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**June 2023**  
**Metro deep-dive- May data**

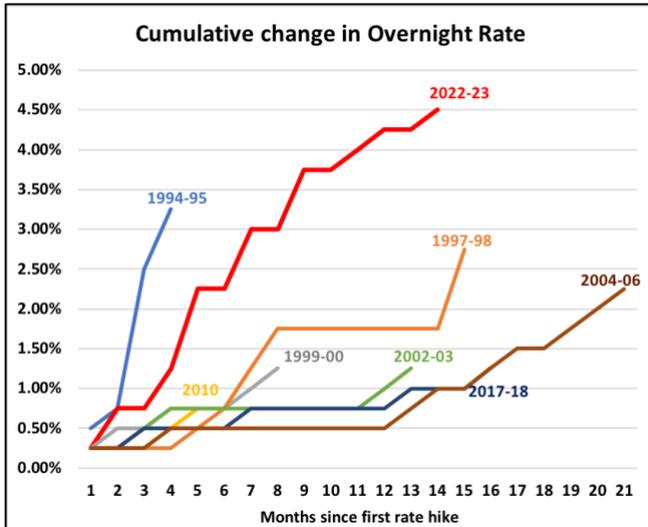
**Quick links:**

- 1) Bank of Canada hikes rates in spite of storm clouds on the horizon**
- 2) Finally some sellers show up in Toronto**
- 3) Vancouver home sales continue to surge**
- 4) Calgary market strengthens, inventory tumbles**

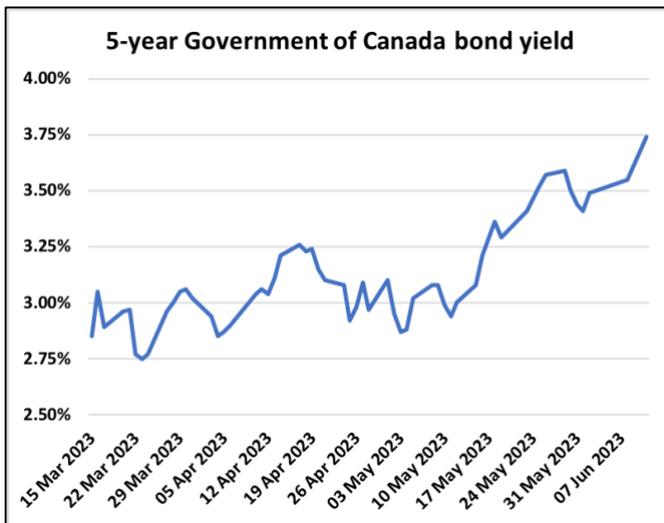
## 1) Bank of Canada hikes rates in spite of storm clouds on the horizon

### Bank of Canada makes surprise rate hike

The Bank of Canada raised its policy rate by 0.25% to 4.75% this morning. This is already the largest cumulative interest rate hiking cycle since the 1980s, and there may be more to come. Markets are pricing in a 100% chance of another rate hike in July:



Bond yields are surging on the surprise hike, with the all-important 5-yr benchmark yield up 20bps to 5.74%. Expect more fixed rate hikes in the coming week:

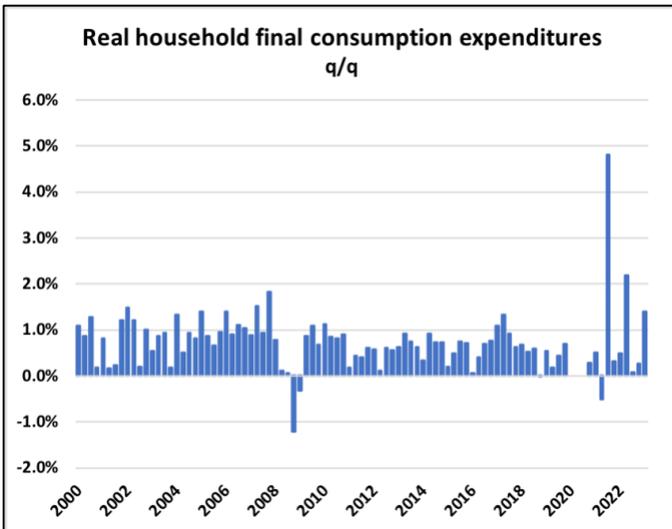


While all major metros saw a solid increase in seasonally adjusted home sales in May, we should expect that this latest hike and talk of additional increases should put a serious damper on demand through the summer.

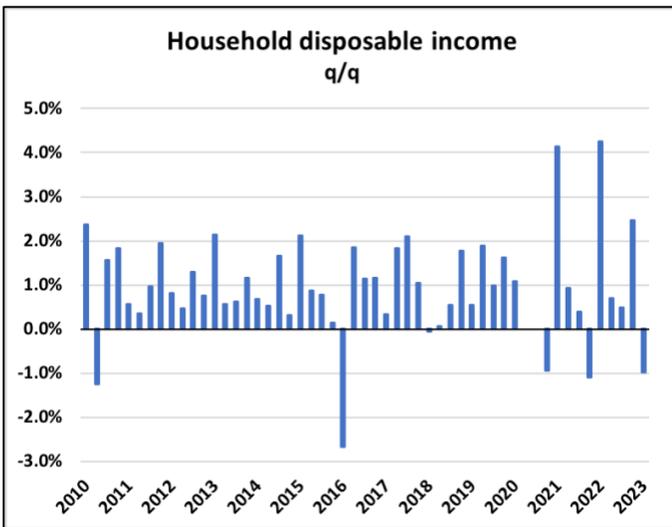
**Solid Q1 GDP report**

Real GDP growth in Q1 surprised analysts by coming in at +3.1% on an annualized basis vs expectations of +2.5%.

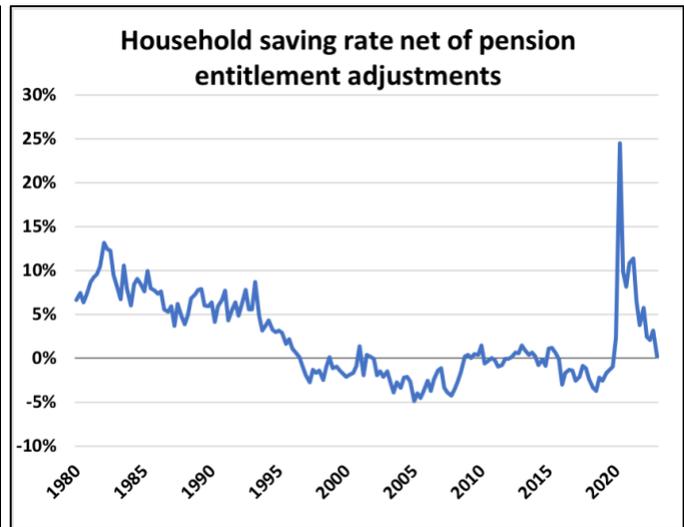
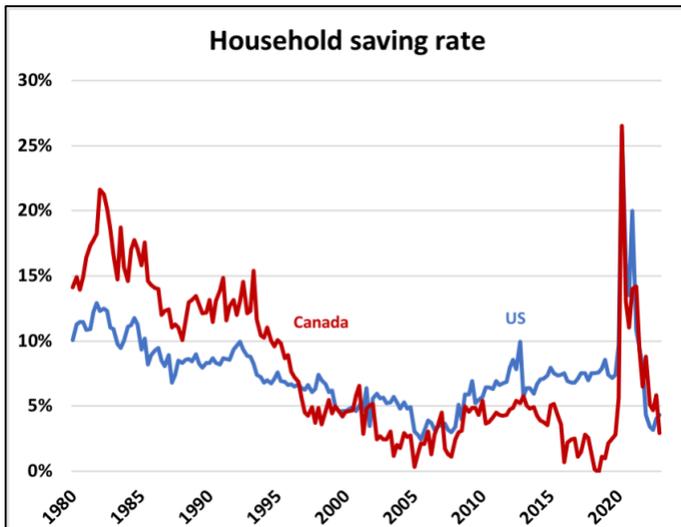
The consumer put in a solid showing, with household final expenditures (ie consumer spending) up 5.7% on an annualized basis in the quarter.



Consumption grew in spite of a 1% sequential decline in disposable income in the quarter, which was weighed down by a drop in government transfers:

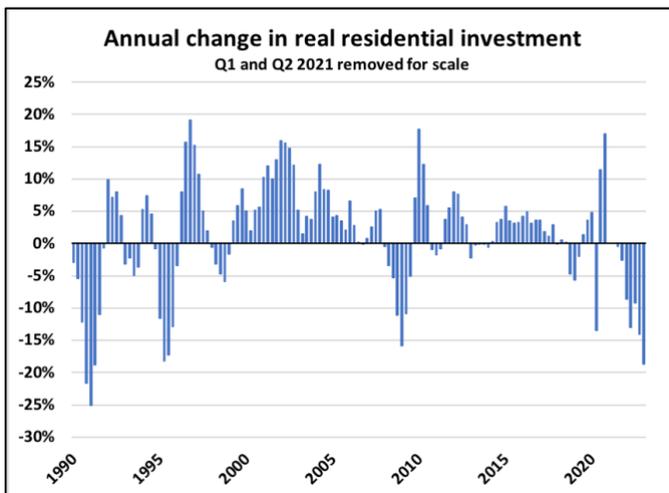


This seeming contradiction is explained by a sharp slowdown in household savings which fell back to pre-pandemic levels of 2.9% from 5.8% in Q4 2022 (and compared to 4.3% in the US in Q1). Importantly, savings net of pension adjustments, which is a better measure of “active” savings, fell to zero for the first time since 2019:

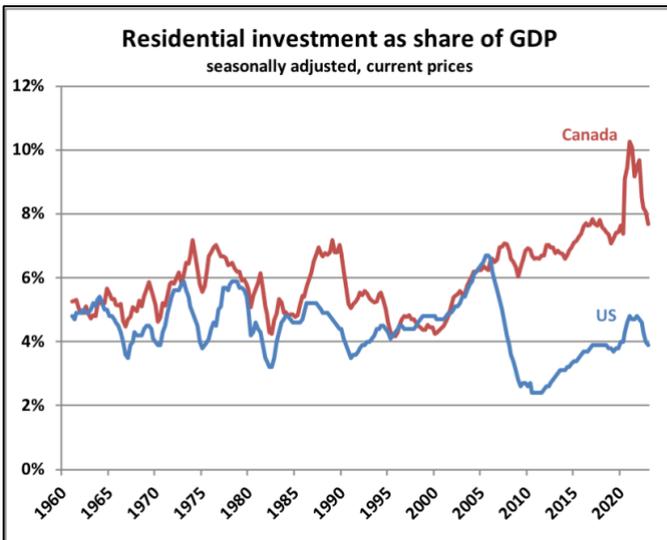


**Housing still a drag**

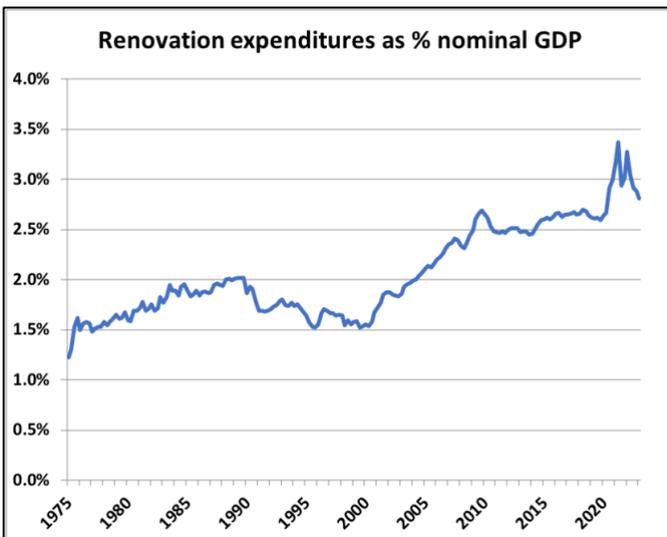
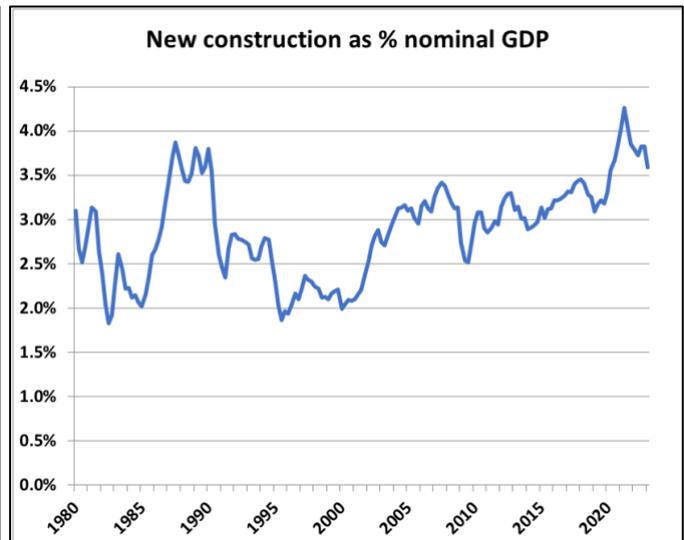
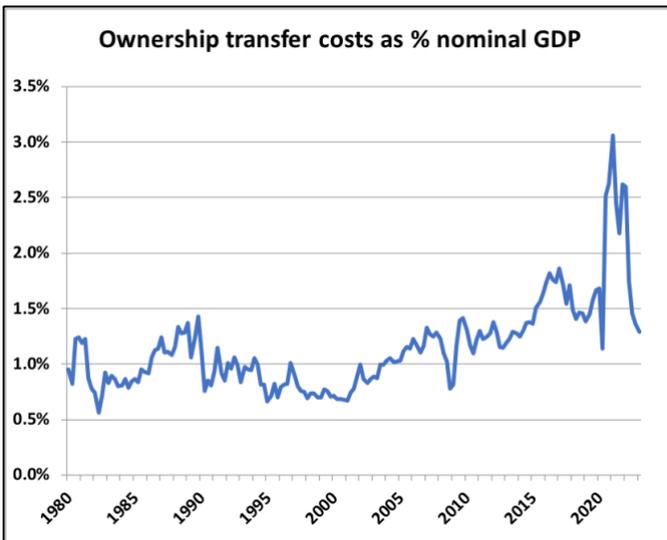
Residential investment slumped by 15% on an annualized basis and was down 20% relative to Q1 2022. That represents the steepest contraction since the early 1990s, and it's a strong indicator that an economic slowdown is on deck. Canada has never seen a +10% annual decline in real residential investment that hasn't been associated with recession:



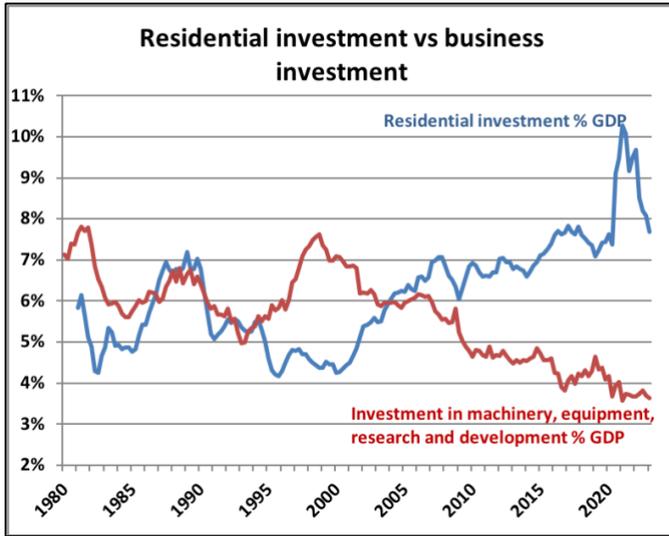
Residential investment is off the highs but still nearly 8% of GDP, well above prior cyclical peaks in the 1970s and late 1980s. There's potentially further to go here:



The only component of residential investment that has fully retraced the post-pandemic bounce is ownership transfer costs, which is a straight feedthrough from resale activity. New construction and renovation expenditures are still barely off their respective record shares of GDP:



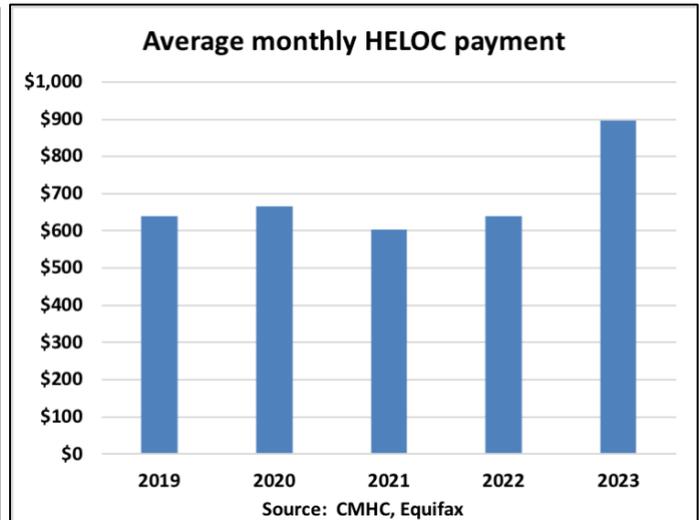
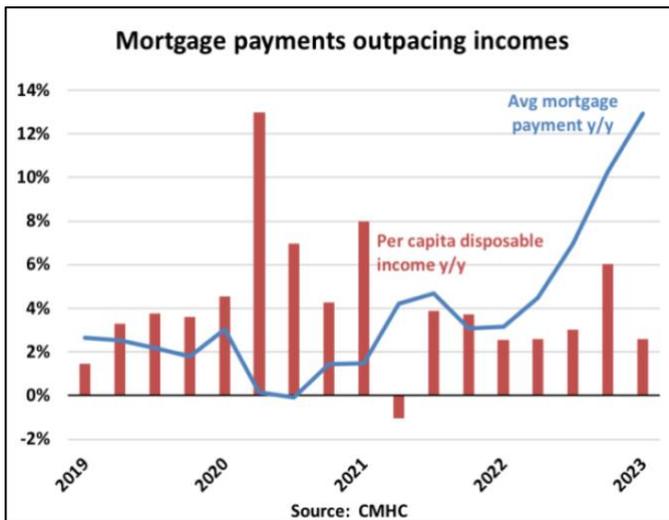
Real expenditures on machinery and equipment fell nearly 10% on an annualized basis following a 29% contraction in Q4 last year. That leaves business capex plus research and development (a proxy for business investment) at a mere 3.6% of GDP and still near a record gap relative to residential investment...which is not good news for future productivity growth. The gap between business investment and housing investment remains near a record.



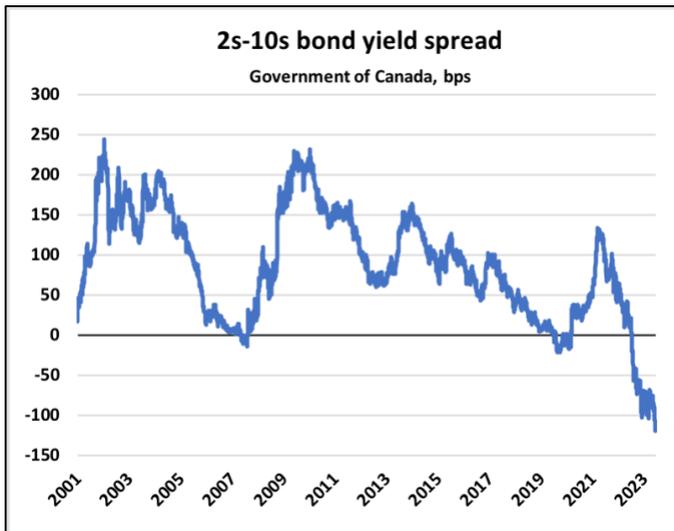
**Recession indicators mount**

The consumer came to the rescue in Q1, but how durable is consumer spending in the face of rising debt payments and weaker disposable income?

New data from CMHC and Equifax show average mortgage payments now outpacing disposable income growth by the widest margin on record while average HELOC payments have ballooned from \$600/month to \$900.



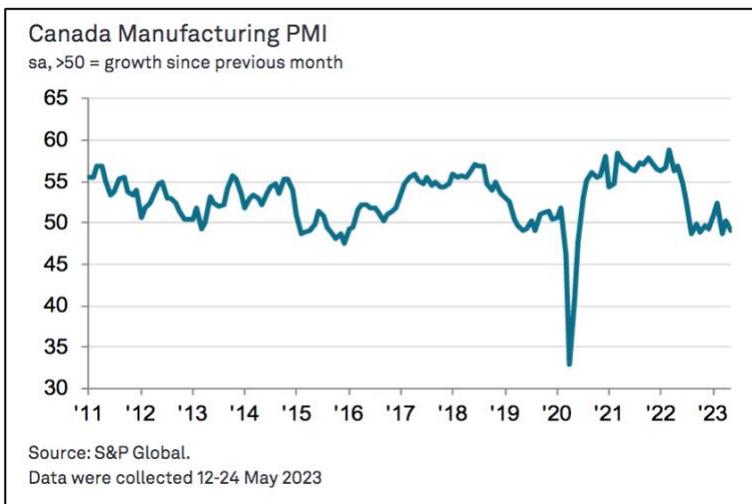
Other indicators this week continue to point to a likely recession later this year or in early 2024. Consider the Canadian bond yield curve where 10-year bonds now yield 110bps less than 2-year equivalents...something we haven't seen since the 1970s. That deeply negative yield curve is a classic recession indicator that points to a likely economic slowdown within a year:



We also learned that Canada’s manufacturing sector slowed in May. The Purchase Managers Index (PMI) fell to 49 in May from 50.2 previously (a reading below 50 means the sector is contracting). From Markit<sup>1</sup>:

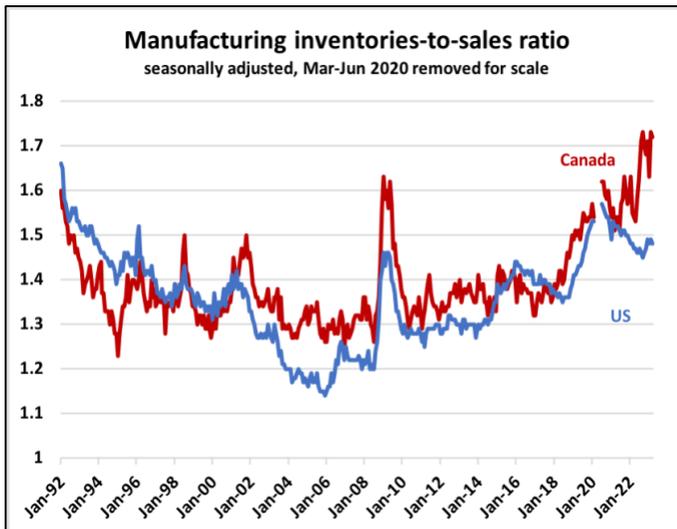
Canada’s manufacturing sector slipped into negative territory during May on the back of concurrent falls in output, new orders and employment. Anecdotal evidence pointed to the negative impact of high inflation on spending budgets, whilst destocking remained a common theme amongst manufacturers and their clients.

