The Edge Report

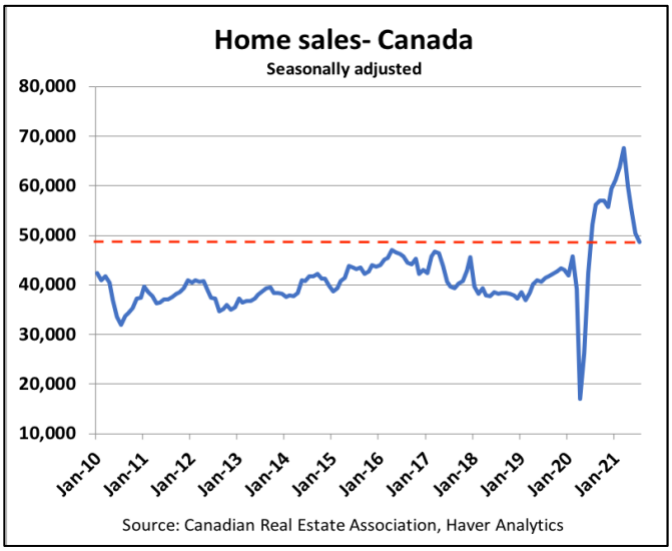
August 2021

Hyperlinks:

1) Sellers disappear as listings hit fresh 20-year lows

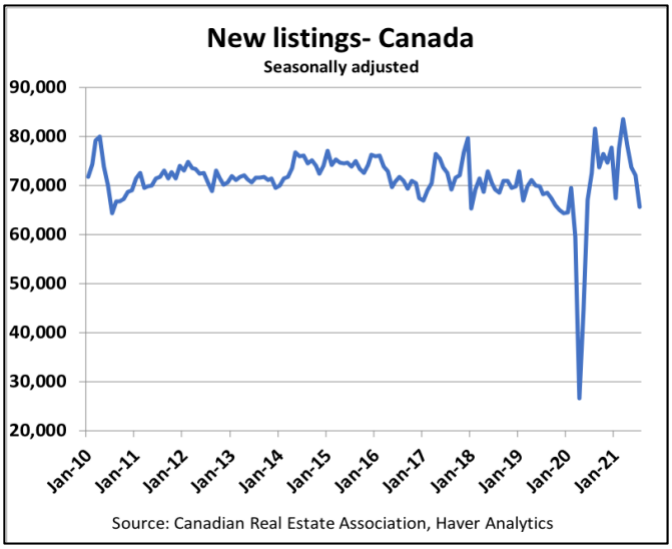
i) Home sales continue to slow from record levels

Canadian home sales slipped 3.5% m/m in July and are now down a cumulative 28% from the March peak. That's quite a slowdown, but it still leaves sales roughly 10% above the previous highs from 2016:

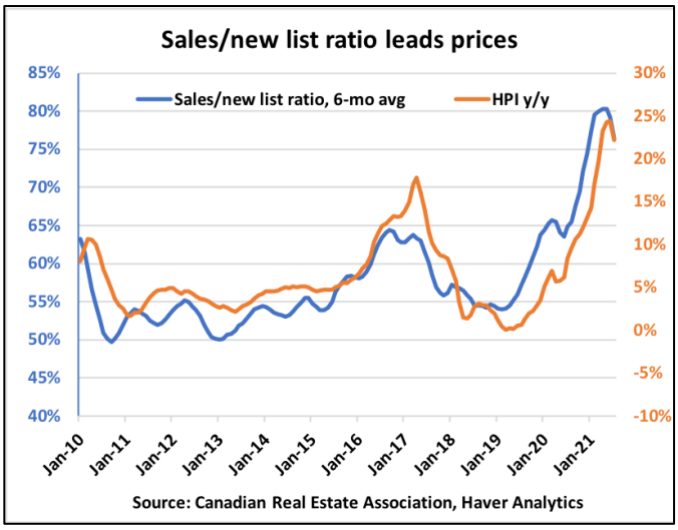


ii) Sellers disappear, new listings plunge in July

The bigger story remains the persistent lack of resale supply. New listings fell 8.8% m/m to hit the lowest level since the onset of the pandemic:



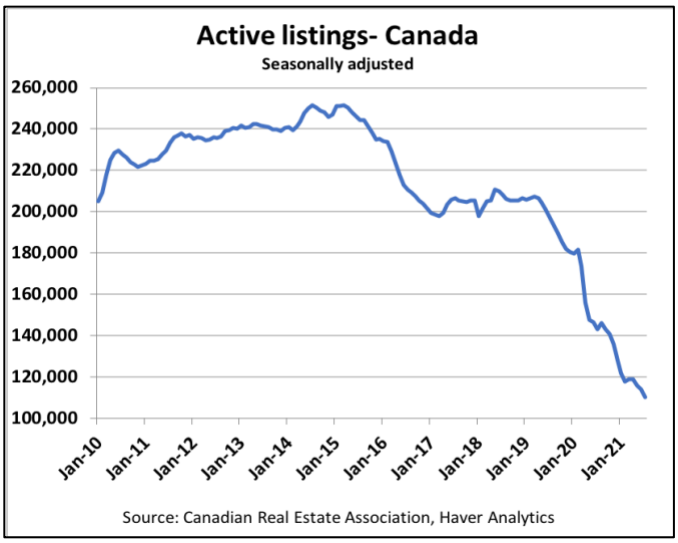
The sales-to-new listings ratio, a measure of the flow of new supply relative to demand, rose to 74% in July on a seasonally adjusted basis, up from 69% in June. While this is way off the record peak of 91% to start the year, it remains one of the highest readings on record. For context, the 2016 and 2017 market peaks never saw this ratio above 70%. This is still a remarkably tight resale market:



At least part of the decline in new listings is likely a function of prospective sellers choosing to hold off listing until the fall. After being cooped up for most of the past year, most people just want to be out enjoying the summer. We should see listings normalize come September.

iii) Inventory hits fresh 20-year lows

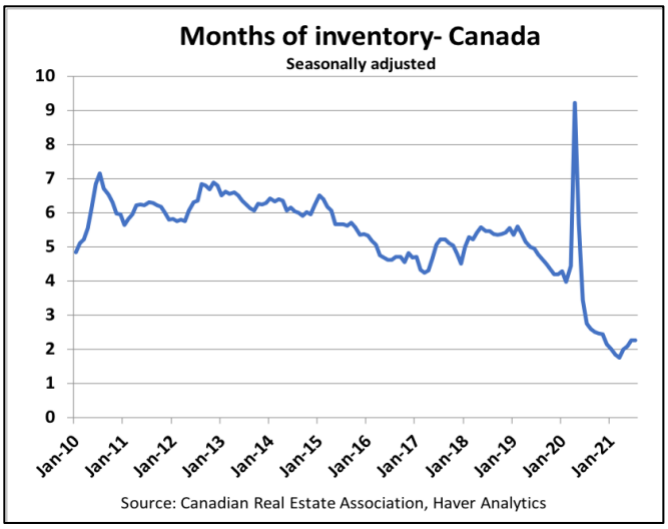
The low level of new supply coming to market helped push active listings to a fresh 20-year low, down another 3.0% m/m seasonally adjusted in July. Inventory levels are down 23% from this time last year and are almost 60% lower than in 2015.



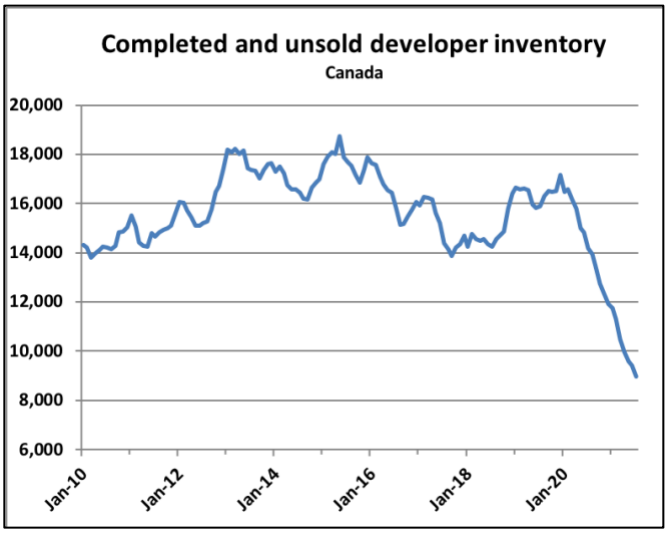
The table below highlights the dramatic decline in new listings and active inventory across the country:

	Sales		New listings		Active inventory	
	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted
Canada	-6.6%	-3.5%	-9.4%	-8.8%	-22.9%	-3.0%
BC	+3.2%	-2.5%	-14.2%	-12.7%	-31.1%	-7.1%
AB	+23.5%	-10.5%	+3.7%	-9.2%	-5.4%	-1.4%
ON	-12.3%	-3.2%	-11.5%	-6.9%	-29.8%	-5.7%
QC	-20.3%	-1.1%	-25.1%	-16.5%	-29.0%	-4.2%

Months of inventory was a razor-thin 2.3 in July. To frame just how absurd that is, consider that this measure was at 4.0 just prior to the onset of the pandemic, and that was already a record low at the time:

