The Edge Report

July 2021

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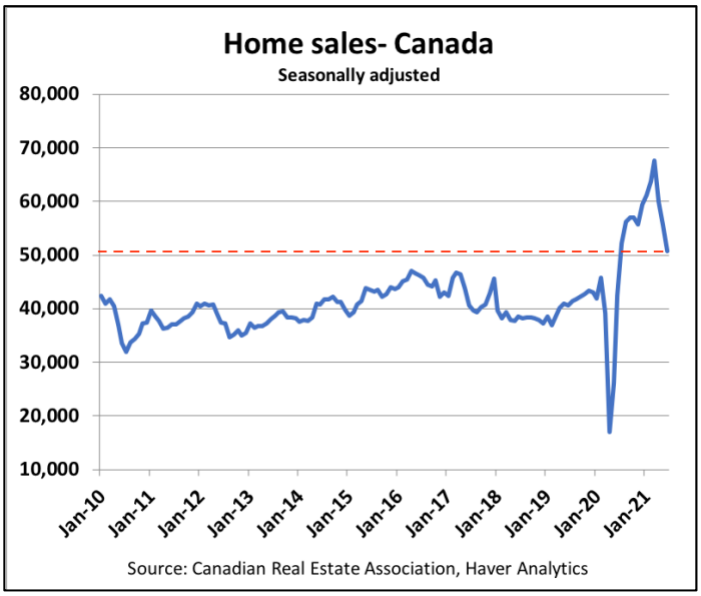
Prepared For:

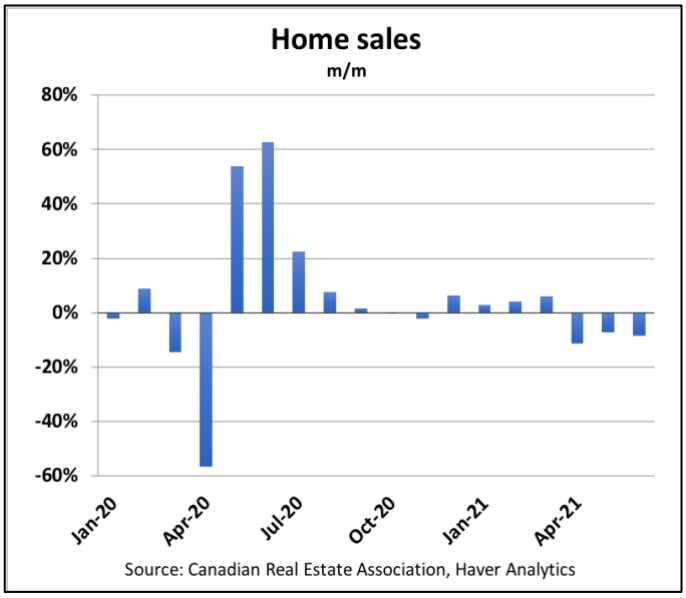
1) Home sales slide again in June but inventory hits fresh 20-year lows

Some key highlights from this month's national resale data:

i) National home sales down 25% from peak but still exceptionally strong

Canadian housing is suffering from a bit of a hangover following the blowout in Q1. National home sales have fallen a cumulative 25% from March including a 8.4% m/m drop last month. Even with that decline, home sales remain well above prior peak levels from 2016. Notable demand deceleration aside, this is far from a weak market:





Mid-month sales data from Toronto point to a further slowdown in demand led by steep declines in single-family home sales. The first two weeks of July have seen an 18% y/y drop in single-family sales partially offset by a 10% increase in condo sales.

ii) Home sales fall most in BC and ON; Is deteriorating affordability beginning to weigh on demand?

Sales declines in June were steepest in BC (-14.6% m/m) and Ontario (-9.0% m/m):

	Sales		New listings		Active listings	
	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted
Canada	+19.6%	-8.4%	+9.4%	-0.7%	-21.9%	-1.4%
BC	+43.6%	-14.6%	+6.7%	-4.9%	-23.2%	-3.7%
AB	+54.9%	-6.2%	+23.0%	+0.8%	-3.3%	-0.1%
ON	+21.2%	-9.0%	+11.2%	+0.4%	-24.6%	-4.4%
QC	-11.4%	-1.9%	-10.4%	-2.2%	-33.9%	+1.3%

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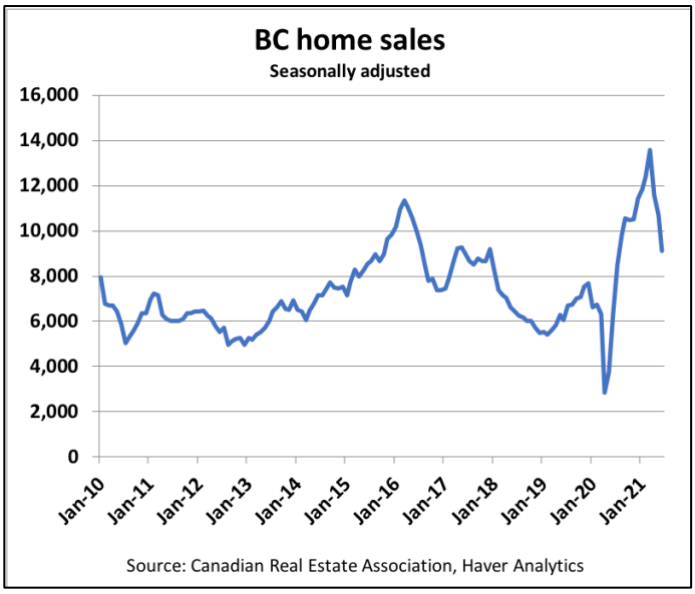

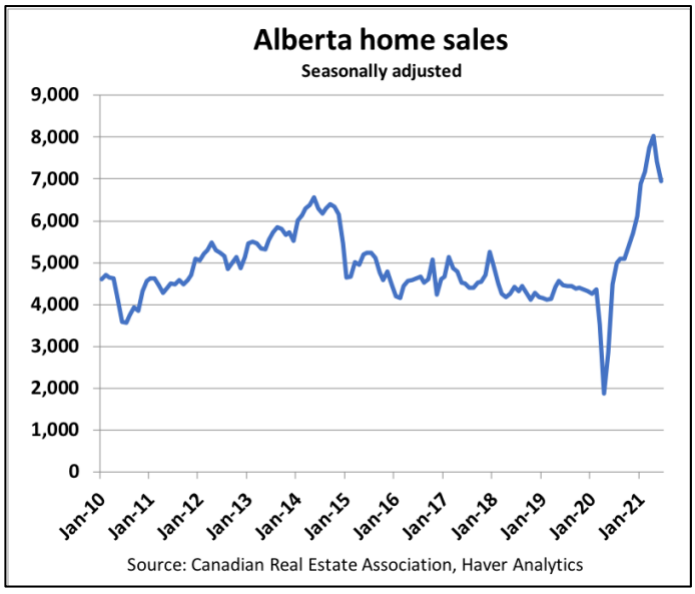

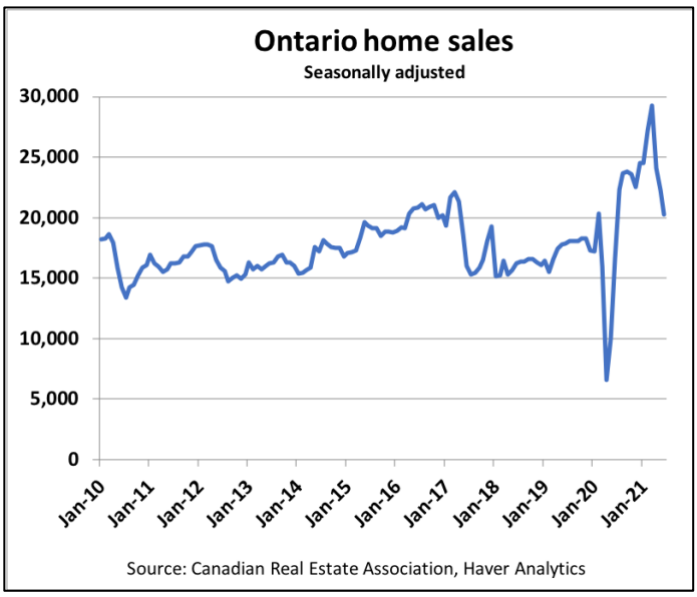

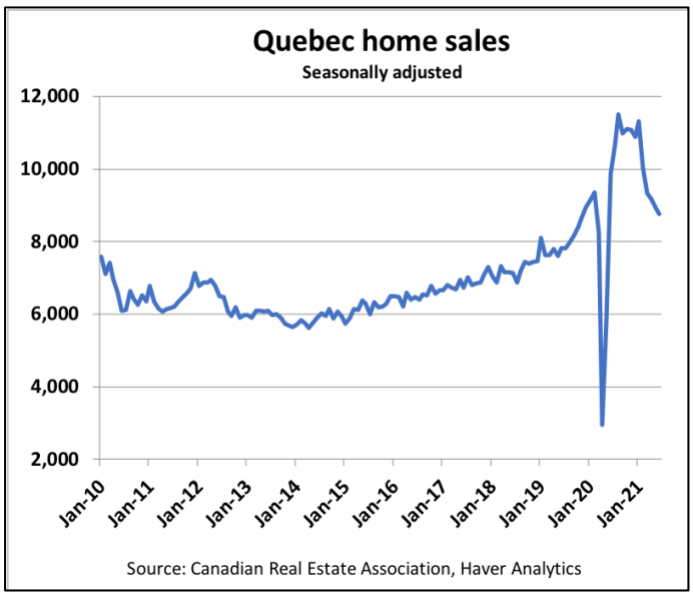

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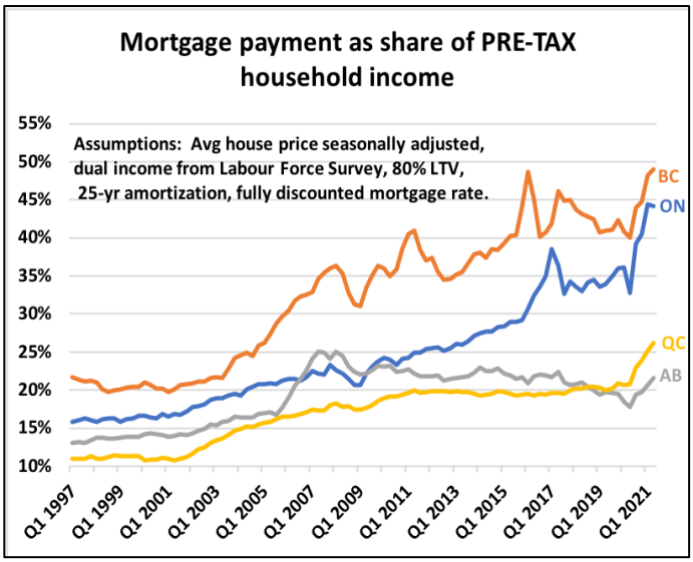
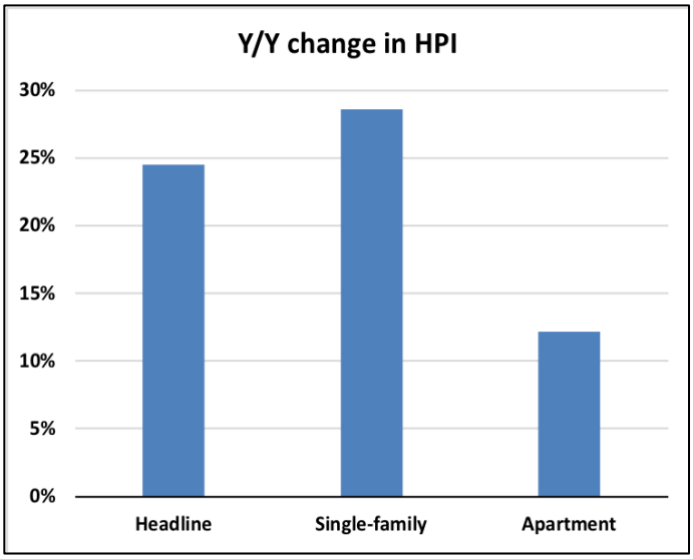
My estimates of affordability put BC and Ontario at the worst level on record while Alberta continues to be more affordable than it was from 2005-2015. It's one of the reasons I think Alberta metro house prices will outperform the national average over the next few years:

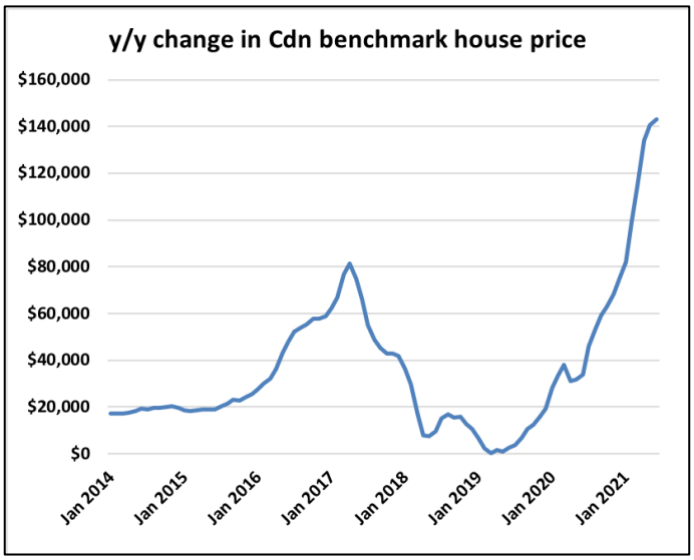


It does raise the question of whether we're seeing some fatigue in the single-family segment due to extremely strained affordability.

iii) Prices surge 24% y/y, small towns see extraordinary increases

House prices nationally rose 24.4% y/y including a 28% jump in the single-family segment. The typical house in Canada has increased in value by a record $143,000 in the past year according to the MLS House Price Index. This is an astonishing increase but it's quite likely that June marked the peak in price appreciation:





Q2 saw real house price increases in excess of 20% for the first time on record:

