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## **The Edge Report**

### **December 2021**

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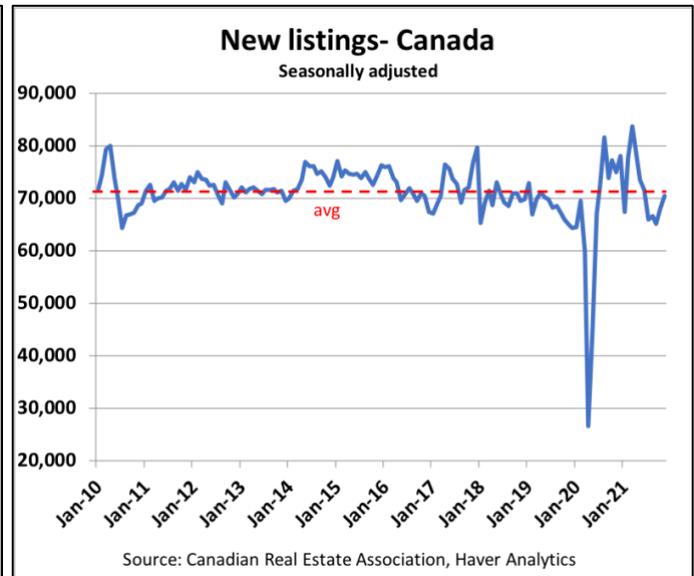
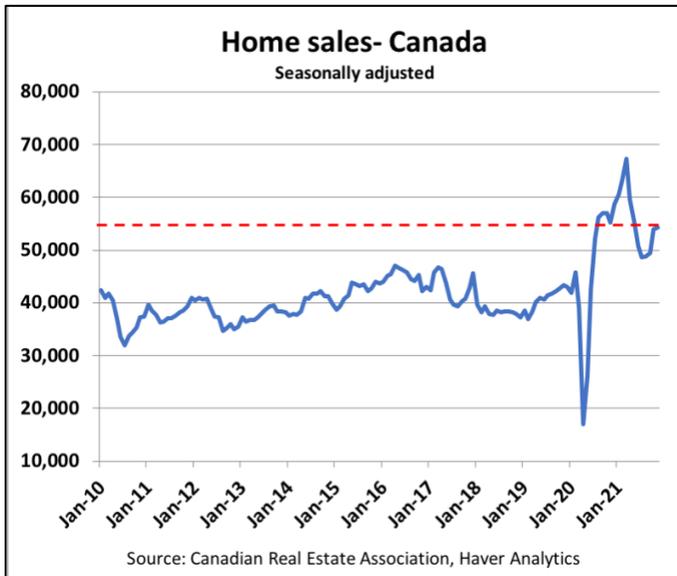
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- ii) Bond yields roll over, but inflationary risks are still firmly to the upside
- iii) Trudeau mandate letter suggests they'll be targeting investors in 2022

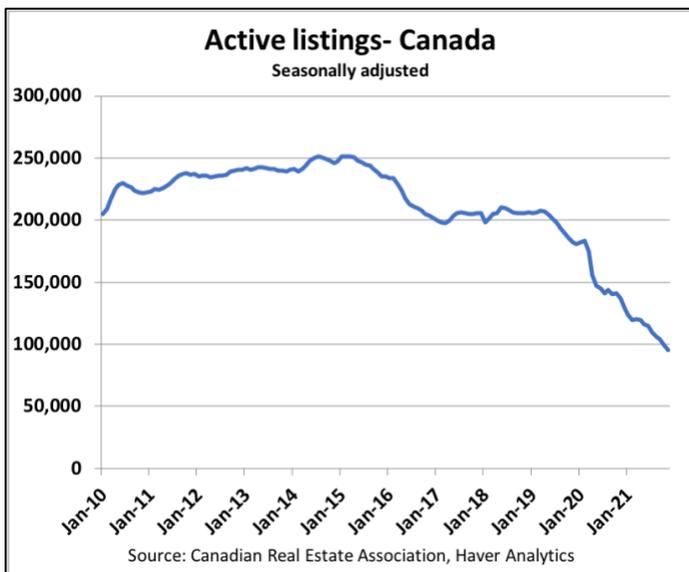
## 1) National home sales update

### i) Home sales still strong, inventory continues to melt

Home sales ticked up 0.6% m/m seasonally adjusted in November, boosted in part by a massive 6% jump in Alberta. We did see a modest increase in new listings, up 3.2% m/m, but they still remain slightly below decade averages:



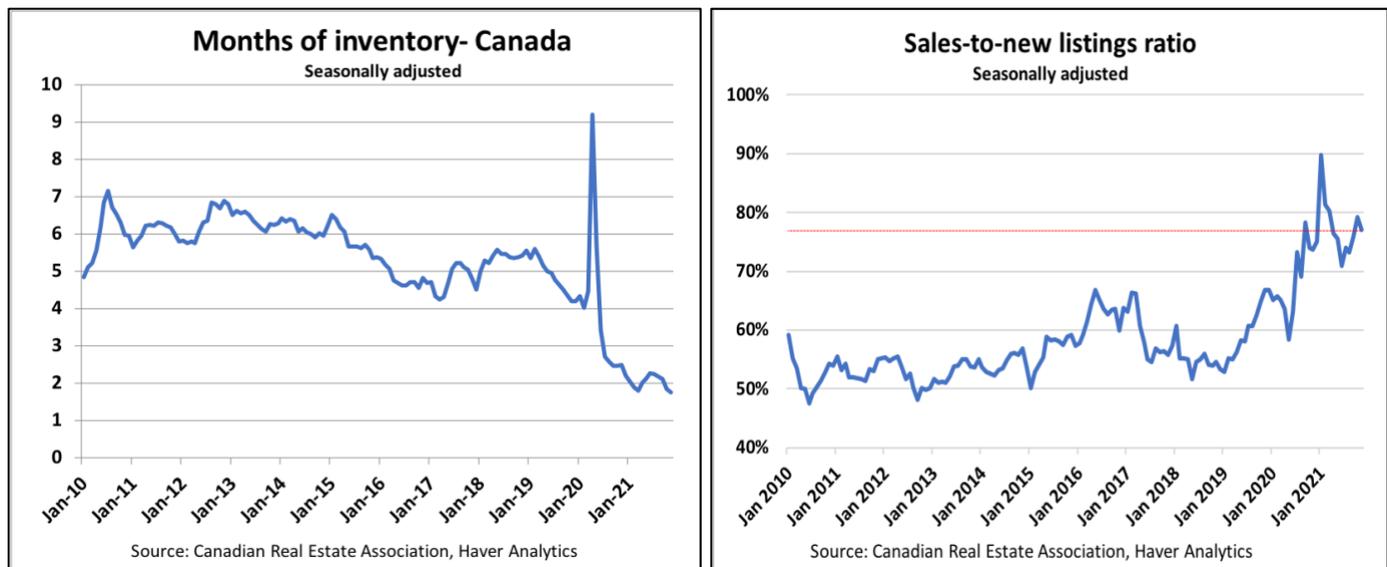
I sound like a broken record here, but I'll say it again. The #1 story in Canadian housing remains the relentless decline in inventory in virtually every metro across the country. We're now below 100,000 listings (seasonally adjusted). By my estimates, that's likely the lowest level of for-sale inventory in 30 years.



The table below shows a breakdown of key metrics by province:

	Sales		New listings		Active inventory	
	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted
<b>Canada</b>	-1.9%	+0.6%	-12.4%	+3.2%	-30.6%	-4.6%
<b>BC</b>	-5.3%	+1.7%	-13.5%	+2.5%	-38.2%	-4.0%
<b>AB</b>	+30.3%	+6.0%	+3.6%	+3.5%	-18.5%	-5.1%
<b>ON</b>	-1.6%	-1.0%	-19.0%	+3.3%	-44.0%	-5.0%
<b>QC</b>	-16.8%	-1.4%	-14.5%	-0.3%	-26.7%	-3.3%