[...] Undermining the PMI in May were reductions in both output and new orders. Rates of decline were relatively marginal in both instances, with firms commenting that client budgets had been squeezed by high inflation. Spending from industry and municipal clients was said to be down. Some customers were reported to be cutting spending as they sought to lower inventories.

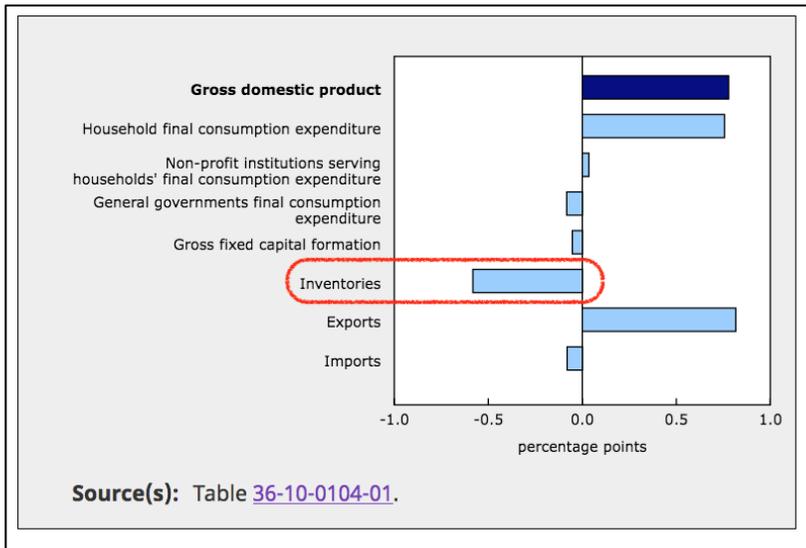


Note the comments on destocking. A trend I’ve flagged before is the massive amount of inventory held by Canadian manufacturers, relative to both sales and new orders. In both cases, that ratio has blown out above 2008-2009 levels:

<sup>1</sup> <https://www.pmi.spglobal.com/Public/Home/PressRelease/20450eeeff534c6682c452cf5af98707>

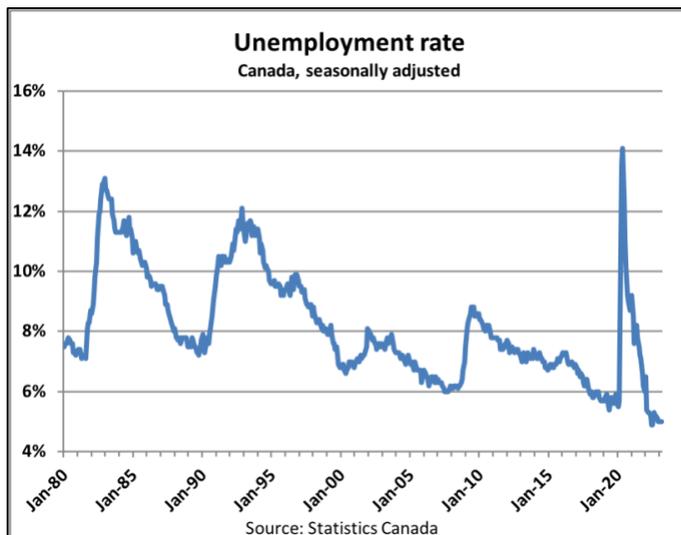


Not surprisingly, inventories were a drag on GDP growth in the first quarter, a trend that may persist for the remainder of the year given the magnitude of the build over the past year:



All this to say, while Q1 GDP was a pleasant surprise, we should still expect an economic slowdown later this year.

My base case remains that we see a "normal" and likely relatively mild recession (NOT a financial crisis) in which the unemployment rate ticks up 1.5-2%. That's not great news, to be sure, but keep in mind that the unemployment rate currently is near a record low of just 5%. A move up to 7% would put us at an unemployment rate that was typical from 2010 to 2016....not exactly a disastrous time for the Canadian economy.

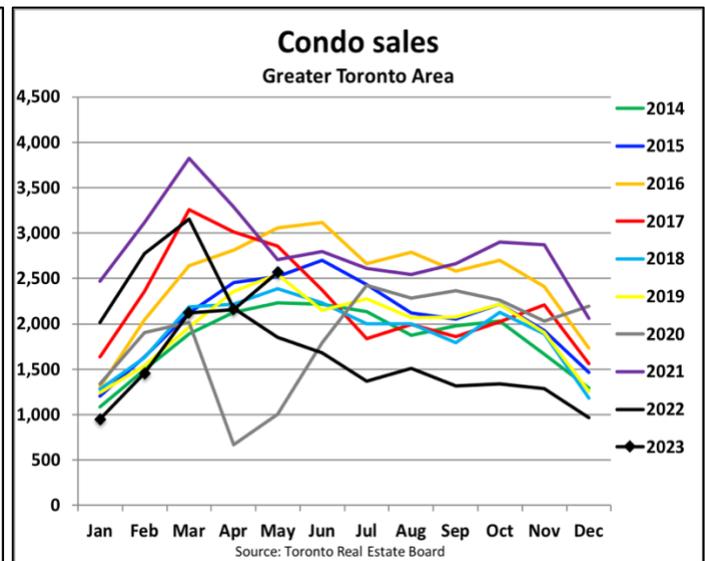
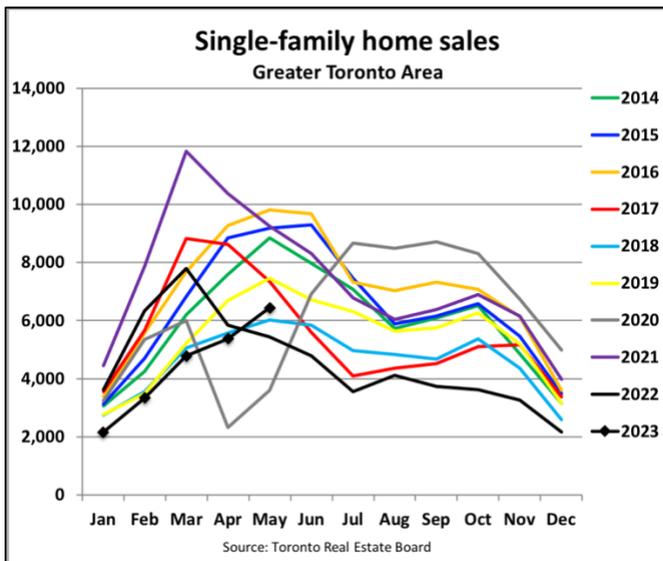
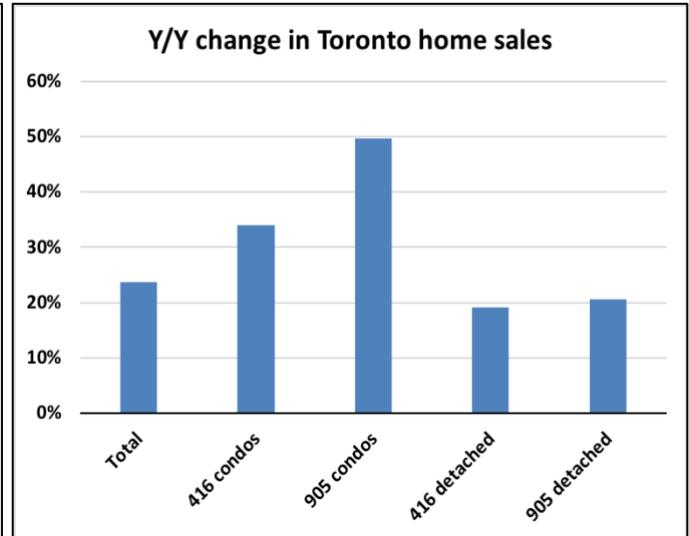
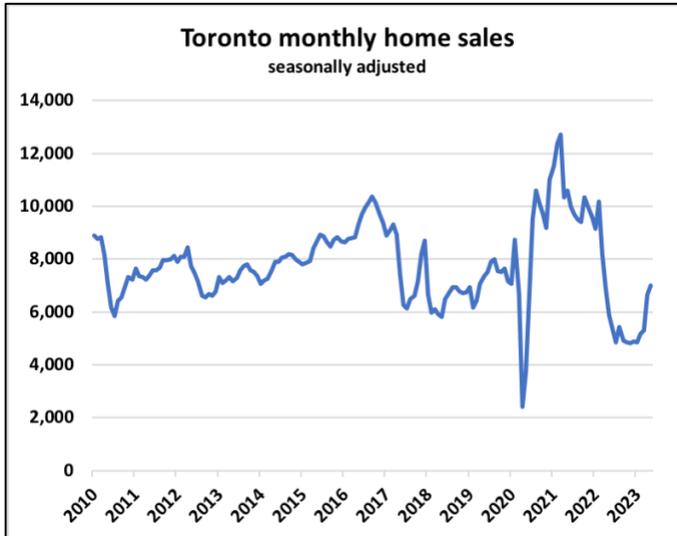


I still expect that we extremely close to a peak in rates, and we should see the Bank of Canada begin cutting in early 2024 with the policy rate settling around 2.5% by the end of next year.