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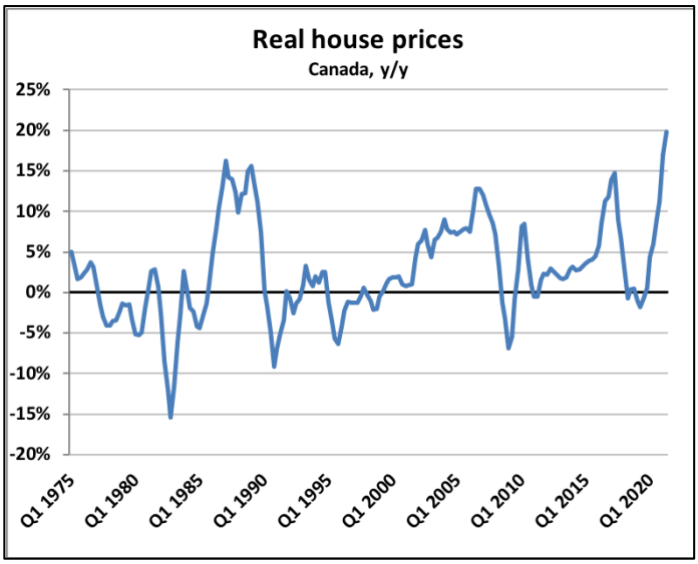
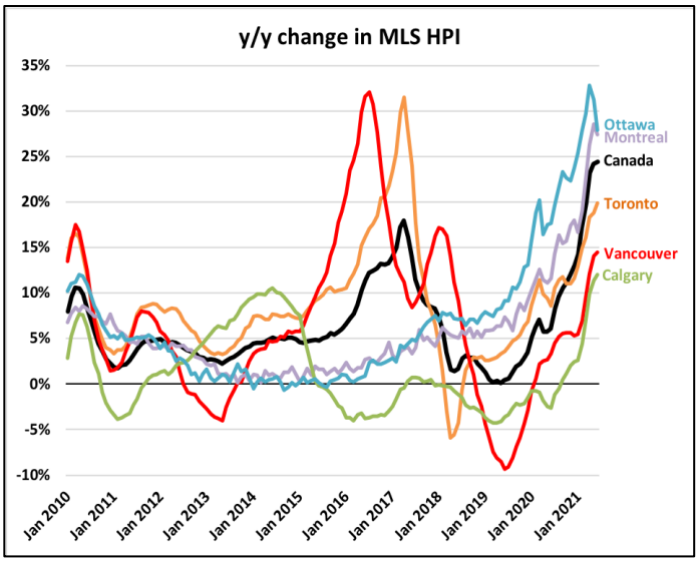


Toronto and Vancouver continue to underperform the broader index. Even cities like Calgary are posting the largest price increases in over a decade:



The craziest gains are still in the smaller centers, particularly in Ontario where many towns are seeing prince increases in excess of 40% y/y

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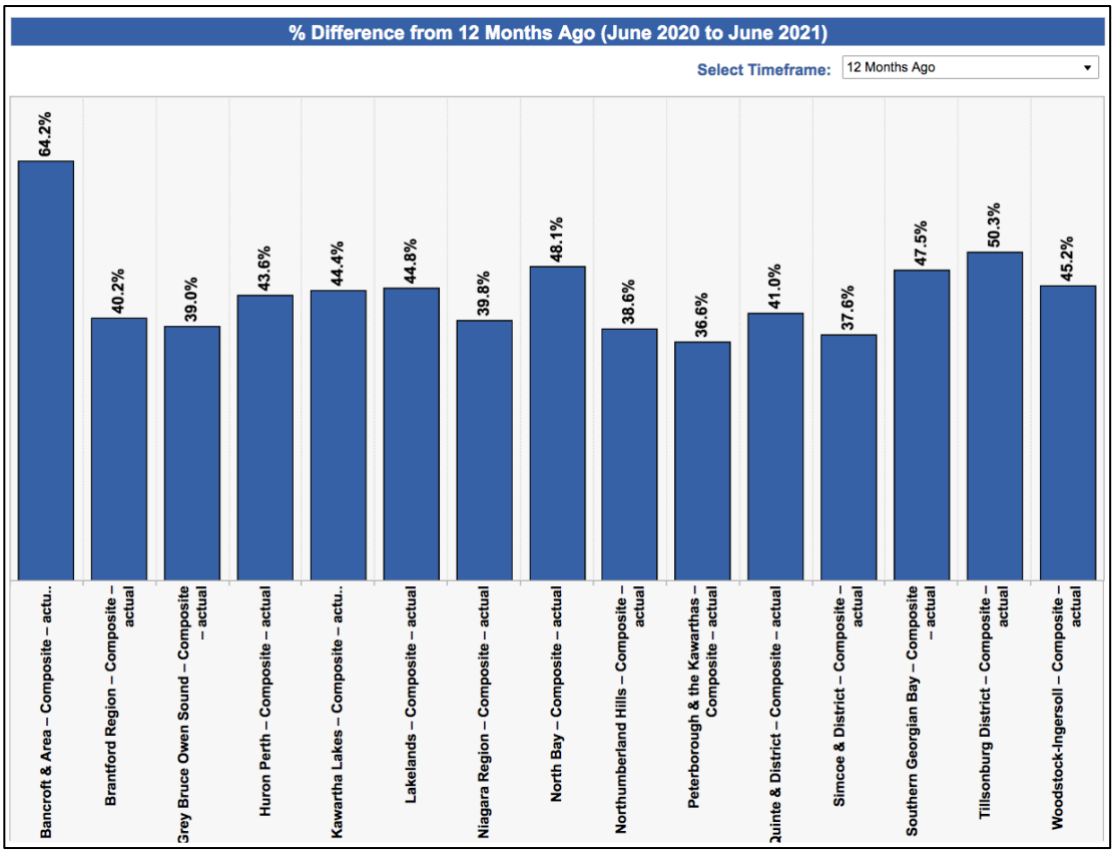

These are some absurd price moves. If migration patterns reverse and we see inflows back into the big cities, there's some serious potential downside to prices in these small towns given their low levels of liquidity even at the best of times.

iv) Did June mark a peak for price growth?

Monthly price gains have decelerated for 4 consecutive months with June posting the smallest gain in a year at "just" 0.9% m/m.

The sales-to-new listings ratio fell to 69% in June, the 5th straight decline and the lowest since August of 2020.

To be clear, that's still an exceptionally strong number (a balanced market is generally in the 50-55% range), but it is way off the January high of 91%. This metric is a very good predictor of future pricing trends, and with it now turning over sharply on a 6-month rolling basis, we can reasonably expect y/y price growth to either have peaked in June or to do so this month.

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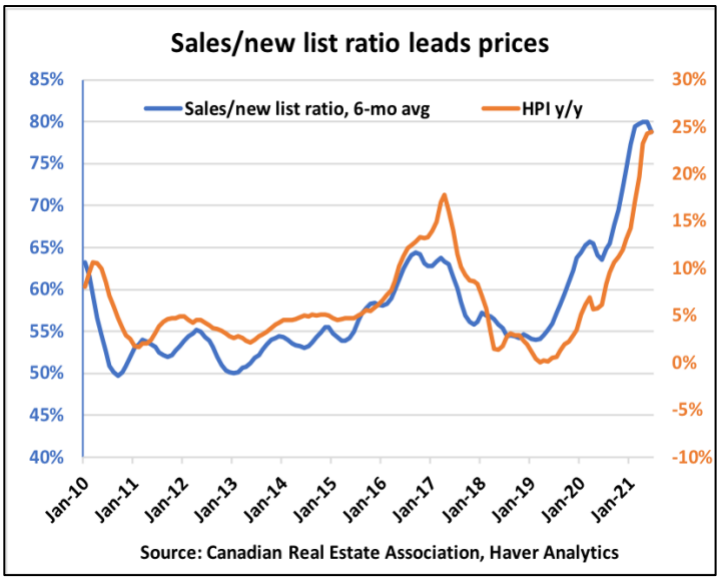
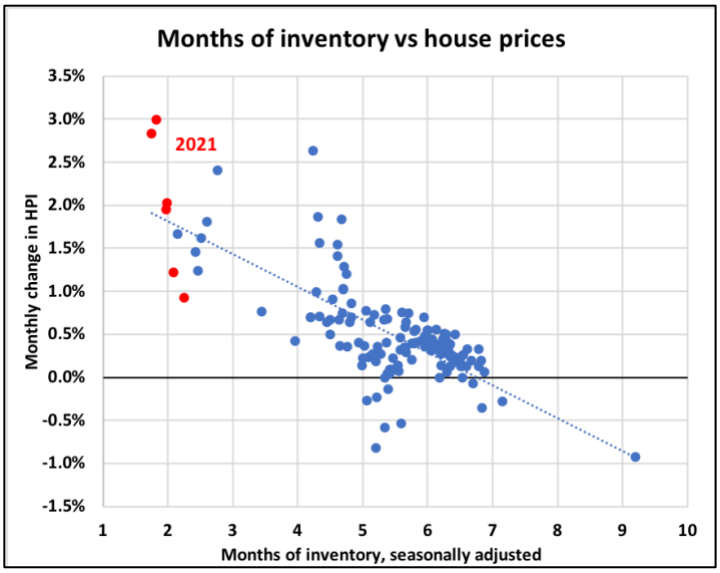


v) A moderation in price *growth* on deck but no declines until inventory rises

I want to be clear: When I say price *acceleration* has peaked, I don't mean that prices are set to fall.

It's important to remember than in the past 15 years, there have been no monthly declines in seasonally adjusted house prices with less than 5 months of inventory on the market:



Months of inventory in June was a scant 2.25 nationally and only 1.1 in Ontario. It's on the rise, but it's got a long ways to go before we can expect any sort of "landing":

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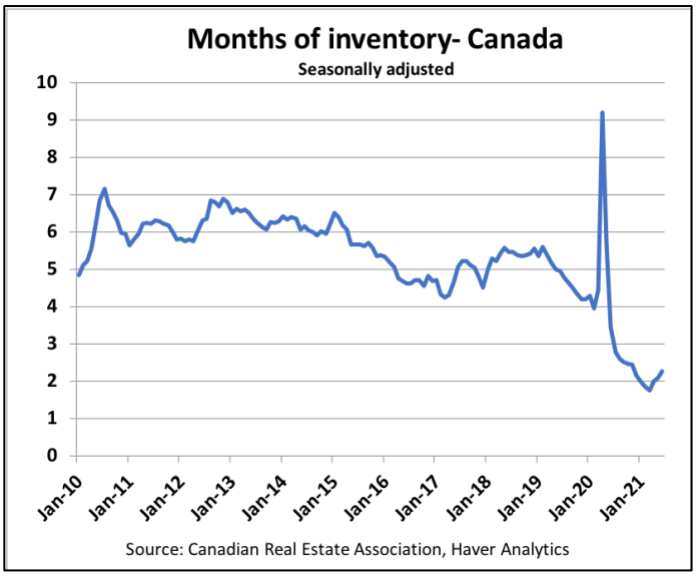
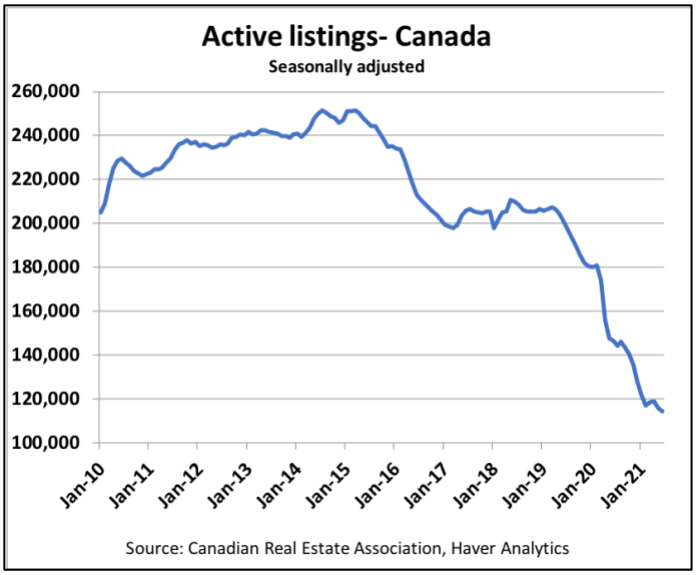


The issue remains the persistent decline in active listings across the country. Seasonally adjusted inventory fell 1.4% in June to hit fresh 20-year lows. Until this dynamic changes and we see substantially more supply (or a very steep decline in sales) there simply won't be sustained downward pressure on pricing:



To further put context on it, inventory levels in Ontario, BC, and Quebec are roughly ½ of "normal" levels from the past decade. Ontario's decline is most pronounced. Inventory is only 1/3 of what it was from 2010-2016:

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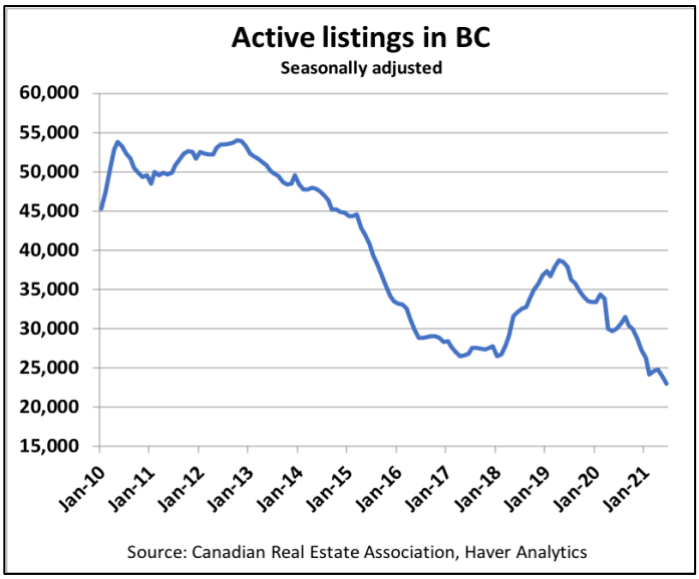
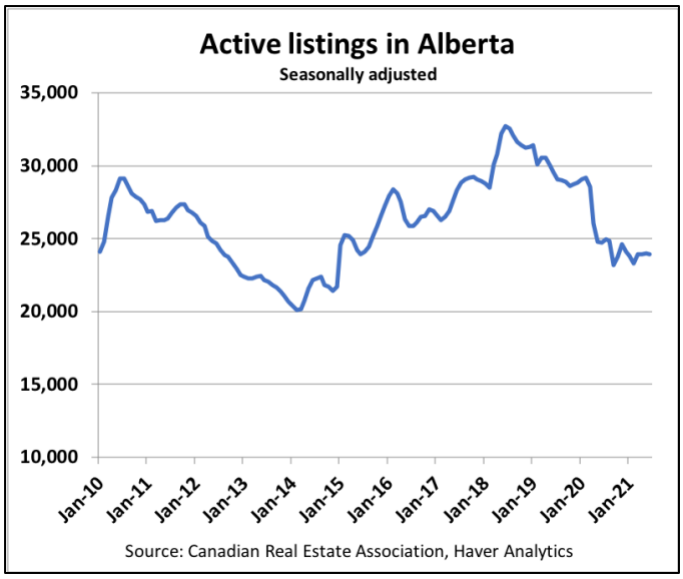
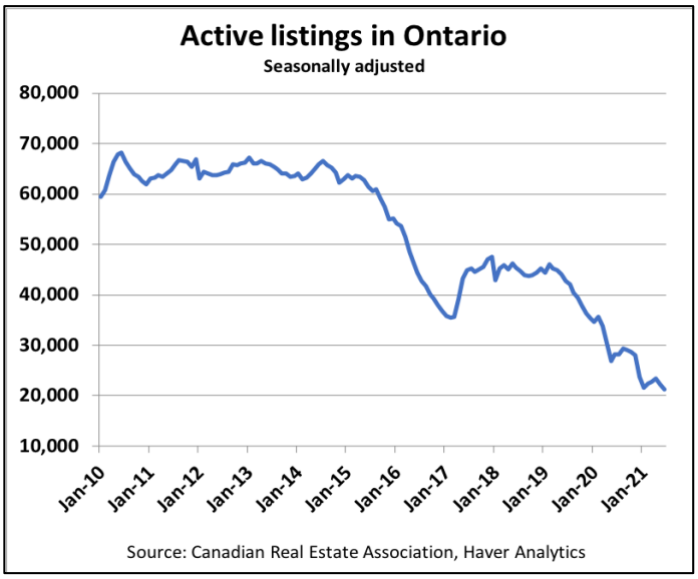
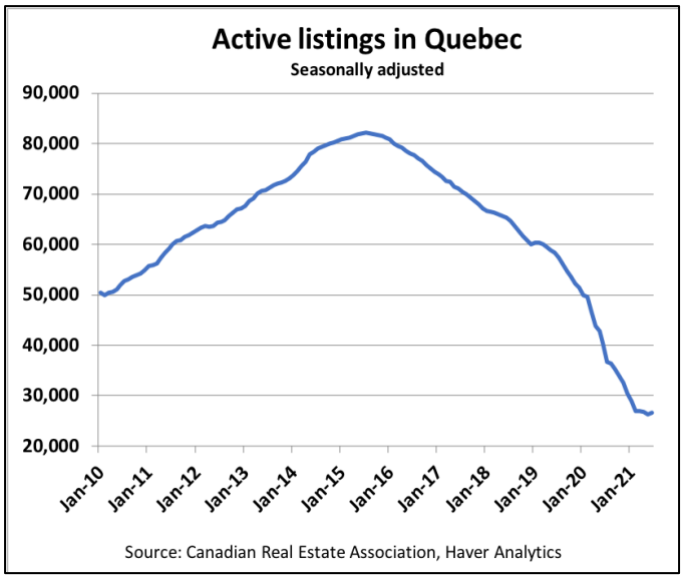