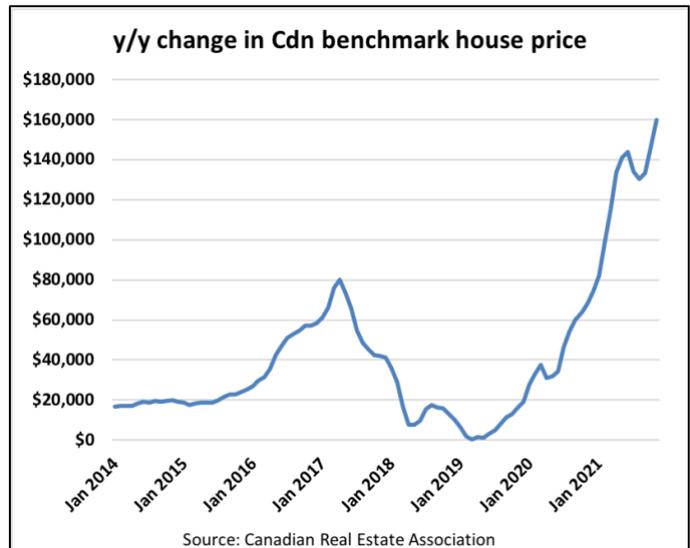
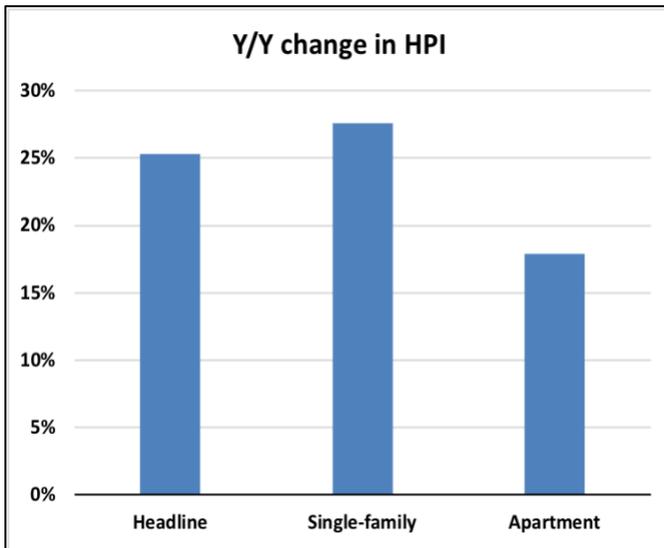
We set a new record low for months of inventory at a mere 1.75 in November. This remains the best predictor of house price trends 6-months out, and it looks very likely at this point that we'll see prices squeeze right through the spring.



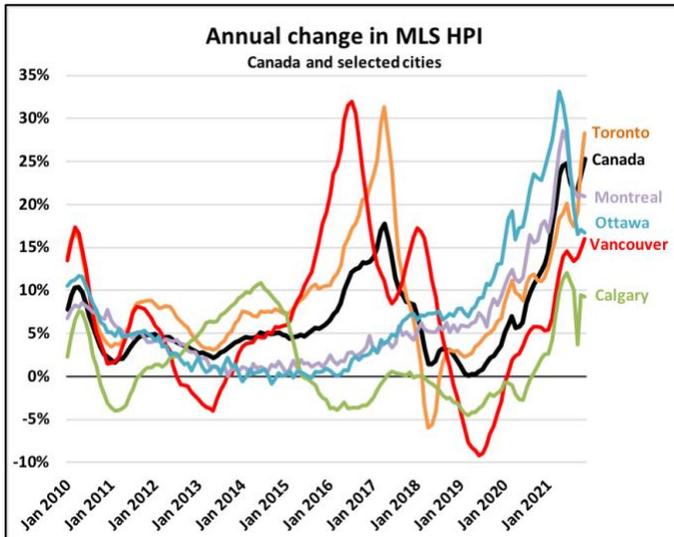
The MLS House Price Index shot up another 2.7% on the month and was up 25.3% compared to last year. The benchmark price hit a new high of \$791,000.

Now remember this number: \$21,000. That's how much the typical home in Canada appreciated.....in **NOVEMBER!**

Compared to last year, the value of the typical home is up a record \$160,000!



With a “return to the city” dynamic in swing, Toronto is back to being the leader for house price appreciation among big metros:



## ii) Focus on Alberta: Wildly undervalued and primed for takeoff

I won't bore readers with a rehashing of my Alberta thesis, you can read about it in prior Edge Reports, but I will point out that the resale market is tightening dramatically and looks set for a major move higher in prices.

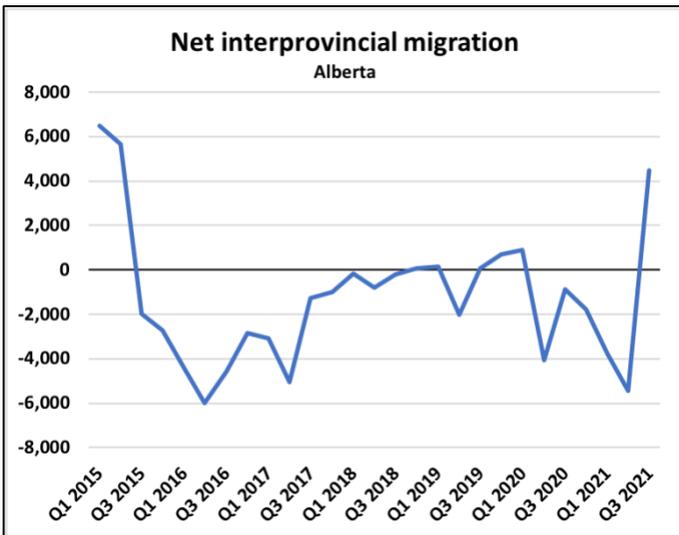
Consider what's happening to the supply/demand balance across the province right now. Months of inventory in November was just 2.5. That's the lowest since May 2007.



This metric is the single best predictor of where house prices are going. And when it's this low, it portends very strong upwards momentum within the next 6 months. House prices in Calgary were up 8.9% y/y in November while in Edmonton it was less than half that.

Consider that the last time the market was this tight, prices in Calgary were ripping 28% y/y and Edmonton was seeing 54% y/y growth. Now I'm not calling for those sorts of returns, and as I said last month, I think there may be a bit of an overhang on the rental side in the short-term, but let's just acknowledge that there's plenty of room for a "catch-up" trade in Alberta given how absurdly affordable it is relative to anywhere in BC or Ontario.

As the old saying goes, the cure to low prices is low prices. Exceptionally affordable housing has a neat way of creating its own demand. Net interprovincial migration was strongly positive in Alberta last quarter at nearly 5,000. That means there were 5,000 more people moving to Alberta from other provinces as there were leaving it. That's the single best quarter since 2015 when the wheels fell off the oil patch. That's a huge, important dynamic that I think will accelerate in coming quarters as the economy continues to improve and Alberta soaks up all the housing nomads who are priced out of other provinces.

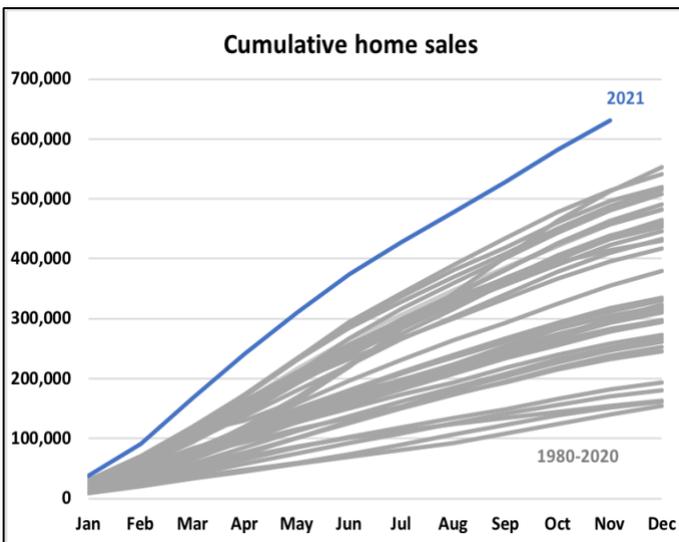


**iii) Just how crazy was 2021? Check out these 5 visuals!**

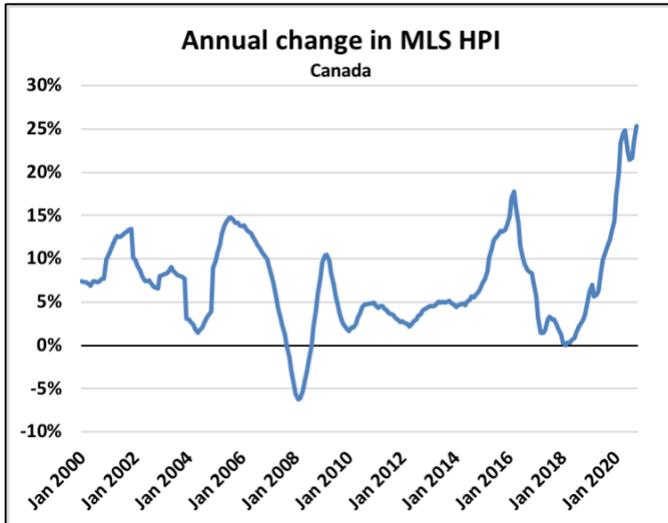
It's easy to lose sight of just how crazy 2021 really was. The charts below help to give some perspective on why it's going to be exceedingly difficult for resale transactions, mortgage volumes, or even house prices themselves, to build meaningfully on this year's numbers.

