person who assigned the contract pocketed the difference without ever taking possession of the property. Realtors were arranging these transactions and making a commission on each one and, in some cases, were themselves the buyer or seller. The original owner didn't benefit at all and often had no idea this was happening. And all of this was legal.

You can imagine this didn't go down very well with the government or with the public, particularly as it was happening amid growing concern about housing affordability.

I was working at the Financial Institutions Commission at the time, and after that story came out, I found myself leading an expert panel that was asked to make recommendations on how to put a stop to this practice and restore public confidence.

The panel delivered a report that included 28 recommendations to strengthen the regulations protecting consumers and hold real estate agents more accountable for acting in the public interest.

The government adopted all the recommendations and, overall, I felt like we had done some good. But the report was also very clear that none of the recommendations would meaningfully affect declining affordability. House prices weren't increasing because of the poor conduct of some in the real estate sector. Rather, poor conduct in the real estate sector was driven by the fact that houses were being treated more like speculative investments than homes to live in.

A prudential view

Shortly after the report was delivered, I moved to a new job at the Office of the Superintendent of Financial Institutions—OSFI. OSFI's job is to design and implement rules to keep the country's banks safe. When I arrived in the fall of 2016, housing was getting a lot of attention.

OSFI's concern was that continually increasing house prices had lulled mortgage lenders into a sense of complacency. Banks were relaxing their underwriting standards, focusing less on borrowers' capacity to repay their mortgages and relying more on the assumption that collateral values—the price of houses—would only increase.

In the fall of 2017, we decided to strengthen the mortgage underwriting guidelines for banks. The biggest change was introducing a stress test, which required borrowers to demonstrate that they still had room to make their mortgage payments at a higher interest rate than their contracted rate.

The practical effect of the rule was that it reduced the maximum amount of mortgage debt borrowers could access. In an environment where house prices were increasing, you can imagine this change was not popular with everyone.

The criticism was loudest from the mortgage broker and real estate industries. Their view was that the stress test made affordability worse and risked cooling the housing market. Some economists and banks were more supportive, but many people saw the policy as an attempt to offset low interest rates or to cool overheated markets in certain cities.

We spent the next year explaining that this was not the purpose of the stress test. It was not a forecast that interest rates would rise, and it was not an attempt to slow the rise in house prices. It was a way to make sure borrowers had a margin of safety against a range of risks: higher interest rates, a loss of income or unexpected expenses. That seemed prudent for borrowers and for banks, and our job was to keep banks safe.

The experience since then has proven the value of the stress test. It did what it was designed to do. It strengthened mortgage underwriting, gave borrowers a buffer and helped protect financial stability through a period of sharply higher interest rates. I will come back to this point in a few minutes.

But the stress test did very little to make housing more affordable as prices continued to climb.

An international view

In 2019, I moved to Switzerland to work with the Basel Committee on Banking Supervision, an organization that brings together central banks and bank regulators from around the world to set standards for large, globally active banks. The lesson from that job was that the challenges Canada was facing were not unique.

By 2019, many advanced economies were facing the same pattern. House prices had outpaced incomes, mortgages were getting larger, and household debt was reaching record levels. Australia, Sweden, New Zealand, the United Kingdom and Switzerland were all facing versions of the same problem.

Housing had become a fault line running through the financial system. It was the biggest asset on household balance sheets and the main collateral supporting bank lending. A sharp correction could spread quickly from households to banks to the broader economy. The 2008–09 global financial crisis had shown how damaging that dynamic could be.

So regulators were focused on resilience. They were strengthening mortgage underwriting, and some introduced stress tests, loan-to-income limits or loan-to-value limits. Many also required banks to hold more capital as the credit cycle

matured. The objective was for banks to be strong enough to withstand the downturn when it came.

But the credit cycle we were preparing for never arrived. What came instead was a global pandemic. Emergency interest rate cuts and fiscal measures helped support the economy through a once-in-a-generation shock. But these measures arrived alongside constrained housing supply, a sudden demand for more space as people were confined to their homes, and, later, a surge in population growth from immigration. Instead of a downturn, Canada and many other countries saw a housing market boom.

Mortgage credit surged as households borrowed at very low rates, adding more debt to balance sheets already heavily exposed to real estate. Then, as economies reopened, inflation surged and central banks raised interest rates sharply to restore price stability.

Canada weathered that shock relatively well. Households and banks absorbed the increase in interest rates. It was not without pain. Some borrowers faced real stress, but the losses many feared did not materialize. Banks remained resilient and the system absorbed the shock. But the regulatory policies that helped absorb the shock did not prevent further deterioration in affordability. In Canada, the average house price rose about 50% in two years.

Looking back across these three experiences—here in British Columbia, at OSFI and internationally—the pattern is clear. Each set of policies was aimed at a real risk. Each helped make part of the system safer. But none changed the underlying dynamic: housing was becoming more tied to household wealth, credit and economic growth. And the more that housing supported financial resilience and economic activity, the harder it became to restore affordability without creating new risks.

A central bank view

And that brings me to our work at the Bank of Canada.

Let me start by dealing head on with the argument that the blame for high house prices rests with central banks that kept interest rates too low for too long, making it easier to borrow more and bid up housing.

There is no question that low interest rates played a role. After all, that's how monetary policy works. It supports the economy by stimulating demand and it works most directly on those things we need to borrow to buy.