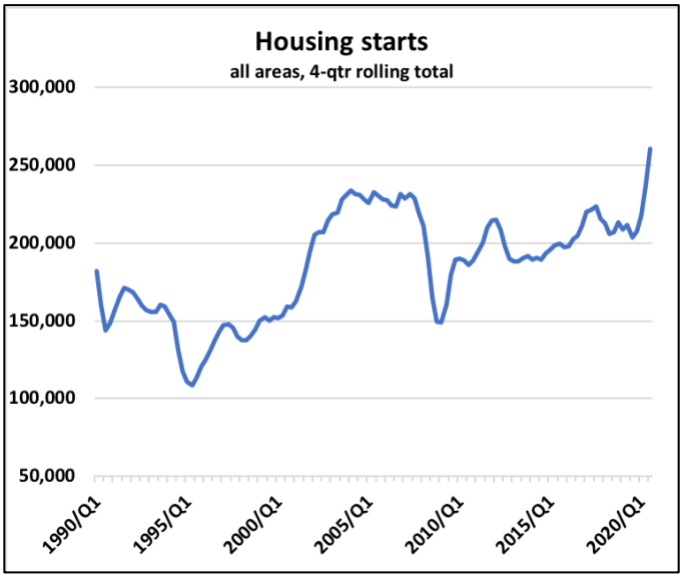
Prepared For:

2) Supply deep-dive: Housing starts hit +40-yr highs, rental construction boom continues

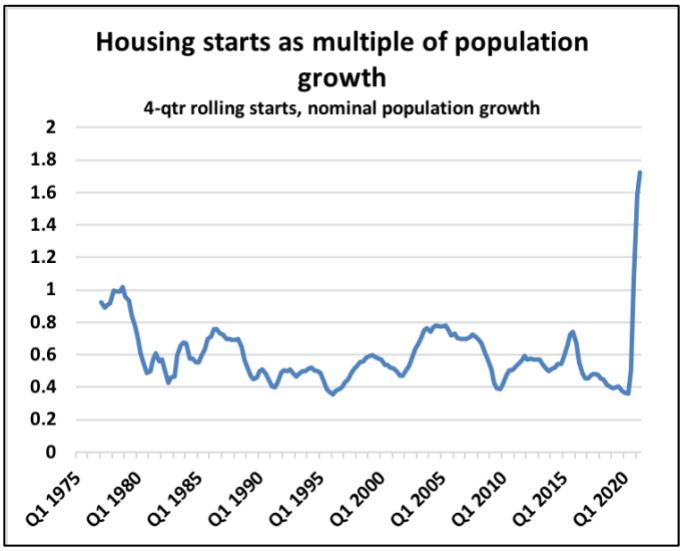
i) Plenty of new supply in the pipeline as housing starts continue to surge

The solution to low resale inventory is lots of new supply, and on the surface it seems we're going to get it. Housing starts came in at 282k on a seasonally adjusted annualized rate (SAAR) in June. That brought the 6-month trend to an absurd 293k SAAR, by far the highest on record.

We've now seen 261,000 new homes started in the past year. You have to go back to the mid-1970s to find the last time we had this level of new construction:



That's a ton of new supply to be sure, but it's particularly notable given population growth that is still running at just ¼ of the 2019 peak. In fact, over the past year we've started construction on nearly 1.8 new homes for every 1 person added to the population. Obviously this ratio will readjust as borders reopen and population growth picks up again, but wow what a chart!



Dwellings under construction have also surged to all-time highs at nearly 320k, more than double what it was just a decade ago:

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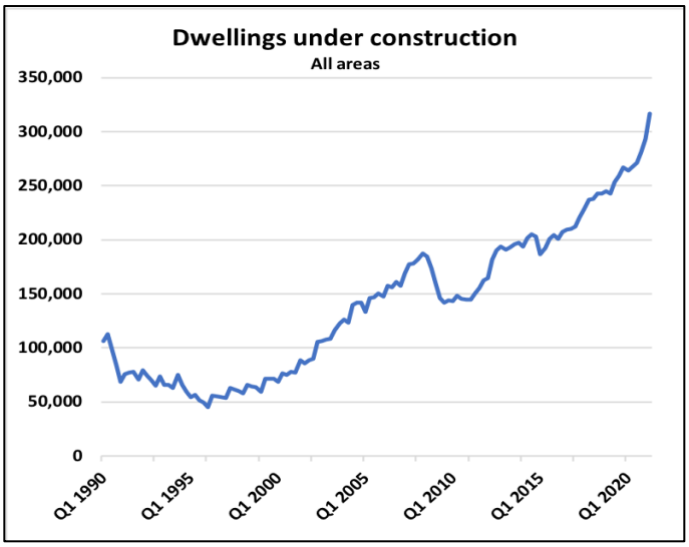
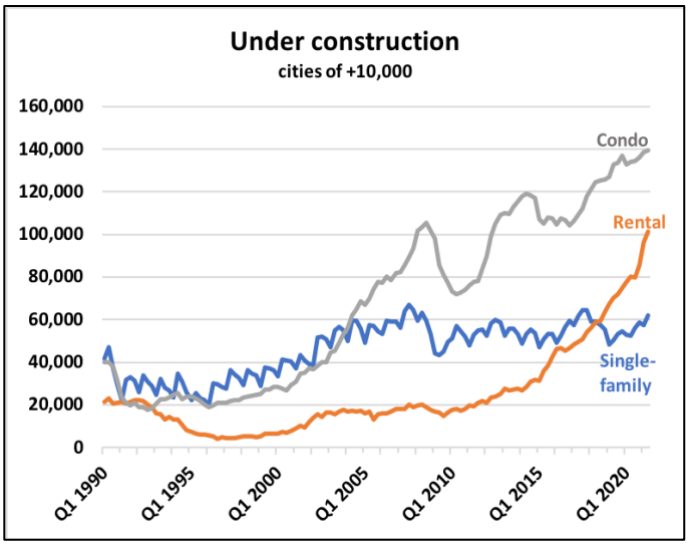


ii) New supply still skewing heavily to rentals and condos, less to single-family

On the surface it looks like plenty of supply to move the needle on the housing inventory issue, but disaggregating the data continues to tell a different story. Dwellings under construction are surging entirely due to condos and a massive increase in new rental supply. In fact, 60% of the y/y increase in under construction inventory is due to rental construction alone:



We see the same thing in housing starts. Single-family is barely back to 2018 levels on a 12-month rolling basis, and the seasonally adjusted monthly figure actually declined 4.8% m/m in June. Meanwhile, rental starts continue to hit new highs:

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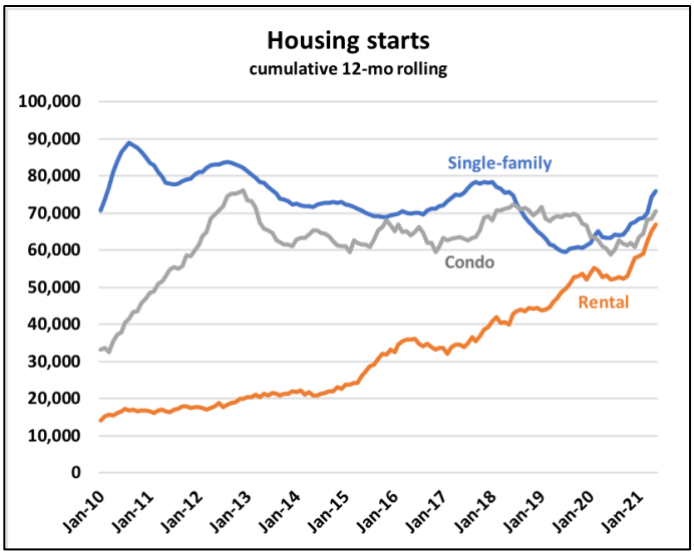
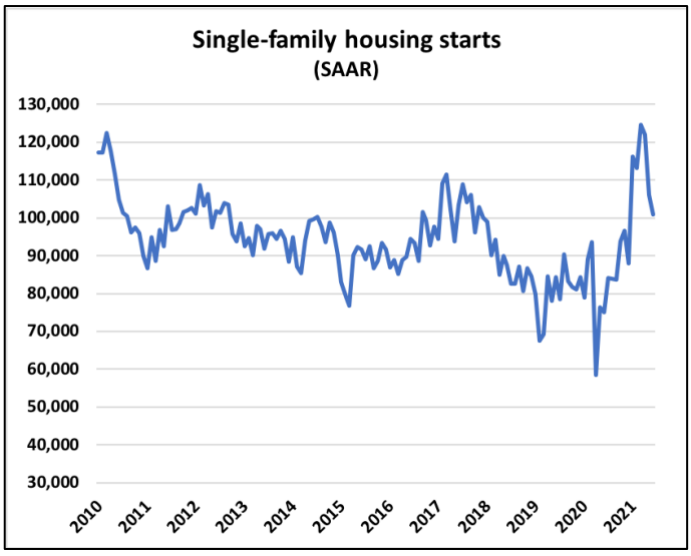
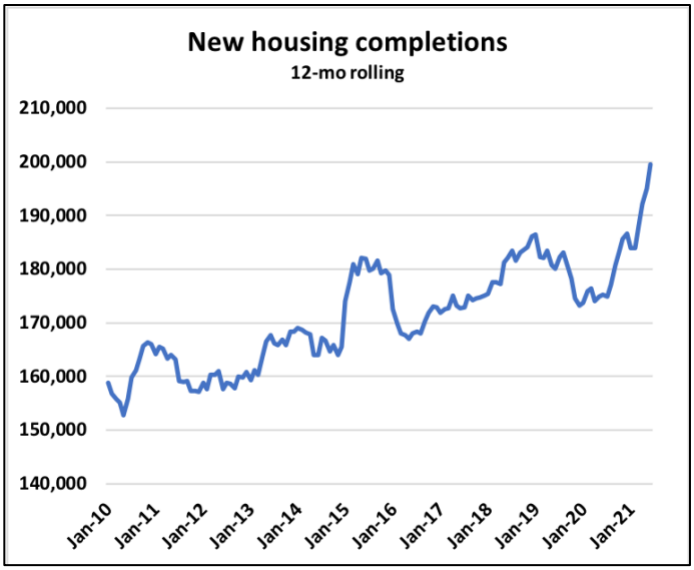
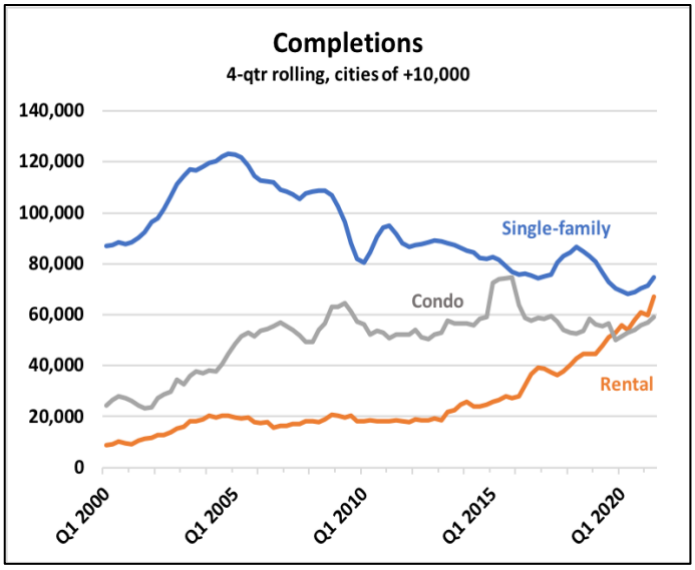




New housing completions are also surging and have hit 200,000 in the past year, the highest tally since the 1980s, but single-family completions are still way below long-term norms and may soon be eclipsed by rentals for the first time ever:





So the bottom line remains the same: We've structurally underbuilt single-family homes, and that dynamic hasn't changed even with the increase in housing starts. At the same time we're seeing what is potentially a cyclically oversupplied rental market that could weigh on apartment rental growth and occupancy rates for the next couple years.