Consider:

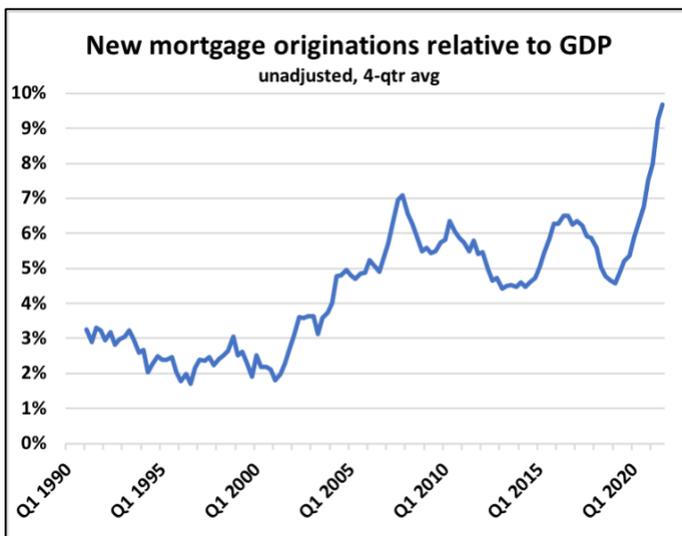
- i) We've already set an annual record for home sales by a wide margin with one month still to go. We're on track to surpass last year's highs by 21%. Just how much this year was an outlier is evident in this chart:



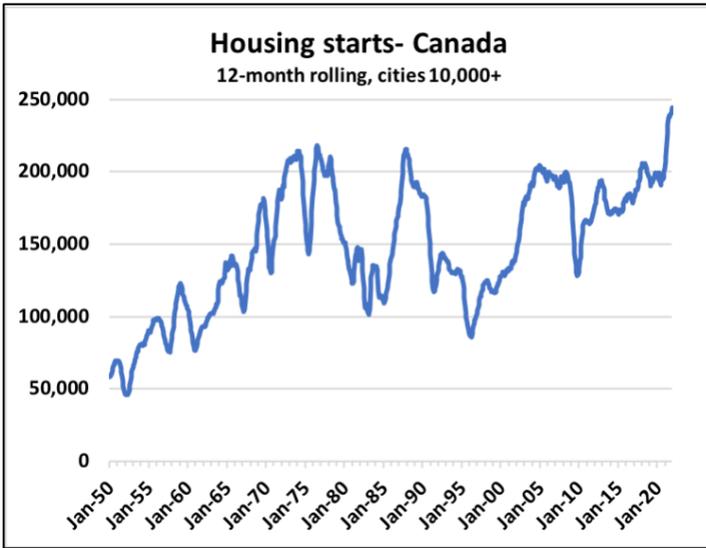
ii) We just saw the largest annual house price gain in at least 20 years



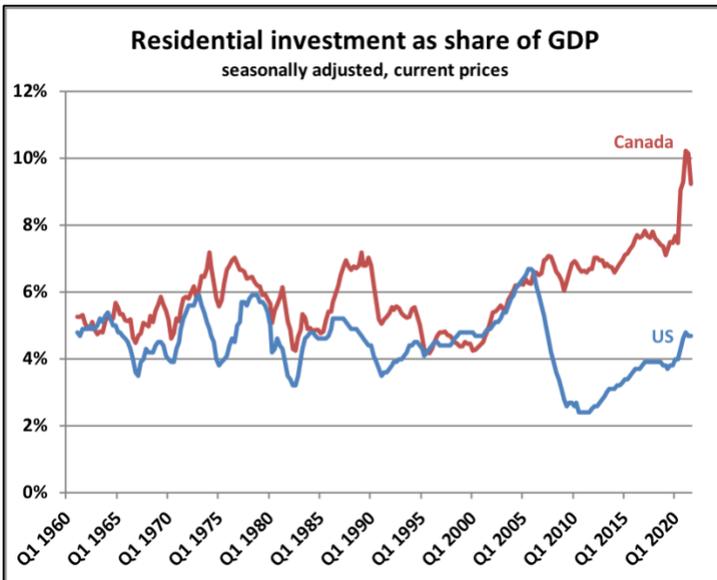
iii) Mortgage originations hit the equivalent of nearly 10% of GDP over the past 4 quarters. The prior record was just over 7%:



- iv) Housing starts are running at the highest levels in at least 70 years. Now this is one that we can, and SHOULD build on. We need a lot more supply, particularly in the single-family segment, to balance the insane resale market.



- v) Direct investment in housing hit 10% of GDP this year. We had never breached the 8% level previously.

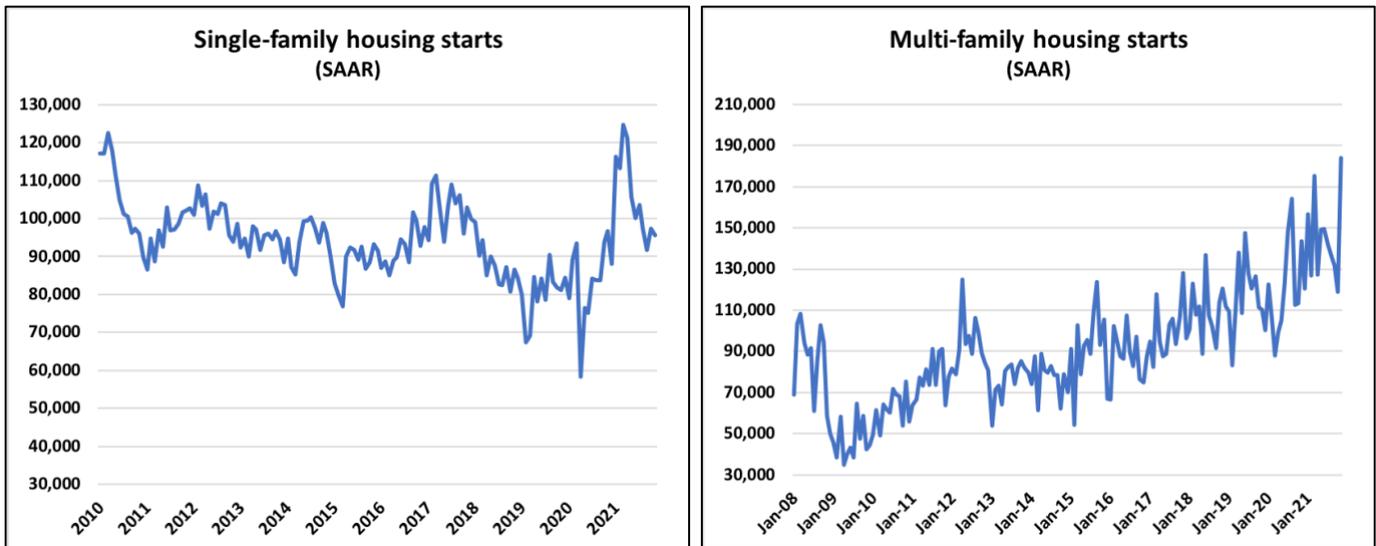


## 2) Supply/demand deep-dive: Housing starts rip on rental surges, population surges in Q4

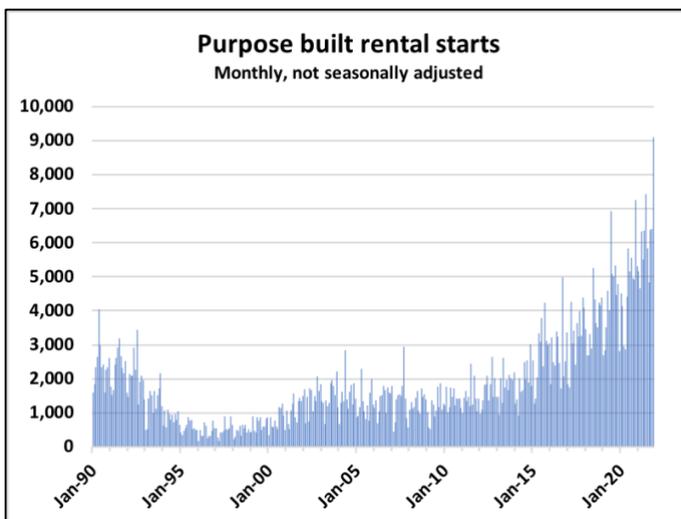
### i) Housing starts surge to 300k SAAR, one of the highest readings on record

November housing starts surged an absurd 26.4% m/m to a monster reading of 301,000 on a seasonally adjusted annualized basis. That's only the 3<sup>rd</sup> time in history when we've breached the 300k mark, and it was actually a record in unadjusted terms at just over 23,000 unit starts on the month. We've never seen that many new homes started in any month in history.