But interest rates were not the only force at work. The same period also saw strong immigration that contributed to population growth, limited housing supply, zoning and infrastructure constraints, incentives to borrow and speculative investment as more people saw housing as a way to build personal wealth.

So the story is more complicated than low interest rates. But that doesn't let monetary policy off the hook. The intersection of monetary policy and housing is something my colleagues and I at the Bank think about a lot. We recently examined this topic as part of our review of our monetary policy framework. Our framework is the approach we use to keep inflation low and stable, mainly by setting the policy interest rate. We review it every five years to make sure it is still serving Canadians well in a changing economy.

This year we decided to ask ourselves two important questions—questions we thought were probably on the minds of Canadians too. First, could or should monetary policy do more to lean against rapidly rising house prices? Second, does the way shelter costs are measured in inflation give us the right signal about the cost pressures Canadians are facing?

Both questions brought us back to the dilemma I have been describing today. A housing market that has become deeply tied to wealth creation, credit and economic growth creates tough policy trade-offs.

I will start with the first question: should monetary policy do more to lean against rapidly rising house prices? Interest rates matter for house prices. They affect the cost of borrowing and, when prices are high and mortgage debt is large, they can move through the housing market in powerful and uneven ways.

If the Bank raises the policy interest rate, credit becomes more expensive. That can take some pressure off house prices by reducing demand. But higher rates also make it harder for new buyers to qualify for a mortgage and increase payments for some existing borrowers. And the effects won't stop at housing. Higher interest rates will slow spending and investment across the economy.

A rate cut has its own trade-offs. Lower rates can improve housing affordability by making credit more accessible and reducing borrowing costs. But if housing supply is constrained, stronger demand can end up pushing prices higher. And because lower rates also boost demand more broadly, they can add to inflationary pressure.

That is the core challenge. Monetary policy can influence demand across the economy—including demand for housing. But it is a blunt tool. We set one interest rate for the whole economy. We cannot set one rate for housing and another for everything else. And interest rates cannot directly address supply constraints. They can't build homes, rezone land or speed up permits.

Now let's take the second question. What is the best way to capture housing costs in our inflation measure? Here, too, we found real trade-offs.

Canada's consumer price index (CPI) measures housing mainly as the cost of shelter over time. For renters, it's straightforward: it's the cost of rent. For homeowners, it includes ongoing costs such as property taxes, insurance, maintenance and

mortgage interest. The purchase price of a home is treated differently because a home is also an asset.

That distinction has a logic to it. But it's a bit at odds with how people experience housing affordability. High house prices affect whether Canadians can buy a home, how much debt they carry and how much wealth they build. So house prices may not be consumer prices, but they still shape how Canadians experience affordability.

On the other hand, if we included house prices more directly in the CPI, we would risk mixing two different things: the cost of living today and the value of an asset that may rise or fall over time.

There is also the mortgage interest effect. When we raise interest rates to bring inflation down, mortgage interest costs rise. Because those costs are included in the CPI, higher interest rates temporarily add to measured inflation even as they work to reduce inflation more broadly. Put simply, the tool we use to reduce inflation can, for a time, add to the inflation number itself. That can be hard to explain. Taking mortgage interest costs out of the CPI would avoid this problem, but it would also remove a real cost that many households are paying.

So we looked at alternative ways to measure shelter costs, including approaches used in other countries. Some measures put more weight on house prices, some treated mortgage interest costs differently, and others use rental values as a proxy for the cost of owner-occupied housing. What we found was that each option had advantages, but each came with its own problems. There was no simple change to our inflation measure that would do a clearly better job of capturing the affordability challenge Canadians are facing.

The bottom line—our review was a clear reminder that there are no simple fixes to our monetary policy framework that make trade-offs disappear. Interest rates can influence house prices, but they are too blunt to target housing affordability directly. No single measure of shelter costs fully captures the affordability pressures Canadians face. The most important lesson we took from our review is that we need to explain these trade-offs better and be clear with Canadians about what monetary policy can and cannot do.

Conclusion

Let me close by coming back to where I started. Housing affordability is hard to solve, not because no one has tried, and not because the problem is poorly understood. It is hard because, over a long period of rising house prices, housing became tied to many other things we also care about: like household wealth, financial stability and economic growth.

Rising prices made housing less affordable, but they also supported household wealth and economic growth. Falling prices may improve affordability, but they also

reduce household wealth, slow economic activity and can put stress on borrowers and lenders.

Regulation can make markets fairer, strengthen borrowers and banks and help the financial system absorb shocks. But it can't restore affordability. That will require a broader, sustained effort: more supply, better planning and infrastructure, regulation that protects resilience, and incentives that don't add demand to a market already short on supply. We're on the right track on many of these things, but we have a way to go and it will take time.

For central banks, the best contribution is still price stability. Low, stable and predictable inflation gives households, businesses, builders and governments a better foundation for decision-making. Housing must remain an important input into monetary policy decisions, but targeting house prices directly with interest rates would ask monetary policy to do more than it can reasonably do—and would risk imposing costs across the broader economy.

The lesson I take from all of this is that housing affordability will not be restored by asking any one policy to do more than it can. The goal has to be a policy mix that increases supply, protects resilience and reduces the economy's dependence on rising house prices.

That will take patience and coordination. It will take choices that are consistent over time. And it will take a willingness to look beyond the immediate symptoms to the deeper forces driving affordability challenges.

If we can do that, we have a better chance of building a housing market that provides shelter, supports stability and contributes to prosperity without asking housing to carry so much of the economy on its back.

Thank you.