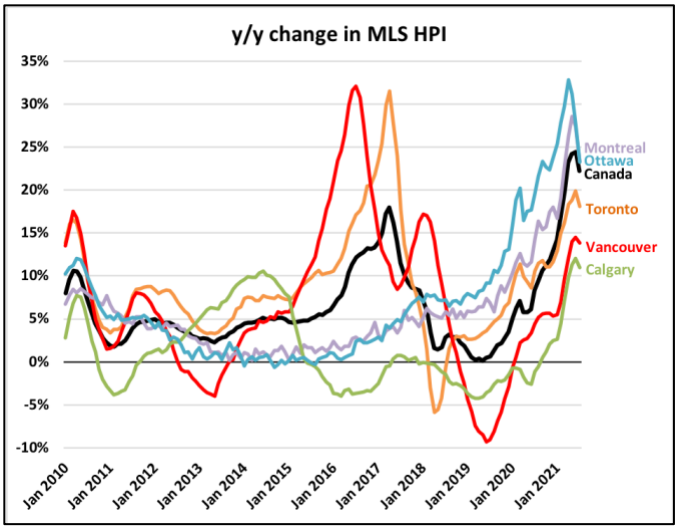


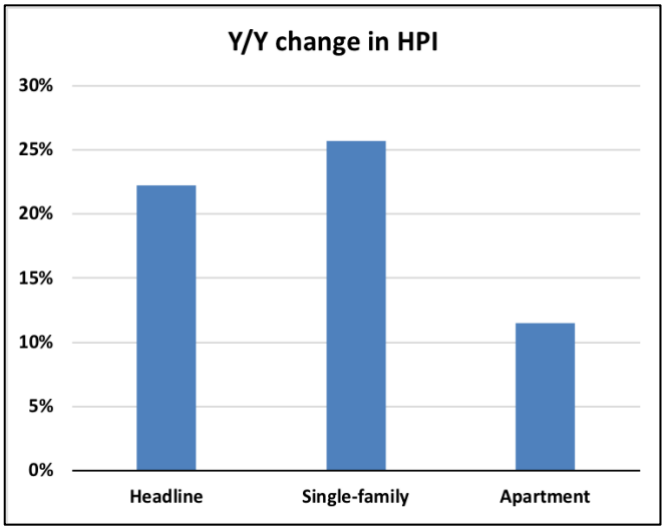
To further reinforce the point, housing starts data last week showed another stunning decline in unsold developer inventory across the country. With so little resale inventory available, buyers are quickly snapping up anything developers can build it:



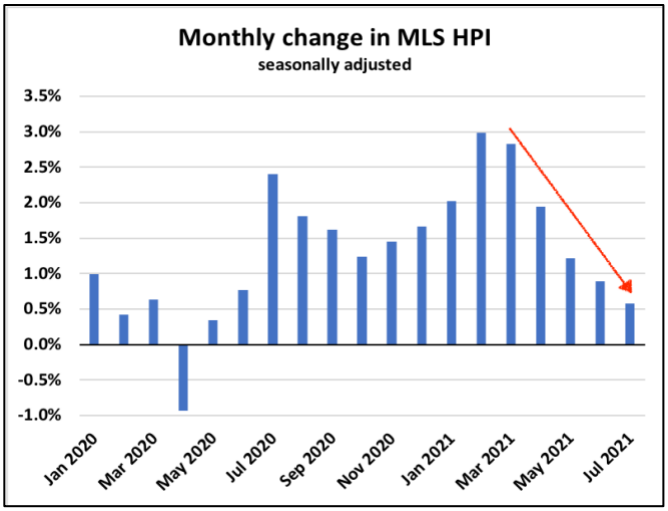
iv) Prices lose momentum, "cottage country" sees declines

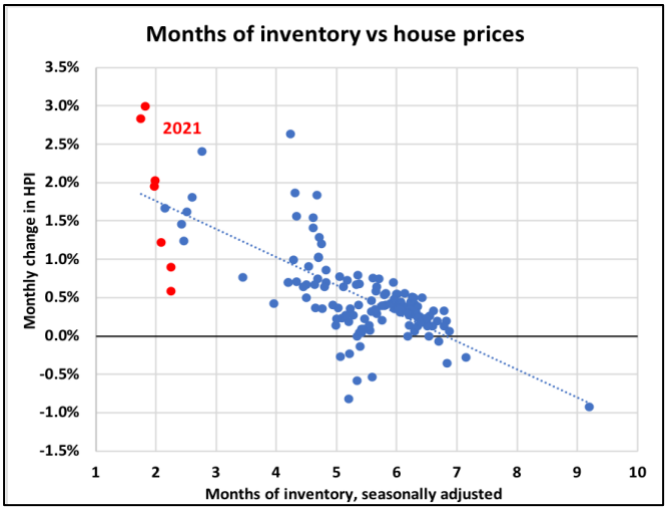
After hitting a +30-yr high of 24.4% y/y in June, price gains decelerated to 22.2% y/y last month. Still, that equates to $133,000 of new equity for the average homeowner relative to this time last year:



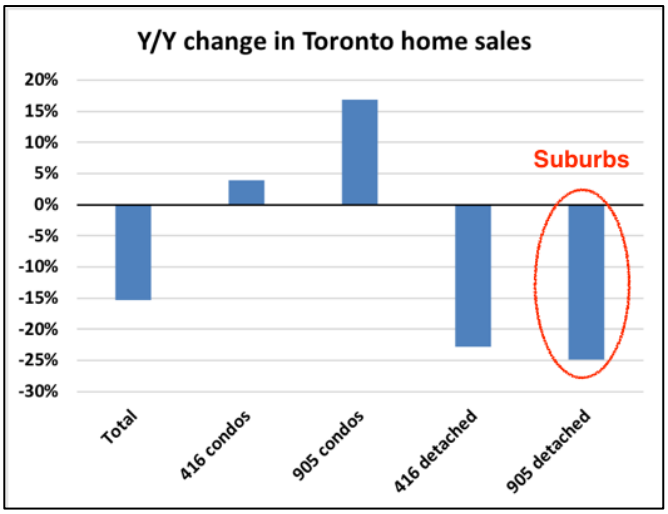


There's also been a notable deceleration in monthly price gains since the start of the year, with July registering the smallest monthly increase since June 2020. But it's important to remember that we've never seen sustained monthly declines in house prices with months of inventory at less than 5. That means we need to see inventory levels more than double or sales cut in half (or some combination of both) before we can reasonably expect prices to decline:

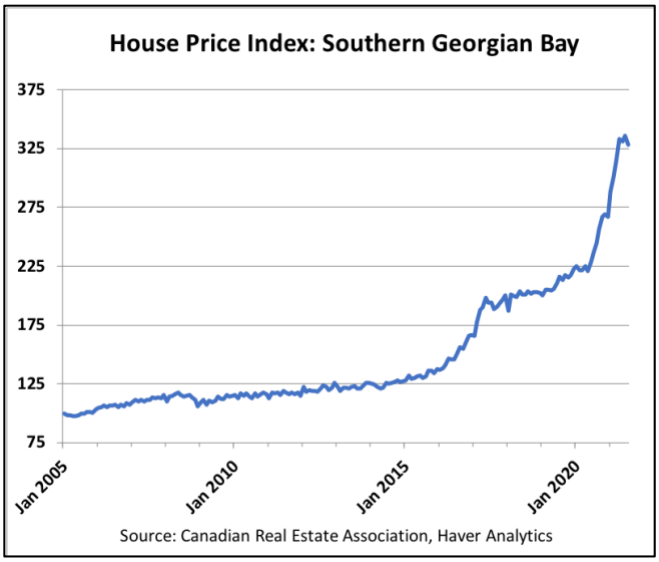


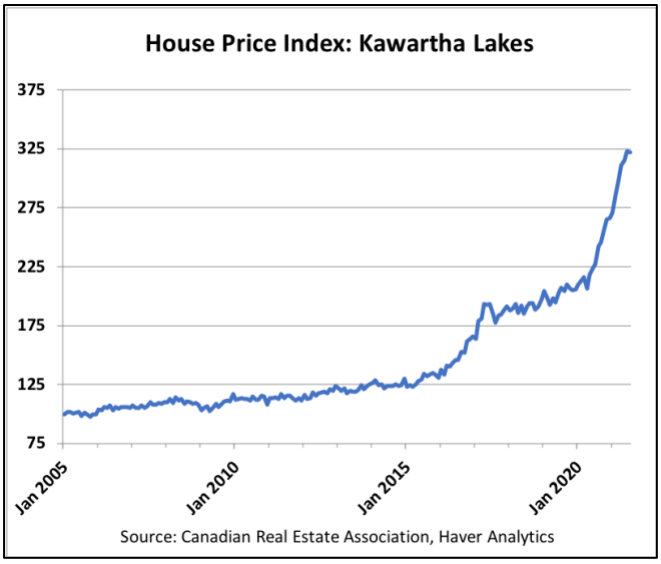


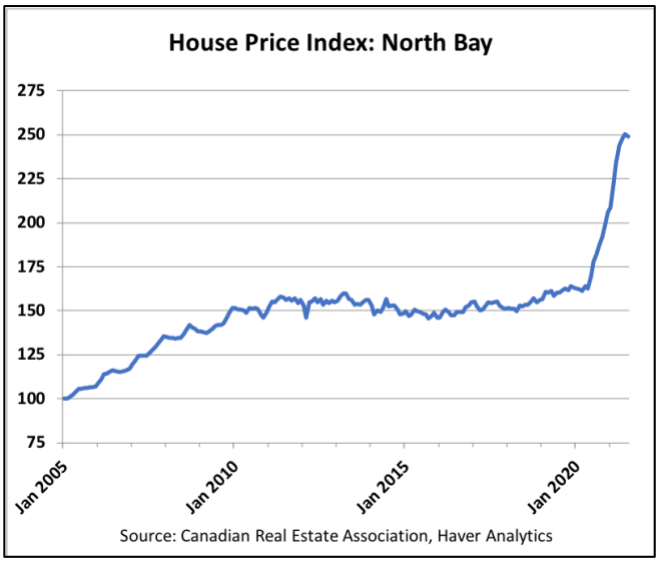
That's not to say there won't be pockets of weakness. As flagged in the last Metro Deep Dive, the preliminary data out of Toronto showed signs of a reversal in the "flight to the suburbs" trend we've seen since the start of the pandemic, as evidenced by the disproportionate slowdown in detached home sales in the suburbs:



The latest house price data provides further confirmation of a cooling in some popular cottage/vacation areas. The seasonally adjusted house price index posted declines in Southern Georgian Bay, Kawartha Lakes, and North Bay in July.