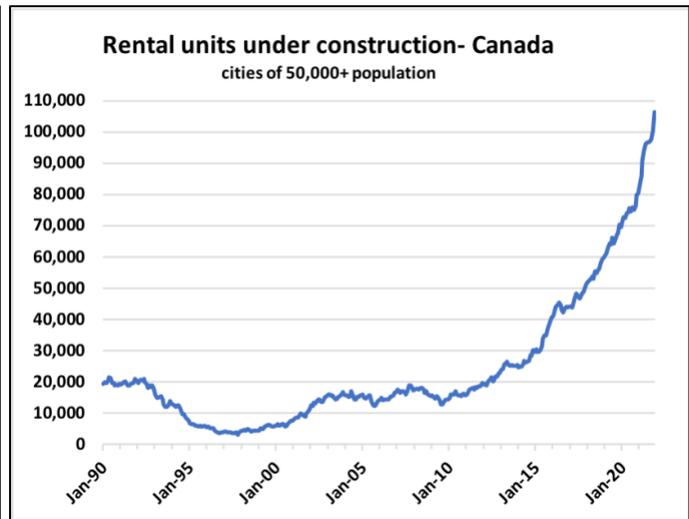
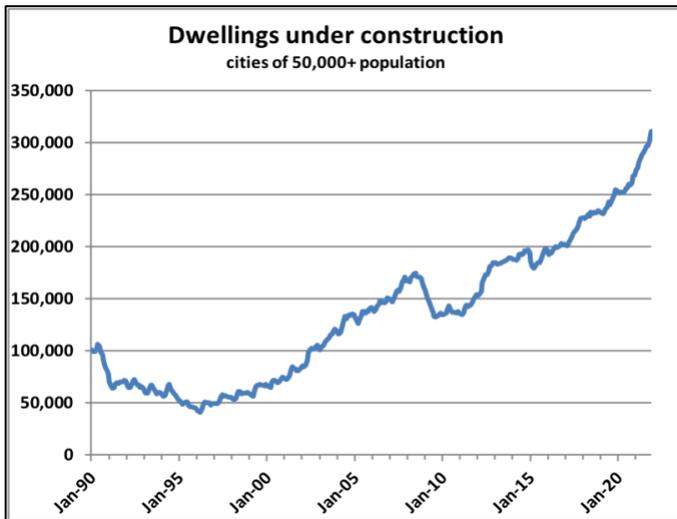
The issue remains one of composition. As you can see below, single-family housing starts have actually settled back to decade averages after surging higher earlier this year. This is where supply is most needed, but it's still not materializing. On the flip side, multi-family starts hit a new record in November:



And what accounted for all the multi-family starts? Not condos but rather rentals which came in at a record for the month...a mere 22% above any prior monthly reading.



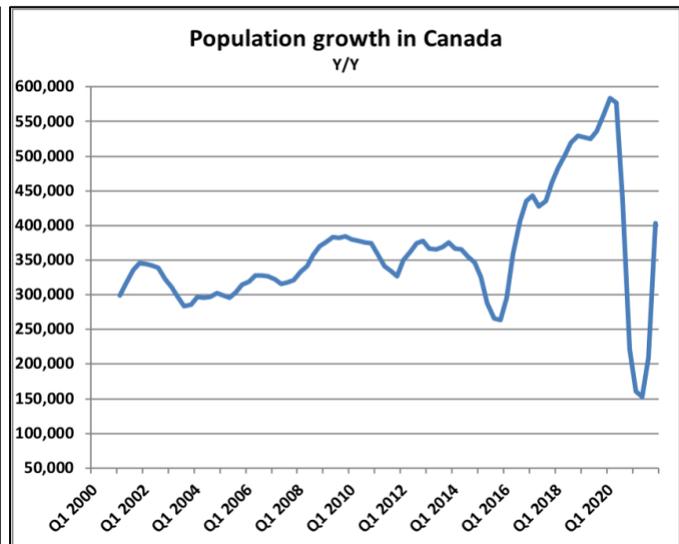
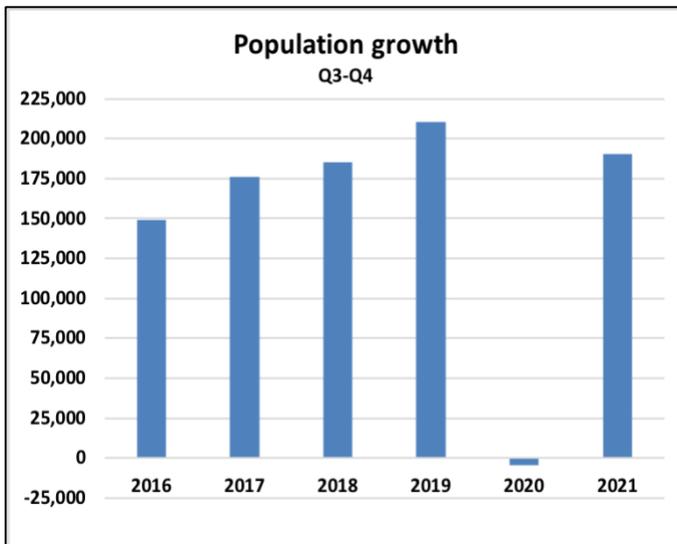
The number of dwellings under construction in larger metros has surged to new highs of 310,000 of which nearly 110,000 are rentals:



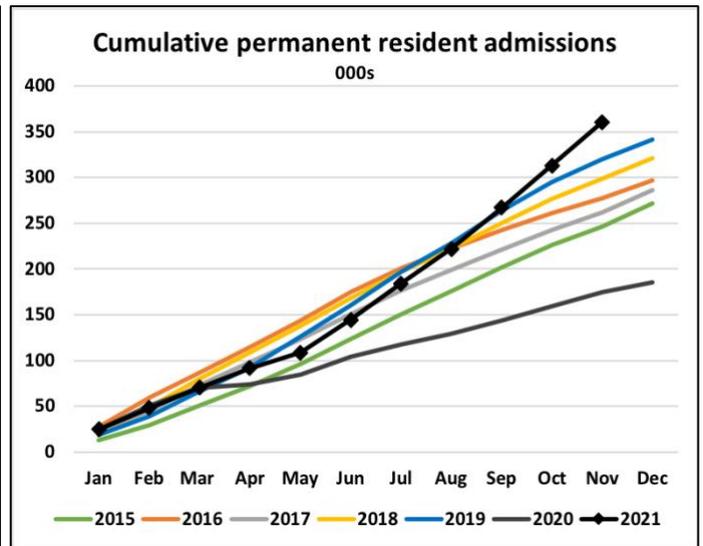
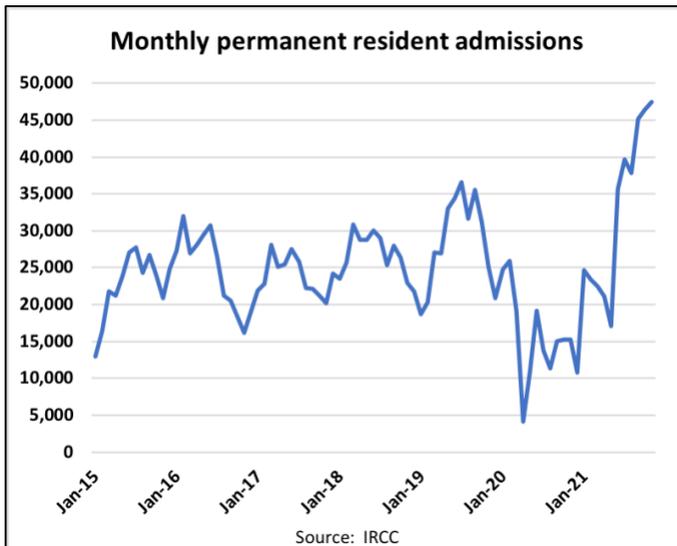
There are 43,000 more homes under construction than last year at this time, but 27,000 of that increase is attributable to the massive runup in rentals. I know I've said it before, but if there's overbuilding anywhere, it's in this segment and NOT the single-family segment.

**ii) Population growth surges in Q4**

The latest population estimates from Stats Canada shows Q4 growth at the second highest on record at just over 190,000 for the quarter alone. That helped push total y/y population growth above 400,000 for the first time since the pandemic began.



Chalk this up to the massive number of new permanent residents coming to Canada in the past few months. Canada has welcomed nearly 140,000 permanent residents between September and November, a record going back to at least 1948. We're now back to record annual immigration levels with one month still to go:

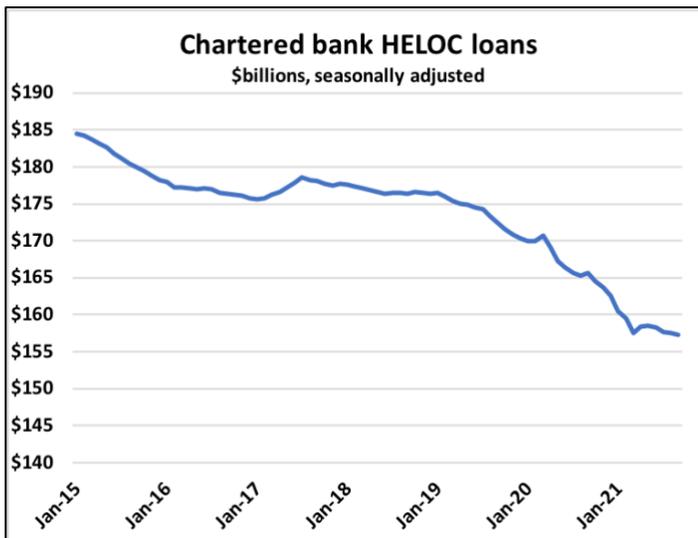


Population growth outright fell in this quarter last year, and those favorable base effects helped the y/y numbers this quarter. From here the comps get a bit more challenging, and I still think it's very unlikely we get anywhere close to the ~600k population levels we saw at peak for at least a couple years.

