July 2023
Metro deep-dive: June data

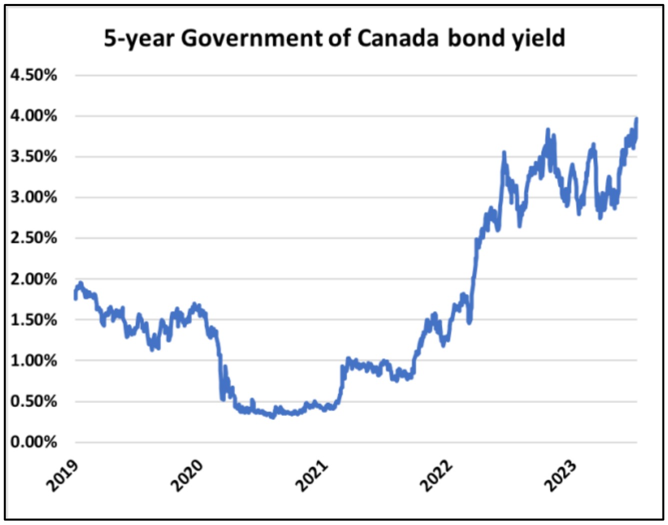
Quick links:

1) Macro commentary: Affordability blowout, population surge
2) Sales weaken, inventory builds in Toronto
3) Vancouver sales weighed down by rising rates
4) Calgary market continues to strengthen

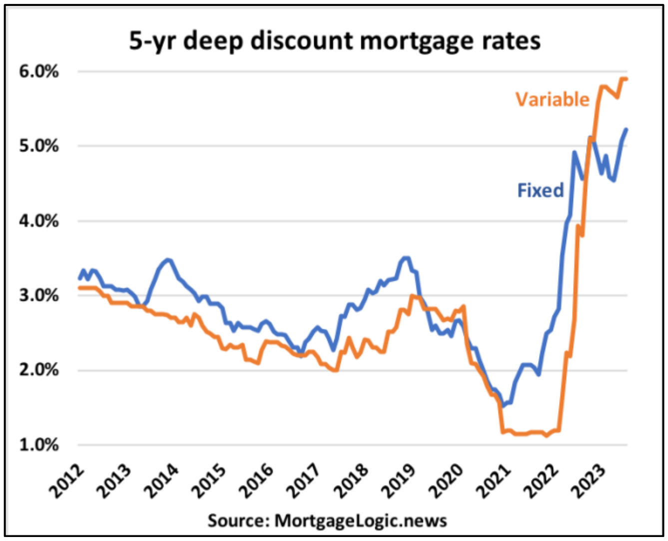
1) Macro commentary: Affordability blowout, population surge

Rising rates pressure affordability

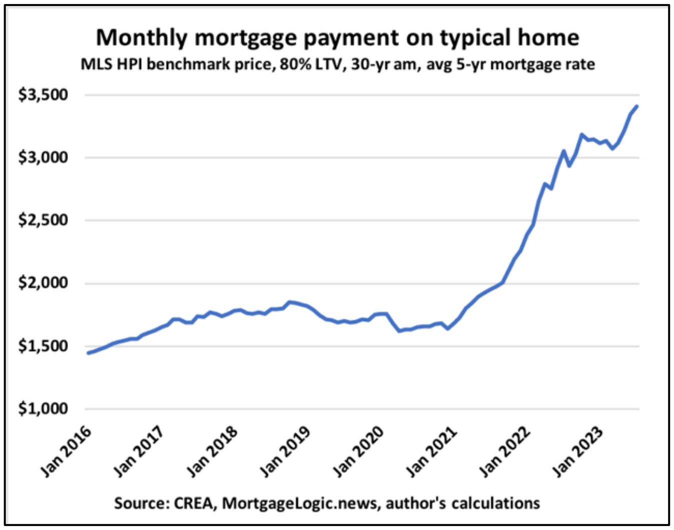
Canadian bond yields exploded higher over the past couple weeks, with the bellwether 5-yr bond yield touching 4% for the first time since 2007:



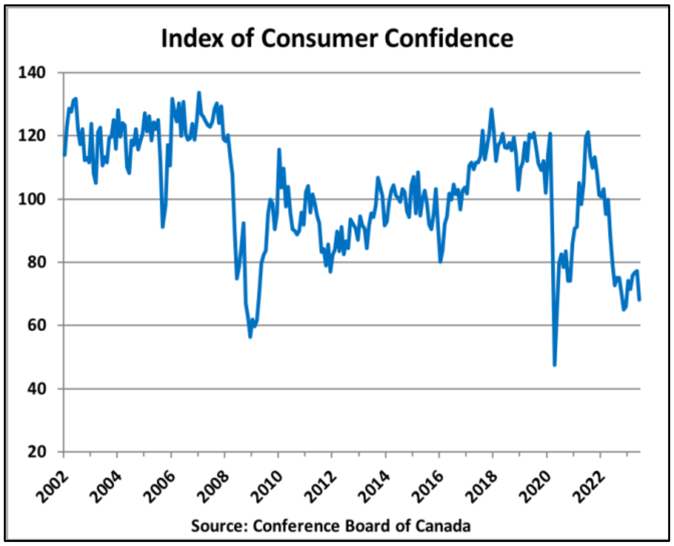
Consequently we had mortgage rates back on the move and now above the October 2022 highs, with potentially more to come if the Bank of Canada follows through on expectations for another hike tomorrow:



The damage has already been done on the affordability front. A buyer purchasing a typical home and financing at today's rates is looking at a monthly mortgage payment that is $330 higher than the same buyer just 4 months ago. That sort of move will almost certainly knee-cap the housing market and put an end to the rebound in home sales we've seen in recent months. I continue to expect sales to fall 10-15% seasonally adjusted through the summer.



Already we're seeing consumer sentiment come under pressure, with the Conference Board's reading skidding 9.2 points last month. Generally the first casualty of falling confidence is big ticket expenditures like housing:



From the Conference Board:

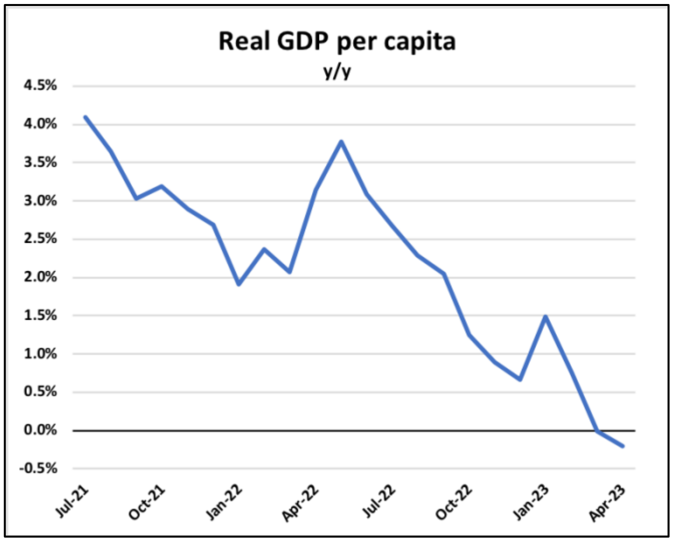
> The index of consumer confidence dropped 9.2 points to 68.1 points in June – its lowest point so far this year – as every province/region sees declines.
>
> […] Following in kind, outlooks on major purchases trended negative. The proportion of respondents that saw now as a good time for a major purchase fell 2.6 percentage points to 10.2 per cent, its lowest point since February… proportion of respondents that believed that now was a bad time added 3.9 points to total 66.9 per cent.
>
> […] Following no increases to rates since January's 25 basis point announcement, many consumers may have had begun to think that rates had peaked, inflation was withdrawing in line with the Bank's goals, and household spending could realign to match a capped rate of 4.5 per cent. Consumers holding such views may have had snap reactions as the 25-basis point hike shocked these underlying notions, causing sharp reversions of expectations. If expectations now change from stability to a future of possibly further hikes, consumers could overcompensate with exceptionally restrained spending in preparation for additional hikes, leading to a downward spiral of consumer confidence.

This comes as we see early signs of a weakening in the labour market. Yes, last week's jobs report beat expectations with headline employment jumping 60k (+20k exp) including a whopping 110k growth in full-time employment, but the internals were considerably less rosy.

For starters, massive population growth is now running well ahead of new job creation which pushed the unemployment rate up 0.2% on the month to hit 5.4% nationally. It's now risen by 0.4% over the past 3 months, which may not sound like a lot but is the largest non-lockdown related increase since 2019. And prior to that you have to go back to the Financial Crisis to find the last time the unemployment rate ticked up like this.

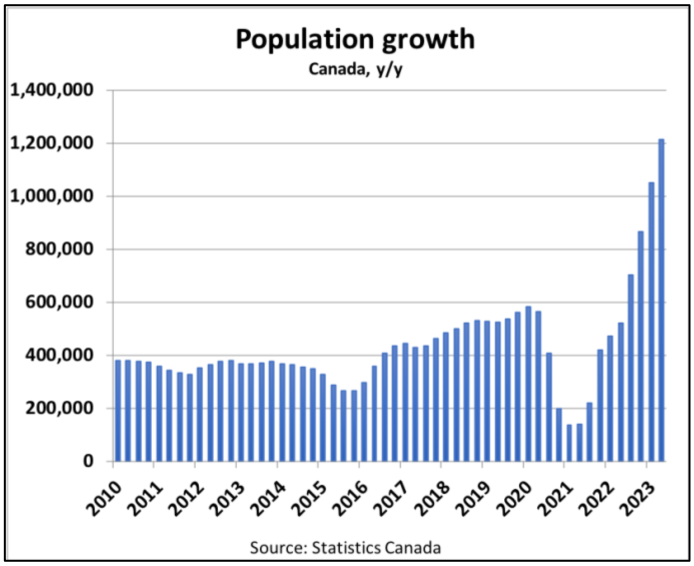
Further, hours worked, which matter much more for GDP than headline employment, were up only 0.1% m/m which didn't even fully retrace the 0.4% contraction in May. That leaves hours worked down over past 3 months for the first time since Q3 2022.