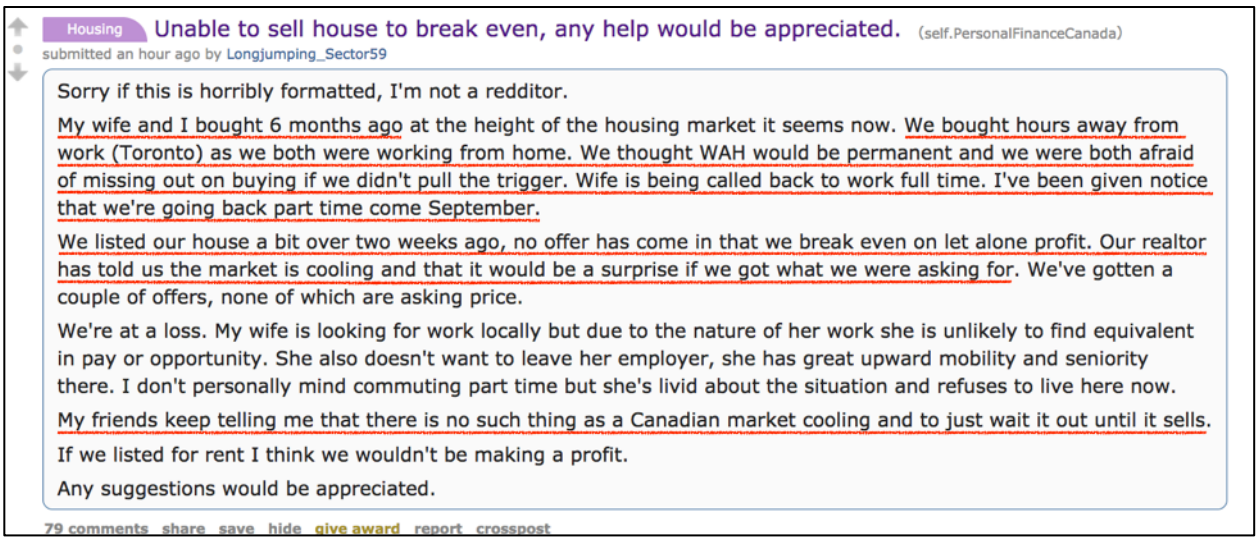






The anecdotes are just as telling. Mortgage broker Ron Butler is reporting that appraisals are starting to "fail" on certain rural properties and that the trend is accelerating. To be clear, these aren't waterfront properties in popular areas, but the fact that banks and appraisal companies are beginning to question valuation on less liquid properties is a sign that the crazy boom times of Q1 are well behind us:

And over on Reddit, a new homeowner who bought earlier this year "*hours away from Toronto*" is shocked that they may be stuck with a loss now that they're being recalled to the office and have decided to sell:



This is a trend to watch. At this point a modest cooling has to be expected after some of these regions saw prices run up 60% y/y. But these markets tend to be highly illiquid and are prone to significant price volatility in both directions.

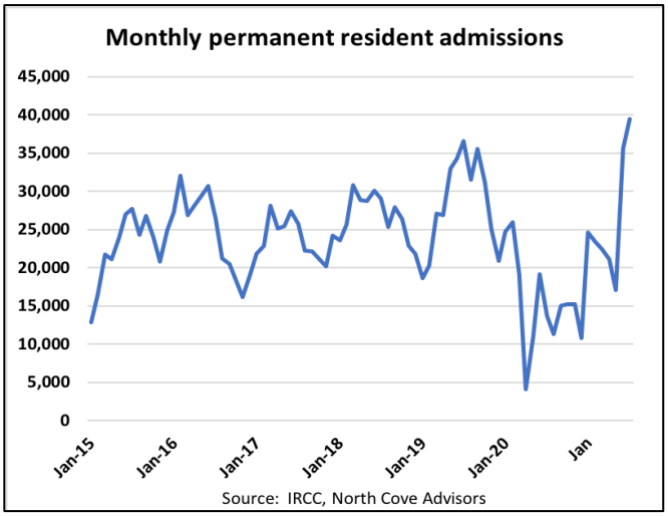
2) Supply/demand deep-dive: Housing starts hit +40-yr highs, immigration surges in July

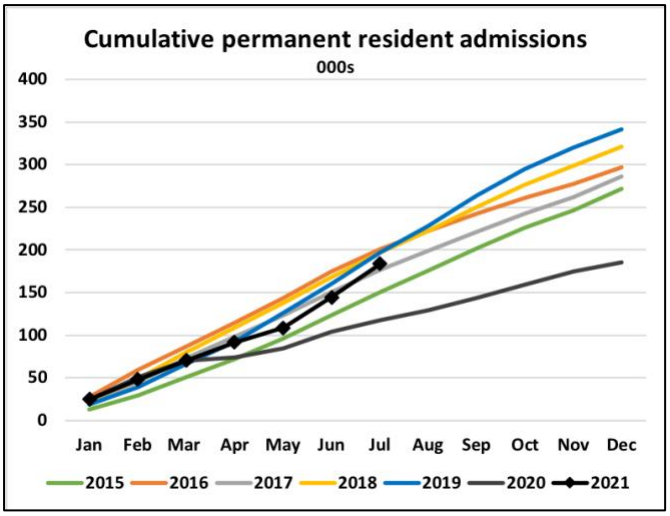
i) Canada admits record number of new permanent residents in July

First, from CTV[1]:

> Canada is on track to meet its goal of 401,000 new permanent residents this year after adding record numbers in June and July, Immigration Minister Marco Mendicino said on Friday.
>
> Canada counted 39,500 new permanent residents in July - a number that has not yet been published officially - after 35,700 in June, both monthly records, the minister said. That brings the 2021 total so far to more than 184,000.

If that data is correct, it means that not only did July see a record for that month, but it would be the highest number of permanent resident admissions of ANY month since at least 2015. Cumulative year-to-date admissions are still running below 2018 and 2019 levels, but that will change quickly if Canada can sustain the pace from June and July:

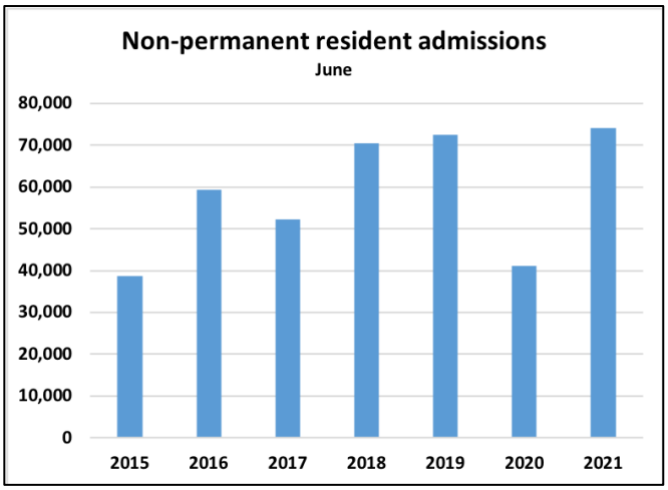




ii) Return of foreign students causes dramatic tightening in rental market

Non-permanent resident admissions, which are made up primarily of foreign students and temporary workers, hit a record for the month of June, nearly double what they were last year at this time:

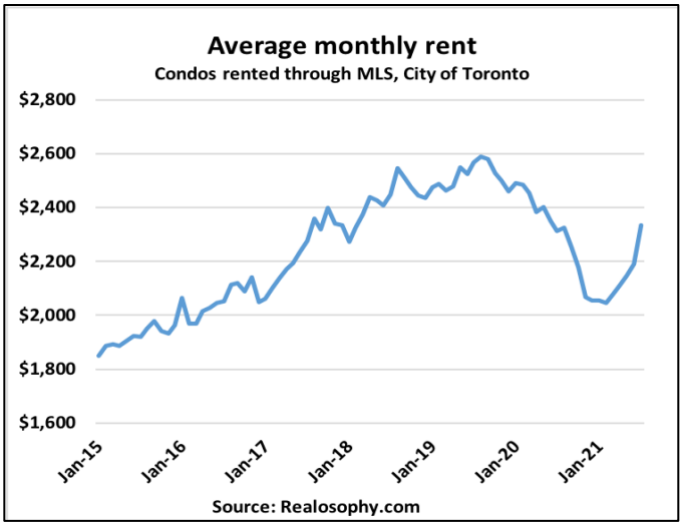
[1] https://www.ctvnews.ca/mobile/politics/canada-on-track-to-meet-ambitious-2021-immigration-target-minister-says-1.5546419



This influx of students ahead of the fall semester is having a marked effect on the rental market in major cities. From the Globe and Mail[2]:

> […] In the past three weeks, overseas students have begun making plans to return to the city, says real estate agent Simson Chu.
>
> […] Mr. Chu says students attending the University of Toronto, Ryerson University and George Brown College are searching for condo units and rental apartments downtown.
>
> "I think what I'm observing right now is the students," Mr. Chu says. "That's the first wave of coming back."
>
> […] One new tenant offered to pay five months' rent up front. Another, a full year. "They offered one full year up front without seeing the unit because they are still in China," Mr. Chu says, and the bloated inventory of recent months is being absorbed.
>
> Mr. Chu recently listed a three-bedroom basement apartment that the owner was willing to lease for $2,500 a month. The student who leased it offered $2,700 a month, he says.