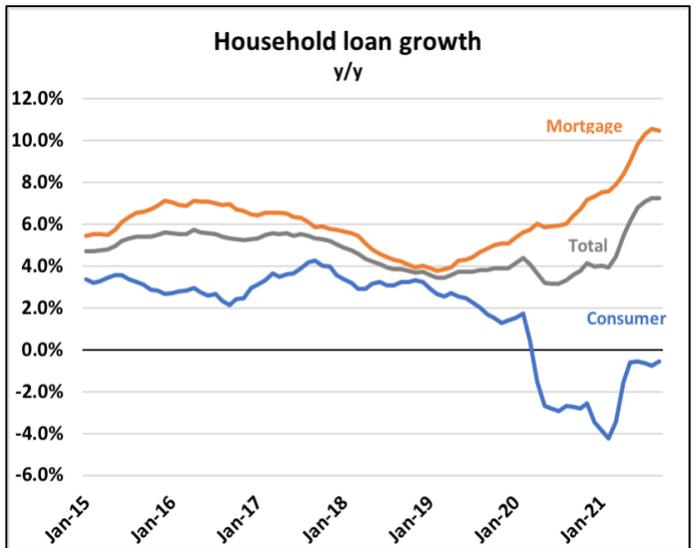
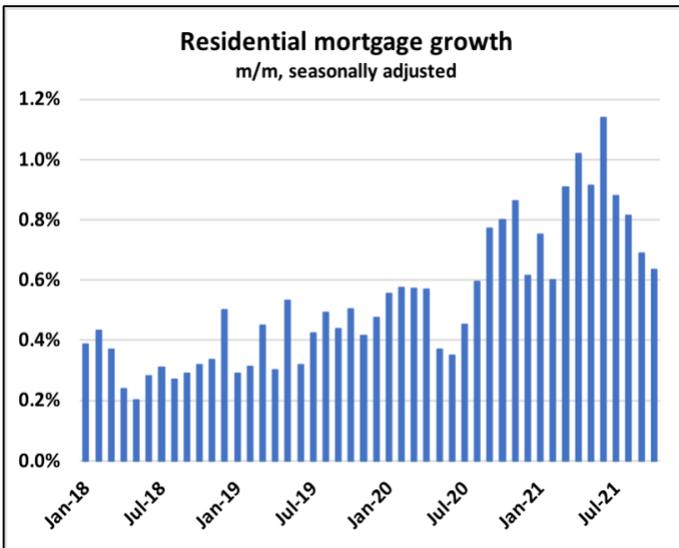
### 3) Household credit update: Big revisions puts mortgage growth above 10% y/y

#### i) Big revision to household credit data puts mortgage growth above 10% for first time since 2008

Statistics Canada and the Bank of Canada revised historical household credit data in October. The revision involved reclassifying over \$100B of HELOC debt as non-revolving mortgages. Their official reporting now more closely aligns with bank reports which show a HELOC balances steadily declining since 2015:

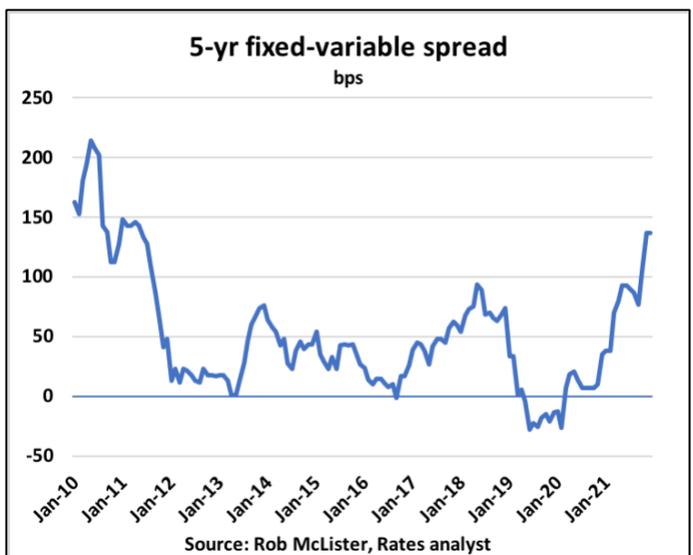
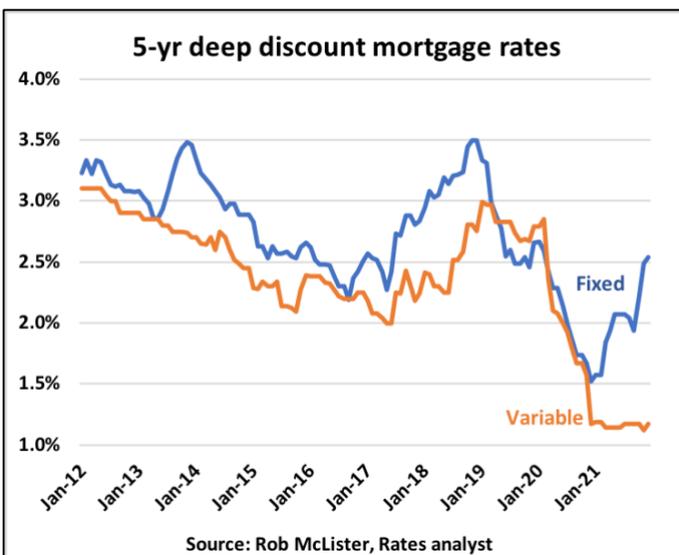


In Canada, HELOCs are lumped in with other non-mortgage consumer credit. With that reclassification, we now see that mortgage credit growth is above 10% y/y for the first time since 2008 while non-mortgage consumer credit is still negative on a y/y basis and remains well below pre-pandemic levels:

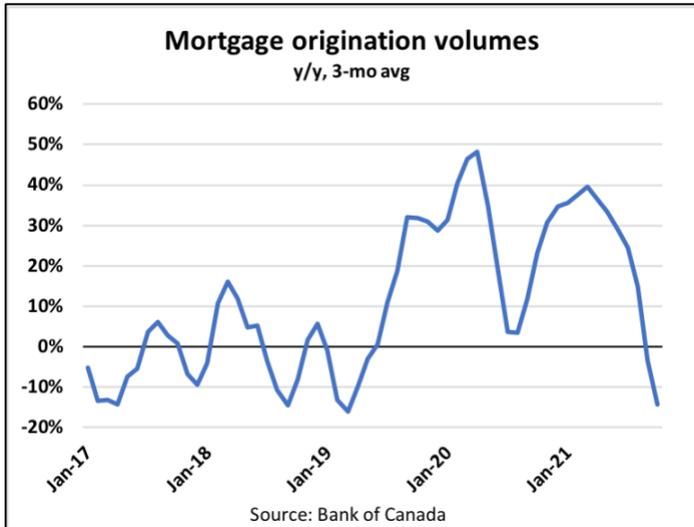


**ii) Variable rate originations jump 84% y/y**

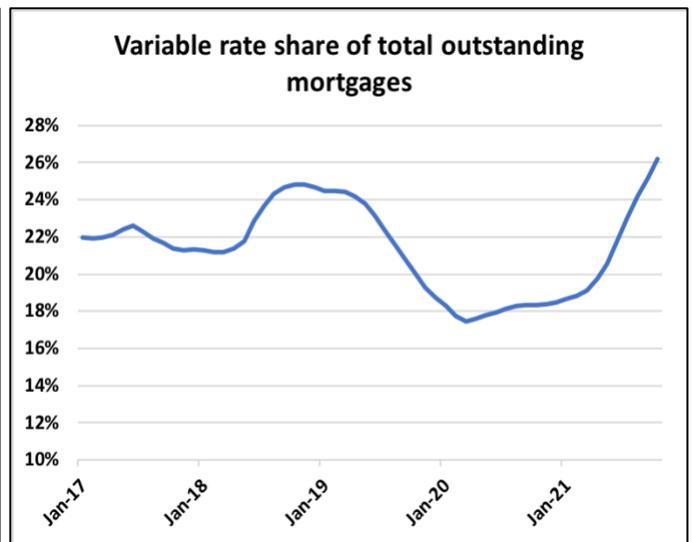
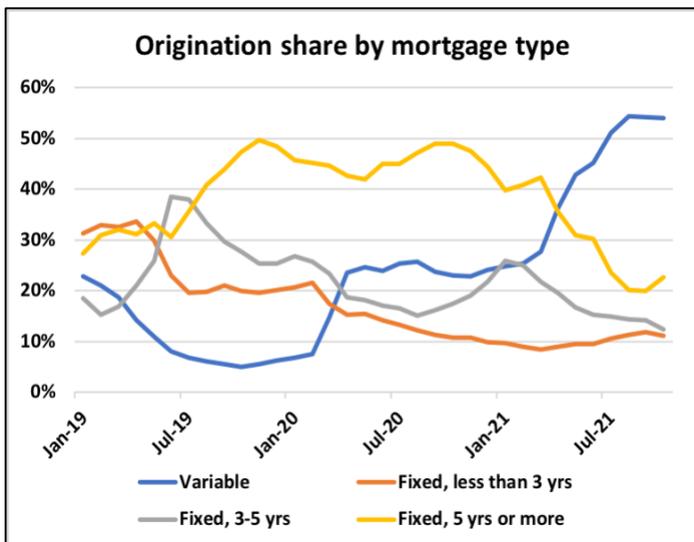
Discounted 5-yr fixed mortgage rates have broken above the 2.5% level, up more than 100bps off the late 2020 lows. Variable rates remain near record lows with the gap between the two now pushing to 140bps:



Total originations slipped 21% y/y in October and are trending at -14% y/y over the past 3 months.