To hammer the point home, if there were any signs of overbuilding, it would show up first in rising unsold developer inventory. There's just no indication of that right now, in fact it's quite the opposite. Completed, unsold developer inventory is plunging, particularly in the single-family segment:

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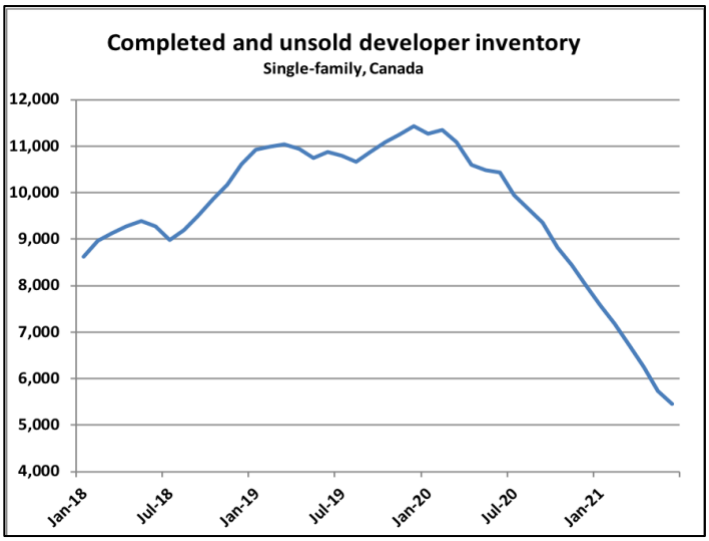
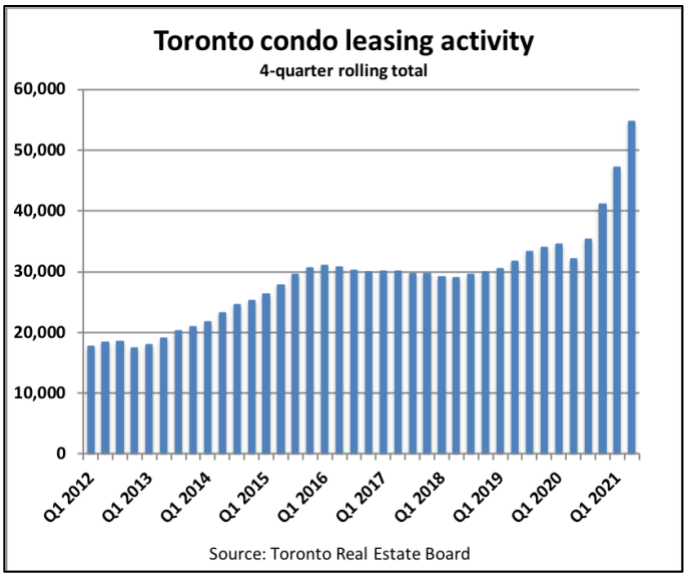


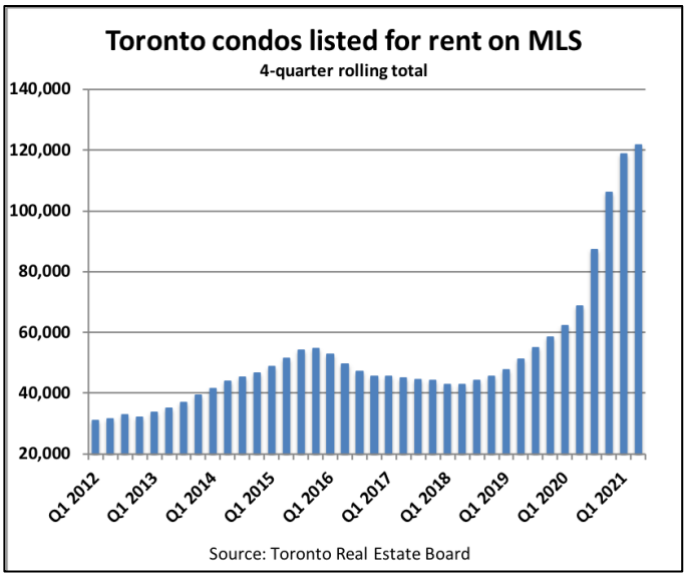
iii) Potential overbuilding of rentals remains a concern in spite of pickup in activity

To be clear, rental activity is picking up. The number of condos leased in Q2 spiked 104% y/y across the Greater Toronto Area, in part due to lateral movements by existing tenants to lock in lower rents. From the Toronto Regional Real Estate Board:

> *"Renters continued to benefit from lower average rents compared to last year, which was a contributing factor to increased rental transactions."*

The number of condos listed for rent also rose by 14.7% y/y:





While this represents a major improvement from prior quarters, it's important to note that this is still a relatively weak rental market. If we look at the lease/list ratio, a crude measure of supply and demand, we see that while Q2 was up sharply from 2020 levels, it remained well below levels from the prior 4 years:

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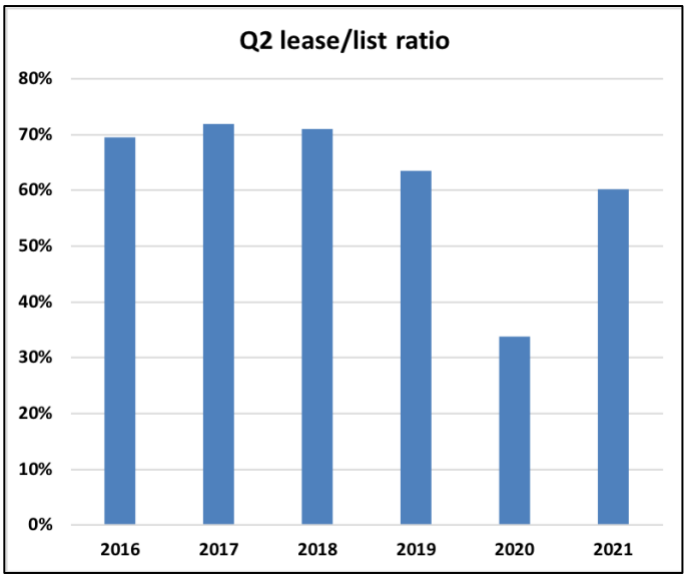
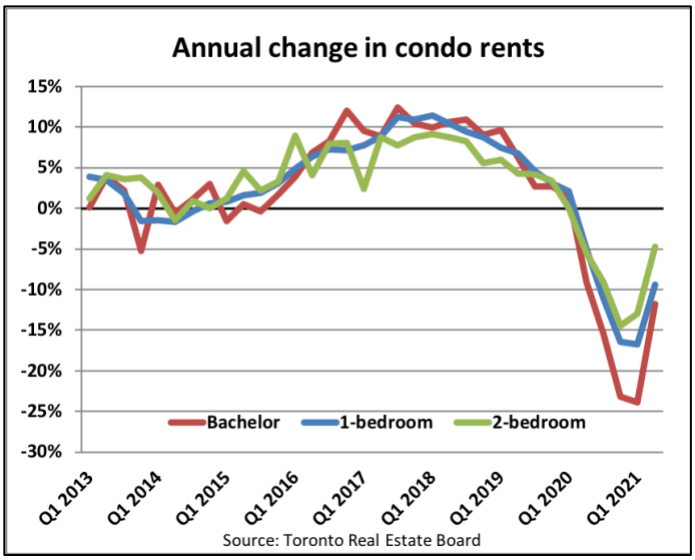


Rental prices rose sequentially but remain ~15% below peak levels.



Demand will continue to recover, but the concern at this point is that it will be met with a deluge of new supply in coming quarters. There are over 100,000 rental units under construction across the country.

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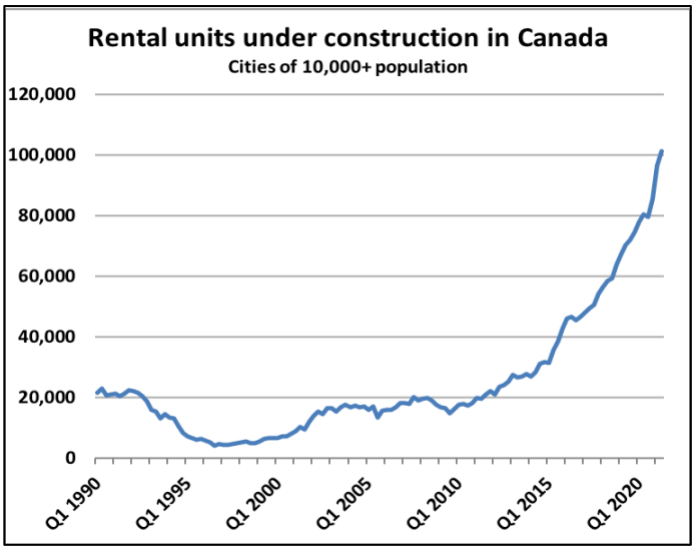
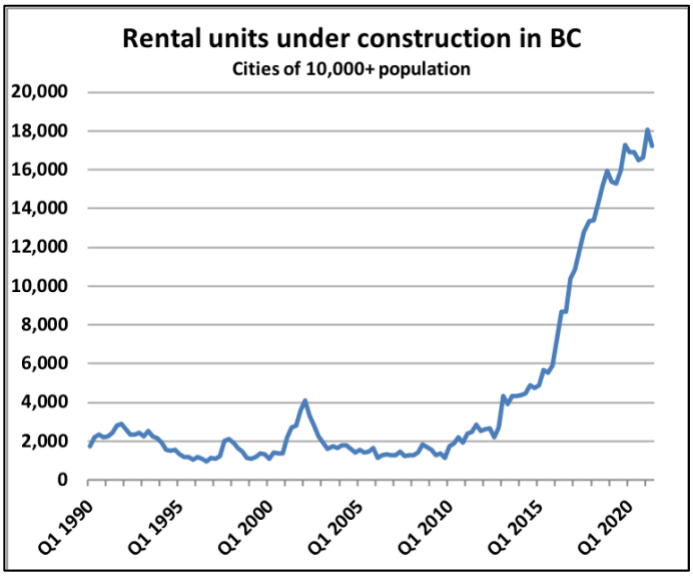
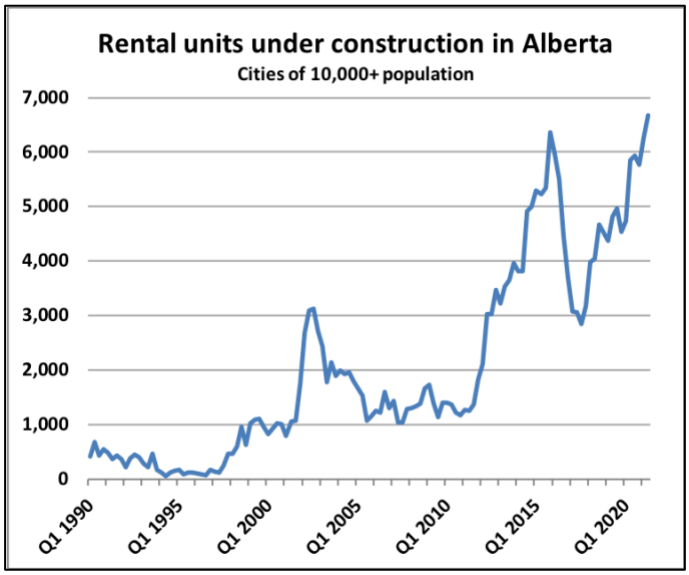


All provinces have seen a surge in new supply, notably in Quebec where they are closing in on 40,000 rental units under construction, an 8-fold increase in just 6 years:





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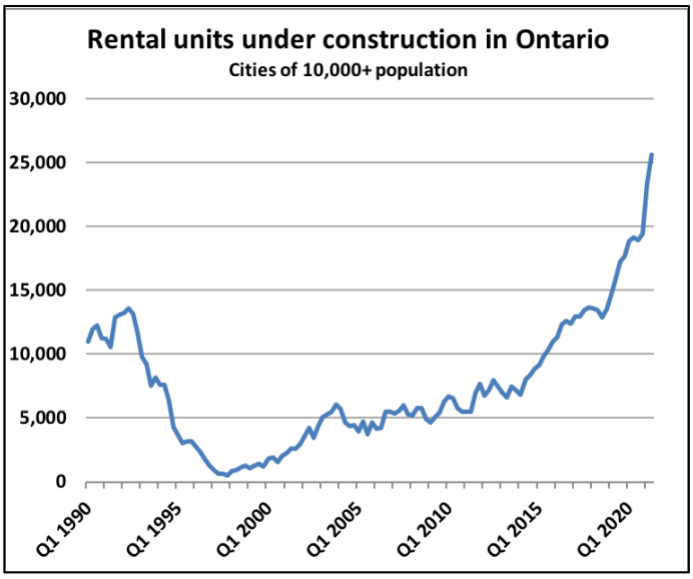
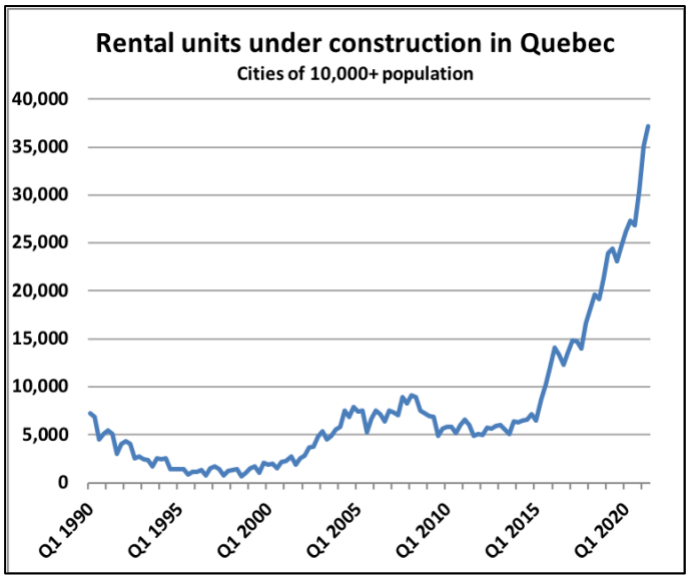
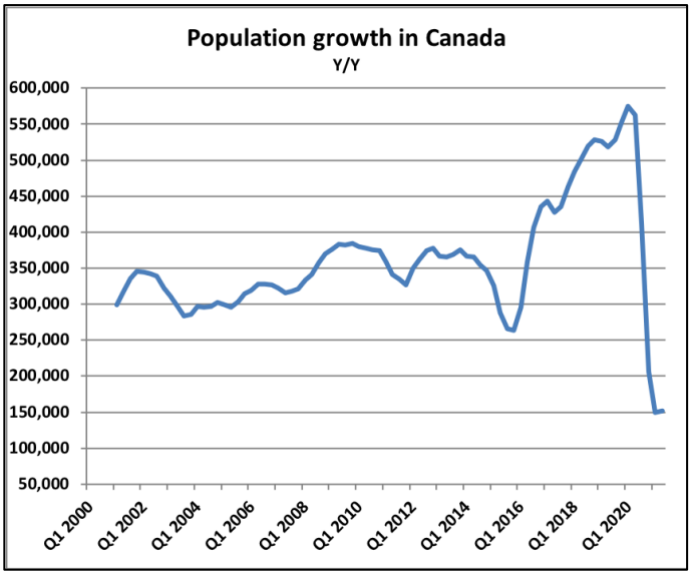




The question now is how quickly population growth will rebound. My view is that we've likely seen the lows in population growth, currently just 150k y/y vs 575k at peak, but it will take longer to get back to those highs than people generally think, and that means we may not see new highs in apartment rental prices in big cities for until well into 2022 or 2023:



Having said that, I have to acknowledge that the rental market in Toronto appears to have picked up even further in July based on anecdotes from people in the space:

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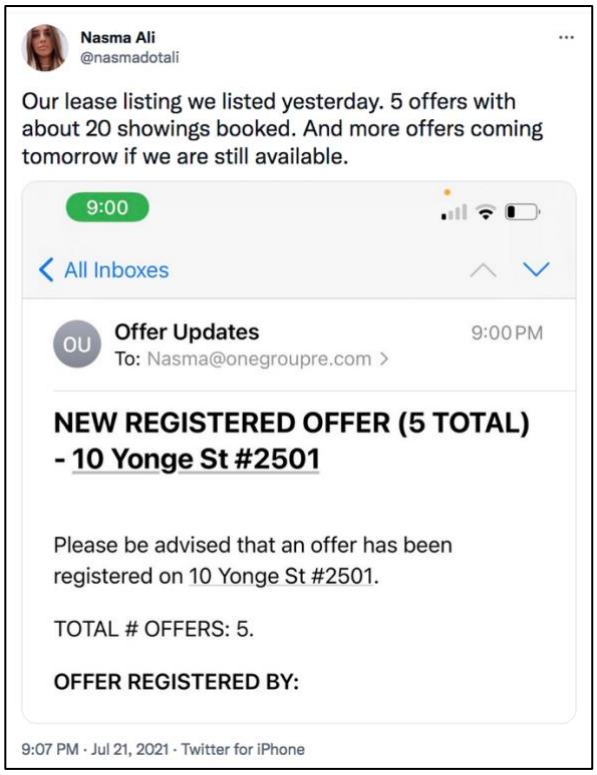

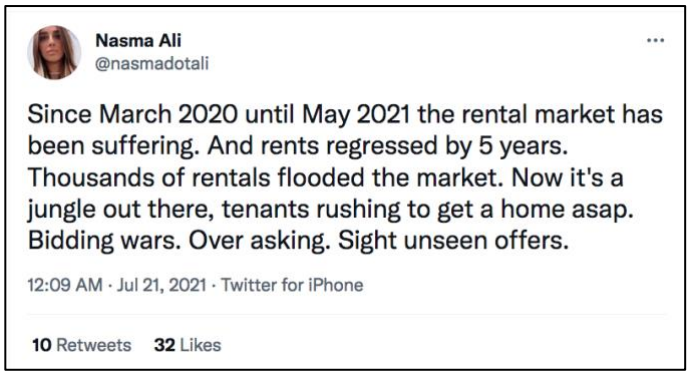

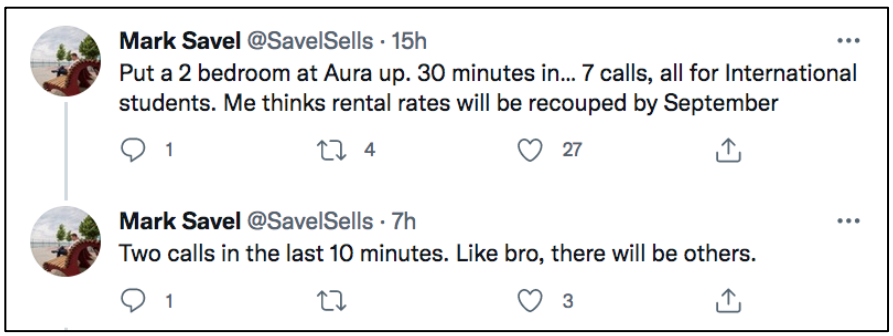

I may be totally wrong on this, but for now my base case remains that after this initial reopening surge, the trajectory of the rental market in major cities across the country will slow and we will not return to pre-COVID levels of tightness for at least another year, and likely longer.

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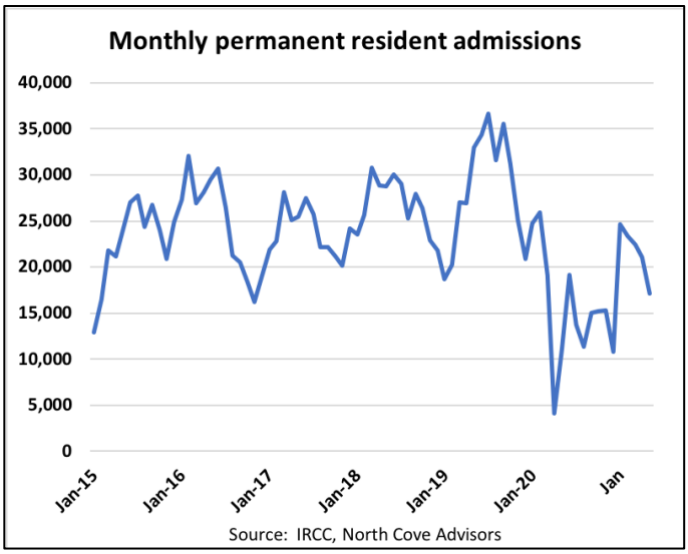
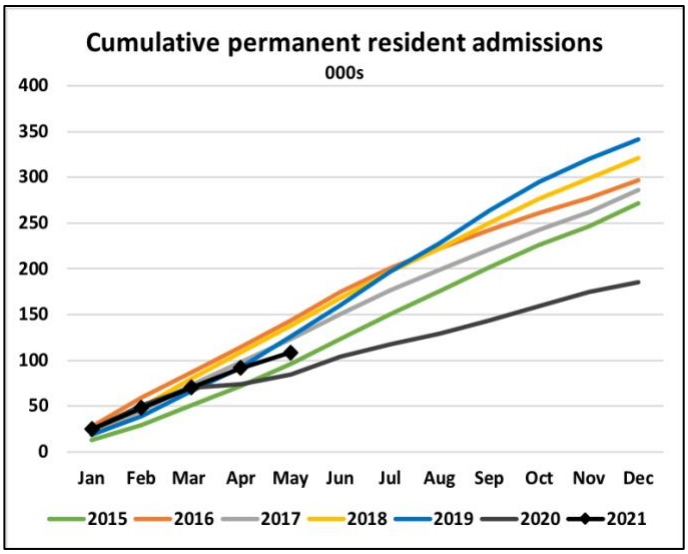
iv) Population growth continues to disappoint but will improve as borders reopen

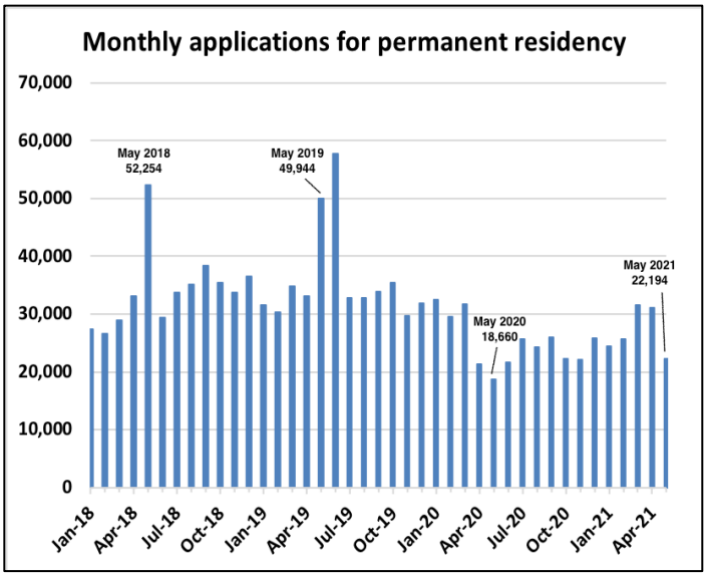
Digging in on population dynamics, let's first note that permanent resident admissions are slowing and are falling further behind that ambitious 400k target Canada set by the feds.

May saw just 17,100 new permanent resident admissions, the lowest monthly total of the year. That puts cumulative admissions at barely over 100k so far in 2021, well below 2016-2019 levels and a country mile behind the pace needed to hit the targets envisioned by Ottawa:





Yes, this is primarily a border closure issue, and it will improve as things reopen. But new applications are also tanking and came in at one of the lowest levels of the entire pandemic in May. Applications were less than half the pre-COVD levels for the month. This tells us that the pipeline of new applicants is not what it was before the pandemic, and that should be a concern to policy makers:



Again it's easy to blame border closures, but I do wonder how much incremental demand has been pulled to the US under the new, much more welcoming administration.

Regular readers will know that non-permanent residents are the real drivers of the quarter-to-quarter volatility in population numbers. If we disaggregate headline population growth into its three main components, this immediately becomes clear.

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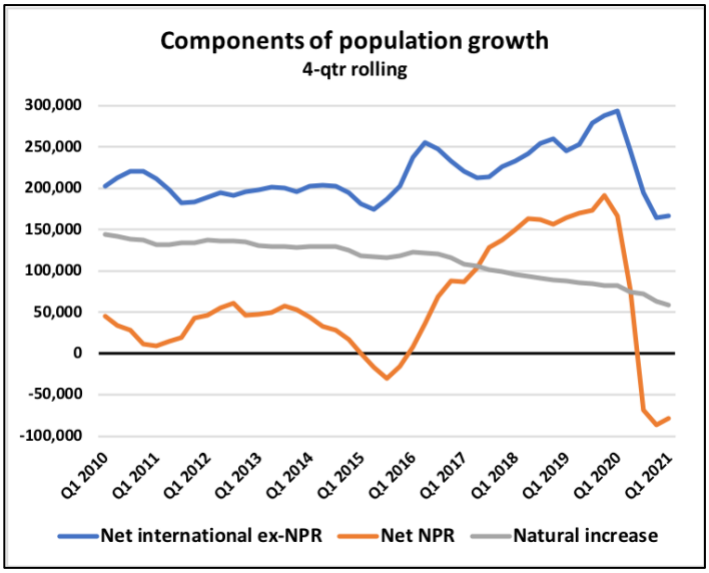
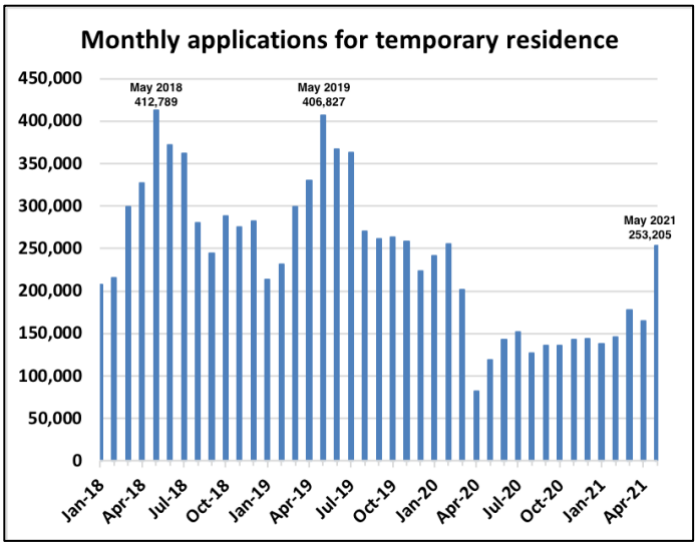
Those three main buckets:

- Net international ex-NPR (blue line in the chart below): This captures permanent immigration minus people who leave Canada for other countries. When the government speaks of immigration targets, this is the bucket they're targeting.
- Natural increase (gray line): Births minus deaths
- Net NPR (orange line): This is made up of international students and foreign workers coming, minus those leaving. Don't forget that there's a huge amount of churn in this cohort with major inflows and outflows each quarter. This means any modest change in either inflows or outflows causes huge swings in the net number. You can see just how volatile this data set is:



We've almost certainly seen the lows in net NPRs, which fell nearly 100k y/y in late 2020. But it's also not clear that we'll be going back to peak levels any time soon. Temporary resident applications are also way below pre-COVID levels. This is important given that foreign students have been a huge driver of rental demand in major metros.



My view remains that it will take years to get back to peak population levels, even if the feds hit their lofty targets.

At risk of belaboring the point, I'll highlight the June Labour Force Survey which gave some insight into how Stats

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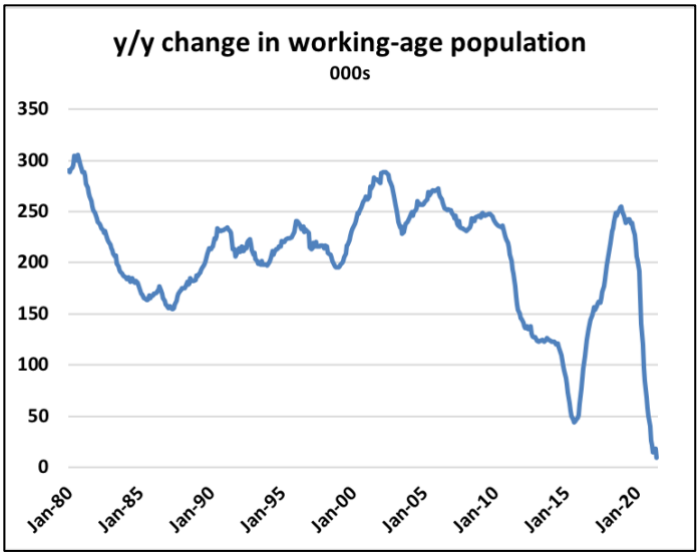
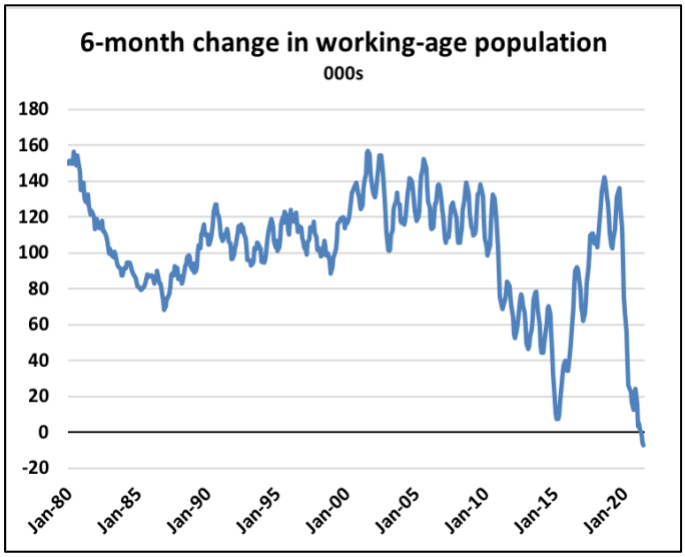
Canada is modeling current population growth. Their estimates of the working-age population (15-64 yr olds) indicated an outright decline of 4k last month, only the 5th monthly decline going back to 1976 and the 2nd steepest on record. Working-age population growth on a y/y basis is barely positive, and it's outright declining over the past 6 months:





This will change as borders reopen, but the fact that applications today are so light suggests that the admissions backlog will be less than people generally believe.