I clearly misread how quickly this market would firm once foreign students returned. Rents have rebounded sharply in major metros like Toronto:



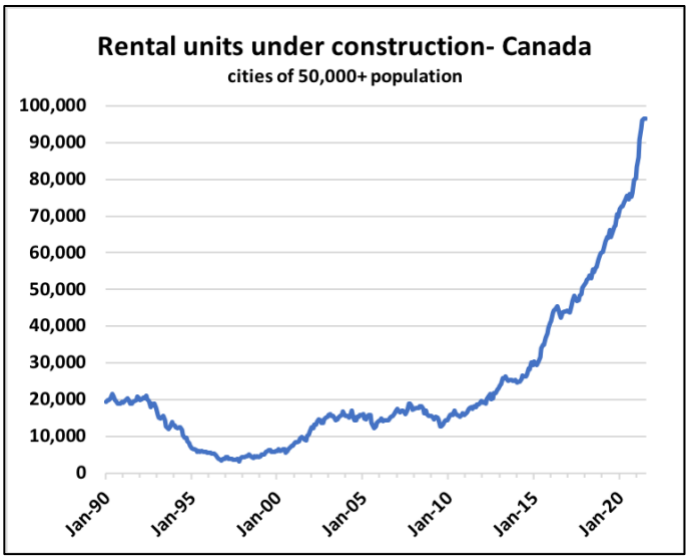
[2] https://www.theglobeandmail.com/real-estate/toronto/article-toronto-sees-back-to-school-rush-for-accommodation-as-students-prepare/

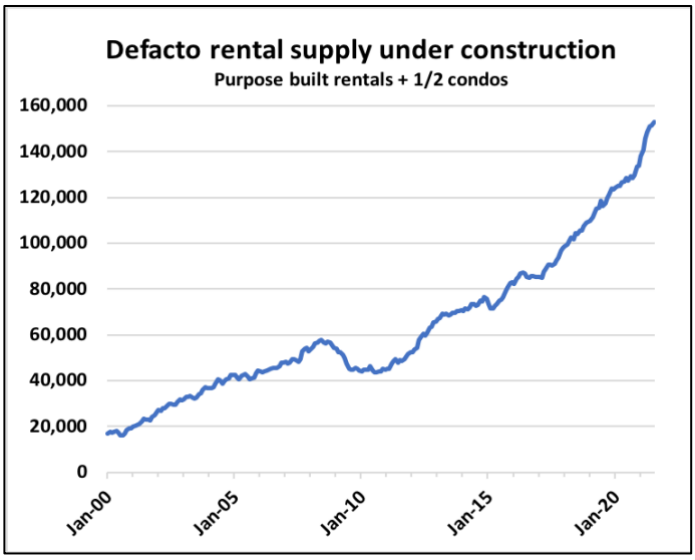
That said, it's still not clear that the current trajectory can be sustained beyond the initial "return to school" surge.

For starters, even with the recent surge in demand, absorption rates, as measured by the lease/list ratio, are still not back to pre-COVID levels. This tells us that new listings are also still elevated. My guess is that with rents still 10% below the highs but clearly recovering, more tenants are moving laterally to lock in lower rents.

More importantly is the supply side. We have yet to see how Toronto will handle short-term rental (STR) enforcement. Under the new rules which came into effect on Jan 1, only principal residences can be rented through STR platforms. The city has yet to take any real enforcement actions due to COVID, but it's reasonable to expect that as they do, we will see a continued flow of these units into the long-term rental market.

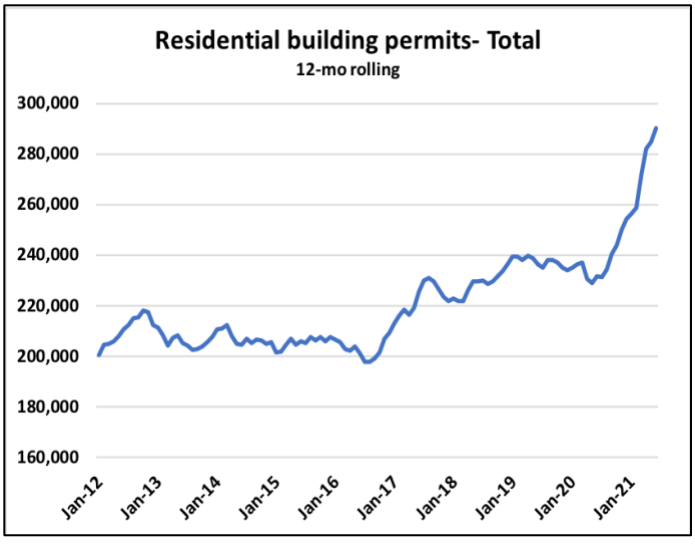
Purpose built rentals under construction also continue to surge and are now closing in on 100k just in larger metros. And if we lump in half of the condos under construction, which is roughly the share that enter the rental market at completion, it's over 150k:

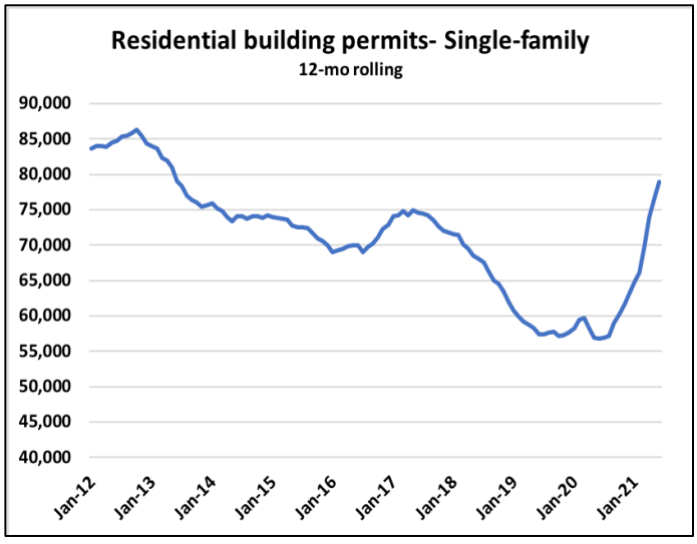




iii) Building permits hit new record, single-family permits hit 8-yr highs

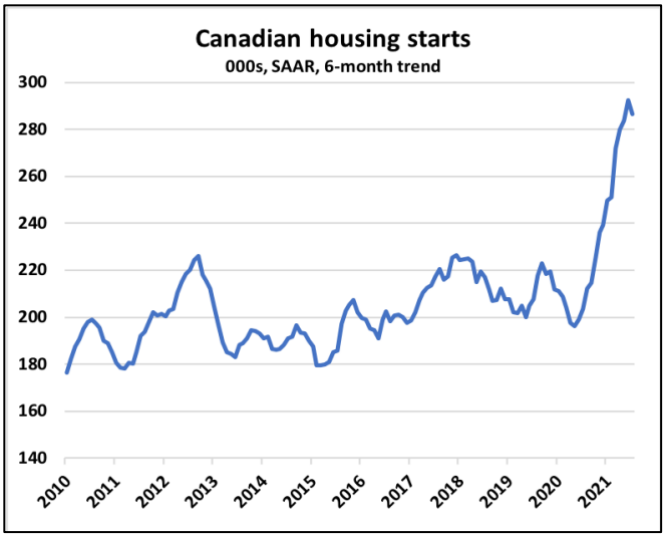
Residential building permits continue to surge and were up another 8.8% m/m in unit terms in June. That brought the 12-month rolling total to 290k, by far the most on record. Even the chronically under-supplied single-family segment has seen permits hit 8-year highs.





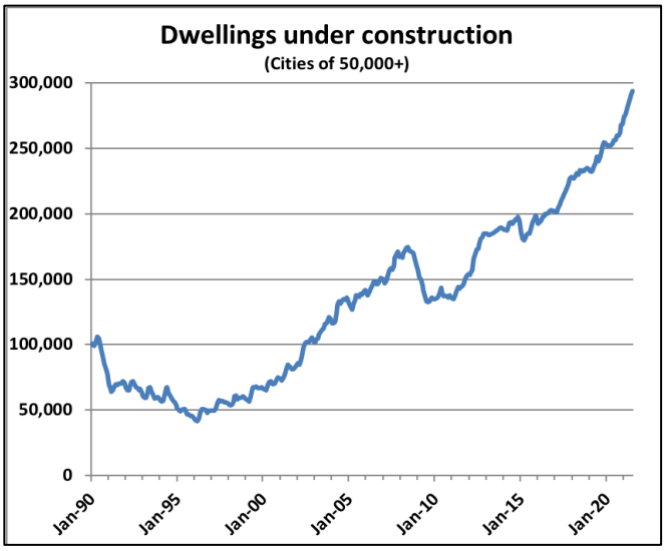
Permits translate into housing starts, usually with a lag of 3-6 months, which means we should see very strong building activity through the remainder of the year. This may help bring some reprieve to an undersupplied market and perhaps finally take some steam out of resale prices.

Housing starts were down a tad in July at -3.2% m/m to 272k on a seasonally adjusted annualized basis. But that monthly number is very volatile. The 6-month trend, which smooths out some of those month-to-month wiggles is running at an incredible 286k, way above any estimate of household formations.



Single-family starts rose 5% m/m in July after falling for the past 3 months. The 6-month trend is now at 112k SAAR, the highest since 2010.

New supply in the construction pipeline continues to grow. There are now almost 300k units being built across the country in larger cities, more than double what there were just 10 years ago:

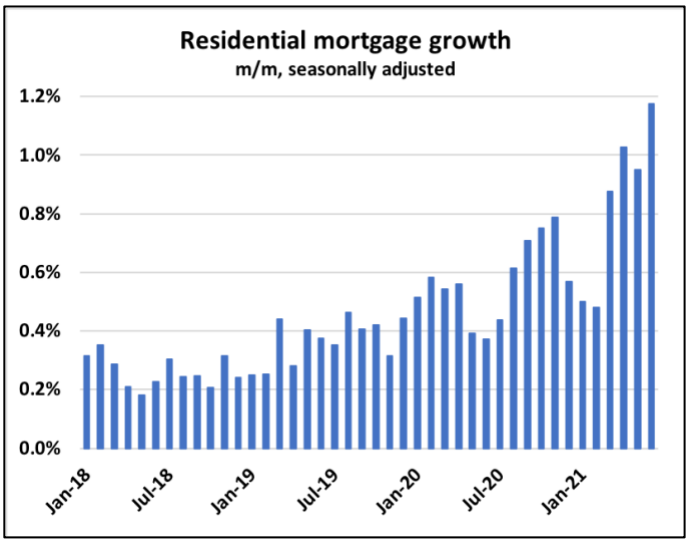


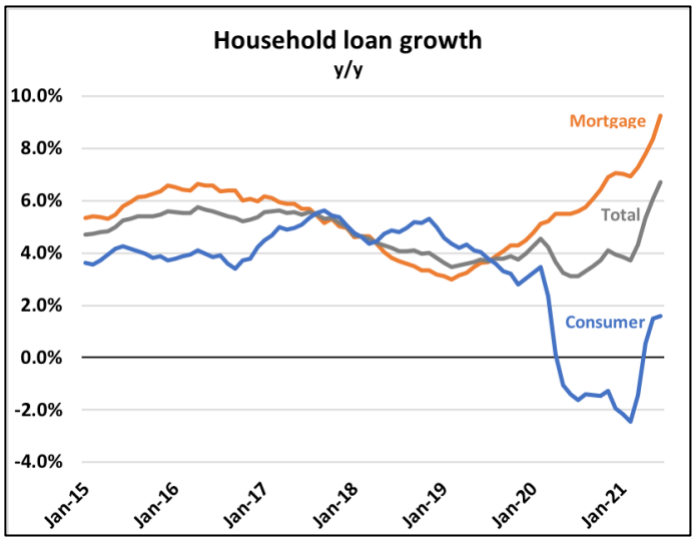
New supply is coming which should help move the market towards a more balanced position later this year and into 2022.