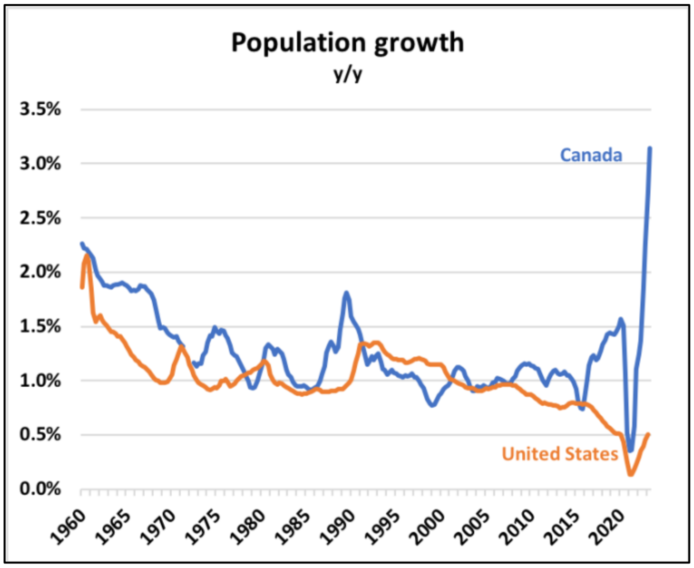
Meanwhile per-capita GDP where growth slipped below zero for the first time since 2021 last month:



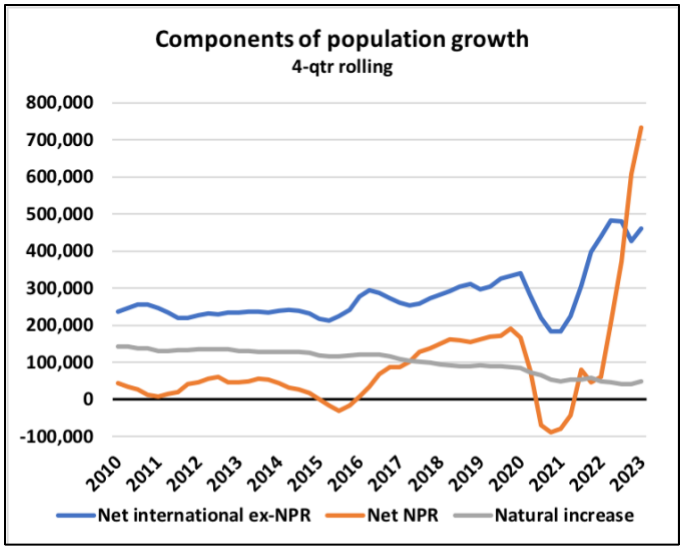
Let's remember that GDP growth is nothing more than population growth multiplied by productivity. We already know that Canadian productivity growth is garbage, in large part due to a structural underinvestment in businesses. That leaves population growth as the main driver of GDP. I'm personally much more in favor of growing each persons' slice of the pie (ie per capita GDP) than the pie itself (headline GDP). But alas I don't control policy out of Ottawa.

This brings us to population growth which just smashed another record to come in at 1.2 million in Q2….a 3.1% growth rate that is a stunning 6x higher than in the US:

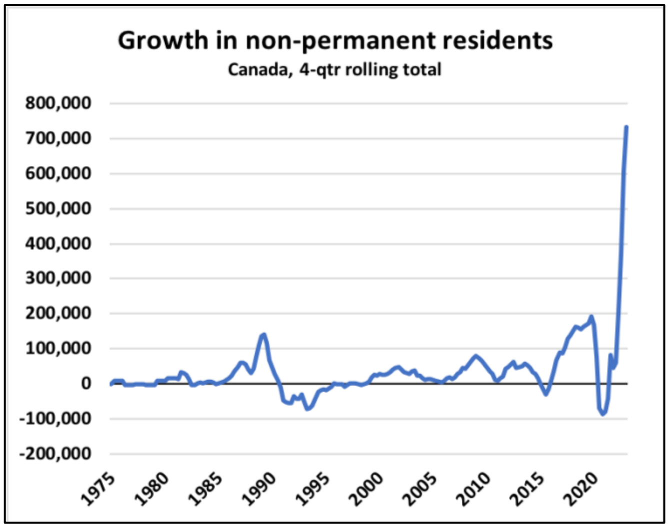




Bullish for housing, to be sure, but also a continuation of the same massively pro-cyclical dynamics we've seen previously. Non-permanent residents (ie temporary workers, international students, and refugees) accounted for a record 60% of that annual increase, with that cohort growing by a whopping 730,000 in the past year.

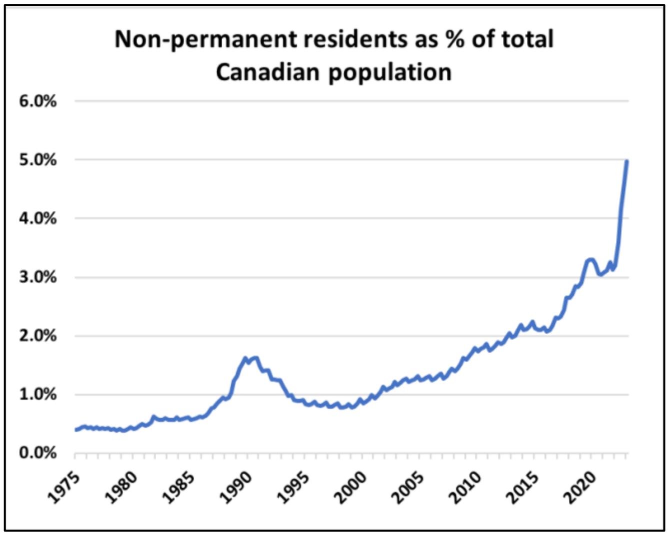


In order for this to be remotely sustainable, you have to think the chart below constitutes a new normal and that non-permanent residents (including temporary workers!) will continue to grow even as economic momentum slows:

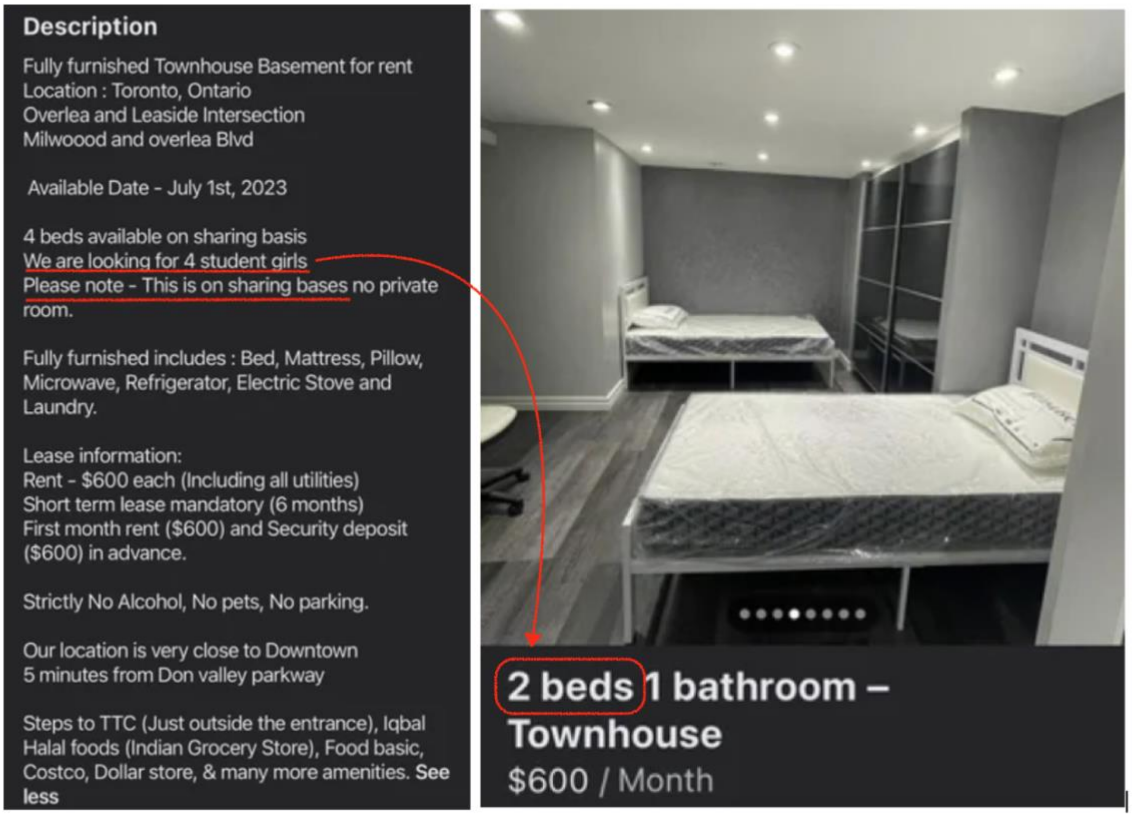


I think that's preposterous and it's far more likely that growth in this cohort slows back to trend line **at a minimum** which would cut population growth in half by this time next year. A weak economy has always been associated with outflows from this cohort, and I think that's a much more likely outcome at this point.

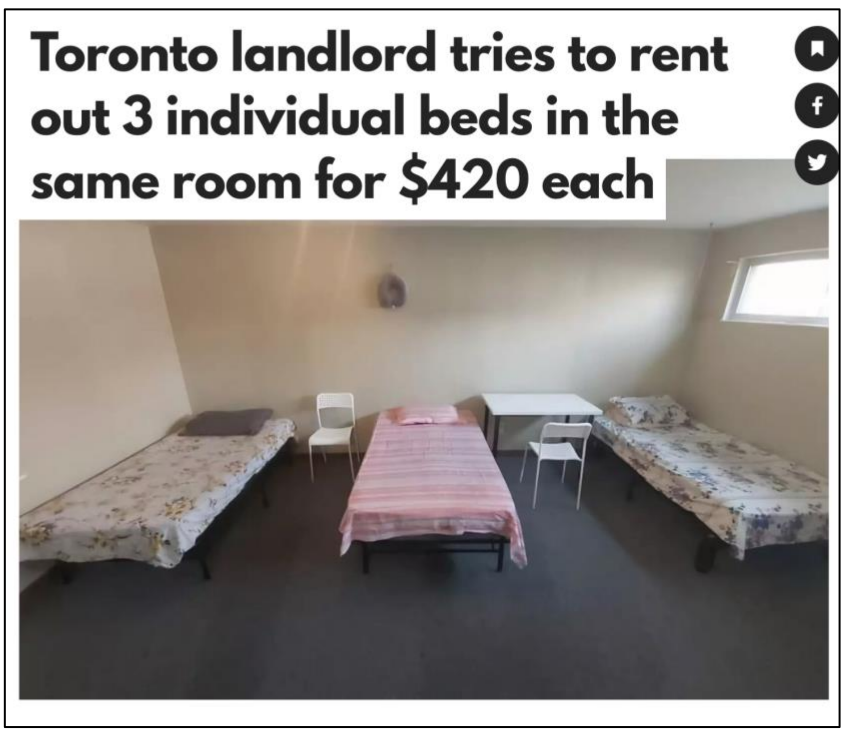
With this group now accounting for 5% of the total Canadian population, the stage is set for a downside surprise in growth if the economy wobbles:



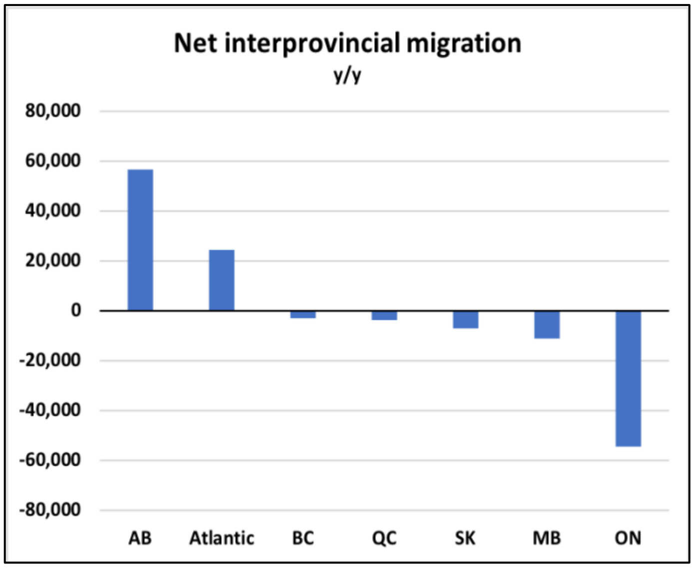
As an aside, adding 730,000 non-permanent residents (almost all of them renters) into the country in one year has some entirely predictable side effects on the rental market. In a sign of how crazy things have gotten, we're now seeing landlords advertise shared BEDS (not bedrooms….beds!).