## 2) Finally some sellers show up in Toronto

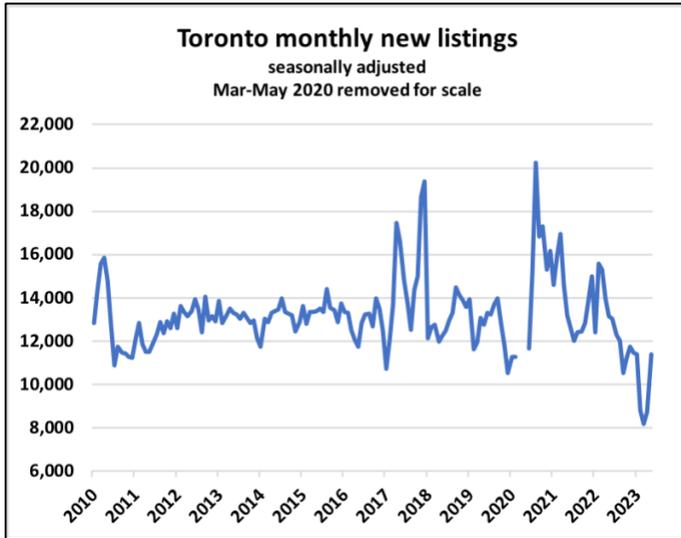
### Sales continue to perk up

Seasonally adjusted home sales across the Greater Toronto Area jumped 5.2% m/m in May and are now up 44% over the past 4 months and are 27% higher than last year at this time:



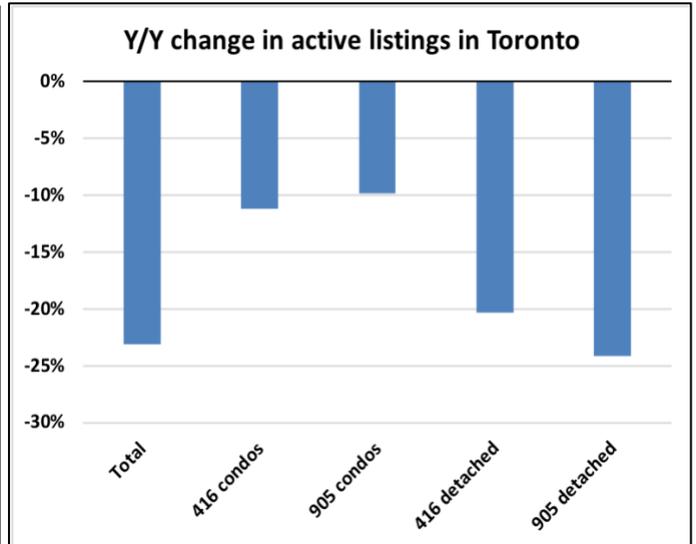
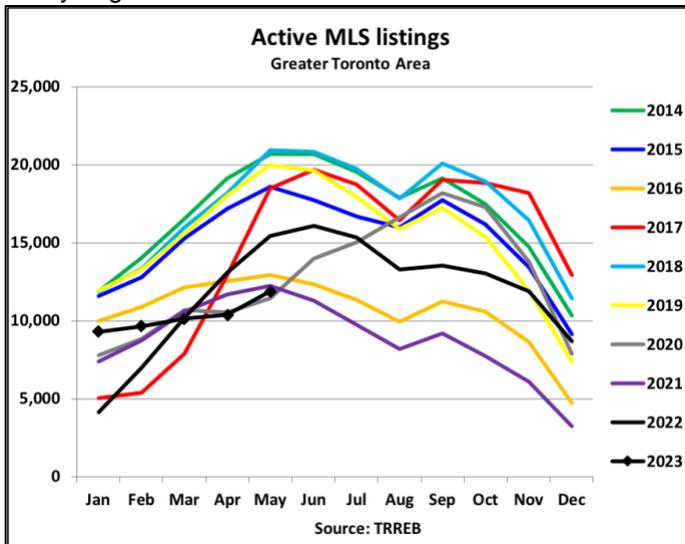
### New listings FINALLY materialize

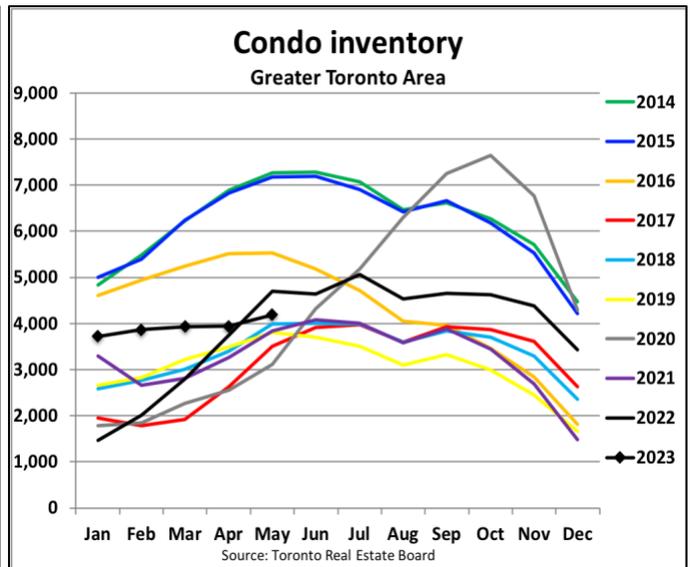
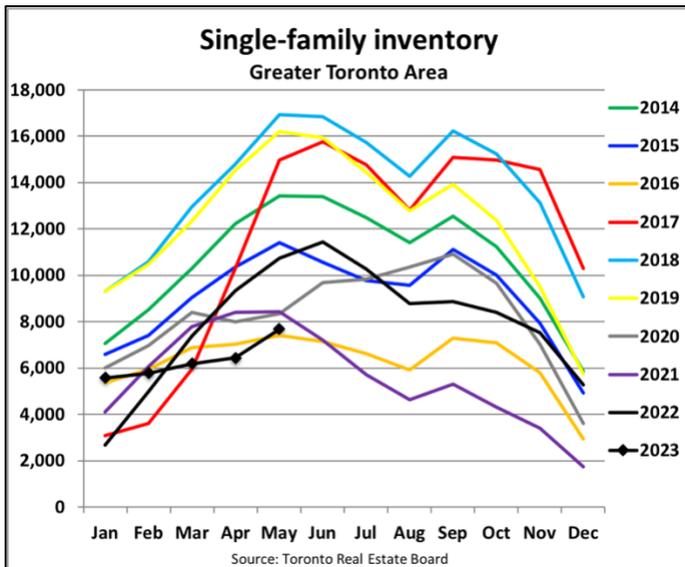
After months of slim pickings, new listings finally ticked up in May. By my math, we saw a nearly 30% monthly increase in seasonally adjusted new listings last month:



### Inventory levels still low

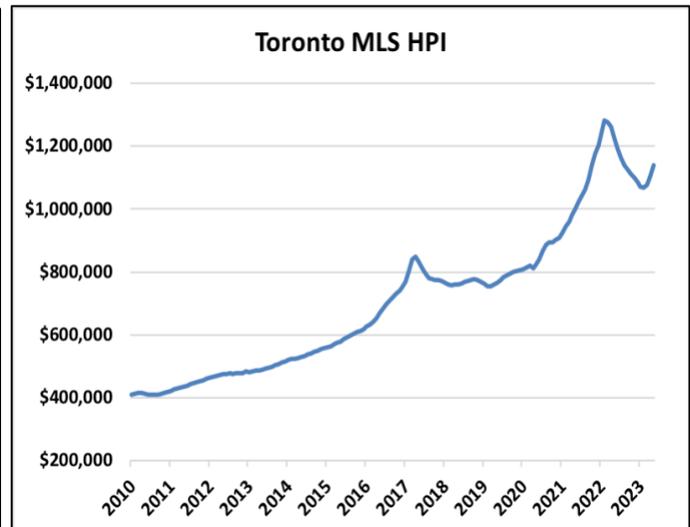
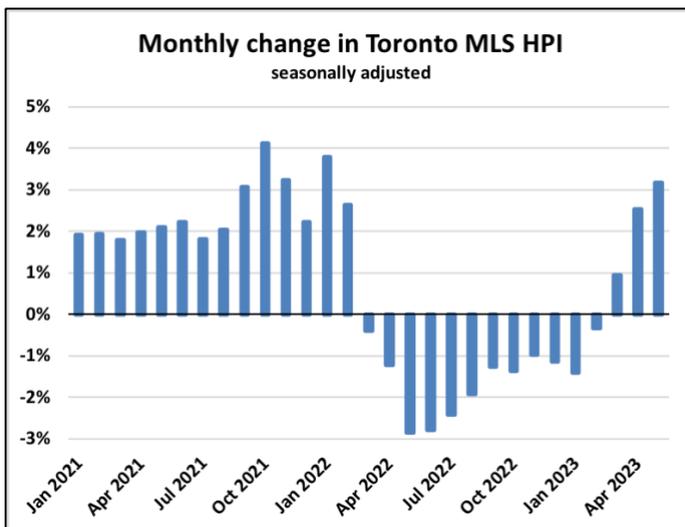
Active listings were down 23% y/y in May and remain near the lowest levels of the past decade, notably in the single-family segment:

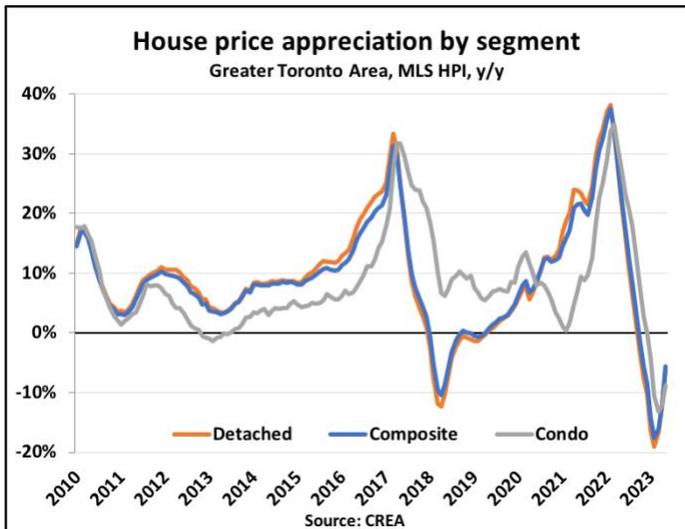




## Strong price growth

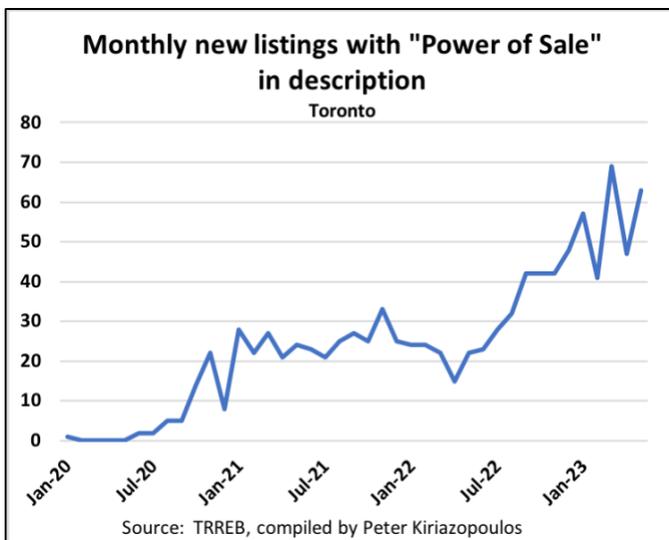
The seasonally adjusted MLS House Price Index registered a whopping 3.1% MONTHLY increase in May...one of the largest gains of the past decade!