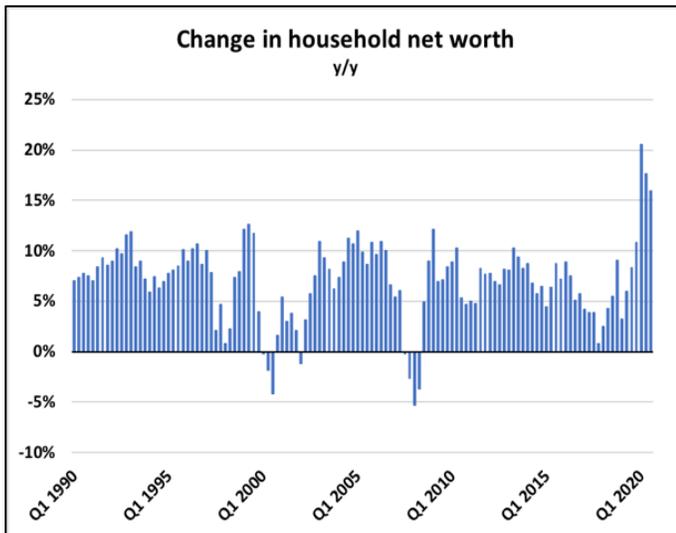
Variable rate originations were up 84% y/y while 5-yr fixed rate originations slumped 52% y/y. That pushed the total share of variable rate mortgages outstanding to above 26%, the highest level since the data was made available in 2016:



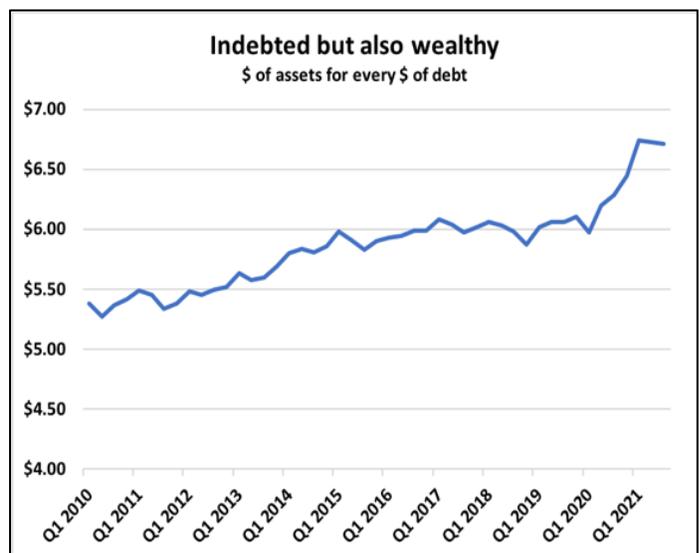
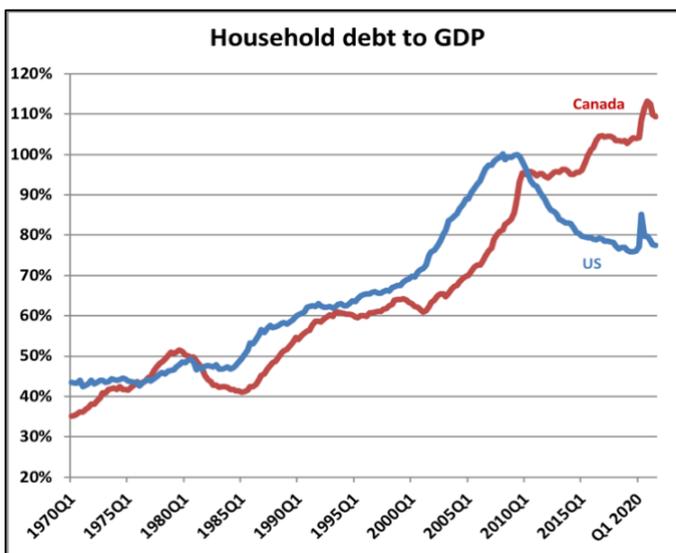
#### 4) Credit check: Household balance sheets look (relatively) solid, insolvencies fall further

##### i) Net worth jumps in Q3, debt service ratios fall

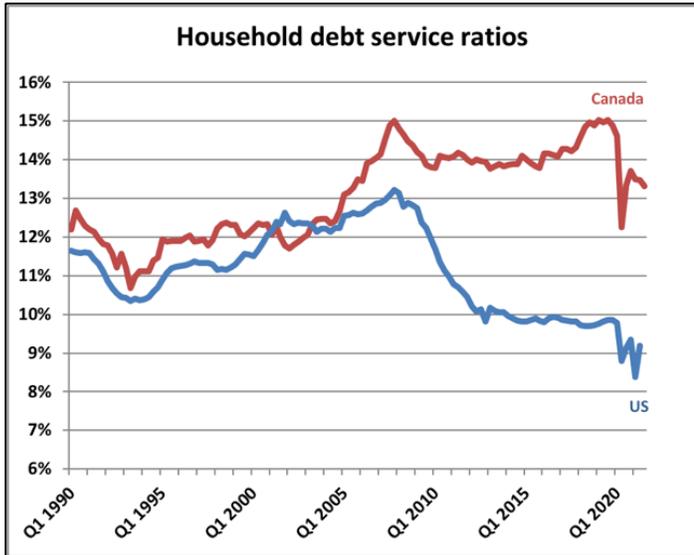
Household net worth surged 16% y/y in Q3. That's one of the strongest showings on record. Real estate accounted for a sizable portion of the gains, and it now represents nearly 44% of household assets. I know this seems low, but keep in mind this captures pension assets (including CPP) and business assets. The average is skewed lower by the handful of ultra-wealthy Canadians who own the vast majority of their wealth in businesses. For the "typical" Canadian, housing equity represents the vast majority of their assets:



Debt levels continue to fall relative to GDP, though they remain very elevated by historical standards. But if we look also at the other side of the balance sheet ledger, we find that Canadians still own nearly \$7 of assets for every dollar of debt:

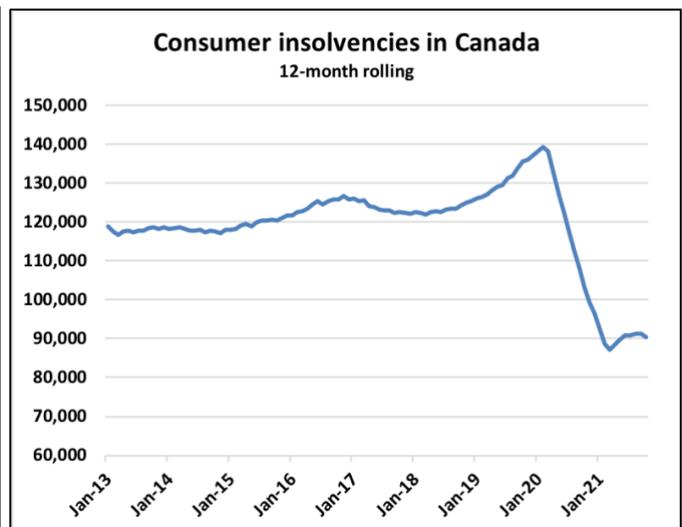
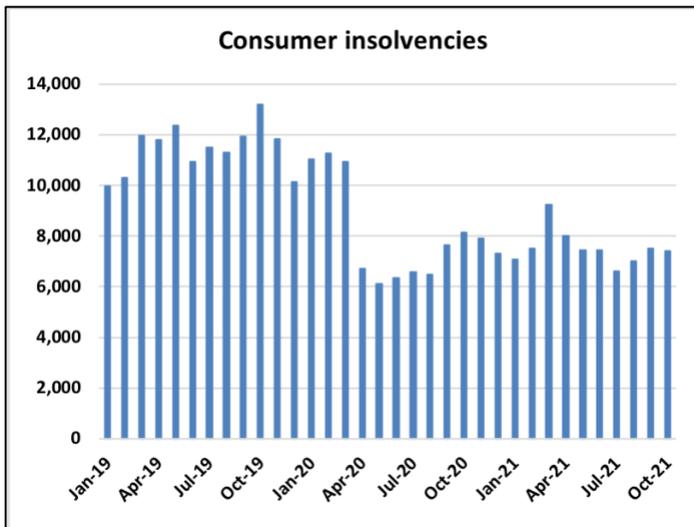