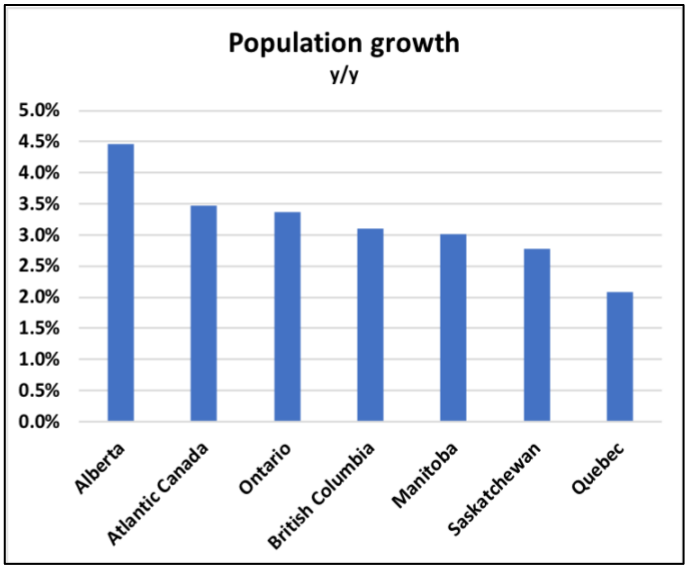


And this one….not shared beds but pretty darn close:



One other interesting tidbit within the data is the flow of Canadians between provinces. There's a clear "affordability arbitrage" dynamic happening where people are leaving high cost of area provinces, particularly Ontario, and heading to lower cost areas like Alberta and the Atlantic provinces, which coincidentally lead the country in population growth in percentage terms. It's one more reason I remain relatively bullish those parts of the country:

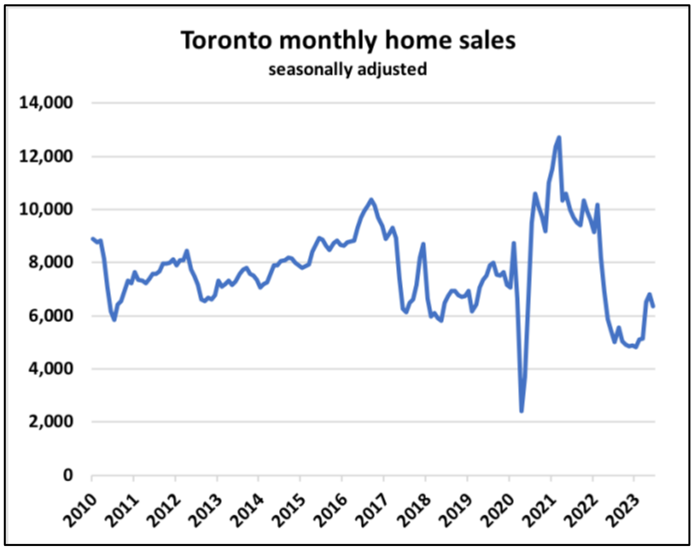


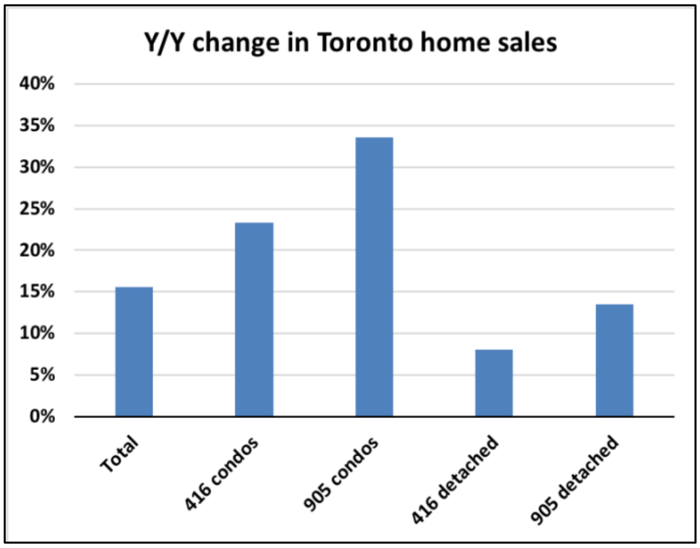


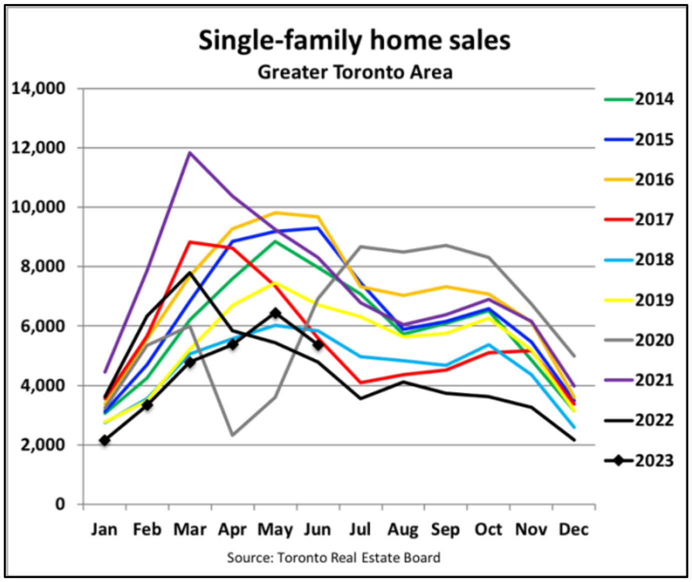
2) Sales weaken, inventory builds in Toronto

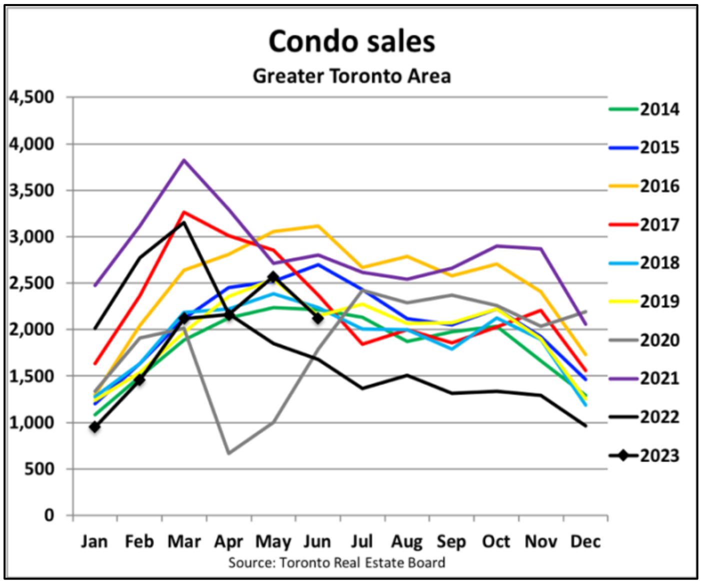
Interest rates weigh on sales

Seasonally adjusted home sales across the Greater Toronto Area fell 6.9% m/m in June, the largest monthly decline since September of last year. Still, sales were up over 15% compared to last year at this time led by a +20% jump in the condo segment.



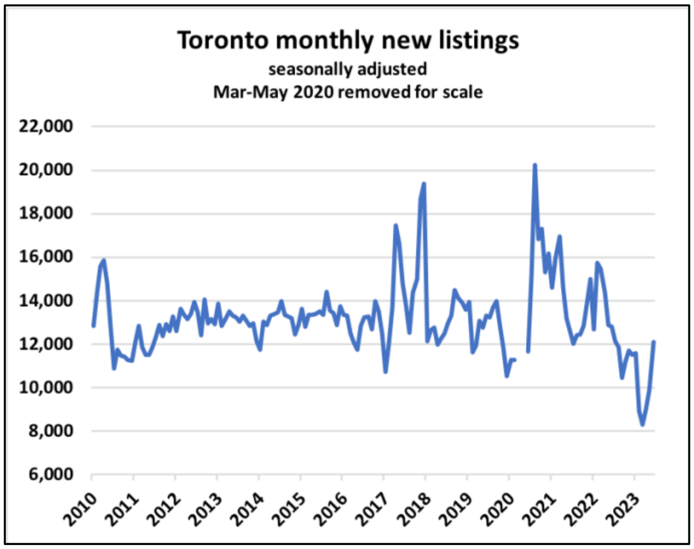


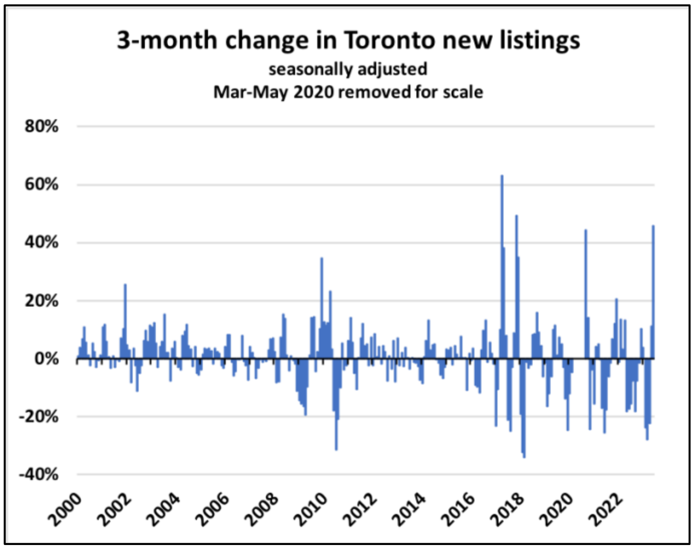




New listings jump

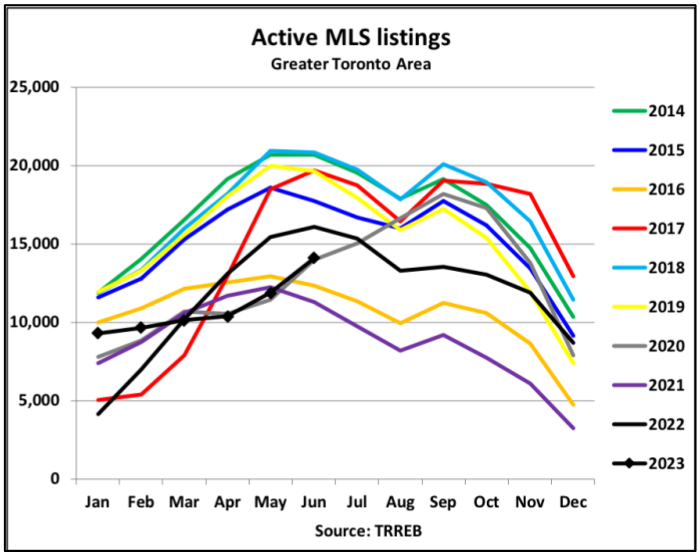
Seasonally adjusted new listings surged an estimated 22% m/m in June. They still remain slightly below normal but are rising quickly. In fact, we've now seen the largest 3-month increase off the lows since the COVID downturn:

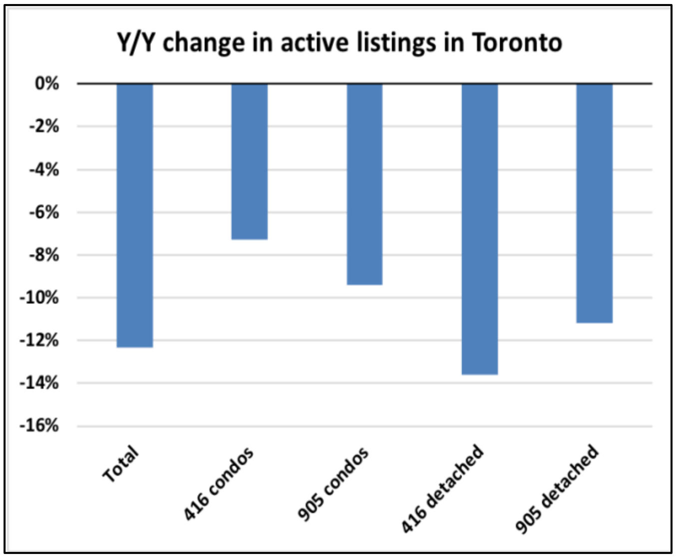




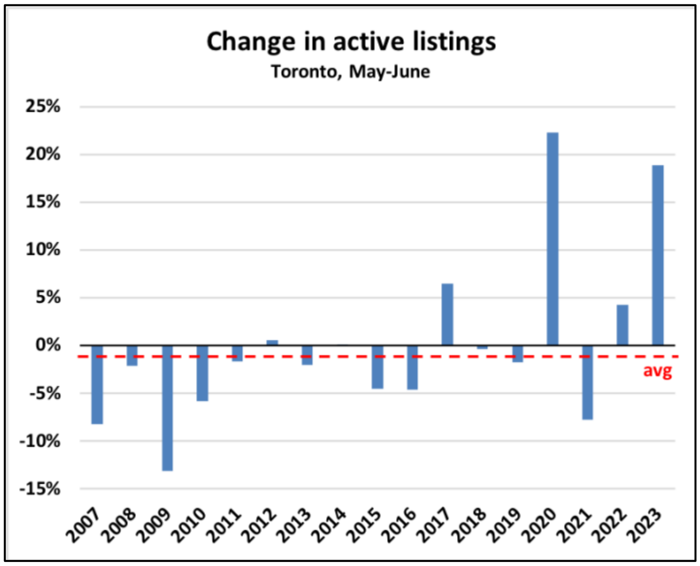
Inventory levels jump

The inventory picture is a bit of a Rorschach test (ie you see what you want to see). In overall terms, inventory levels are relatively low and are down 12% compared to last year…

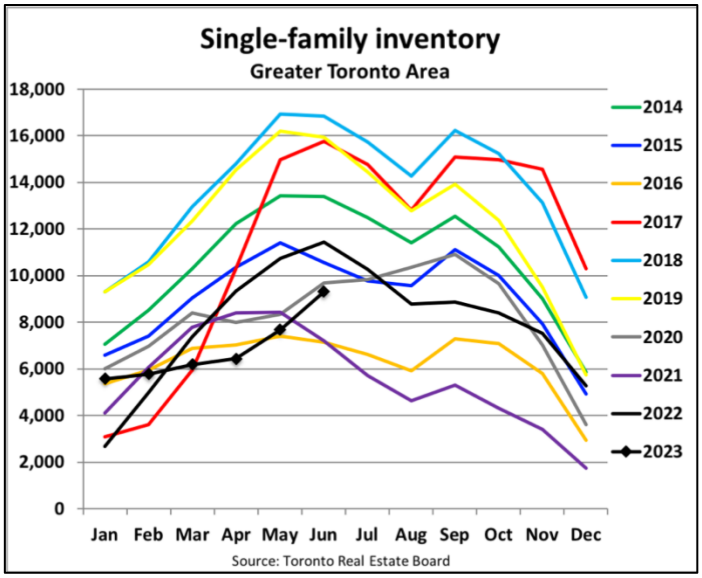


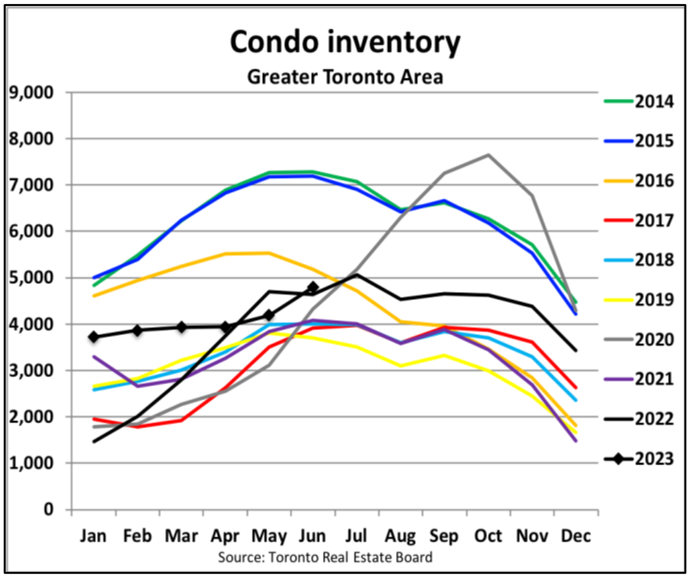


…BUT, it's worth noting that June saw a substantial and counter-seasonal 19% monthly build in resale inventory, the largest build for that month since 2020:



The inventory build was particularly pronounced in the single-family segment. However, inventory is still roughly 20% below "normal" levels over the past decade.

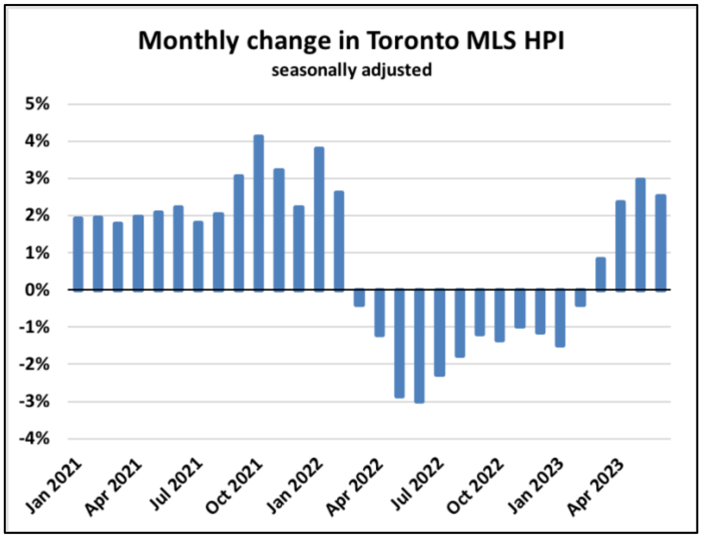


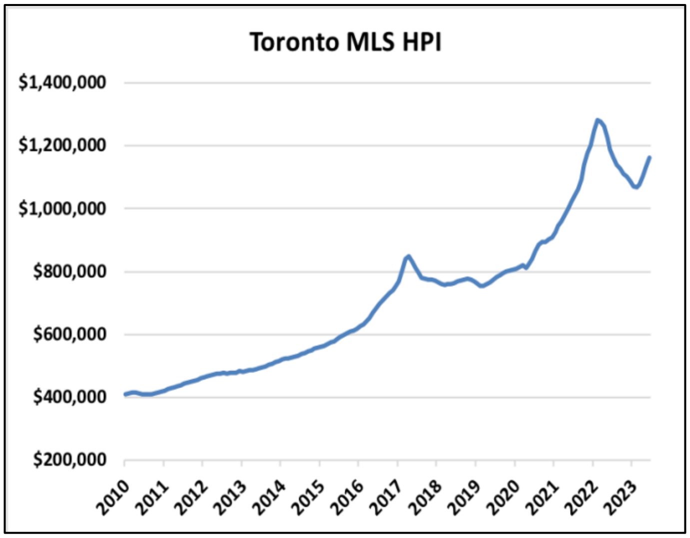


So I guess the right framing is that inventory is low, but we just saw a substantial build that, if continued, will certainly be a headwind to price growth in coming months.

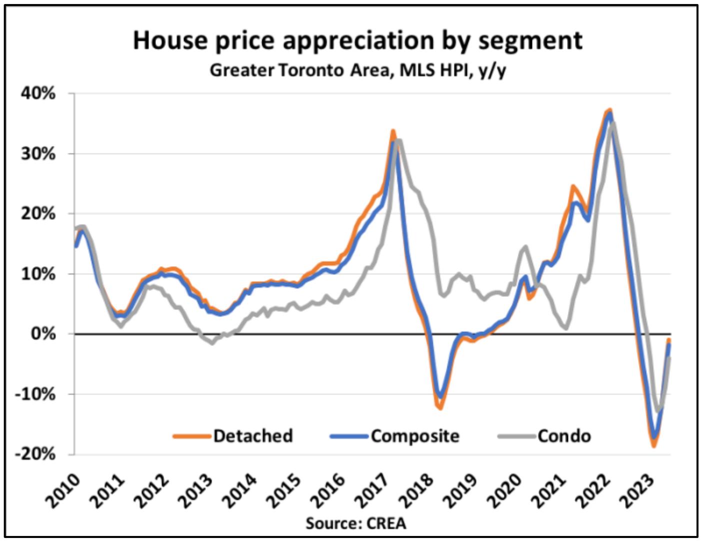
Strong price growth

The seasonally adjusted MLS House Price Index rose another 2.5% m/m in June, bringing the cumulative increase off the lows to 8.9% in just 4 months:



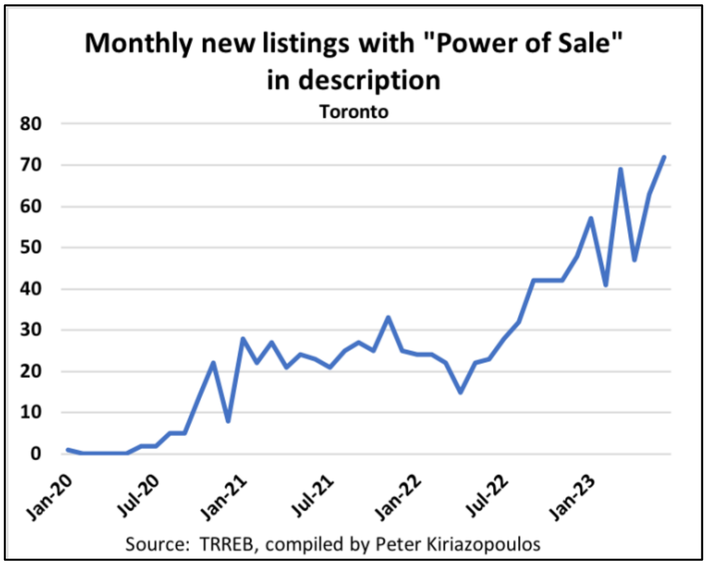


Prices have almost clawed their way back to being flat on the year:



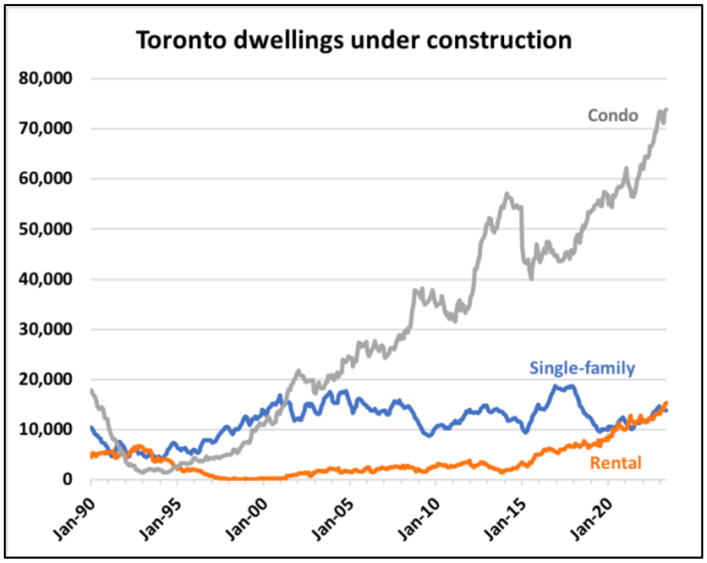
Power of sale listings rise

New listings with the term "power of sale" in the description ticked up to just over 70 in June (thanks again to Peter Kiriazopolous for the data). We should expect this trend to continue given the move in rates and the mounting evidence of some softness in the labour market.