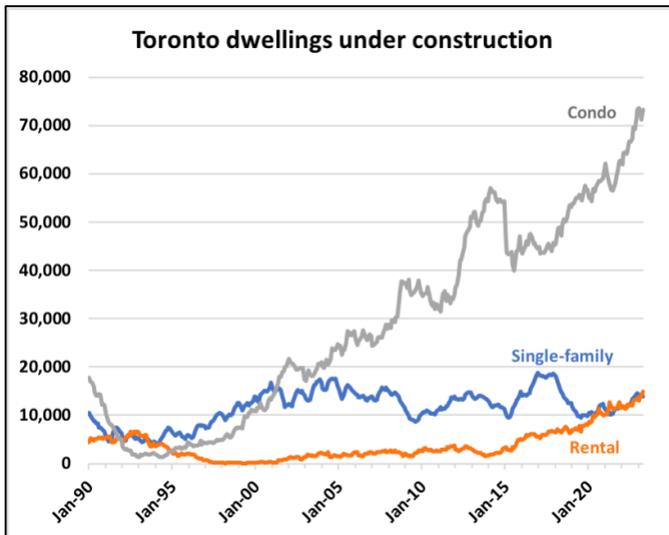
**Power of sale listings rise**

New listings with the term “power of sale” in the description ticked up to just over 60 in May (thanks again to Peter Kiriazopoulos for the data):



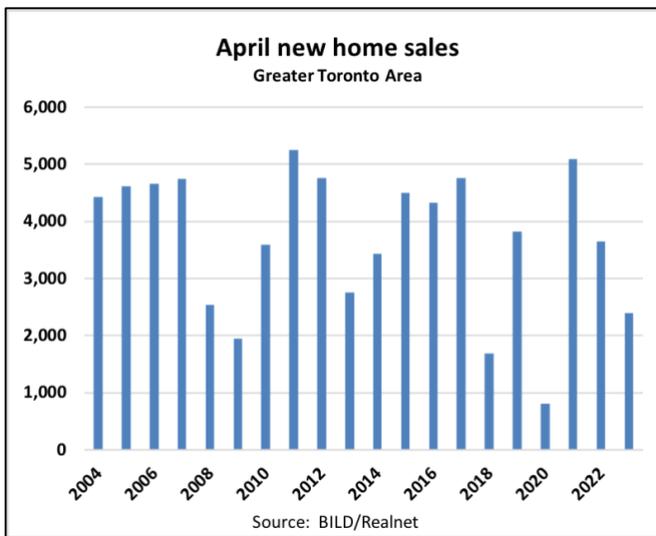
**Construction activity up on rentals**

The number of dwellings under construction across the GTA rose by 2.6% in April including a 5.2% jump in rentals. There are now substantially more rentals under construction than single-family dwellings for the first time since the early 1990s:

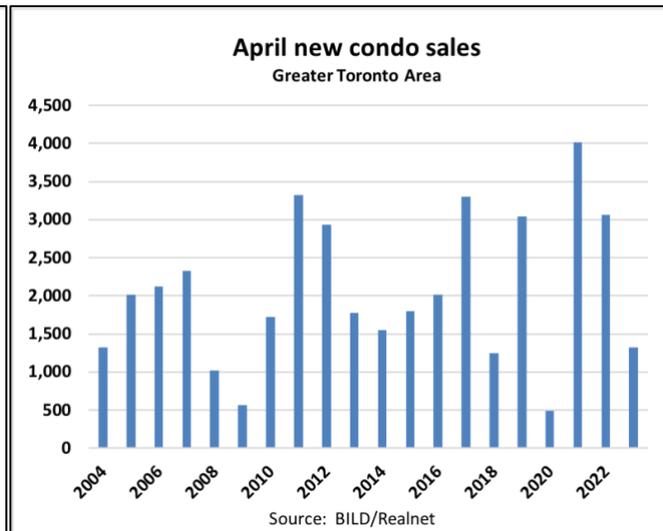
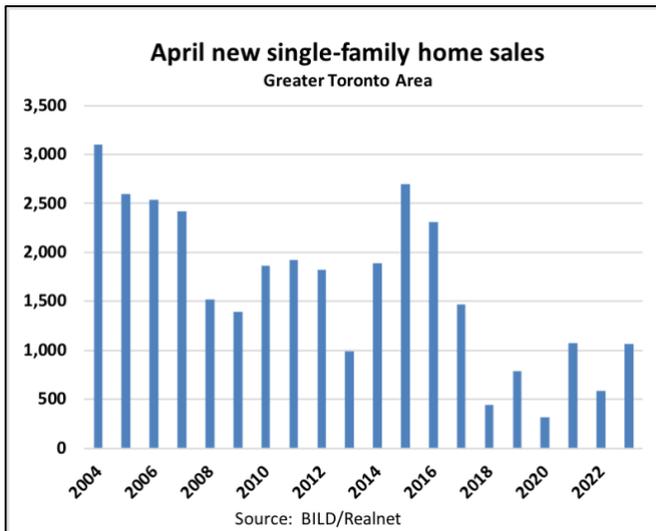


**New home sales remain weak but single-family perks up**

New home sales across the GTA were down 35% y/y in April according to BILD.

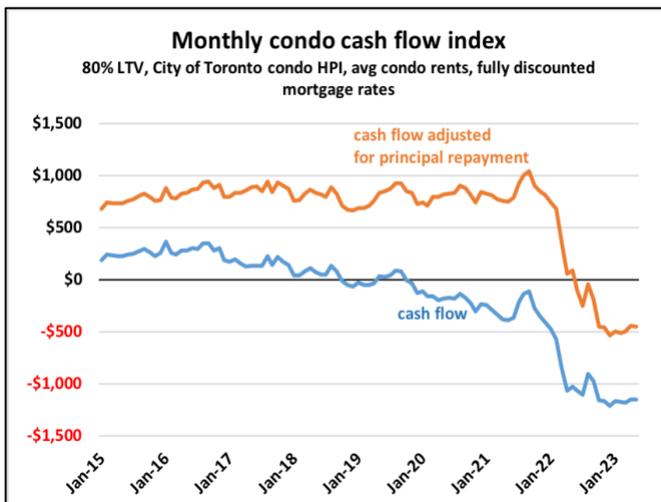


If there's good news, it's that the single-family segment sprung to life with sales up 81% y/y even as new condo sales were down 57%:



### Cash flow negative landlords in the news

The economics on Toronto condo investments continue to deteriorate. Based on rents, mortgage rates, and current prices, an investor who purchased a condo in May and financed it at 80% LTV would be facing negative cash flow of \$1,154 per month. And they would still be \$453 in the red even after factoring in principal repayment:

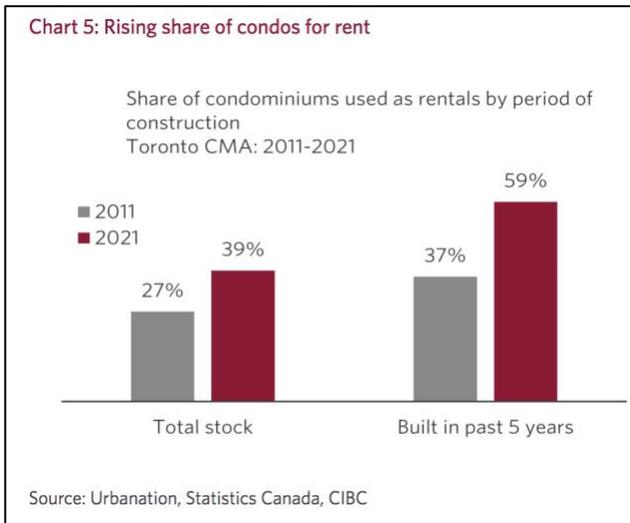


We know that this is not a new phenomenon, and I've been more than a little surprised at the ability and willingness of these investors to eat an increasingly punitive negative carry. Still, this dynamic is worrisome. A fascinating new report<sup>2</sup> from CIBC, with data from Urbanation, highlights the scale of the potential problem. Some key points:

#### The majority of new condos are entering the rental pool

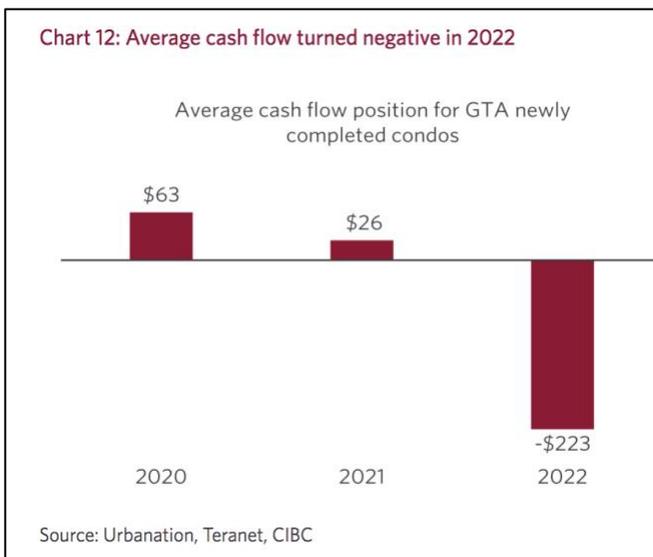
For condos that are less than 5 years old, nearly 60% of units are rented:

<sup>2</sup> <https://economics.cibccm.com/cds?id=2ec45527-c255-482e-ab62-53fe539b8ace&flag=E>



**ii) Average cash flow is now negative**

While my chart above measures the cash flow on a condo purchased in the resale market at any point in time, the report highlighted that new condos completing today are now significantly cash flow negative. And that's even with the benefit of prices that were locked in typically 5 years prior.

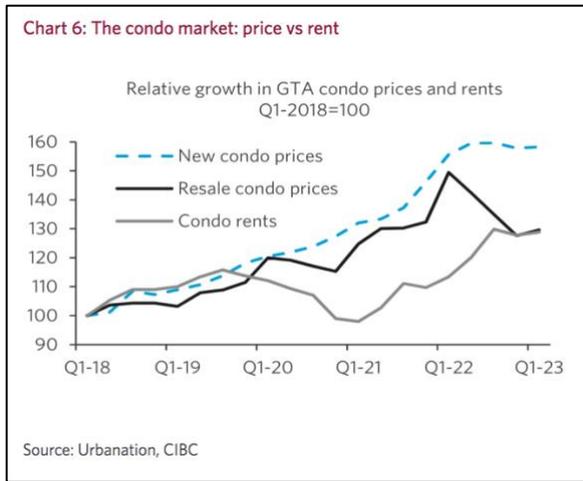


From the report:

The distribution of newly completed condo rentals by cash flow position shows that the highest concentration (14%) of investors was losing \$1,000 or more each month, with a one-third share of investors experiencing negative cash flow of \$400 or more.

iii) **New condo prices have outpaced resale**

New (ie preconstruction) condo prices have significantly outpaced both rents and resale condo prices. This is important since these preconstruction units are typically priced at a substantial premium to resale, often in excess of 20%. If the resale market does not “catch up” to that price by completion, the buyer will face a capital call to bring the mortgage back to at least 80% LTV in order to qualify for financing:



This remains a big risk later this year and into 2024, particularly as we face a record year for completions:



It will be important to monitor whether these units appraise for the necessary amount and whether the preconstruction buyers still qualify for a mortgage given higher rates. On that front, an anecdote from Reddit posted just yesterday is telling. How many more like this?