3) Household credit update: Mortgage growth surges in June, regulators are nervous

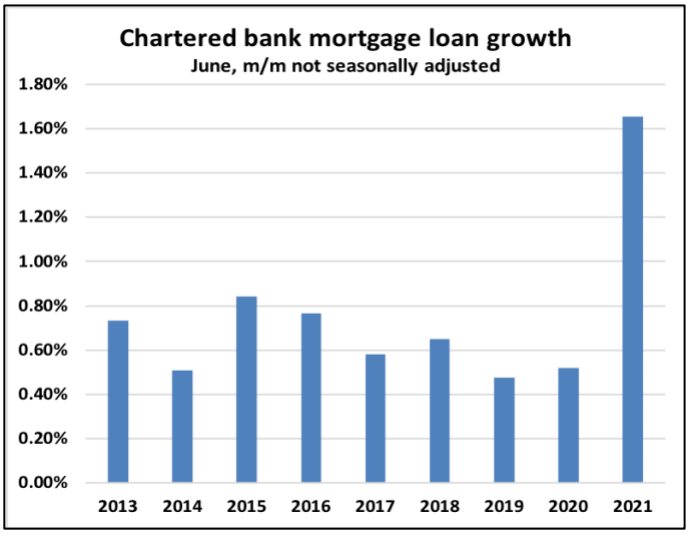
i) Mortgage growth hits highest level since 2007

Mortgage growth surged again in June, up a record 1.2% m/m seasonally adjusted. That's the strongest 1-month growth rate since 2007, and it put the y/y rate above 9% for the first time since 2009:





If we look at the non-seasonally adjusted data from OSFI, the m/m growth for chartered banks in June really stands out relative to prior years:



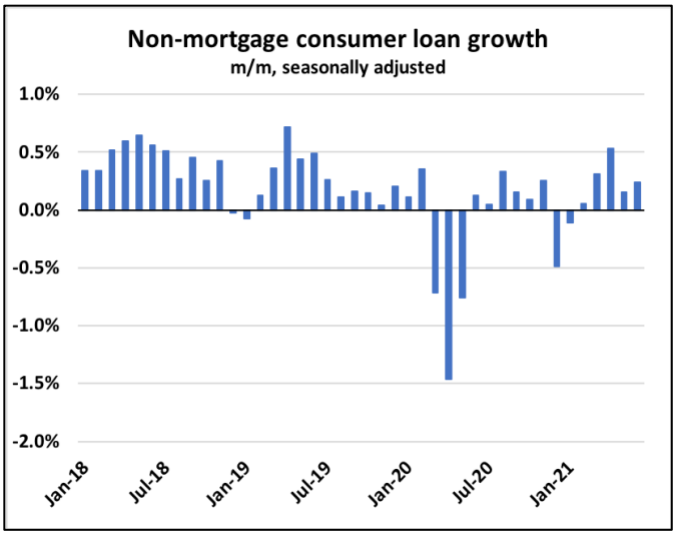
This is primarily a function of record home sales from March that were closing ~90 days later as well as a high level of new completions in Q2. Existing home sales have fallen nearly 30% from those highs, and consequently we should expect mortgage growth to moderate heading into the fall.

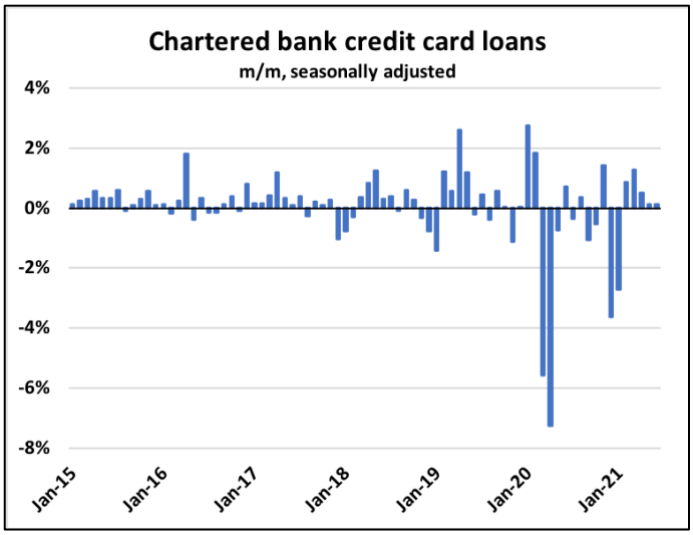
Still, Canadian regulators like OSFI have to be getting a touch nervous, particularly as they watch their counterparts in other countries tighten lending to curb a similar credit boom:

New Zealand to tighten lending further as housing crisis worsens- *Reuters*[3]

[…] The Reserve Bank of New Zealand (RBNZ) said on Tuesday that it plans to tighten mortgage lending further by lowering high loan-to-value ratio (LVR) lending and implementing debt-to-income (DTI) restrictions or interest rate floors. It aims to introduce the measures in October.

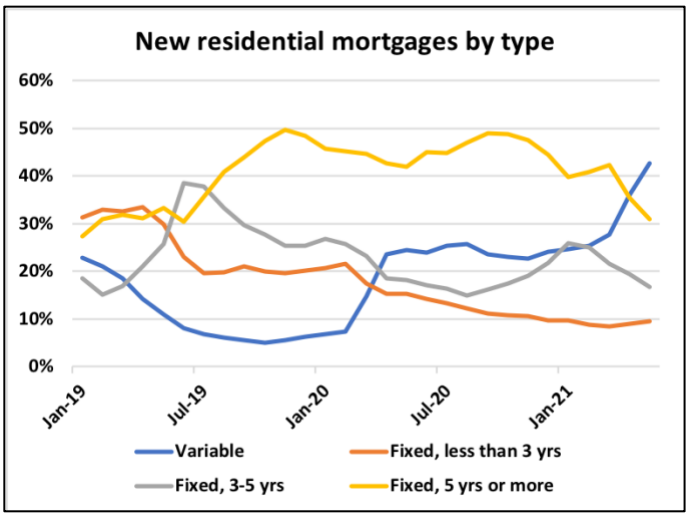
The good news is that non-mortgage consumer loan remains muted. It ticked up to 0.3% m/m in June but was still growing at less than 2% y/y. Credit card balances have been effectively unchanged over the past 2 months and remain 3.6% below year-ago levels:





ii) Variable rate originations surge 156% y/y in June

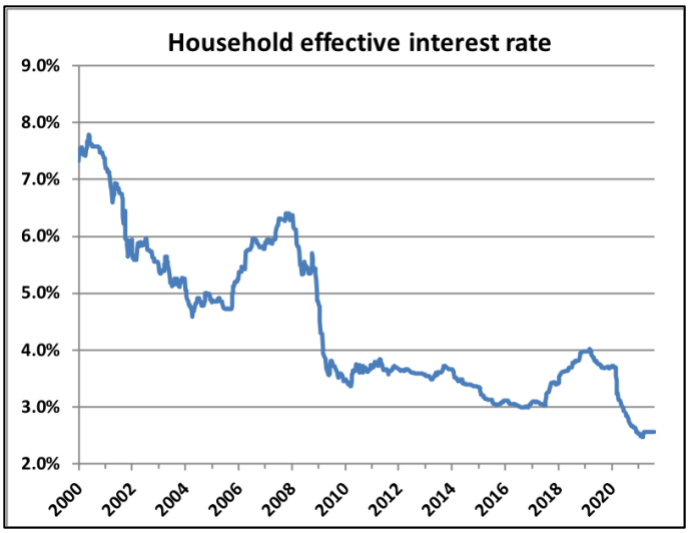
Total mortgage originations rose 35.4% y/y in June with variable rate products accounting for the entirety of the y/y increase. Variable originations spiked 156% y/y vs a 9% decline in traditional 5-yr fixed rate mortgages. Variable is now closing in on 50% of all new originations after sitting at just 5% in late 2019.



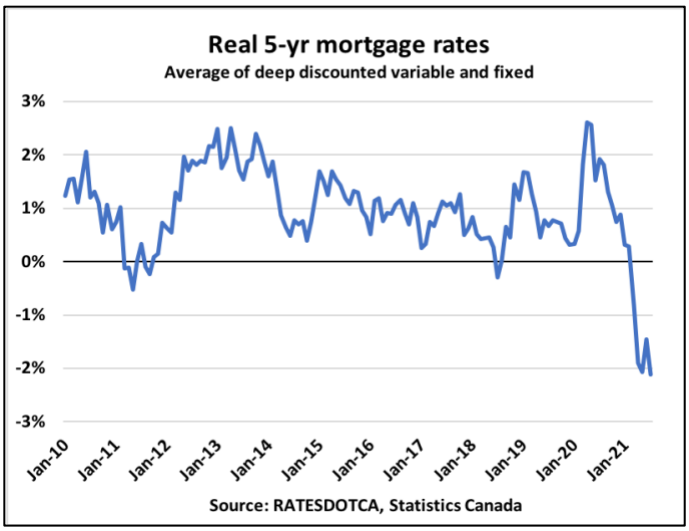
It's worth reiterating that while this is helpful in keeping effective household interest rates at rock-bottom levels (currently stable at just 2.56%), it does potentially complicate the path to normalization for the Bank of Canada as it

[3] https://www.reuters.com/article/newzealand-lending-rbnz-idUSL4N2P93NK

raises the household sensitivity to changes in the overnight rate.