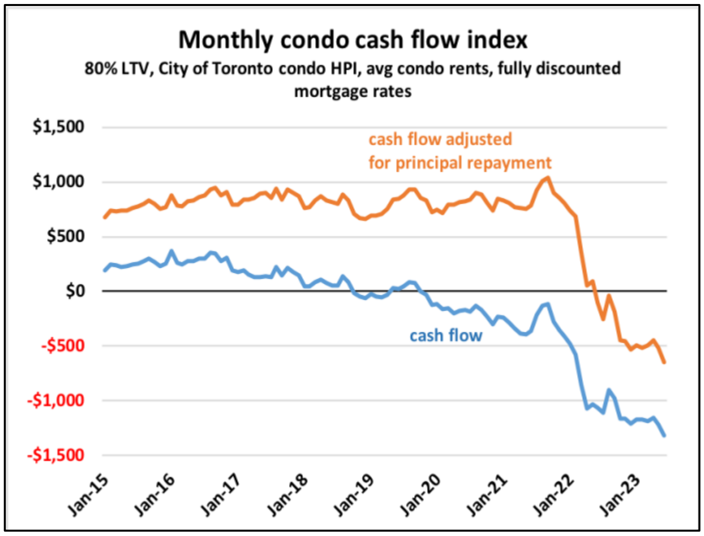
Construction activity up on rentals

The number of homes being built in Toronto rose 0.9% m/m in May led by a 3.4% increase in rentals. In contrast, single-family dwellings under construction fell 1.6% m/m. We should expect this trend to continue given the recent decline in single-family building permits. This dynamic will ultimately set the stage for another supply shock down the road once demand normalizes:



Condo cash flows deteriorate

The uptick in mortgage rates pushed the cash flow index to new lows in June. By this admittedly very simple model, investors buying a typically-priced condo in the City of Toronto, financing at 80% LTV at prevailing rates, and achieving average condo rents for the city, is facing a headline cash flow of -$1,320 per month. The monthly burn is still $645 even when principal repayment is added back.



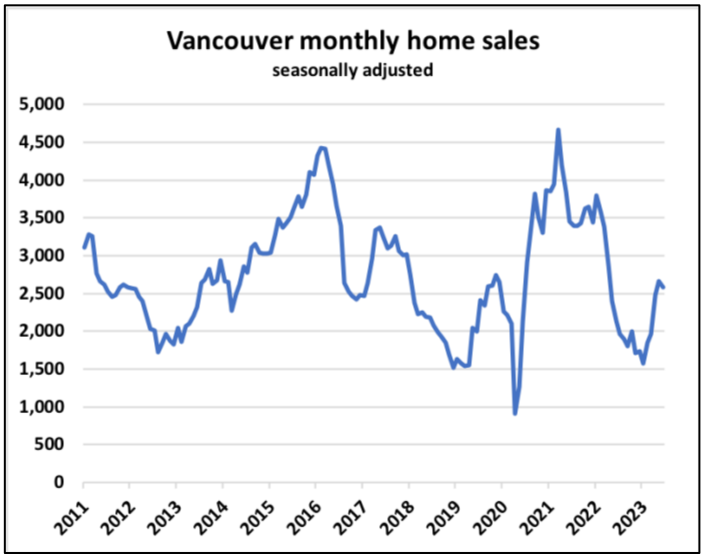
I still struggle with who the marginal buyer is in the condo market today. At these rates, renting is dramatically cheaper than owning for first-time buyers (even with the insanely tight rental market), and there appears to be little incentive for investors to step into the market given current prices….unless you have the view that rates will drop precipitously.

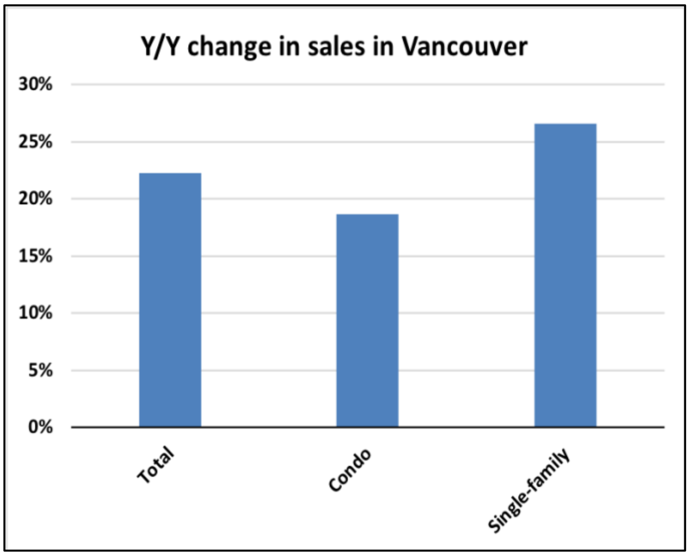
I remain cautious on this market segment over the near term.

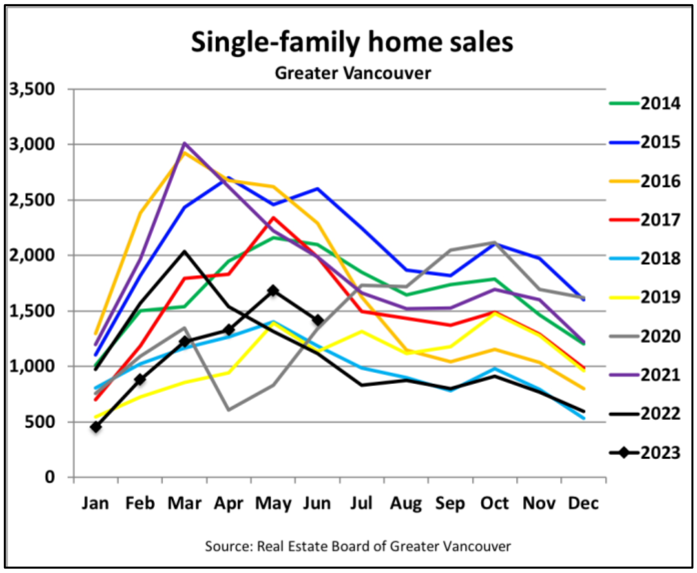
3) Vancouver sales weighed down by rising rates

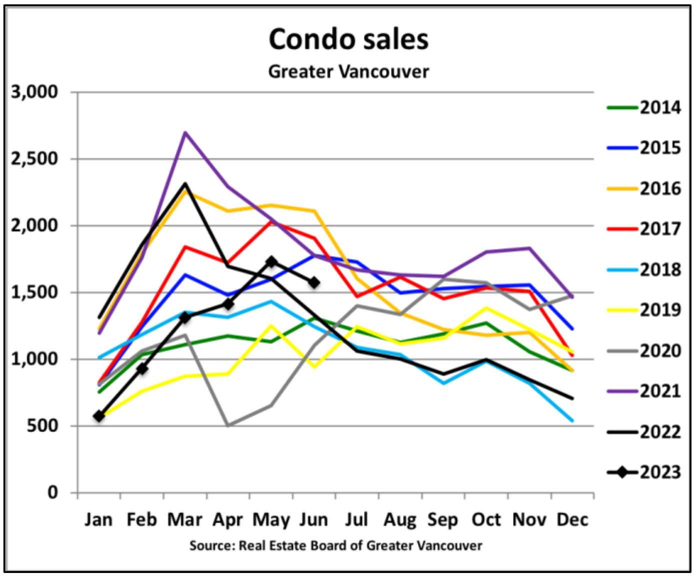
Sales slip

Seasonally adjusted home sales fell an estimated 3% m/m in Vancouver in June but they remain 22% higher than a year ago:



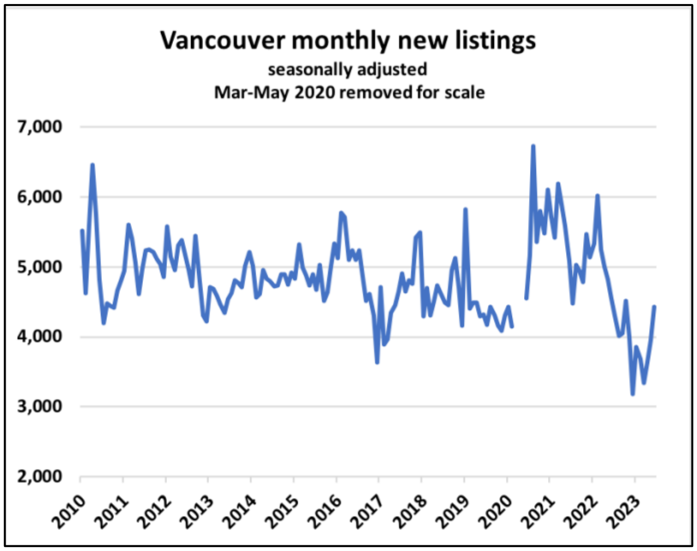


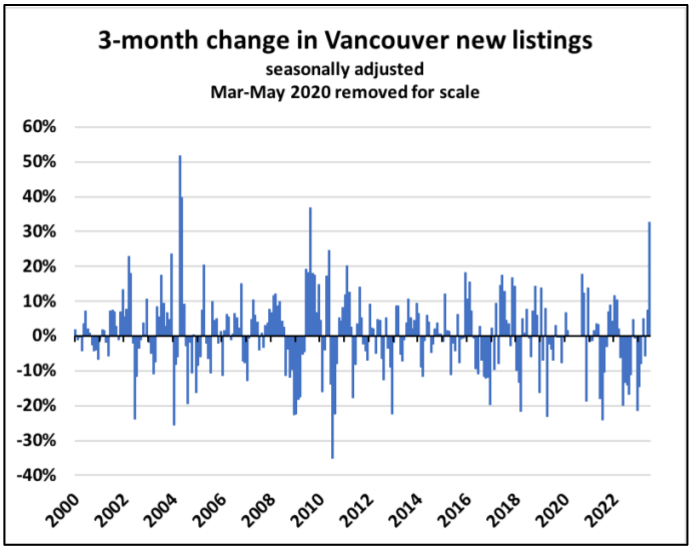


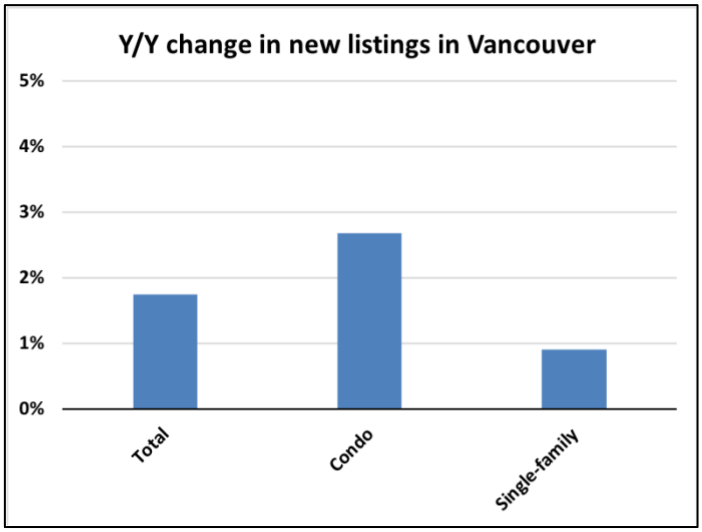


New listings jump

Seasonally adjusted new listings jumped an estimated 12% m/m and have now risen by 33% off the recent lows. While listings are still below normal, this is the steepest 3-month increase since the Financial Crisis in 2008:

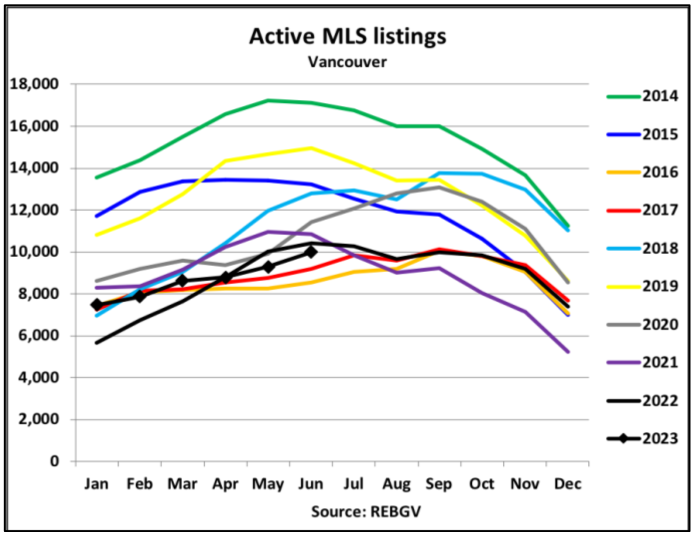


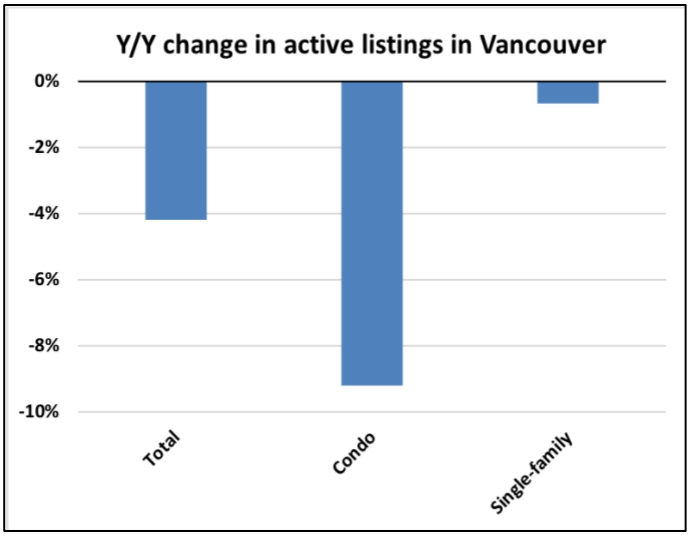


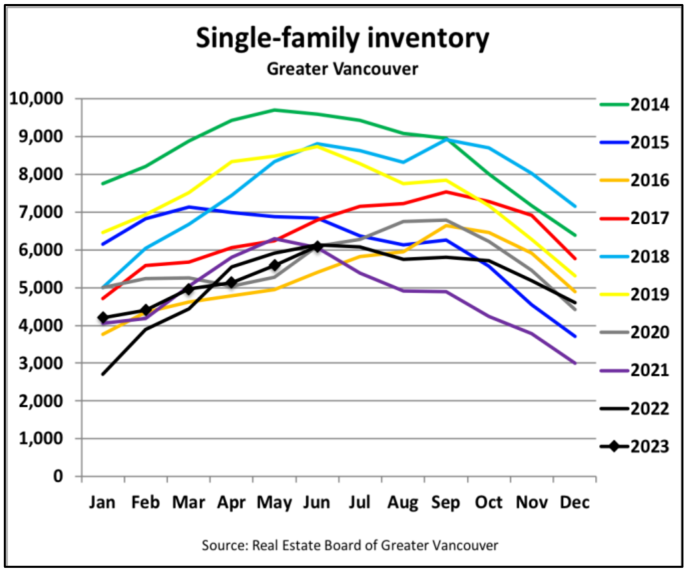


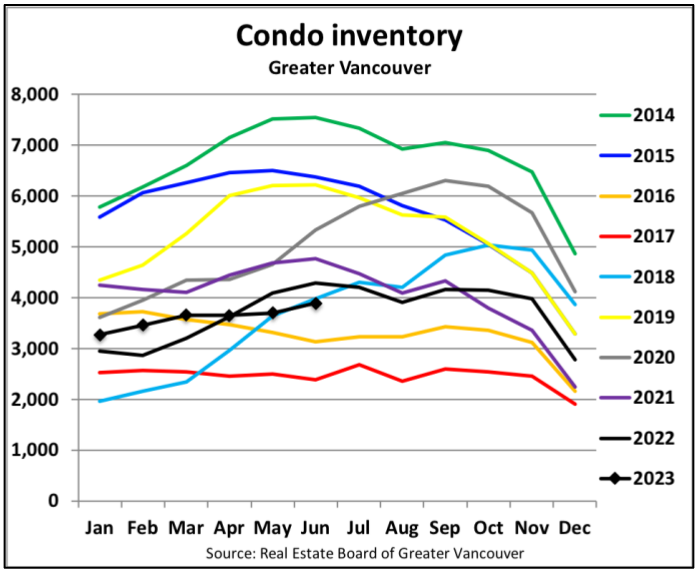
Inventory still tight

Inventory levels remain near the lowest of the past decade across Vancouver, down 4% y/y overall.

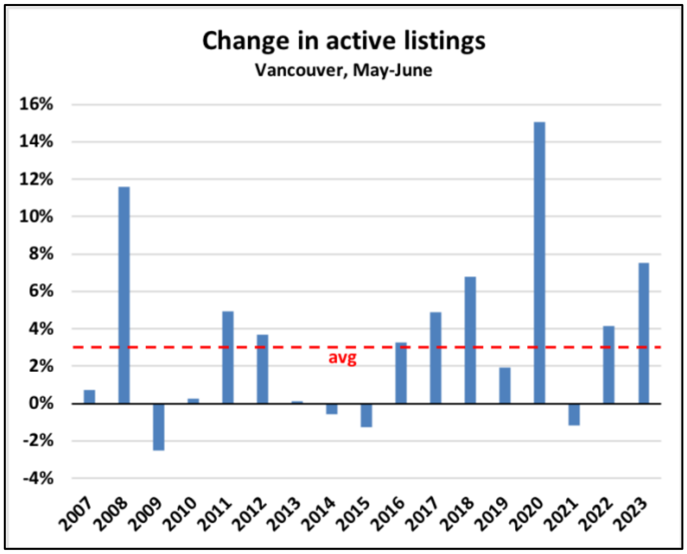






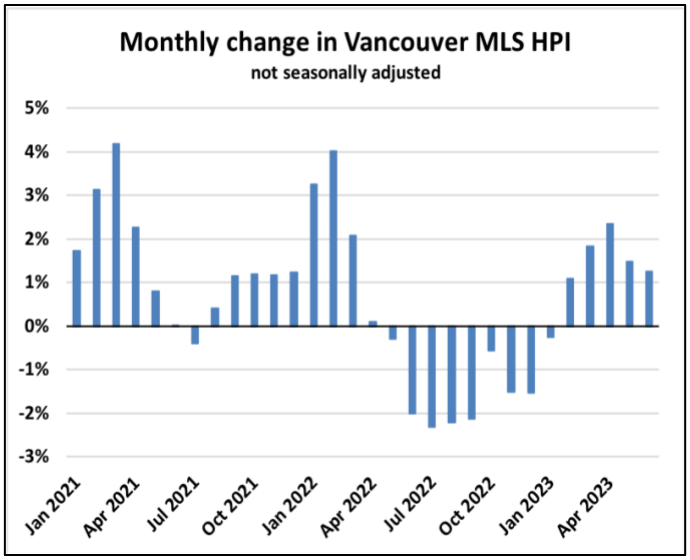


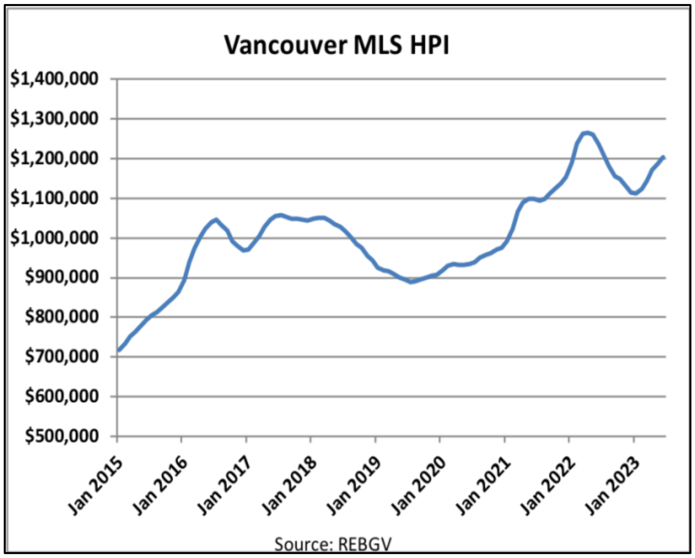
However, as with Toronto, we saw a much larger than usual monthly inventory build in June, a trend that bears watching:



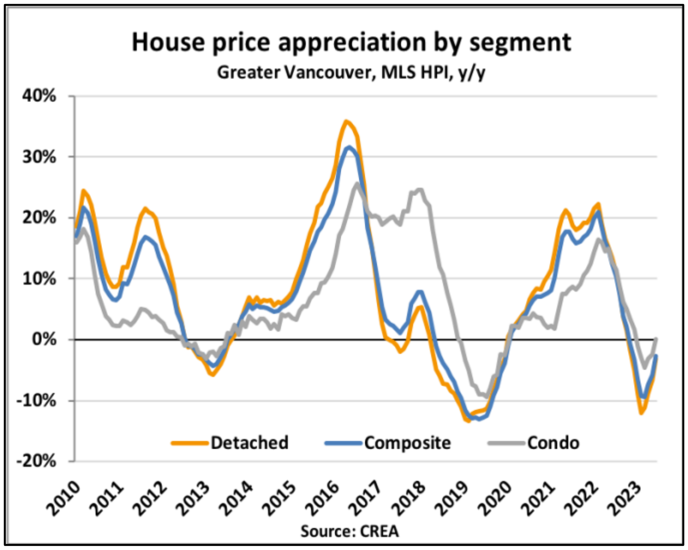
House prices firming

The MLS House Price Index posted a 1.3% monthly gain in June, bringing the cumulative increase from the lows to 8.2% overall:



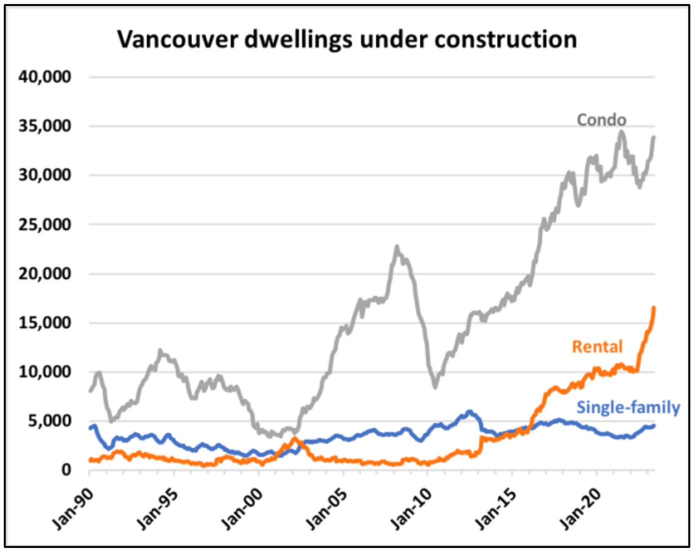


Condo prices are now positive y/y for the first time since late 2022:



Construction activity rises

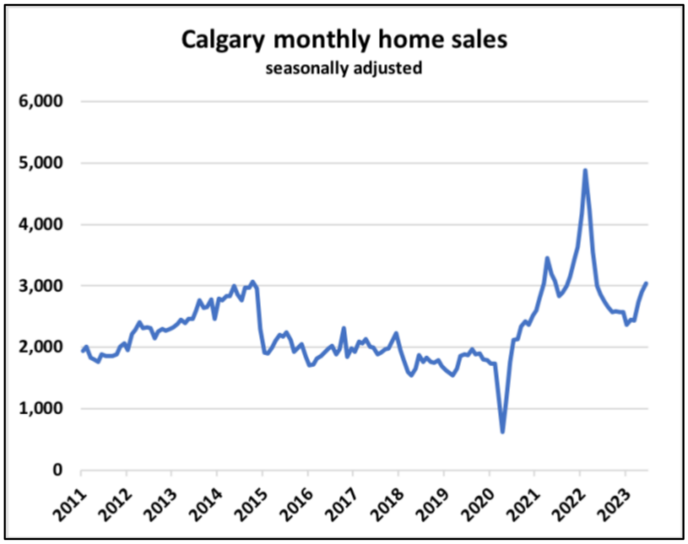
The number of homes being built across metro Vancouver jumped 2% m/m in May and has risen 15% in just 6 months. The increase is particularly pronounced in the rental segment:

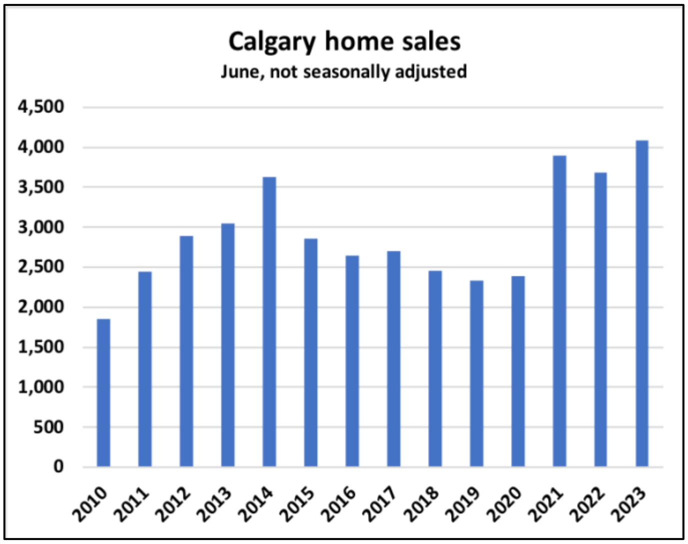


4) Calgary market continues to strengthen

Home sales rise

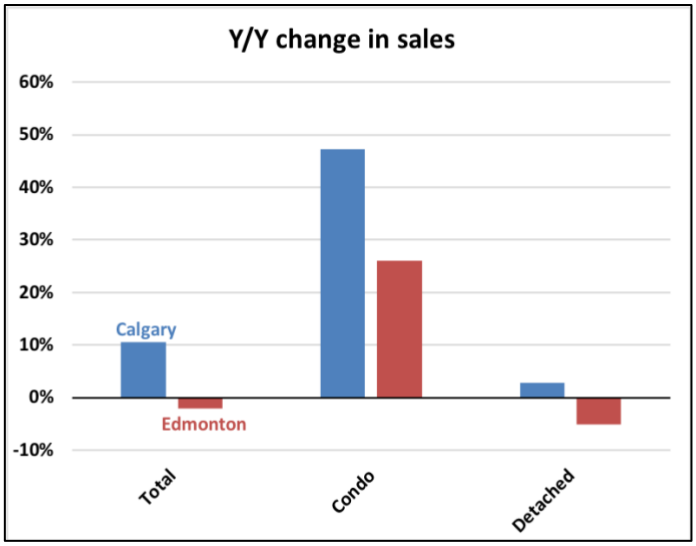
Seasonally adjusted home sales in Calgary rose an estimated 5% m/m in June and hit to hit yet another record for the month.

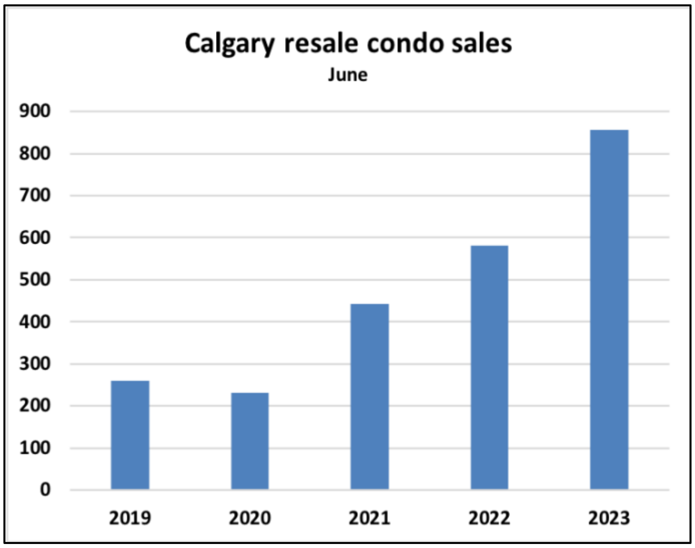




Signs of froth?

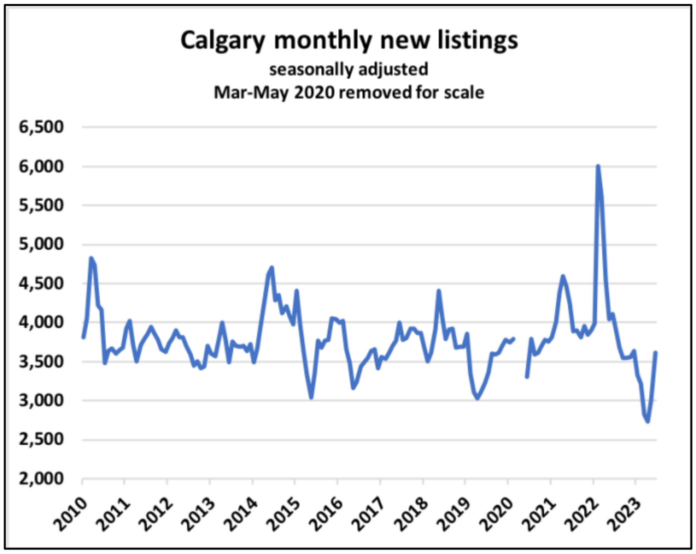
Sales in Calgary were up roughly 10% y/y in June, but saw an almost 50% surge in the condo segment. Perhaps this is merely a reflection of ultra-low inventory in the single-family segment where listings were down 45% y/y to sit at decade lows, but I can't help but notice a rising number of preconstruction condo ads for Calgary developments popping up in my neck of the woods. It makes me wonder if perhaps we're seeing a bit of speculative froth emerging in that market emanating from investors in Ontario:

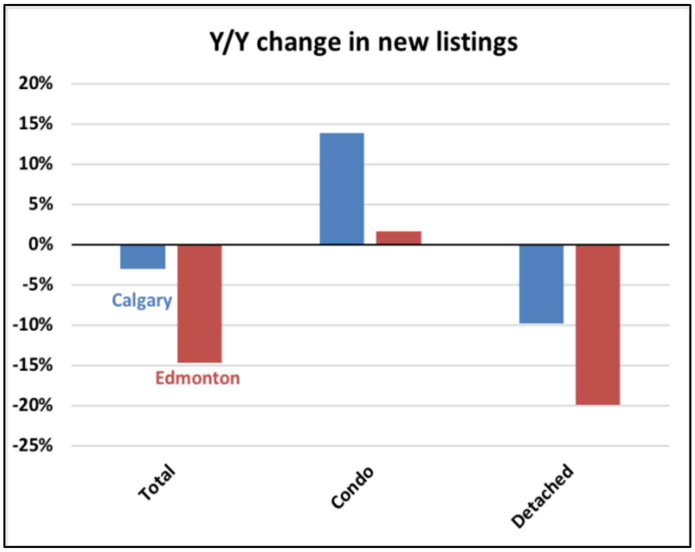




New listings jump

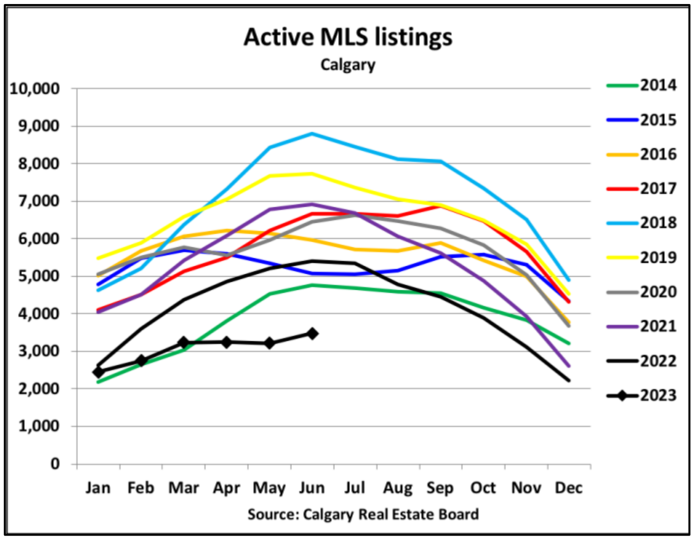
Seasonally adjusted new listings in Calgary surged nearly 20% y/y in June but still remain slightly below normal levels:

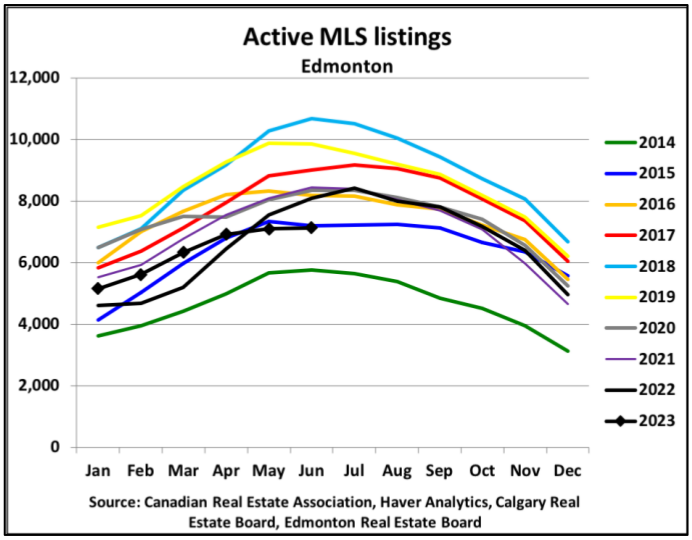


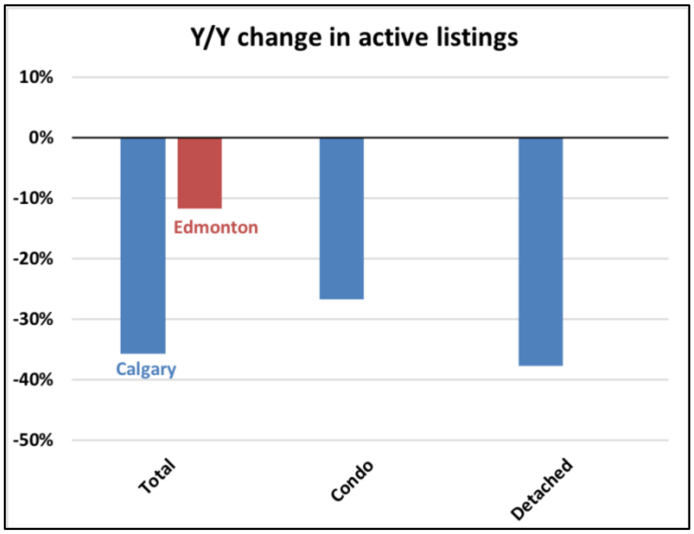


Inventory still bumping along decade lows

Active listings remain at rock-bottom levels in Calgary and are only marginally better in Edmonton. There's just nothing to buy right now:

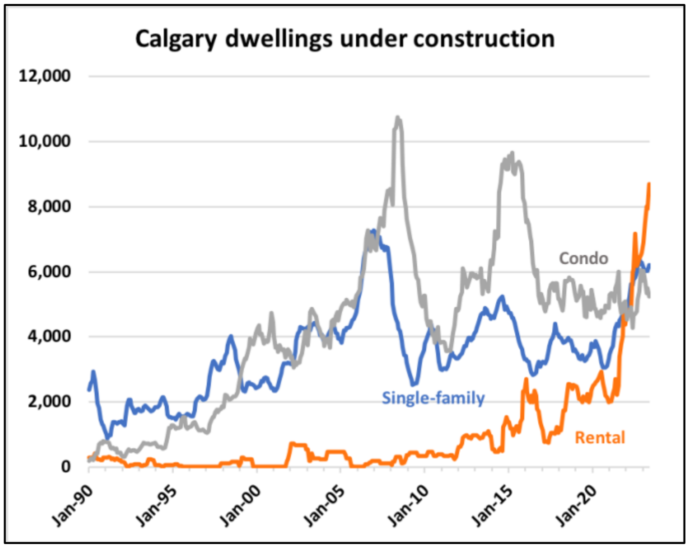




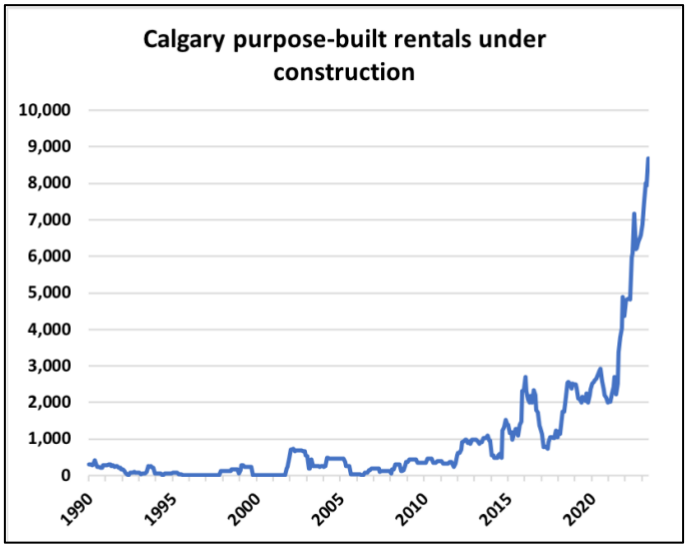


Construction activity jumps in May on surging rentals

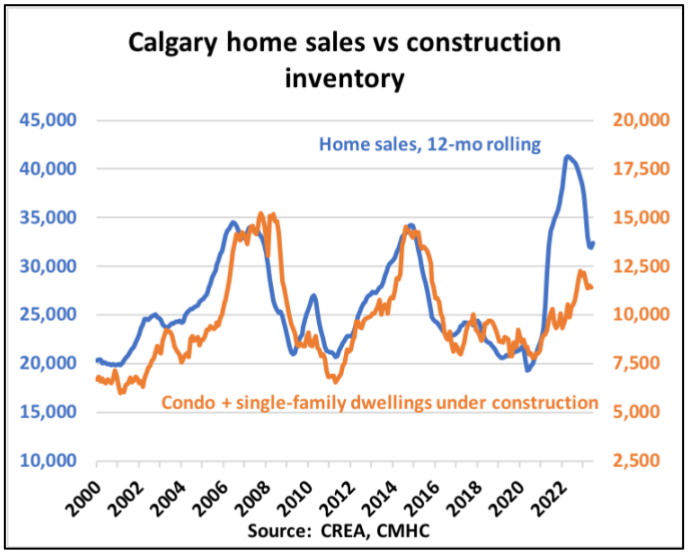
The number of homes under construction in Calgary jumped 3% m/m due to a massive 9% increase in rentals.



It's even more clear just how much rental construction activity has surged when we isolate that one segment. This is sorely needed given the current tightness in the rental market, but a 45% y/y increase in rentals under construction in a major Canadian city is not something you see every day:

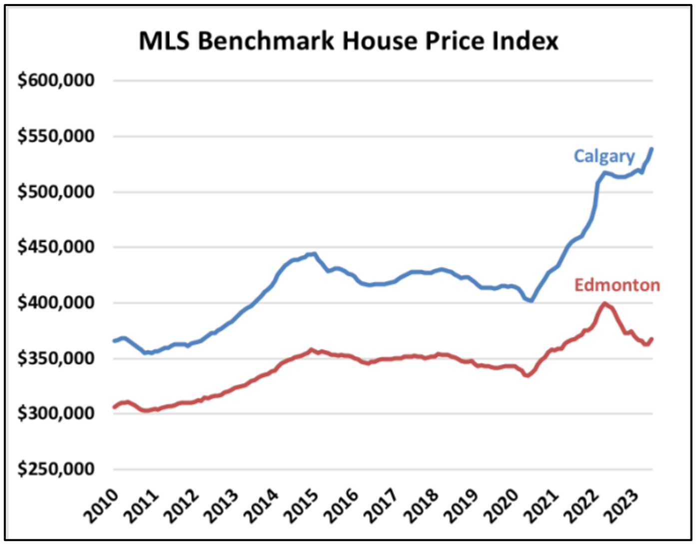


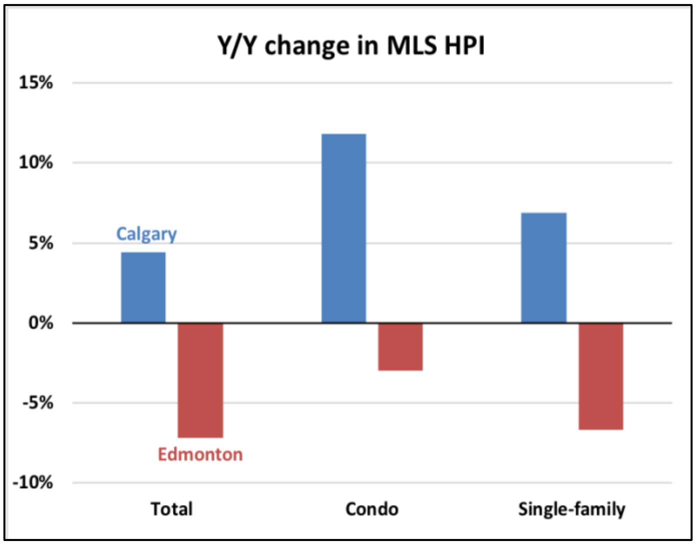
Inasmuch as I am a bit concerned about potential froth in the condo segment, there's also still not a lot of evidence of late-cycle overbuilding in the broader market. I think the current boom in Calgary has legs to run for a while yet:

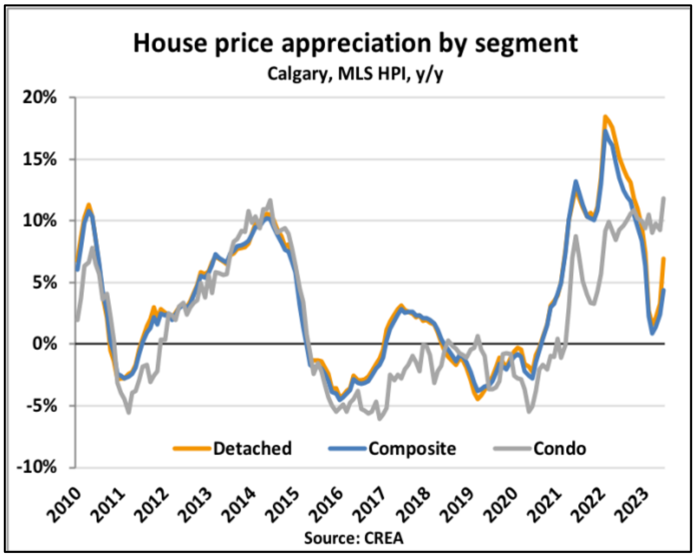


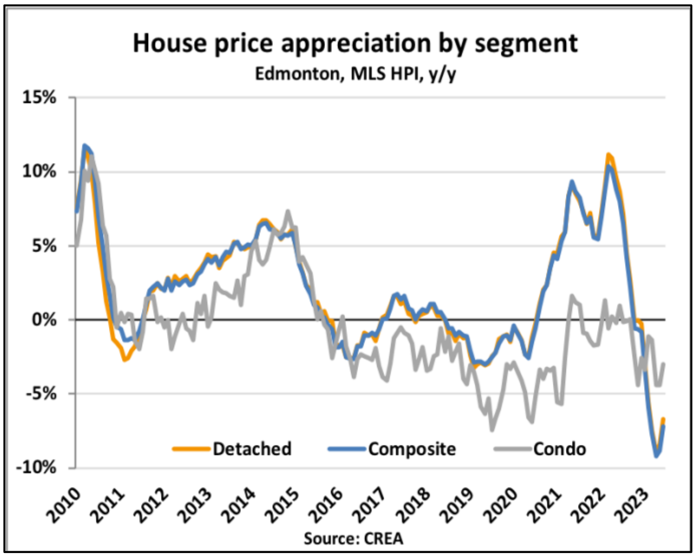
Prices rise in Calgary

Prices in both Calgary and Edmonton ticked up in May, but they remain below year-ago levels over in Edmonton. In both cities, the condo segment is outperforming the broader market:









Have a great day!
Ben