**reddit** PERSONALFINANCECANADA comments

Housing What happens if you might not be able to secure a mortgage on a preconstruction condo years down the line? (self.PersonalFinanceCanada)  
submitted 15 hours ago by IntergalacticBurn

So I left a deposit of around \$100K on a preconstruction condo many years ago. Times have changed and things have happened in life.

I tried consulting some mortgage brokers today since my final tentative occupancy date was issued to me, and they say that my income would not be enough to secure a mortgage.

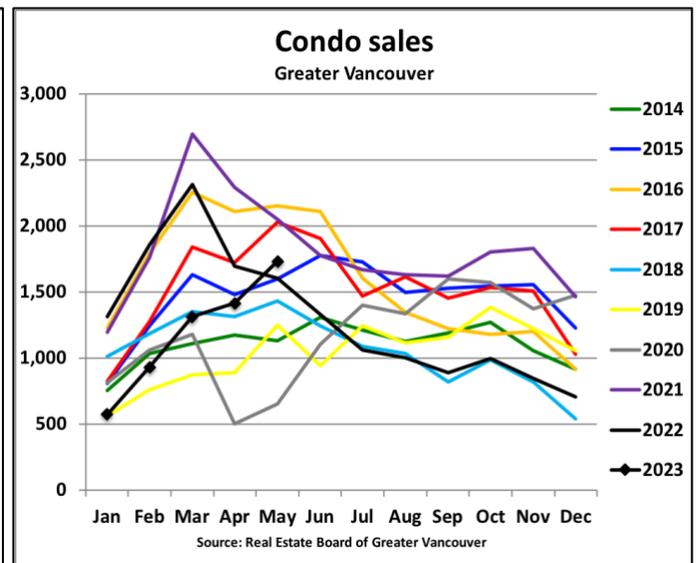
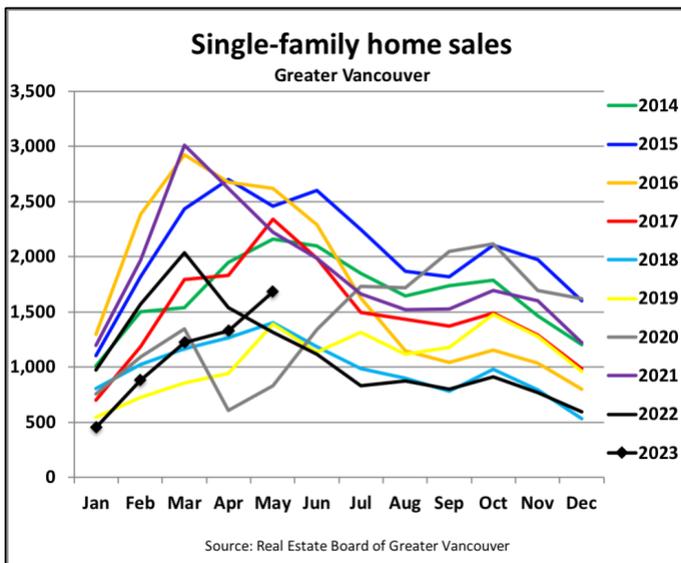
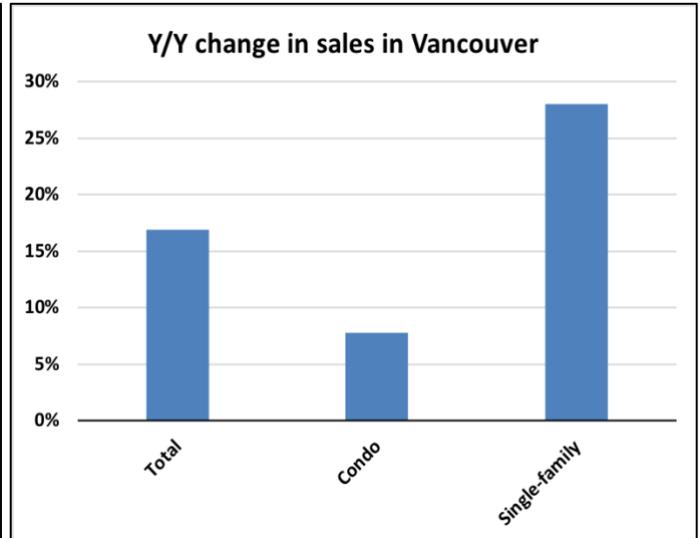
What are my options? I really don't want to let go of this condo. I'm confident I can make the mortgage payments and condo fees and stuff, but my word isn't enough to convince the brokers.

171 comments share save hide give award report crosspost

### 3) Vancouver home sales continue to surge

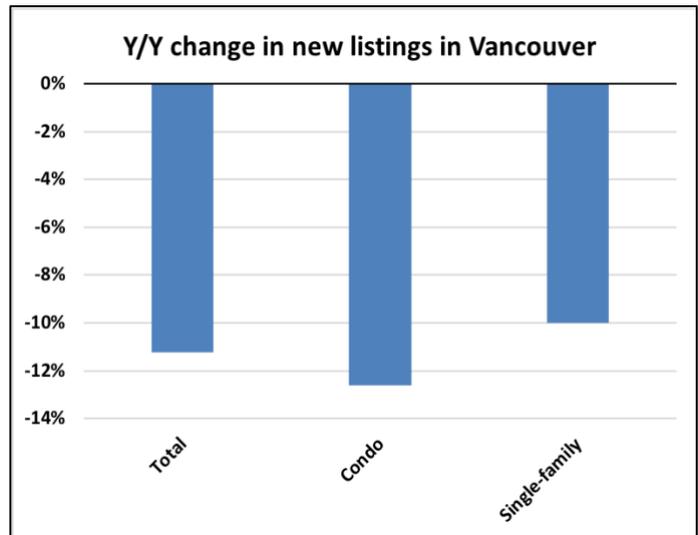
#### Sales boom

Seasonally adjusted home sales jumped 12% m/m in May and have now surged a whopping 74% in 4 months...the strongest such increase since the COVID lows:



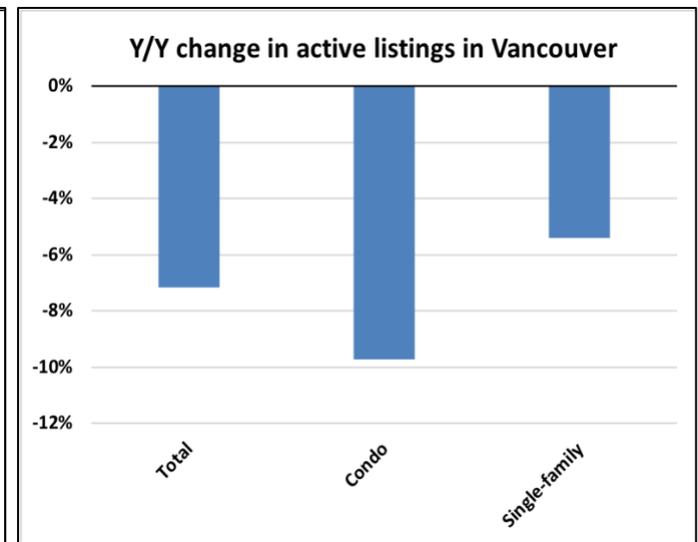
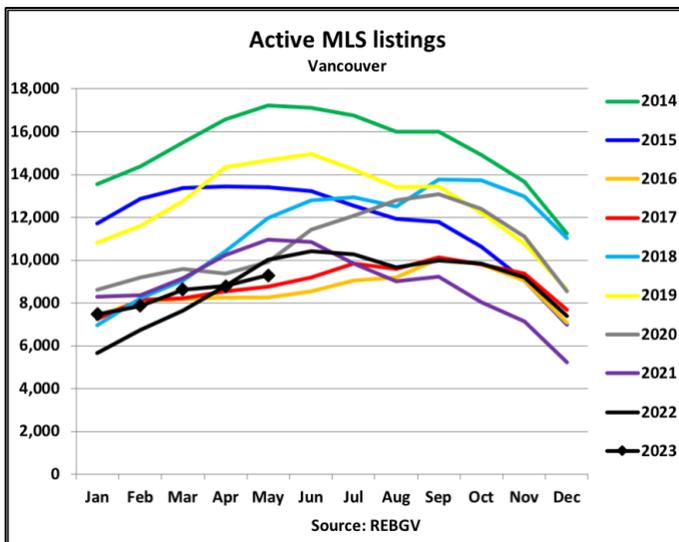
#### New listings jump

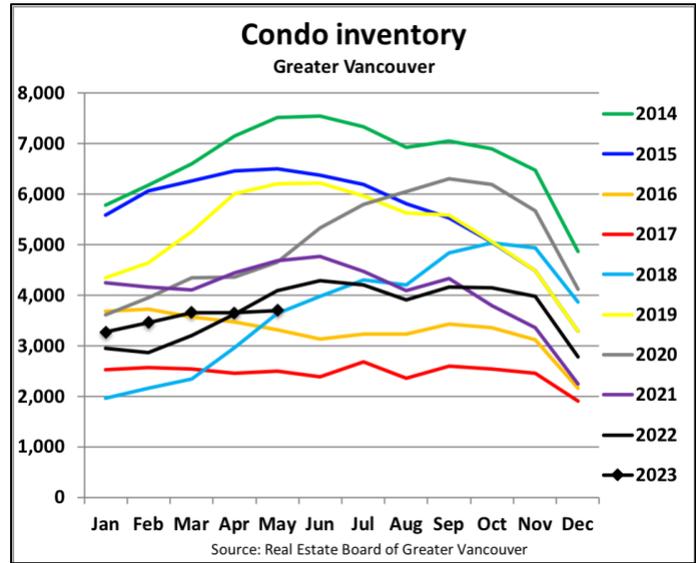
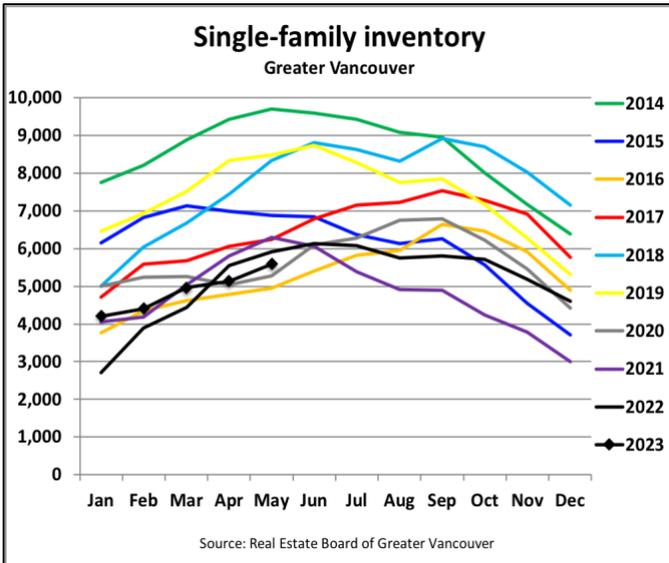
New listings are still down relative to this time last year (-11% y/y) but they did tick up an estimated 20% m/m on a seasonally adjusted basis:



**Inventory still tight**

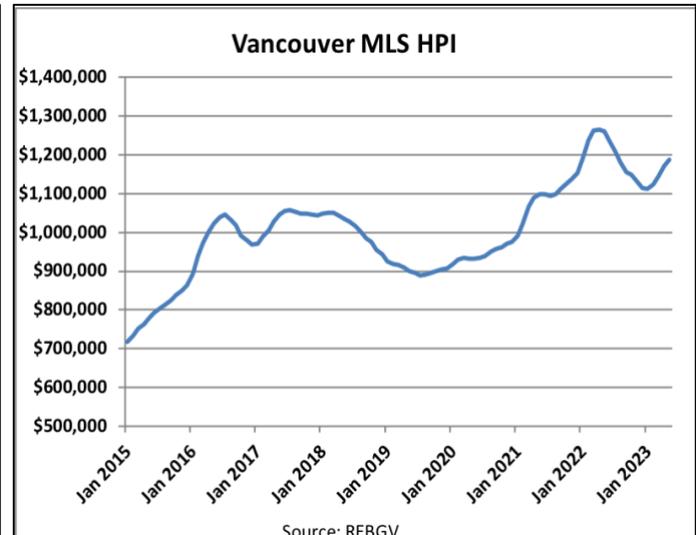
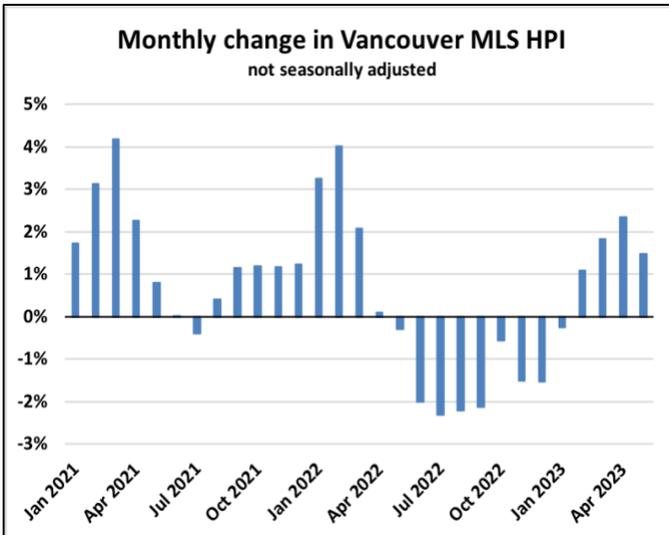
Inventory levels remain near the lowest of the past decade across Vancouver, down 7% y/y overall.

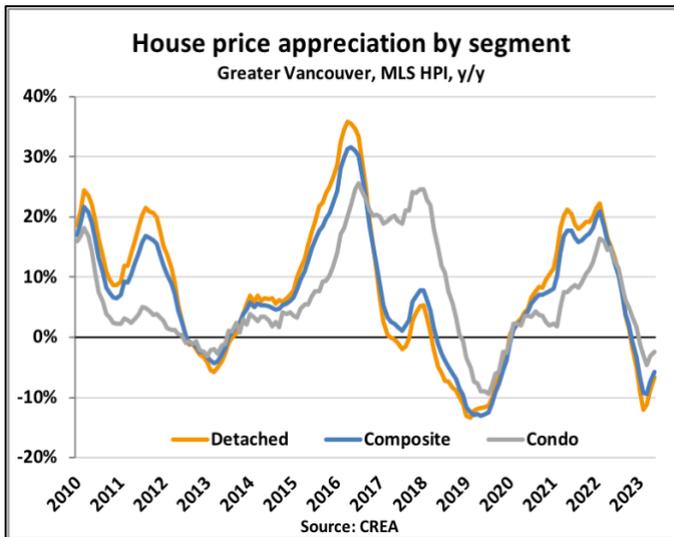




## House prices firming

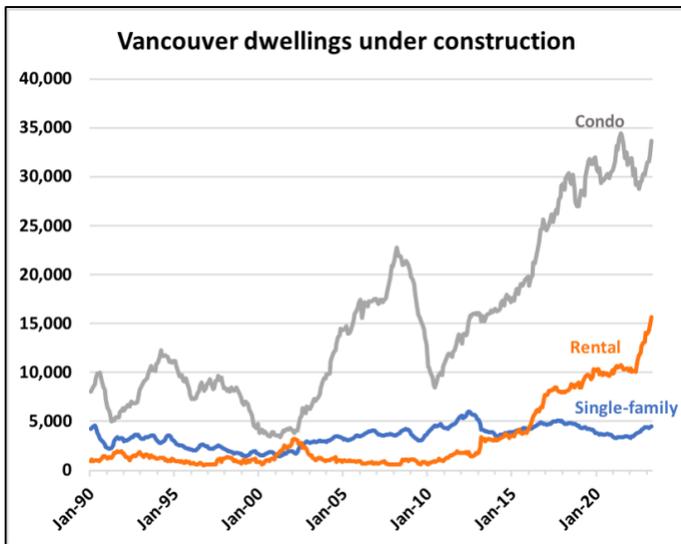
The MLS House Price Index posted a 1.5% monthly gain in May





**Construction activity rises**

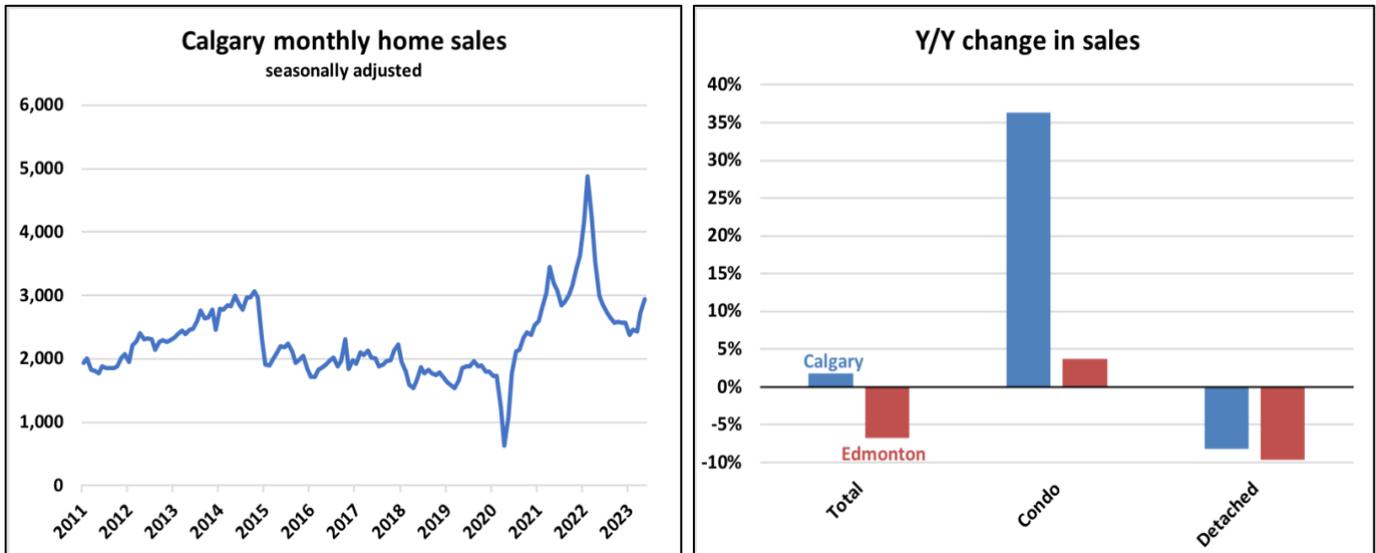
The number of dwellings under construction across Vancouver rose 5.2% m/m in April including a 6% jump in rentals.



## 4) Calgary market continues to strengthen

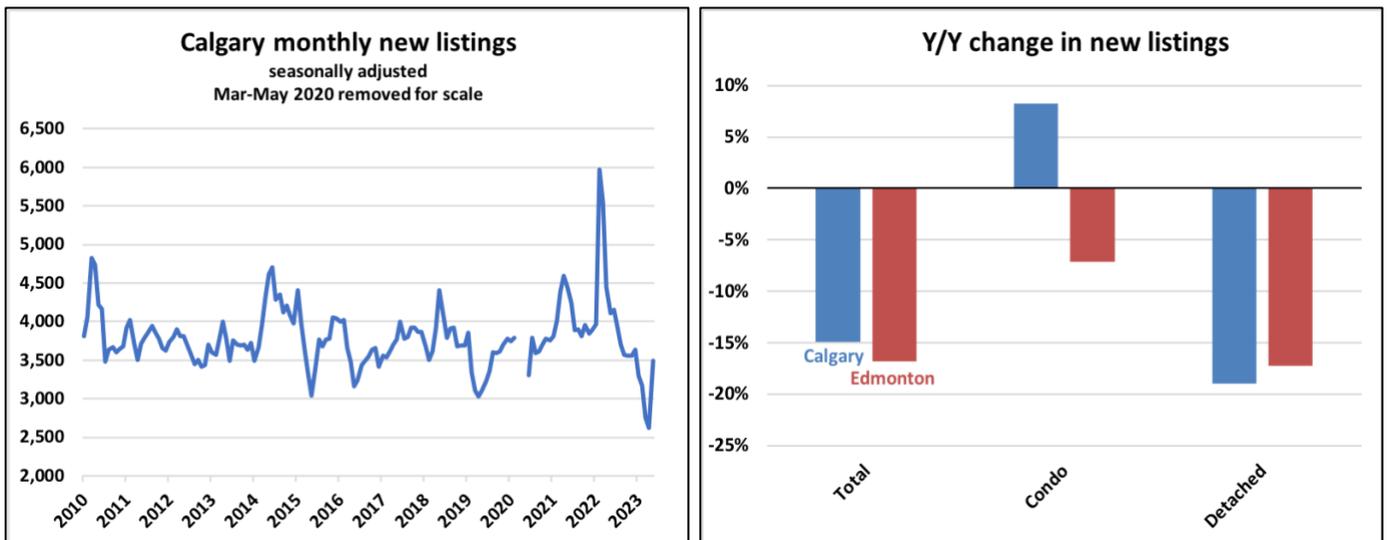
### Home sales rise

Seasonally adjusted home sales in Calgary rose 7.5% m/m in May to hit a record high for that month.