Mortgage rates were have been little changed over the past 2 months, with deep discounted variable rates still available in the 1.2% range and discounted 5-yr fixed rates in the 1.6% range. In the context of headline inflation at 3.7% y/y in July, you can't fault consumers for piling on mortgage debt with the steepest negative real rates in at least a decade:

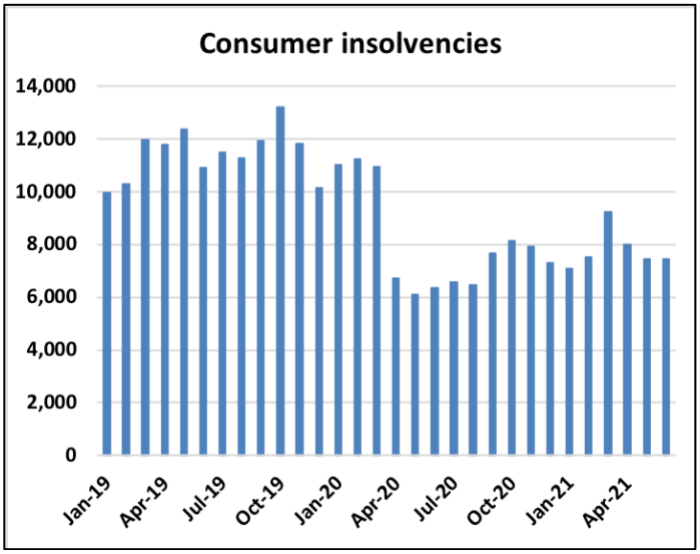


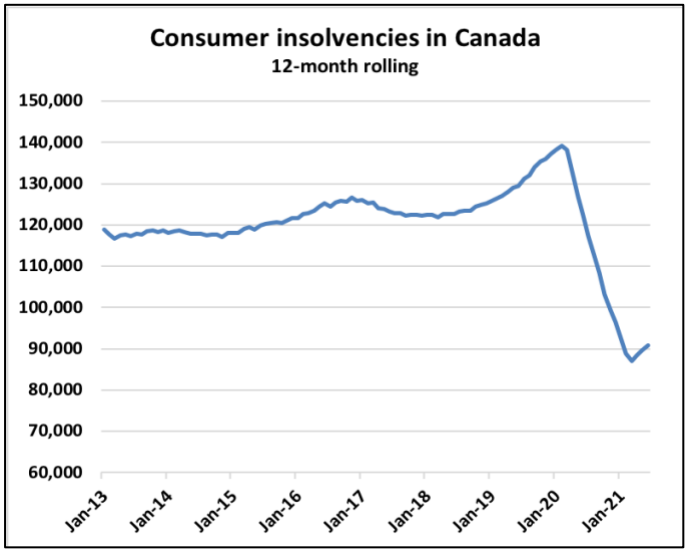
4) Consumer check: Savings still rising, delinquencies low and falling

i) Consumer insolvencies remain 30% below 2019 levels

Consumer insolvencies were up 17.3% y/y in June, but base effects off the summer 2020 lows continue to distort the headlines. For perspective, insolvencies were 32% BELOW 2019 levels for the same month.

Most of the increase was due to a 36% jump in Alberta insolvencies, including a 52% increase in proposals:



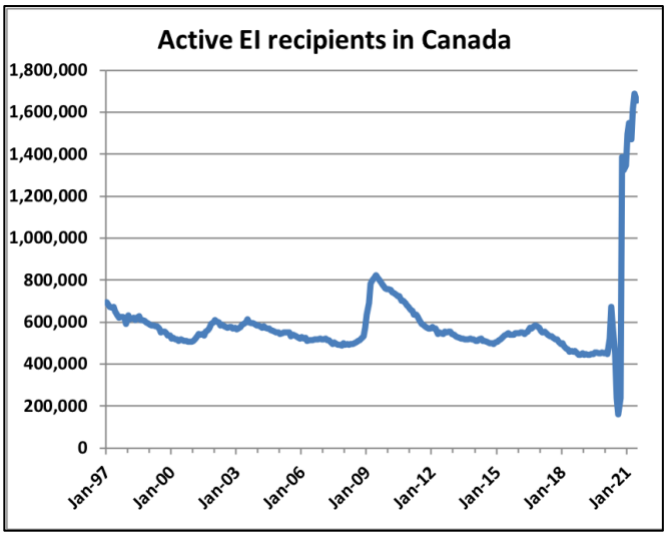


Feedback from insolvency trustees across the country suggest that July was even slower, with several trustees reporting the lowest monthly insolvency total at their respective firms in the past 10 years.

From one trustee, shared here with permission:

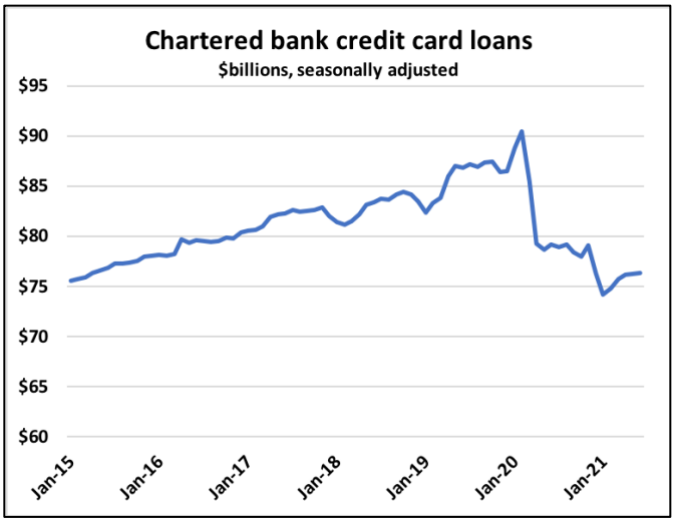
> I think it's because we are in a "sweet spot" right now: those on CRB are still on it, so no pressure; real estate prices are high; interest rates are low; CRA is closed until the election, so no collection pressure.
>
> […] I expect insolvency filings to have bottomed in July (lower than April, May and June when the stats are released), be flat in August, and perhaps slow a gradual uptick starting in September **if** kids are back in school and the economy is more open. Of course the federal election may or may not have an impact on all of that, since CRB and all other benefits will have to continue to election day so the Liberals can get a majority (which they will, easily). After the election they will become "fiscally responsible", so I may be busy in 2022.

As noted above, the data continues to be distorted by the 1.65 million Canadians receiving some form of employment insurance, including CRB (Canada Recovery Benefit). This declined by 30k in June but is still roughly 1.2 million above pre-COVID levels. This may look dramatically different once benefit programs begin rolling off in October:

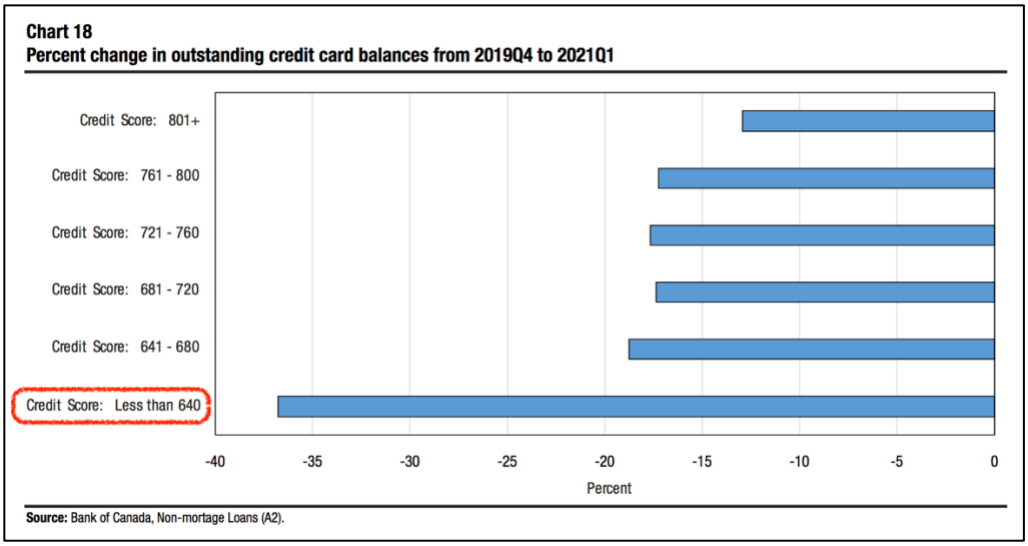


ii) Credit card delinquencies hit new lows, steep declines in outstanding balances among riskier households

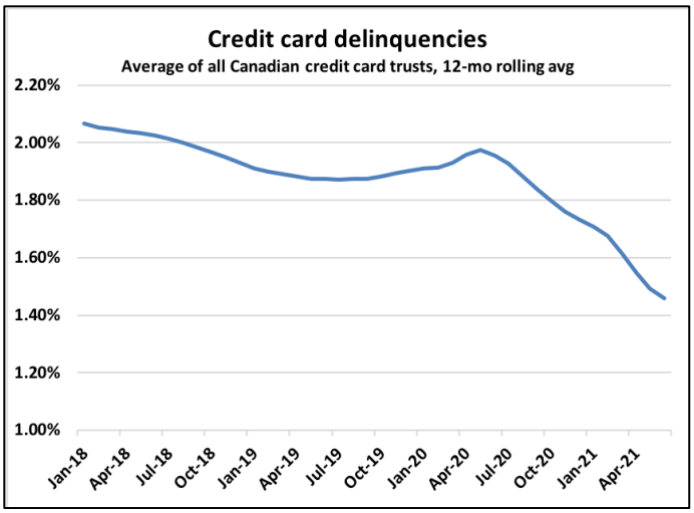
I've previously highlighted the dramatic decline in credit card balances since the pandemic began, which reflects (overly-generous?) government support measures and higher savings due to reduced spending during the lockdown. Although card balances have risen since hitting a low in January 2021, they remain 16% below Feb 2020 levels on a seasonally adjusted basis.