More importantly, the debt service ratio fell in Q3 to 13.3%. Outside of the artificially low reading from Q2 2020 when government transfers caused household incomes to explode, this is the lowest reading in 15 years, and it suggests that households will be just fine to absorb a couple rate hikes next year:

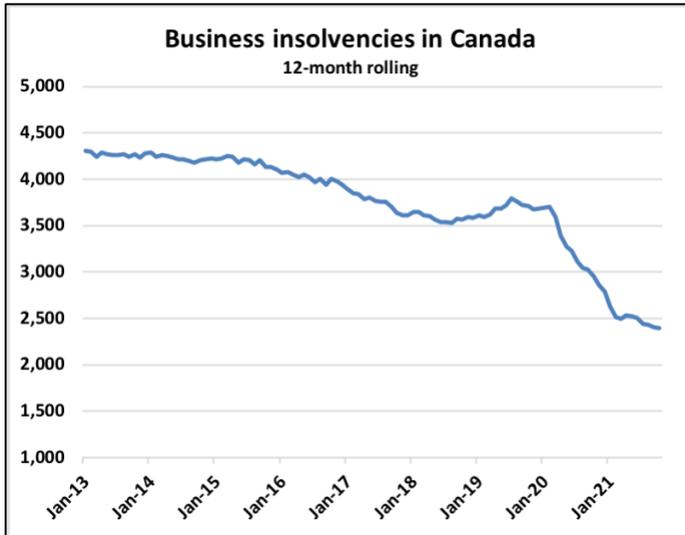


**ii) Consumer insolvencies continue to fall**

Consumer insolvencies were down 8.8% y/y in October and were down 44% compared to the same month in 2019! I still think we'll see insolvencies bottom in Q1 next year, but it continues to amaze me just how low these numbers are:

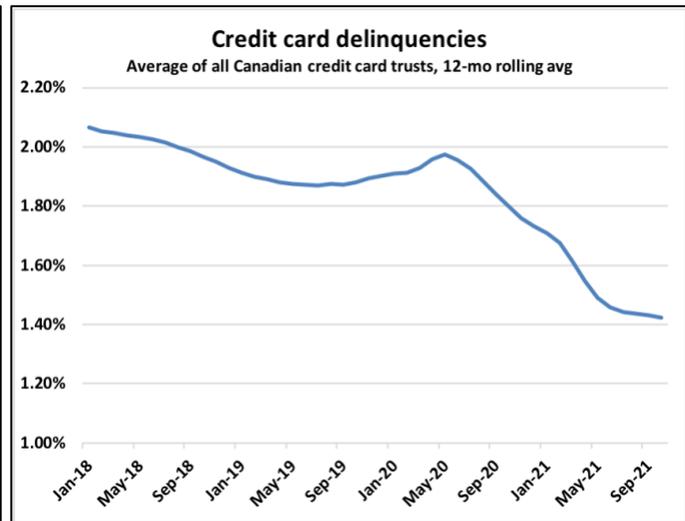
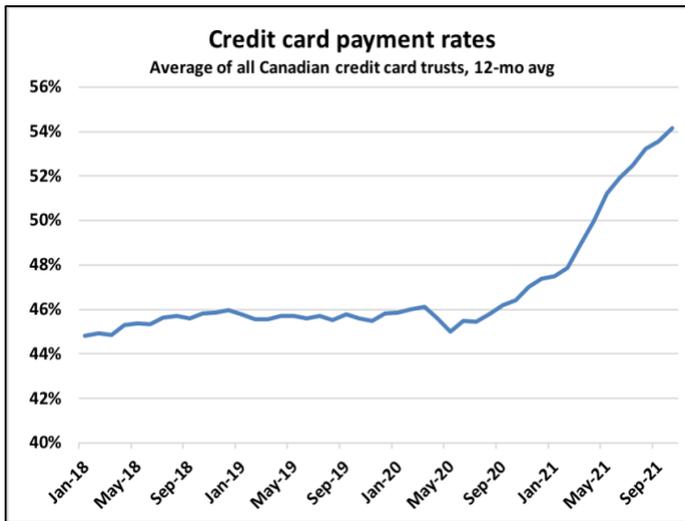


As an aside, the same is also true of business insolvencies which are at the lowest levels since 1987!!!!

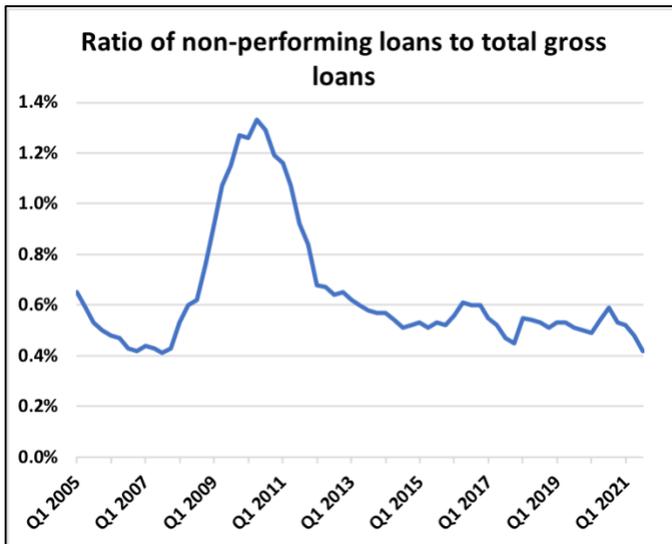


**iii) No signs of stress in monthly credit card data**

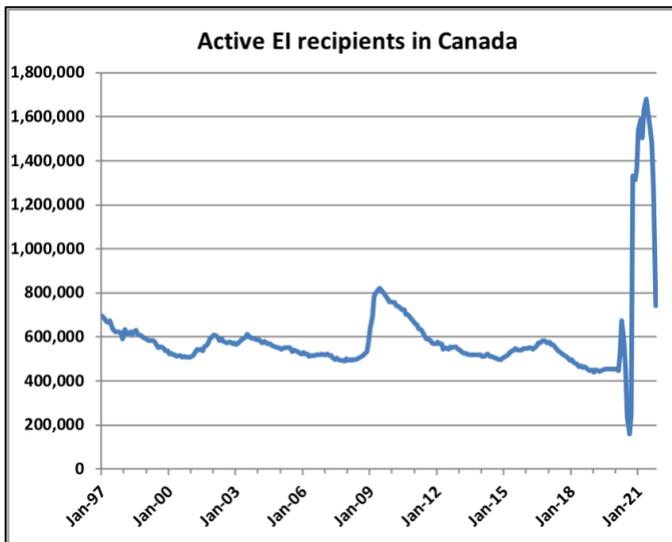
I had wondered last month if we had perhaps seen an inflection point in credit card data. It appears not. Payment rates jumped again last month while delinquencies fell.



No one defaults on a mortgage without missing some credit card payments in Canada, so until this trend changes, mortgage delinquencies will remain at record lows. On that point, total non-performing loans at Canadian banks were barely above 0.4% in Q3, the lowest since 2007:



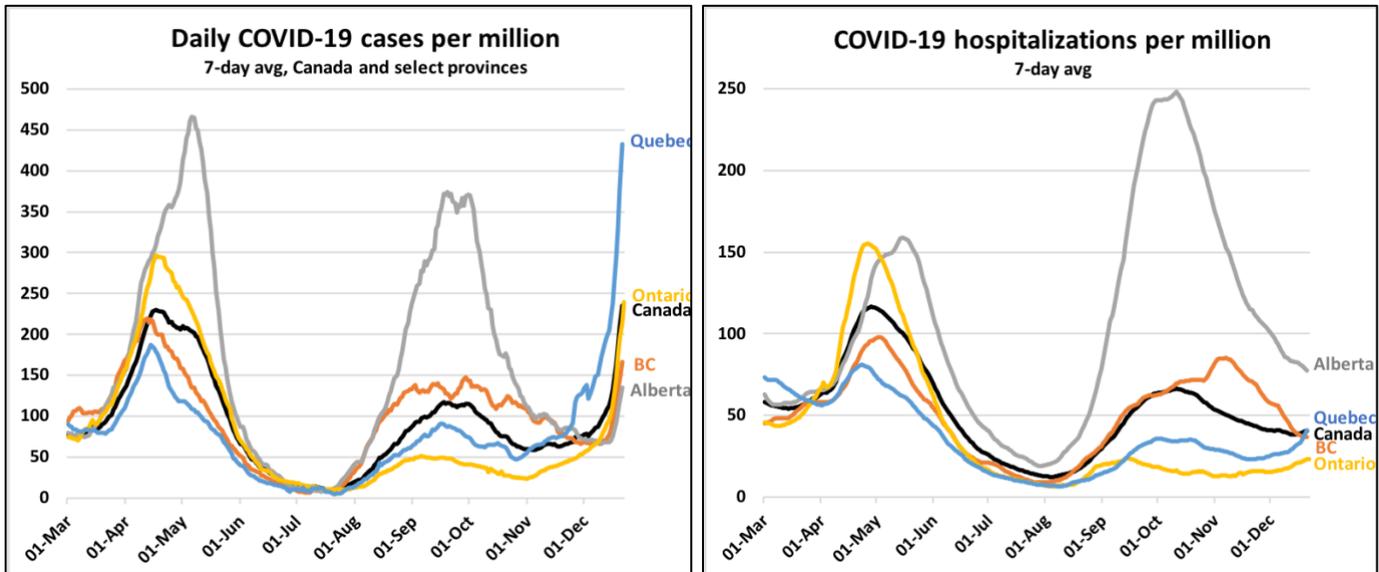
Now I still think it's likely that this starts to change early next year. The big reason is the unwinding of some key income support programs like the Canada Recovery Benefit (CRB). If we look at total Employment Insurance recipients (which includes CRB), the number plunged by a record 540,000 in October. It takes a few months for people to exhaust savings and for the delinquencies to show up among those most at the edge, but I think we'll see that very soon.



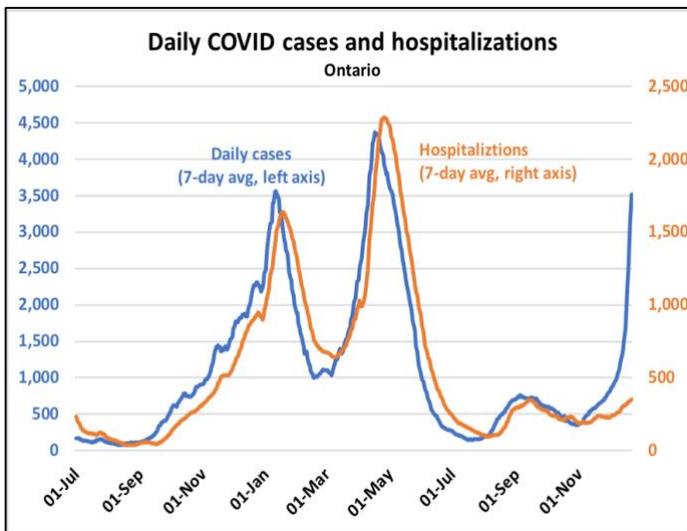
## 5) Monitoring key risks

### i) COVID cases surge as Omicron takes hold

Again, not a judgement on what policy makers SHOULD do, but it's clear that we'll be facing more restrictions in coming weeks...notwithstanding that we have yet to see a material increase in hospitalizations:



To make it abundantly clear, I've zoomed in on Ontario here to show the trend in cases and hospitalizations over time. Early data from other countries suggests that Omicron could be a much milder strain than any previously. So far that seems to be the case here too, though it's admittedly still very early days:

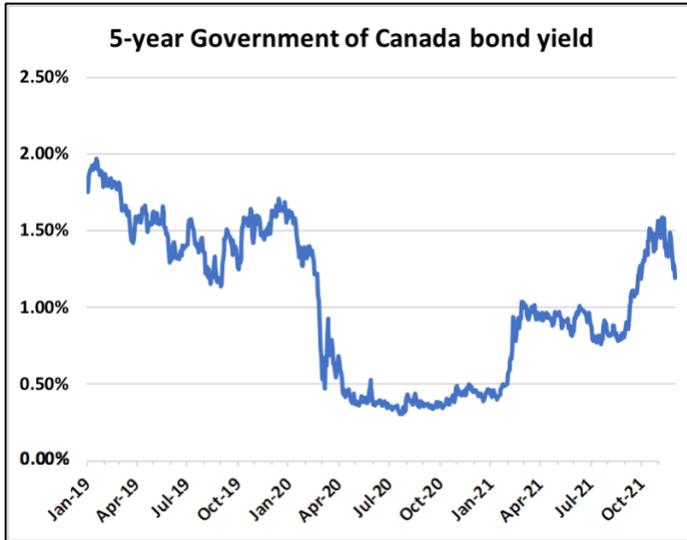


With new restrictions likely on the way, it means we'll see some hit to Q4 and Q1 GDP. Already, mobility data is rolling over, a sign that economic activity has slowed.

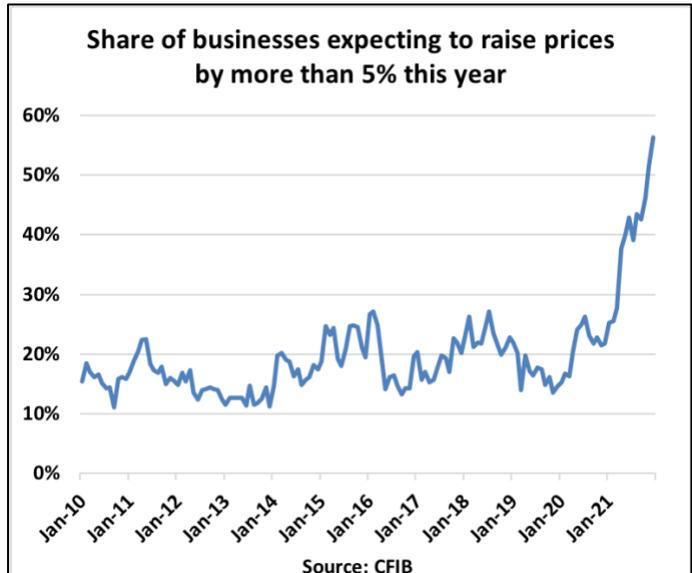
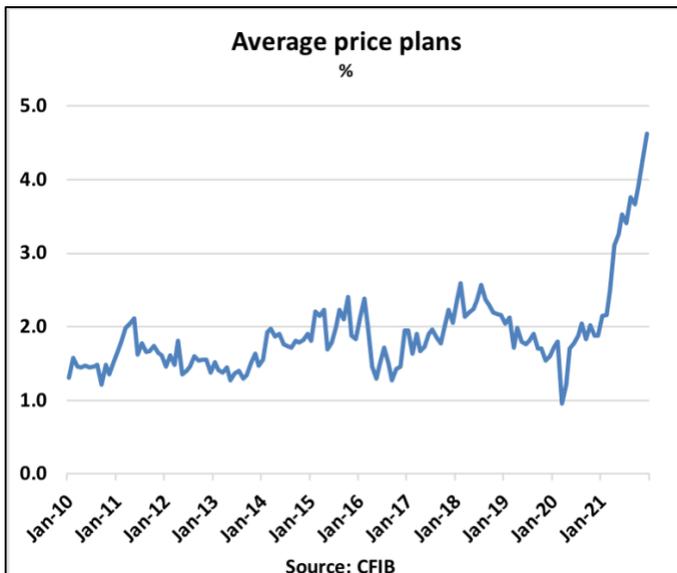
I'm no epidemiologist, but from what I understand, the infectiousness of Omicron all but guarantees that this wave will be intense but short. I'd be surprised if case counts didn't roll over by the end of January.

**ii) Bond yields roll over, but inflationary risks are still firmly to the upside**

Investors are paring back bets for rate hikes in 2022 amid Omicron concerns. The 5-year bond yield, which largely determines fixed rate mortgage pricing, has fallen nearly 30 bps since the recent highs in October:



But don't lose sight of the inflationary risks going forward. The latest business survey data shows a continued increase in price expectations for next year, with nearly 60% of businesses expecting to raise prices in excess of 5%! That tells me that inflation risks are still tilted strongly to the upside, and we'll likely see some more bond market spasms in 2022 as we get through this (hopefully last) COVID wave and economic prospects brighten.



### iii) Trudeau mandate letter suggests they'll be targeting investors in 2022

Prime Minister Trudeau has handed out mandate letters to his ministers. Relevant to readers will be his mandate letter to Housing Minister Ahmed Hussen. The letter can be read below:

<https://pm.gc.ca/en/mandate-letters/2021/12/16/minister-housing-and-diversity-and-inclusion-mandate-letter>

Most of the mandate reflects promises made during the election, including anti-flipping measure and a ban on foreign buyers...neither of which will move the needle on the housing issue.

But there was also this:

- Developing policies to curb excessive profits in investment properties while protecting small independent landlords;
- Reviewing the down payment requirements for investment properties;

Consider this a shot across the bow....a clear indication that financing conditions for investors are set to tighten in 2022.

Regards,  
Ben