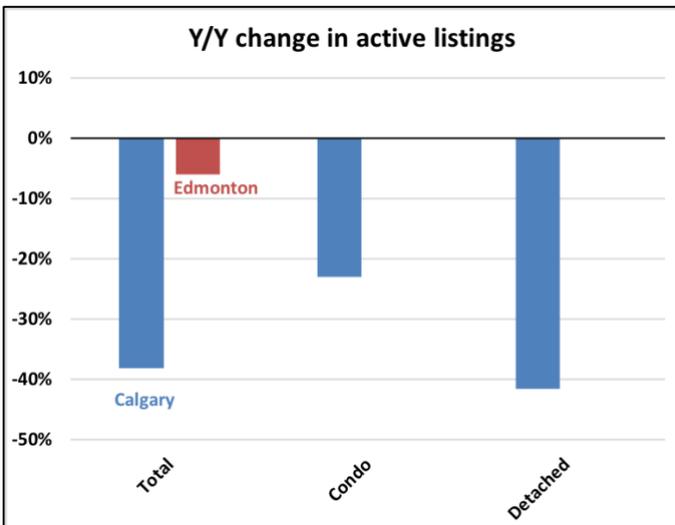
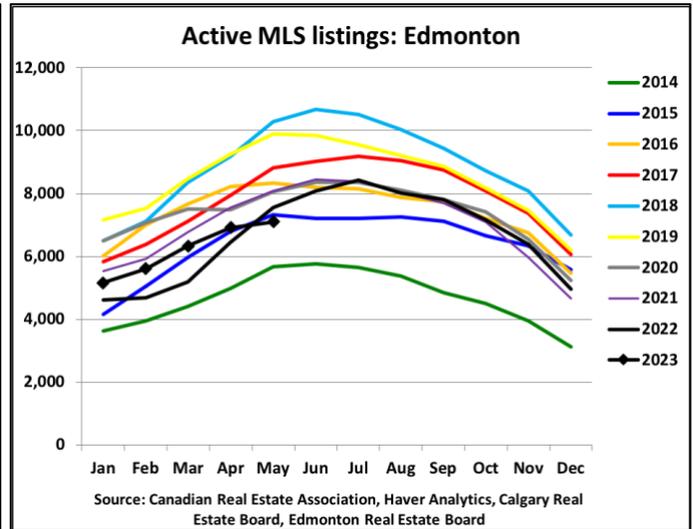
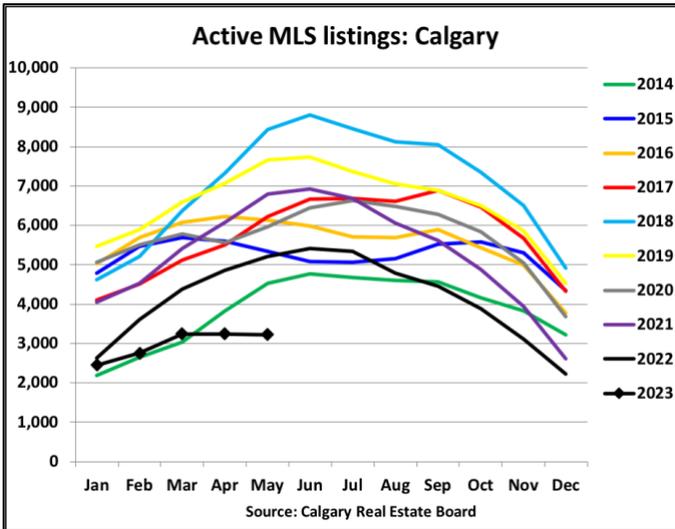
### New listings jump

Sellers finally showed up in May with seasonally adjusted new listings up an estimated 30% m/m. Still, that leaves them 15% below 2022 levels:



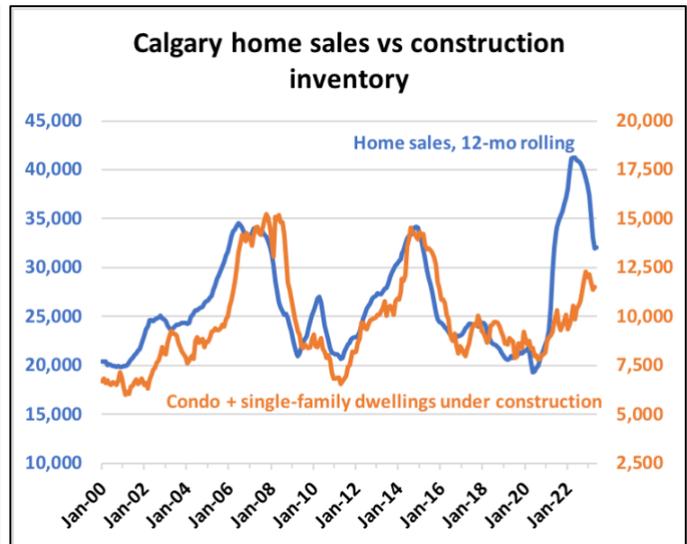
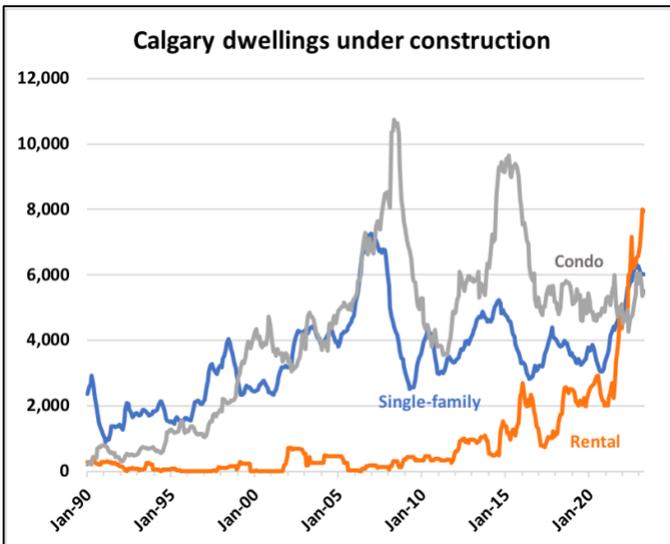
### Inventory way down

The decline in active listings in Calgary remains deeply concerning. Resale inventory was down nearly 40% y/y in Calgary in May and down 6% in Edmonton:



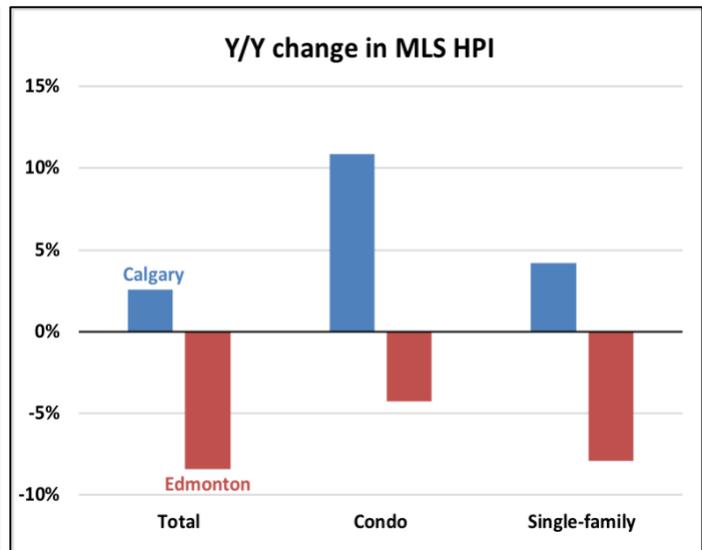
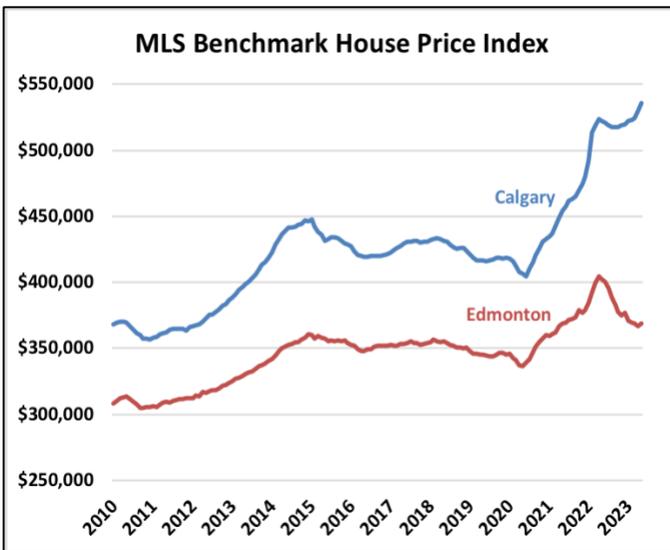
### Construction activity flat in April

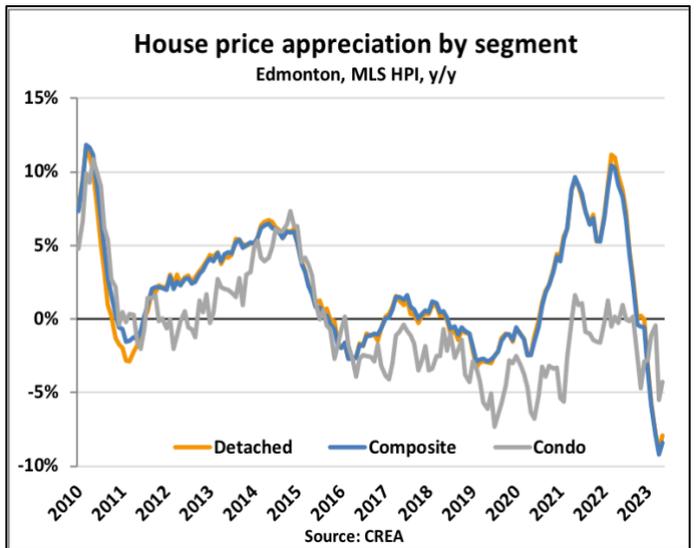
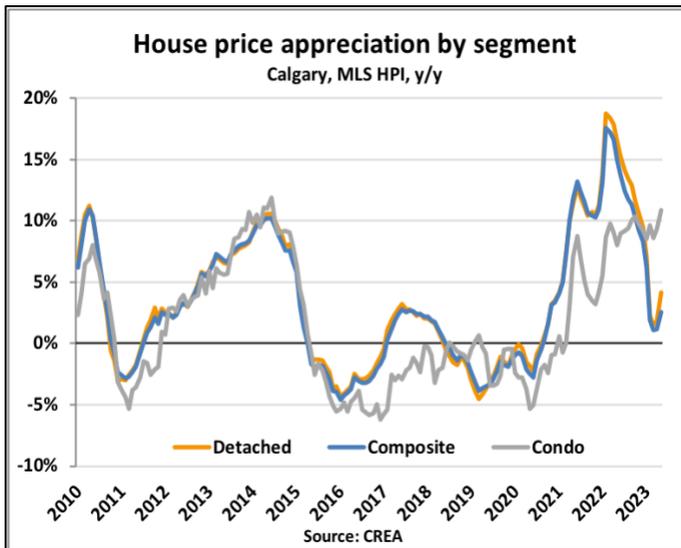
Under construction inventory across Calgary was effectively unchanged in April, and there are still very few signs of a “late cycle” construction boom that typified previous cyclical peaks:



**Prices rise in Calgary**

Prices in Calgary and Edmonton continue to trend in opposite directions, with Calgary posting a fresh all-time high in the MLS HPI while Edmonton has seen its respective index fall 8% relative to last year:





Have a great day!  
Ben