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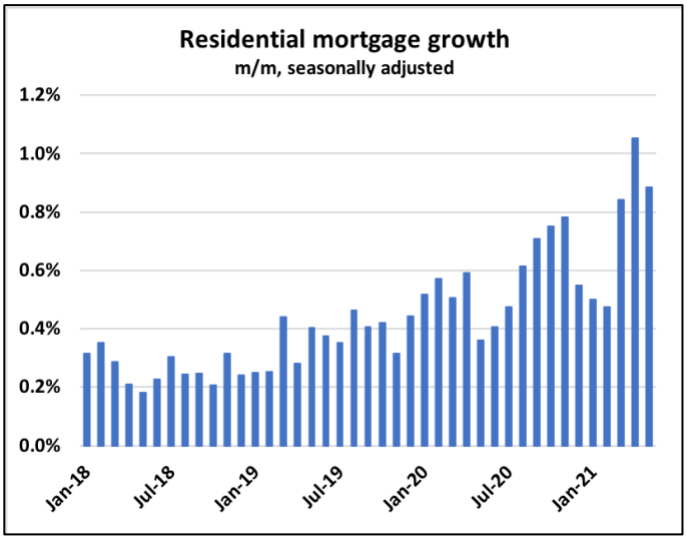
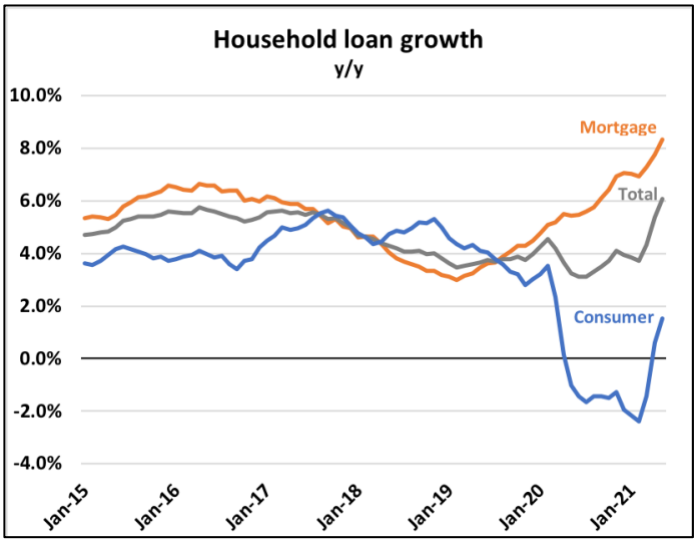
3) Household credit update: Mortgage growth surges in June, regulators are nervous

i) Another strong month for mortgage growth

Residential mortgage credit outstanding grew by another 0.9% m/m in May, pushing the y/y growth rate for mortgages north of 8% and for total household credit growth above 6% for the first time in a decade.





We're hearing from mortgage contacts that June was a record month for originations and by a substantial margin. From Ron Butler on Twitter:

Ron Butler
@ronmortgageguy

The Biggest Mortgage Origination Month in History

In a few days June will be over and although I don't know the numbers in advance my bet is that June 2021 will be the biggest Mortgage Month in the history of Canada

Mortgages Origination lags home purchase about 60 days

2/

8:51 AM · Jun 25, 2021 · Twitter for Android

9 Retweets **2** Quote Tweets **59** Likes

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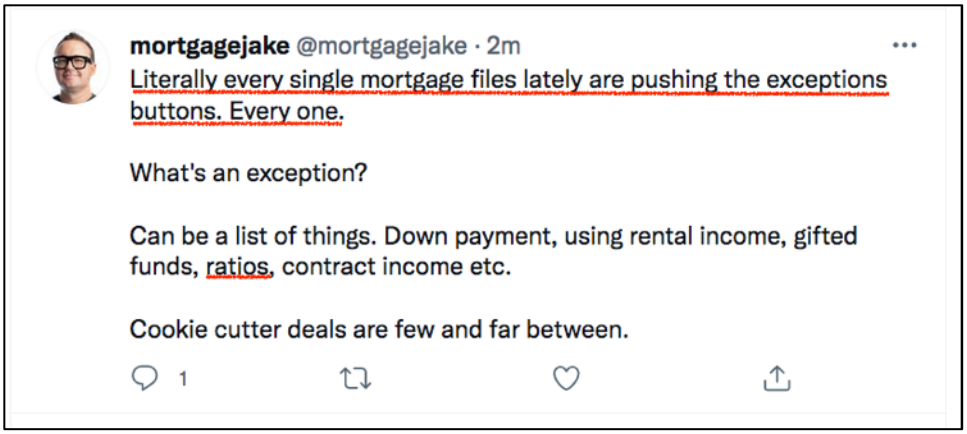
ii) Loosening underwriting by big banks creates a conundrum for regulators

OSFI is finding out that when you issue general underwriting "guidelines" as opposed to black and white rules, it leaves plenty of flexibility for banks to bypass measures like the B20 stress test by allowing borrower debt service ratios to exceed their internal guidelines. It takes a lot of the bite out of the stress test if you can stretch total debt service ratios into the high 40s or low 50s.

And these aren't one-offs; Exceptions of all sorts are now the norm. From "Mortgage Jake" on Twitter:



And with household net worth just posting the largest y/y increase on record in Q1, banks are loosening programs that cater to wealthier borrowers. These programs allow much higher debt service ratios or in some cases bypass income verification altogether. Again, from Jake:

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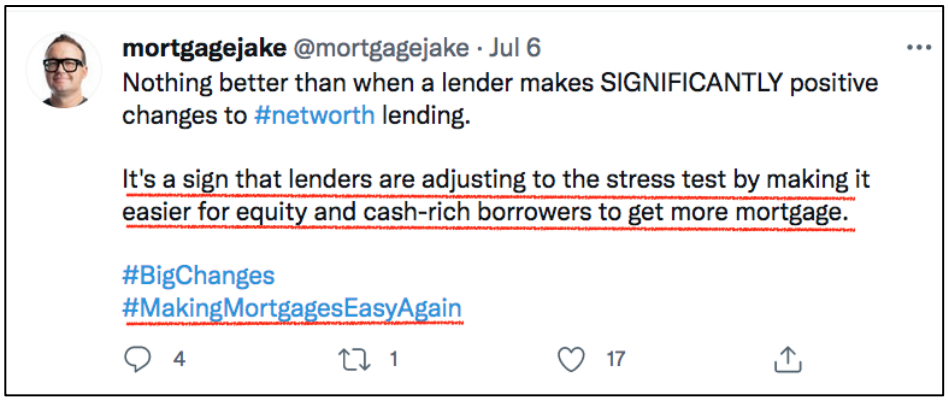
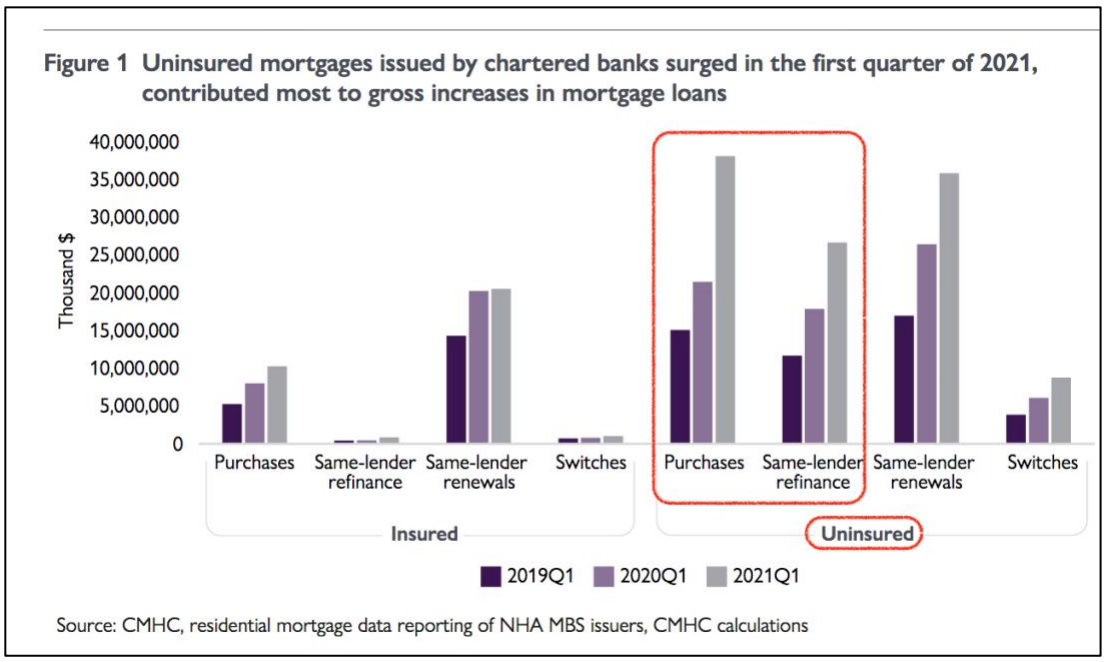


CMHC had some great data this week looking at mortgage growth across various metrics. It's Q1 data, but no reason to think this trend has changed:



The trajectory of mortgage growth and the willingness of banks to provide workarounds to the uninsured stress test is something that OSFI will not be happy with. They recently noted that the share of new mortgages with loan-to-income ratios in excess of 450% had hit new highs.

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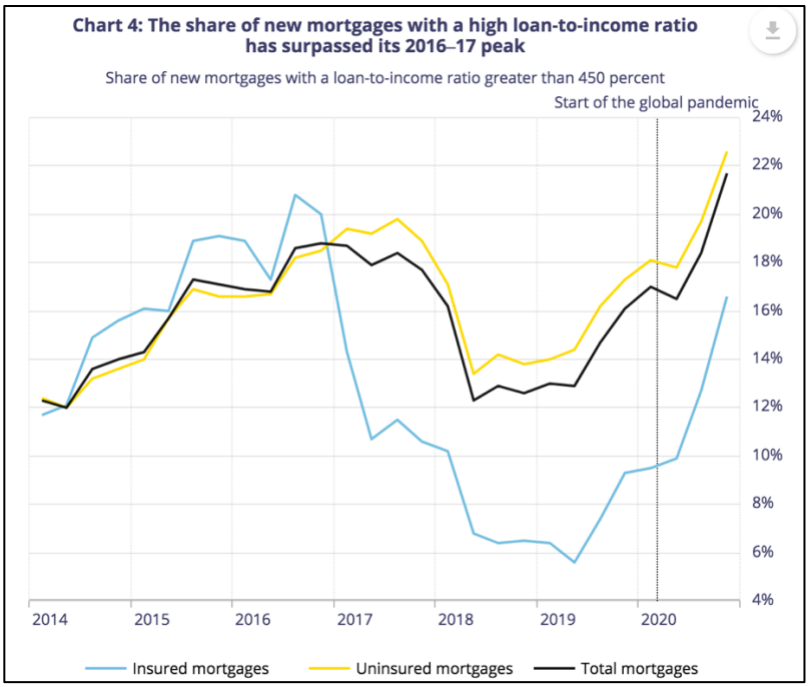

That particular loan-to-income ratio of 450%, arbitrary as it may be, does seem to be a fixation for OSFI, and you get the sense that a hard cap on loan-to-income ratios may be the next step if banks continue to bypass the stress test through these exceptions.

On that point, OSFI's new Superintendent, Peter Routledge, had this to say regarding household leverage on a recent podcast:

> "quantitatively (debt) is higher. A big part of why is that the cost of financing debt is lower. Income isn't lower so households can bear a little bit higher leverage. I would like household debt to income levels to come down. Not all at once, but gradually. It is difficult for that to occur within a low interest rate environment."

Mr. Routledge will likely want to get his feet under him in the new role and see how trends shape up as the economy emerges from the pandemic before implementing any meaningful changes. But I don't imagine he and the others at OSFI are thrilled with what they're seeing in this latest data.

On the flip side, CMHC is signaling a very different approach to mortgage regulation under their new senior management. It was hard to imagine that Evan Siddall's successor would have his same extreme conservative bent with regards to household finances and indebtedness, or his arguably over-the-top adversarial approach to relations with the housing and mortgage industries.

Indeed that appears to be the case. In a big 'tell', the first major policy move from CMHC's new chief, Romy Bowers, was to undo some of the underwriting changes brought in by Siddall during the pandemic:

> **CMHC eases mortgage insurance rules, admits tightening was a mistake -*Globe and Mail***
>
> Canada Mortgage and Housing Corp. is making it easier to get federal mortgage insurance, reversing tougher rules that were imposed a year ago.
>
> […] "We are taking this action because our July, 2020, underwriting changes were not as effective as we had anticipated and we incurred the cost of a decline in our market share," the CMHC said in an announcement.
>
> Effective Monday, the mortgage insurer is lowering the required credit score and loosening other measurements that ensure homeowners have enough income to pay their mortgages and other debts.

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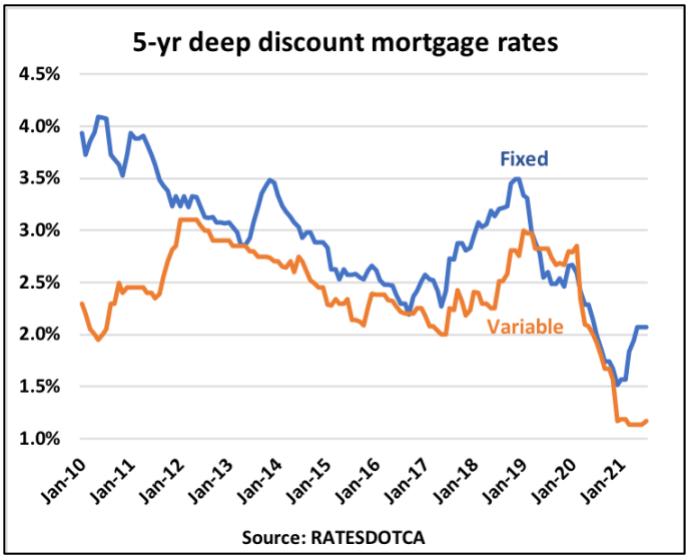
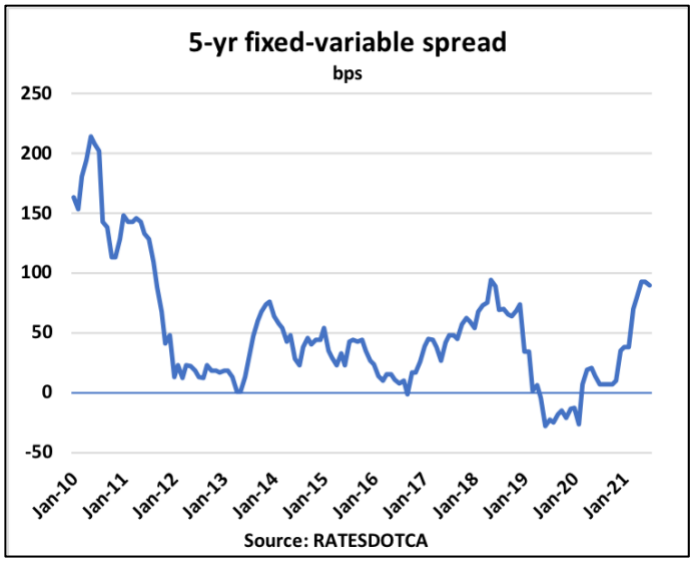
As far as what all of this means for mortgage policy going forward, I remain of the view that the government will likely ease mortgage financing for first-time buyers in coming months, likely via longer allowable amortization lengths on insured mortgages. But I also wouldn't be at all surprised if later this year, or perhaps early 2022, OSFI begins to lean on multiple property owners via tighter underwriting for recreational and investment properties which could take the form of higher minimum down payments and new regulations around source of down payment capital that could preclude borrowed funds as eligible down payments. Beyond that, if things in the mortgage space don't cool down, we may begin to hear more talk of loan-to-income limits.