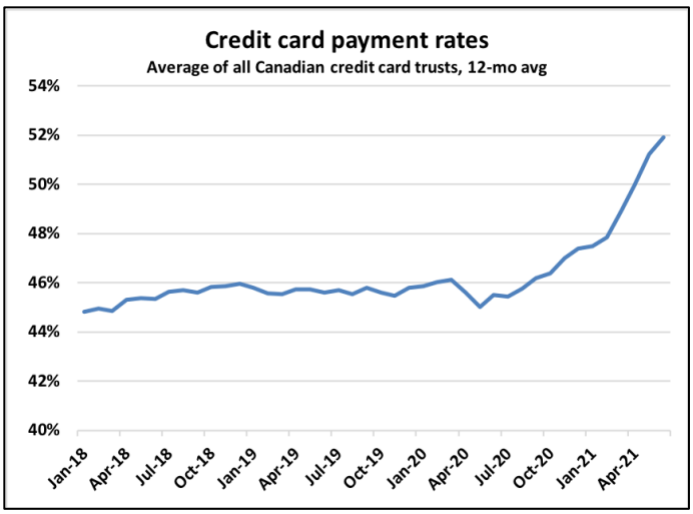
What's particularly striking is not just that balances have declined, it's that they've declined disproportionately among the highest risk households as measured by credit scores. The charts below are from a new research report from Stats Canada this week:

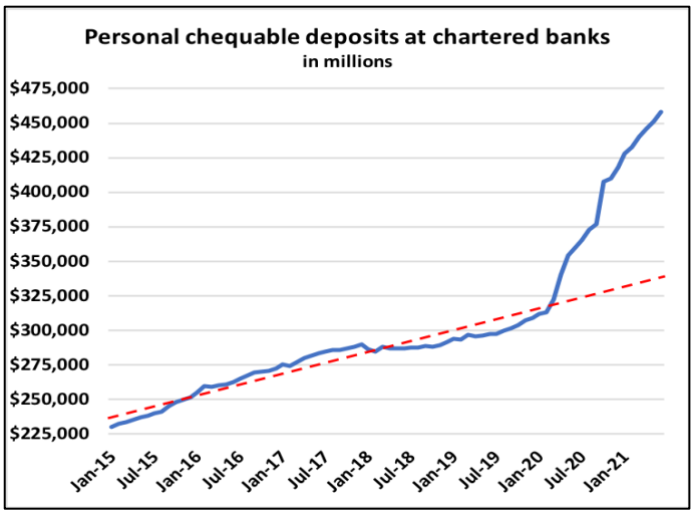


This adds important context that helps explain how credit card delinquencies have been so low. And since this tends to be a great leading indicator of mortgage arrears and overall consumer insolvencies, the fact that they hit fresh all-time lows last month is very positive for loan performance going forward.



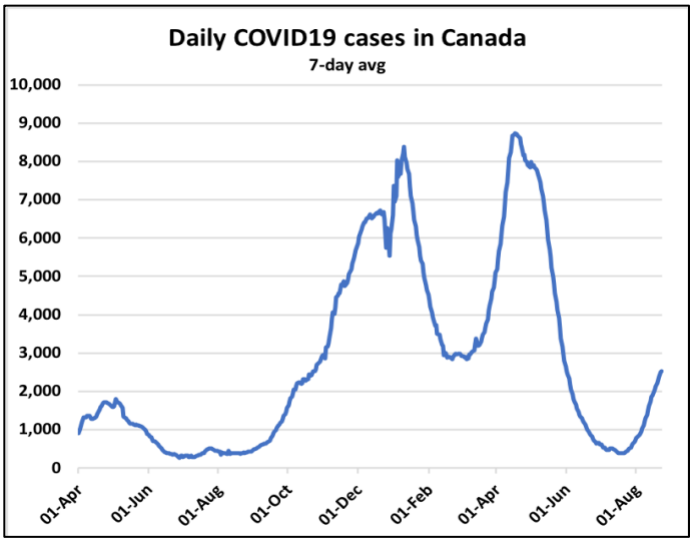
Meanwhile payment rates remain at all-time highs. This suggests that consumers are still flush with cash, and this is furthered evidenced in the relentless rise in chequable deposits at chartered banks which rose another 1.6% m/m in June and stand at over $120B above pre-pandemic levels:

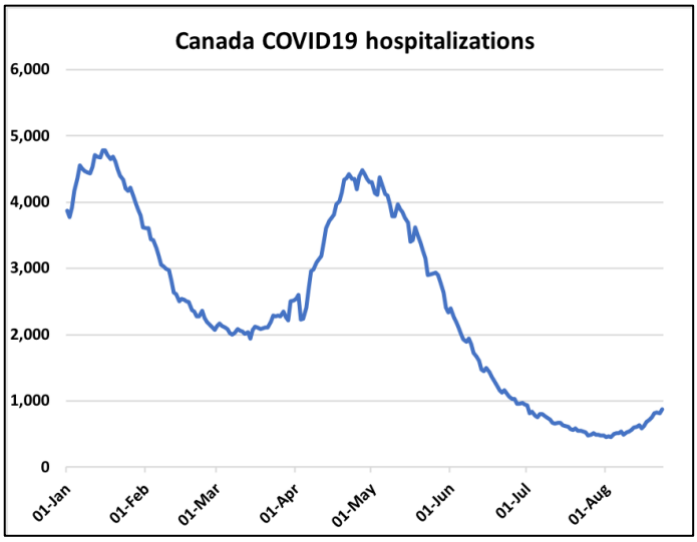




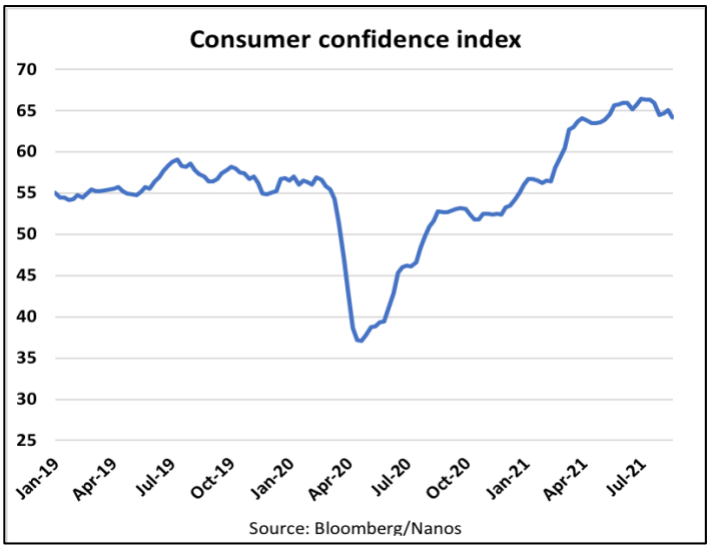
iii) Confidence begins to wane amid Delta concerns

We're starting to see the early signs of another COVID wave in Canada, this one related to the Delta variant. Daily new cases nationally have risen 6-fold since mid-July. Yes, hospitalizations and deaths are way below previous peaks, but as it relates to consumer confidence, headline infection rates matter a lot:





It's no surprise then that confidence is showing some early signs of wavering, albeit from incredibly high levels:

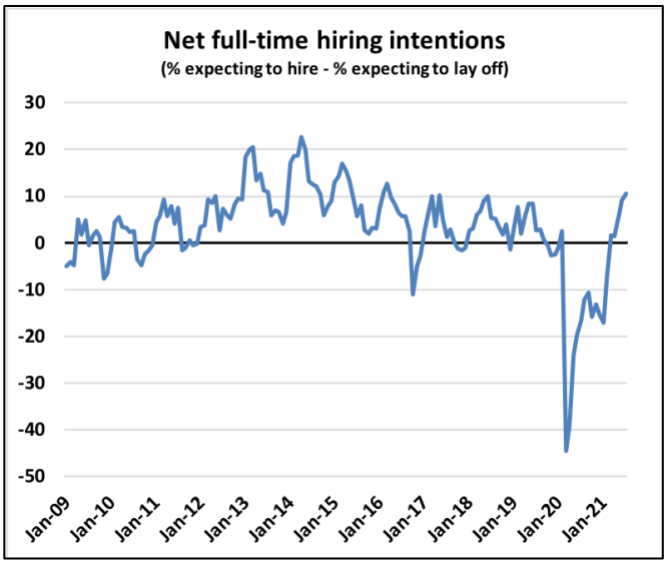


And with confidence slipping a touch, it's no surprise that retail sales dipped 1.7% m/m in July according to preliminary estimates from Stats Canada.

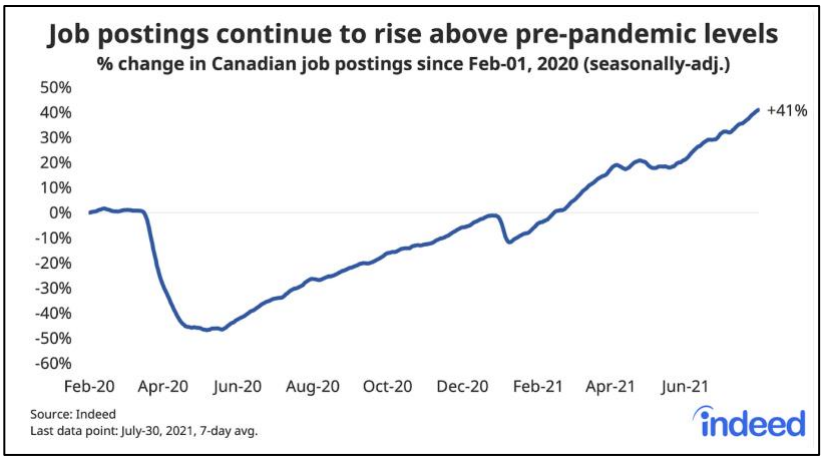
I think it's safe to look through this noisy data and focus on the bigger picture. There are already signs that Delta has peaked in the UK and is starting to top out in the US as well. If that's the case, it suggests that this next wave may be as short-lived as the others. And if the vaccines continue to provide protection from severe complications and deaths, there's even more reason to think that the effect of this next wave will be less severe than others.

Consumer confidence is still relatively high, household balance sheets are as good as they've been in years, and people are still eager to get out and spend….which all suggest that the economy will be on solid footing beyond the fall.

Look also at hiring intentions which are as positive as they've been in 5 years. Businesses want to hire people, and that bodes well for overall employment and wage growth going forward:



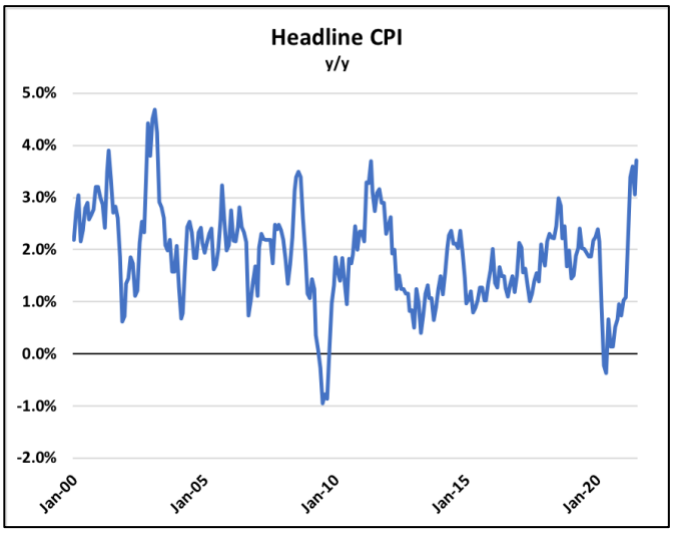
Meanwhile job postings at Indeed are surging as employers scramble to find workers:



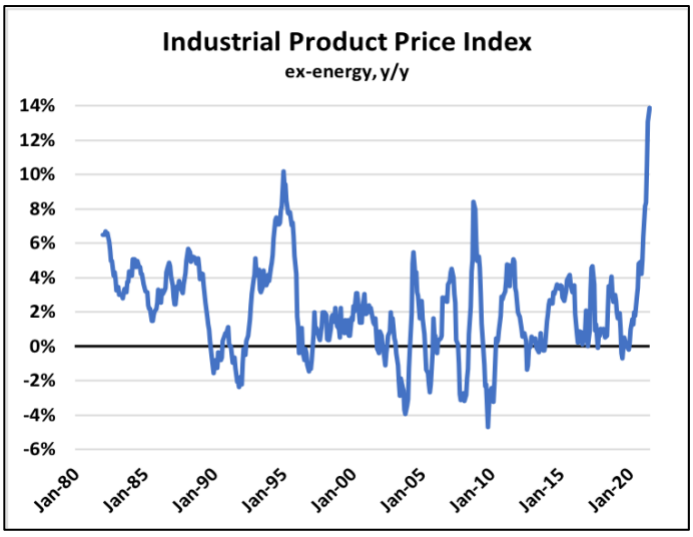
So the recovery is still fundamentally intact, and I don't think this one (hopefully) last wave changes any of that beyond perhaps giving us one more squishy quarter of growth.

5) Inflation hits highest since 2002, bond market shrugs it off

Headline inflation in Canada jumped to 3.7% y/y in July. That's the highest since 2002:



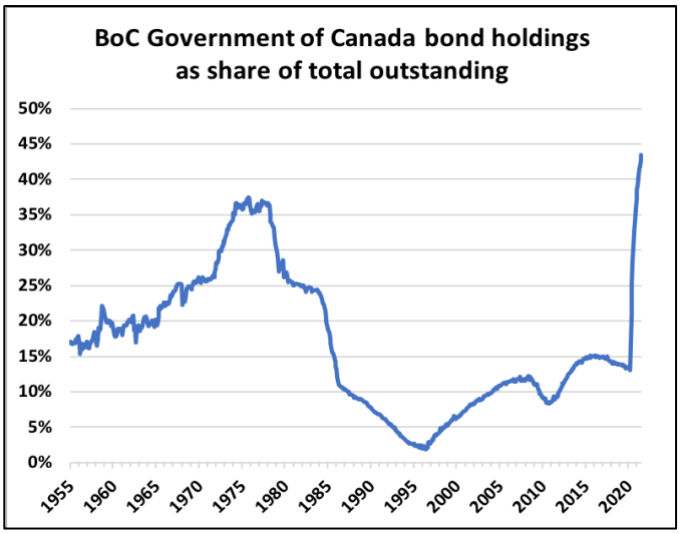
And there's likely still more to come. Forward-looking indicators like the Industrial Product Price Index, which measures the price of goods as they leave factory gates, continues to surge:



What remains more than a bit perplexing is the extent to which bond investors are choosing to look through this inflationary bout. 5-year bond yields, which largely determine fixed mortgage rate pricing, continue a slow grind lower:

The read-though here is that the inflation we're seeing is widely perceived as being transitory, which is what the central bank is telling us. I'm far from convinced that we'll settle back to the 1.5% range that we've been accustomed to since the Financial Crisis of 08…and I think the Bank of Canada's recent missive on "the benefits of inflation overshooting" their 1-3% target tells us all we need to know about their own conviction on this being transitory.

The Bank of Canada now owns nearly 45% of all government bonds outstanding. This aggressive buying has helped keep a lid on rates for now. But as they begin tapering their ongoing purchases, we should expect bond yields to drift higher.



My call remains the following: The Bank will keep the overnight rate pinned even as the bond market pushes longer-term rates higher as inflation proves to be less transitory than expected and the Bank nonetheless pushes ahead with tapering bond purchases. This will result in a growing spread between fixed and variable rates with the latter becoming increasingly attractive. Mortgage rates will stay negative in real terms for the remainder of the year and into next.

6) When housing sneezes, the economy catches a cold

Consider the following:

Most common ages in Canada in 2020:

1-	30
2-	29
3-	34
4-	28
5-	35
6-	31
7-	36
8-	37
9-	27
10-	33

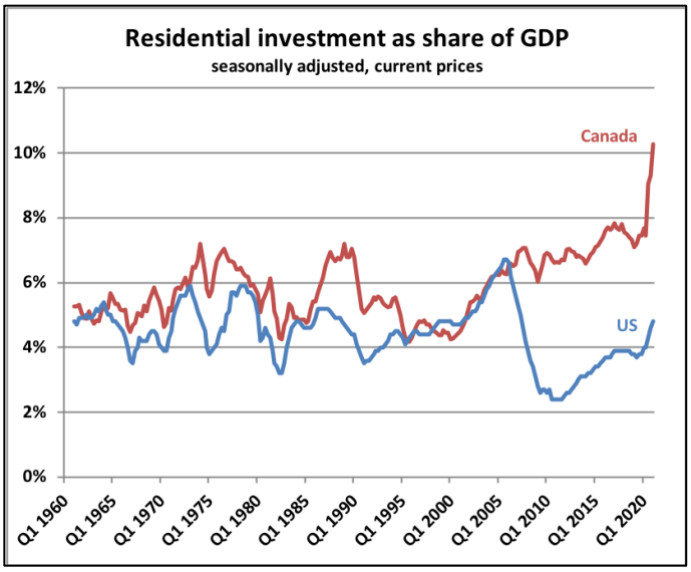
In 2000, 6 of top 10 most common ages were above 40.

Two things should jump out here:

i) Homebuying demographics are still very favorable
ii) Affordability will be a major election focus as all parties try to appeal to millennials who are now the largest voting cohort.

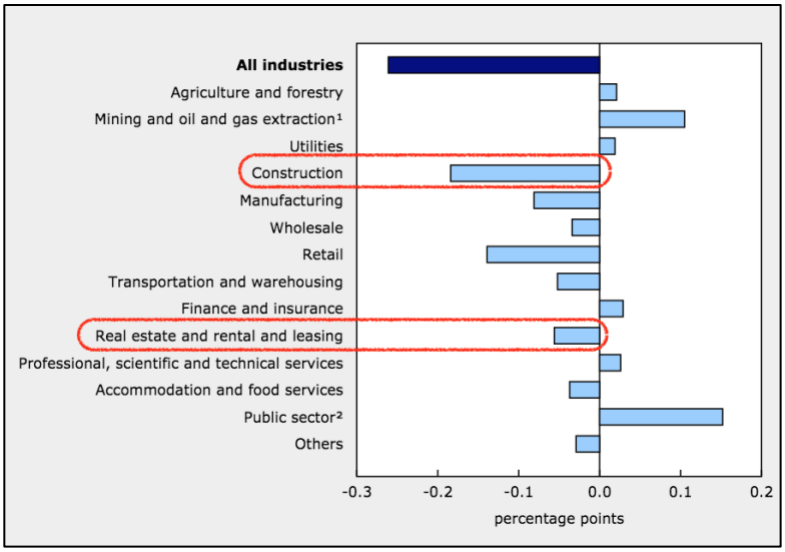
On that latter point, it's interesting to watch all parties advance housing policies that aim to curb speculation and make housing more "affordable". I'll save the analysis on party platforms for a later report, but for now I'll simply point out that creating more affordable housing without causing collateral damage to the broader economy is a tall order indeed.

Recall that direct housing investment now accounts for more than 10% of GDP and is responsible for the majority of economic growth over the past 2 years:



We know that home sales have slowed off the March peak while housing starts have cooled off the Q1 average of over 305k SAAR. That negative rate of change matters a lot for GDP, particularly given how levered Canada has become to housing:

It's not surprising then that housing was the primary driver of the latest GDP print of -0.3% m/m in May:



From the report:

> […] Residential building construction contracted 4.2% in May, down for the first time since November 2020. Declines in single-family homes construction, and in alterations and improvements, more than offset increases in multi-unit dwellings construction.
>
> Repair construction decreased 3.7%, while engineering and other construction activities was up 0.1% in May.
>
> […] The real estate and rental and leasing sector contracted 0.4% in May, following a 0.8% decline in April. This is the first back-to-back decline in the sector since March-April 2020. The output of offices of real estate

> agents and brokers fell 7.2% in May, following a 10.7% drop in April, returning to output levels similar to July 2020. Home resale activity slowed in almost all Canadian urban centres.

Now consider that this hit to the economy resulted from housing going from RED hot to just plain old hot. Does any governing party really want to risk cooling the market too much? I think not.

The good news is that preliminary data points to a +0.7% m/m increase in GDP in June as the economy saw fewer pandemic-related restrictions. Still, it's a good reminder that when Canadian housing sneezes, the rest of the economy catches a cold, and policy makers will have to tread very lightly here.

Regards,
Ben