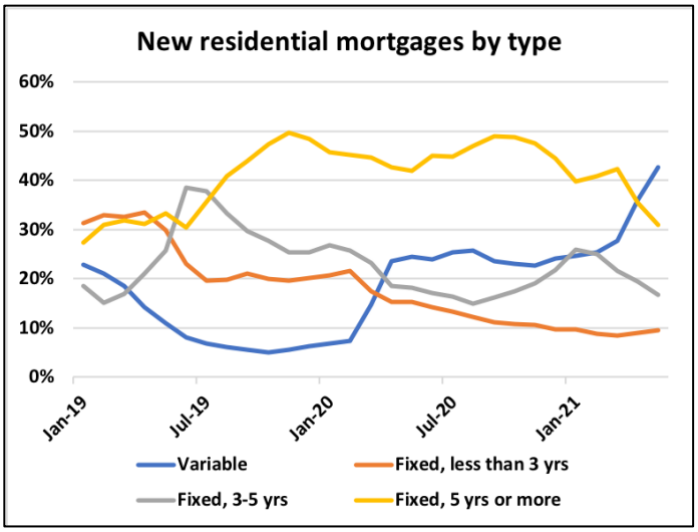
iii) Surge in variable rate mortgages could complicate BoC's eventual rate normalization

Mortgage rates were little changed in the past month. The spread between discounted fixed and variable rate mortgages remains high historically at over 90bps:





Variable rate products continue to look attractive. In fact the share of new mortgages originated in May that had floating rates hit the highest since 2018. And in dollar terms, variable originations spiked 121% y/y in May compared to a 6.3% decline for standard 5-yr fixed mortgage volumes.



This shift to lower cost variable products is helping to keep the effective household interest rate near all-time lows:

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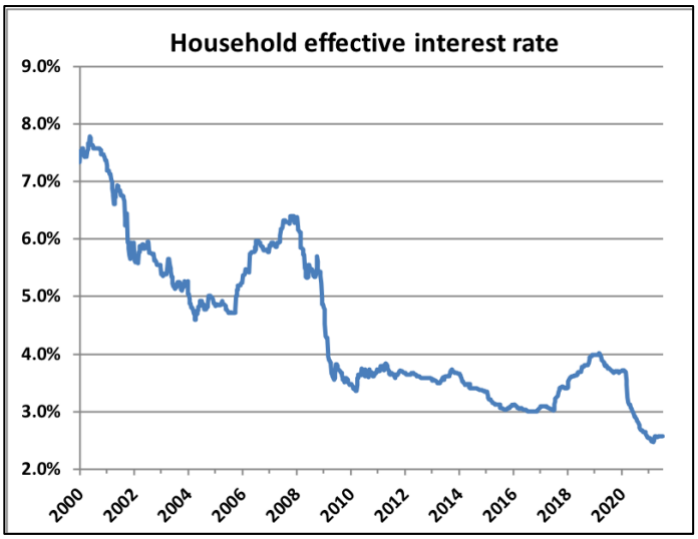


But it does raise the risk that whenever the Bank of Canada does begin their rate normalization process, the feedthrough to household debt servicing will be more rapid and more pronounced than in the past.

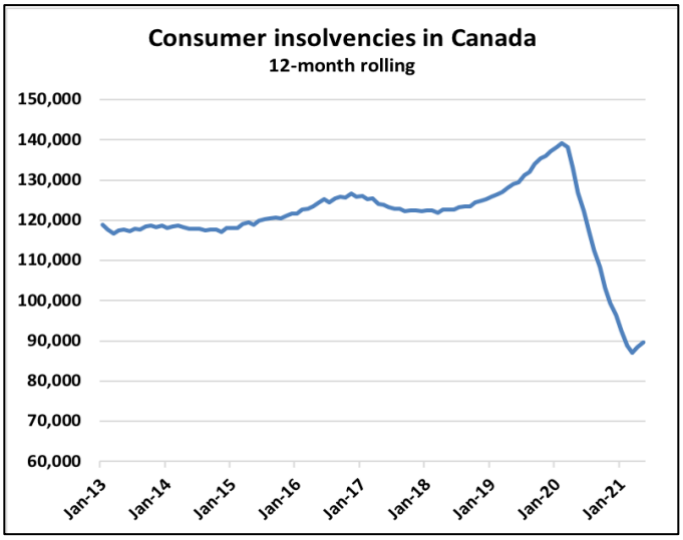
Prepared For:

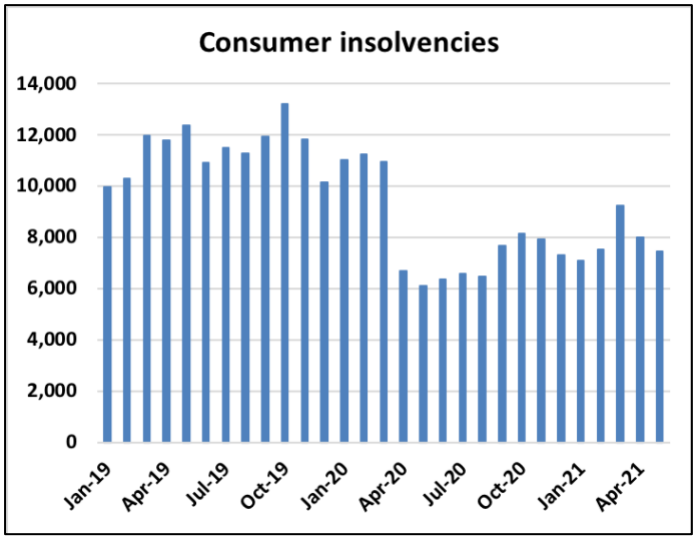
4) Consumer check: Forward-looking credit indicators continue to look great

i) Forward-looking credit indicators look fantastic

Put simply, Canadian consumers are in very good shape for now and there are absolutely no signs of stress in any forward-looking credit indicators.

Let's start with consumer insolvencies. The headline number of +22% y/y in May is entirely a function of base effects. Comp them against May 2019 instead and we're down 40%. And there's still no meaningful upward trajectory in the monthly data:





The biggest increase was in Quebec which at this point last year was seeing the most stringent lockdowns. So again, all base effects. If there's one thing to watch, it's the 52% increase in proposals (restructuring on unsecured debt) in Alberta. Proposals have been very high in that province for the past 3 months:

	Total	Proposals	Bankruptcies
Canada	21.7%	24.7%	15.7%
BC	20.5%	27.7%	2.3%
Alberta	36.6%	51.8%	-5.6%
Ontario	2.6%	-0.2%	11.1%
Quebec	43.2%	54.1%	31.6%

Canadians also continue to sit on a ton of excess savings. Personal chequable deposits at chartered banks were up another 1.2% seasonally adjusted in May and are closing in on $120 billion above pre-COVID trends:

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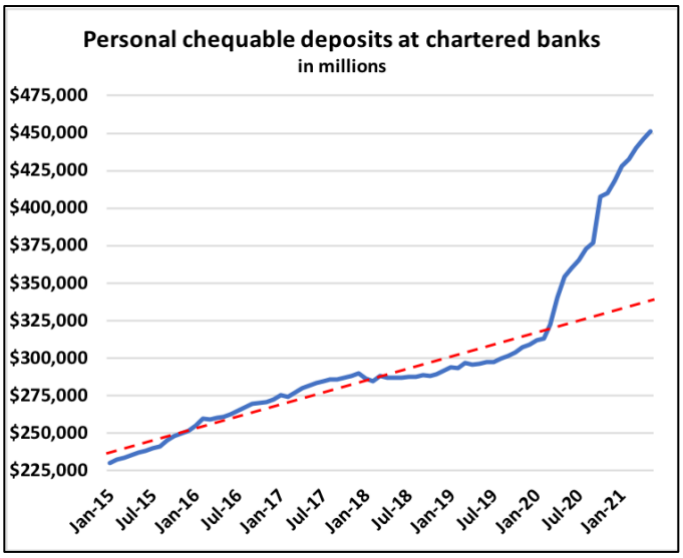
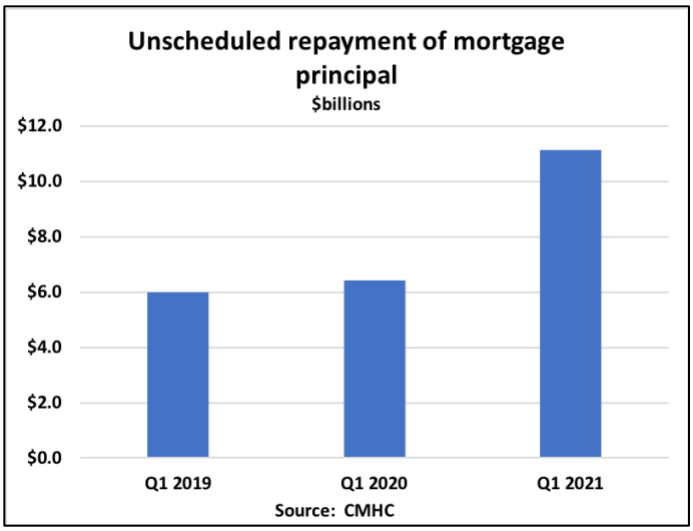


Many Canadians are using these excess savings to pay down debt. We learned from CMHC this week that unscheduled/voluntary mortgage repayments surged in Q1:

> […] Despite a slight drop compared to the previous quarter (fourth quarter of 2020), unscheduled repayments were still much higher than the same quarter in previous years (figure 3), which, shows that mortgage holders are accelerating their repayment, by making payments ahead of schedule or by making lump-sum payments.



We see this same trend in credit card trusts where payment rates have spiked 1500bp y/y in May and June and remain at or near all-time highs across the board. As a reminder, rising payment rates point to healthy consumer cash flows and suggest that future delinquencies will be low:

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	CCCT-National	Cards II-CIBC	Eagle- PC	Glacier-Canadian Tire	Golden-RBC	Master-BMO	Trillium-BNS	Evergreen - TD	Average
May-19	54.8%	40.6%	61.8%	26.8%	53.9%	52.1%	49.8%	49.5%	**48.6%**
Jun-19	48.3%	36.7%	54.8%	24.7%	48.5%	46.6%	43.0%	45.7%	**43.5%**
Jul-19	58.3%	42.7%	65.0%	29.0%	55.8%	54.0%	49.1%	50.9%	**50.6%**
Aug-19	49.9%	38.7%	58.0%	25.8%	51.0%	48.5%	44.5%	46.5%	**45.4%**
Sep-19	52.2%	38.1%	57.2%	25.7%	51.3%	48.6%	44.0%	45.8%	**45.4%**
Oct-19	53.3%	41.3%	60.9%	27.3%	52.8%	50.5%	45.9%	49.1%	**47.6%**
Nov-19	49.1%	37.8%	56.1%	24.9%	50.4%	46.9%	42.1%	47.1%	**44.3%**
Dec-19	57.4%	42.3%	64.8%	28.2%	56.6%	53.4%	51.2%	51.3%	**50.6%**
Jan-20	52.3%	38.7%	57.9%	26.5%	51.1%	47.5%	45.6%	47.2%	**45.9%**
Feb-20	44.8%	33.9%	52.8%	22.0%	44.9%	41.0%	39.9%	41.9%	**40.1%**
Mar-20	51.9%	37.5%	57.2%	25.6%	49.5%	46.3%	43.5%	43.6%	**44.4%**
Apr-20	46.8%	33.7%	53.4%	22.7%	44.2%	42.0%	44.0%	40.1%	**40.9%**
May-20	50.0%	33.6%	53.8%	22.8%	45.6%	42.9%	42.1%	41.3%	**41.5%**
Jun-20	60.7%	39.2%	63.1%	26.0%	59.3%	49.8%	49.3%	48.2%	**49.5%**
Jul-20	62.0%	41.4%	61.8%	27.9%	55.6%	51.3%	50.8%	48.4%	**49.9%**
Aug-20	59.1%	42.1%	59.4%	26.3%	54.5%	49.8%	50.5%	53.3%	**49.4%**
Sep-20	58.4%	45.5%	61.1%	27.2%	55.2%	51.2%	51.2%	51.4%	**50.1%**
Oct-20	58.2%	45.0%	61.3%	27.6%	56.4%	51.7%	51.7%	50.1%	**50.3%**
Nov-20	63.0%	45.2%	61.8%	27.3%	59.0%	53.3%	53.0%	50.8%	**51.7%**
Dec-20	64.9%	49.7%	66.8%	30.1%	61.1%	56.8%	56.8%	55.7%	**55.2%**
Jan-21	54.2%	42.3%	57.2%	26.2%	52.2%	48.2%	47.1%	47.1%	**46.8%**
Feb-21	53.0%	39.7%	55.0%	23.2%	49.7%	45.4%	46.5%	45.1%	**44.7%**
Mar-21	70.0%	50.1%	70.2%	29.4%	63.7%	58.2%	57.4%	57.3%	**57.0%**
Apr-21	65.3%	47.5%	64.5%	28.3%	60.4%	54.9%	54.8%	55.3%	**53.9%**
May-21	70.5%	48.7%	67.2%	29.4%	63.2%	57.2%	57.8%	56.0%	**56.3%**
Jun-21	69.4%		67.9%		64.4%			59.9%	
y/y (bps)	869	1514	474	664	506	1439	1569	1168	1477

Credit card delinquencies came in at the lowest levels on record in May and June at just 1.3% on average. And since borrowers generally don't default on mortgages before missing credit card payments, this is a very good sign for mortgage performance in the near term:

	CCCT-National	Cards II-CIBC	Eagle- PC	Glacier-Canadian Tire	Golden-RBC	Master-BMO	Trillium-BNS	Evergreen - TD	Average
Jun-19	1.67%	2.17%	1.33%	1.99%	1.72%	2.73%	1.75%	1.47%	**1.85%**
Jul-19	1.65%	2.07%	1.35%	2.00%	1.67%	2.52%	1.78%	1.43%	**1.81%**
Aug-19	1.72%	2.18%	1.41%	2.10%	1.73%	2.54%	1.81%	1.48%	**1.87%**
Sep-19	1.72%	2.18%	1.40%	2.14%	1.75%	2.42%	1.79%	1.48%	**1.86%**
Oct-19	1.71%	2.18%	1.45%	2.17%	1.87%	2.34%	1.96%	1.59%	**1.91%**
Nov-19	1.64%	2.24%	1.44%	2.25%	1.97%	2.34%	1.82%	1.63%	**1.92%**
Dec-19	1.65%	2.33%	1.48%	2.20%	2.00%	2.32%	1.80%	1.60%	**1.92%**
Jan-20	1.75%	2.38%	1.59%	2.40%	2.09%	2.41%	1.88%	1.69%	**2.02%**
Feb-20	1.66%	2.42%	1.58%	2.51%	2.15%	2.49%	1.94%	1.74%	**2.06%**
Mar-20	1.81%	2.77%	1.71%	2.55%	2.40%	2.79%	2.17%	1.85%	**2.26%**
Apr-20	1.85%	2.13%	1.69%	2.23%	2.41%	2.95%	2.15%	2.47%	**2.24%**
May-20	1.55%	2.15%	1.46%	1.99%	2.05%	2.49%	1.69%	2.37%	**1.97%**
Jun-20	1.32%	2.02%	1.13%	1.72%	1.46%	2.09%	1.45%	1.87%	**1.63%**
Jul-20	1.23%	1.76%	1.13%	1.58%	1.22%	1.92%	1.29%	1.61%	**1.47%**
Aug-20	1.18%	0.84%	1.15%	1.51%	1.18%	1.88%	1.26%	1.63%	**1.33%**
Sep-20	1.26%	0.98%	1.28%	1.48%	1.18%	1.93%	1.36%	1.32%	**1.35%**
Oct-20	1.32%	1.11%	1.37%	1.54%	1.27%	2.07%	1.45%	1.25%	**1.42%**
Nov-20	1.33%	1.18%	1.36%	1.55%	1.37%	2.08%	1.52%	1.22%	**1.45%**
Dec-20	1.40%	1.32%	1.47%	1.61%	1.68%	2.29%	1.65%	1.29%	**1.59%**
Jan-21	1.54%	1.42%	1.56%	1.77%	1.93%	2.58%	1.67%	1.36%	**1.73%**
Feb-21	1.41%	1.19%	1.56%	1.82%	1.99%	2.62%	1.57%	1.35%	**1.69%**
Mar-21	1.22%	1.05%	1.36%	1.66%	1.83%	2.29%	1.49%	1.27%	**1.52%**
Apr-21	1.08%	1.02%	1.31%	1.61%	1.71%	2.16%	1.29%	1.18%	**1.42%**
May-21	1.00%	0.94%	1.19%	1.53%	1.55%	1.88%	1.16%	1.13%	**1.30%**
Jun-21	0.98%		1.09%		1.46%			1.10%	
y/y (bps)	-34	-121	-4	-46	0	-61	-53	-77	-67

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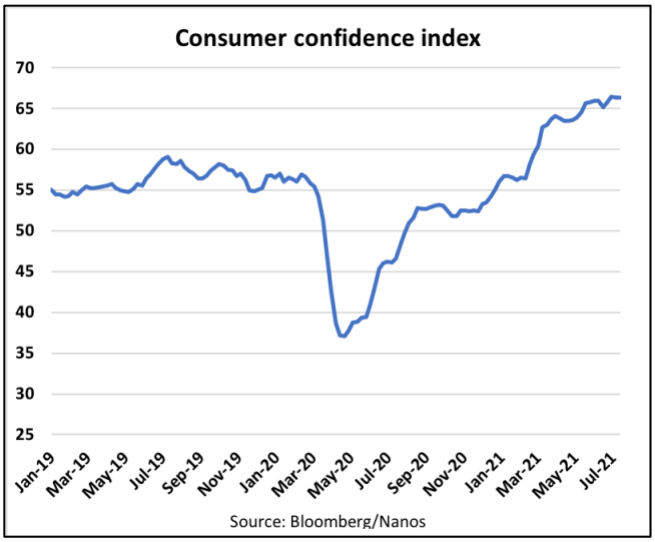
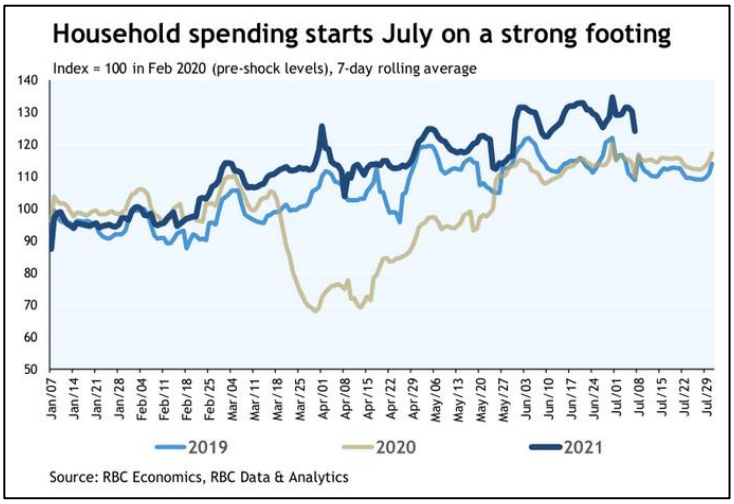
ii) Confidence surges, job growth picks up. Will wages finally follow?

Consumer confidence remains at record highs, and that tells us that Canadians are eager to get out and spend again:



Credit card spending data from RBC Economics suggests that consumer spending is already trending 13% higher than pre-COVID levels so far in July with plenty of room to run higher from here:



With demand for goods and services surging (and with more to come) businesses are hiring again. June saw 235,000 new jobs created across the country, much higher than the 195k expected. And things are only getting better according to job postings on Indeed, which are now 35% above pre-COVID levels as of mid-July:

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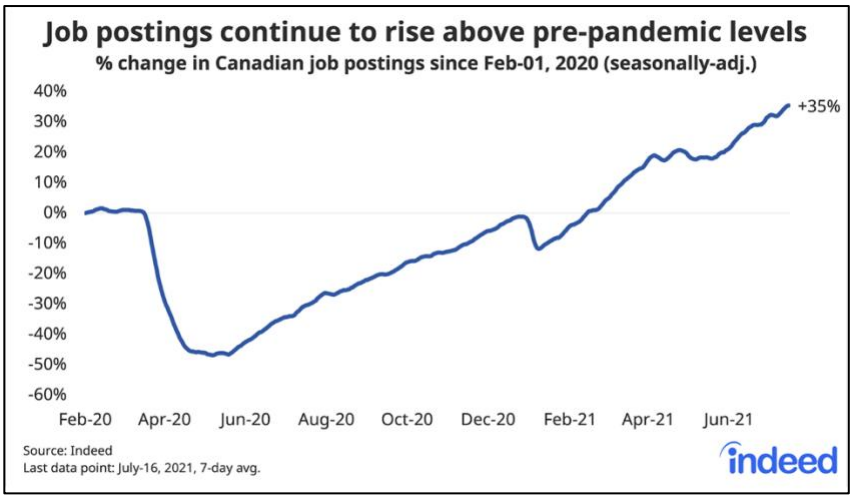
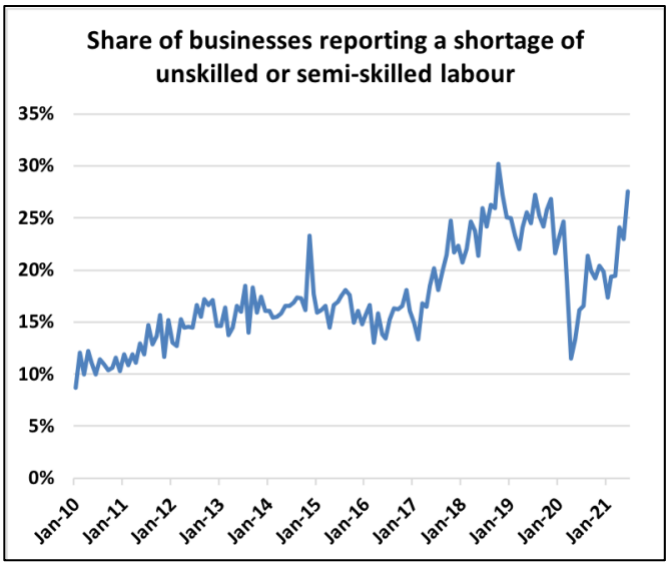


But while businesses are anticipating a major hiring spree, they're also increasingly reporting a shortage of labour according to the Canadian Federation of Independent Businesses (CFIB). In fact the share reporting a shortage of unskilled labour hit the second highest on record in June:



It's easy enough to blame the current income support programs for incentivizing people not to work, but there's more to it than that. CERB/EI will replace a substantial portion of low-skilled wages in sectors like hospitality and retail, but it doesn't go far in offsetting income for higher-skilled workers. And yet businesses reporting a shortage of those workers has also spiked in recent months:

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We also learned that the job vacancy rate hit 4.3% in Q2, the highest since the data started being collected:

So we have a shortage of labour even with a high unemployment rate, rising job vacancies, and an economy that will likely boom over the next year (barring a nasty resurgence of COVID variants).

If you're an employer, the solution is to raise wages and try to pass those costs on to consumers. Indeed we just saw the largest monthly increase in wage plans since the minimum wage increase was announced in 2017. So let's call this the largest "organic" increase in wage expectations in CFIB survey history:

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While this is a positive development, it's important to note that this is an inflationary dynamic that we haven't seen in Canada in several decades.

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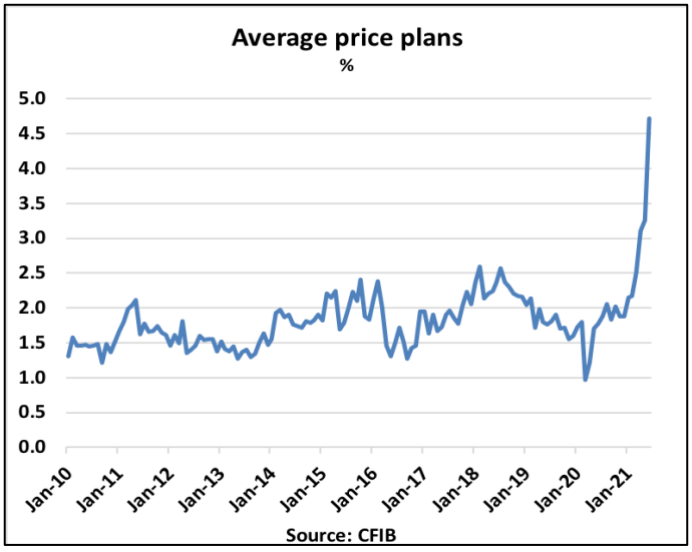
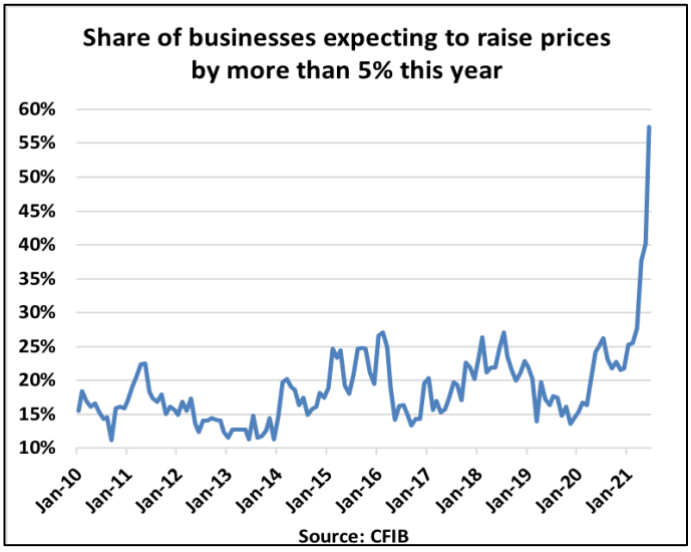
5) Bond market shrugs off inflation scare: No signs of rising interest rates yet

I couldn't possibly have been more wrong about the bond market's reaction to rising inflation indicators. Yields on 5-year Government of Canada bonds have FALLEN 20bps so far this month as bond investors have sided with central banks and clearly view the current inflationary dynamics as transitory. For now that means no upwards pressure on fixed mortgage rates:

It's an interesting dynamic since bond investors are effectively saying that business owners are completely wrong in their own price projections. CFIB data has found that business owners are expecting to raise prices by 4.7% over the next year, with nearly 60% planning to raise prices in excess of 5%. Those are by far the highest readings on record going back over a decade:





Similarly, Bank of Canada data shows that the share of businesses expecting inflation to average +3% over the next 2 years has surged to 35% in the latest Business Outlook Survey. That stood at just 1% a year ago. Equally stunning is that none of the survey respondents see inflation averaging below 1% vs 25% less than a year ago.

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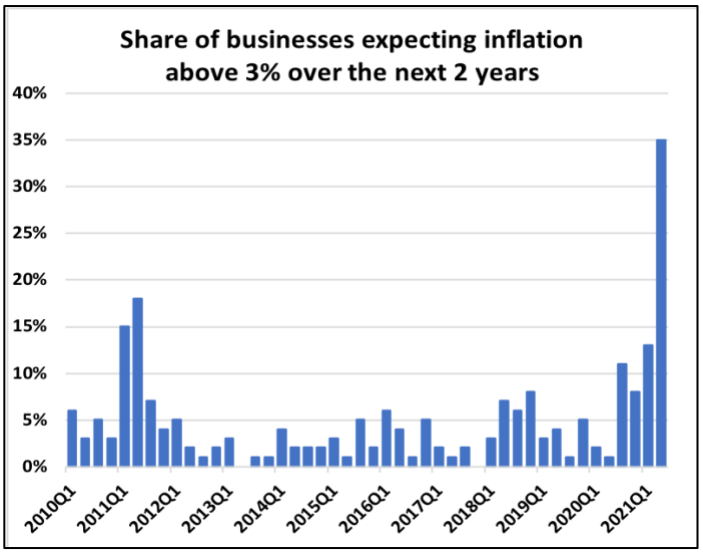
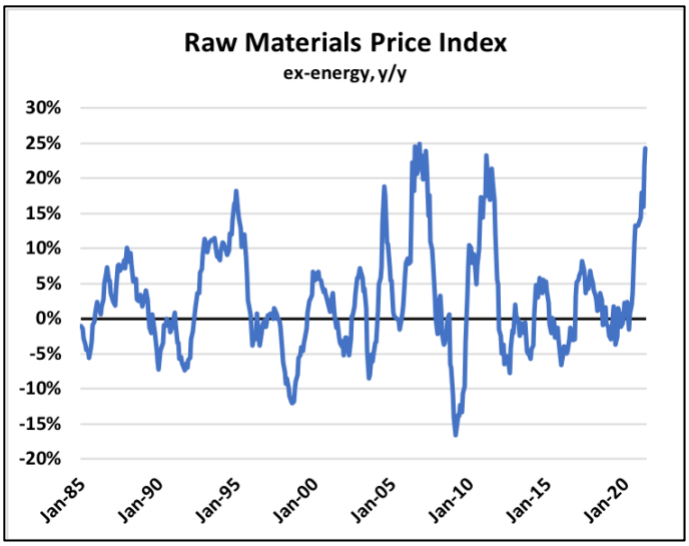
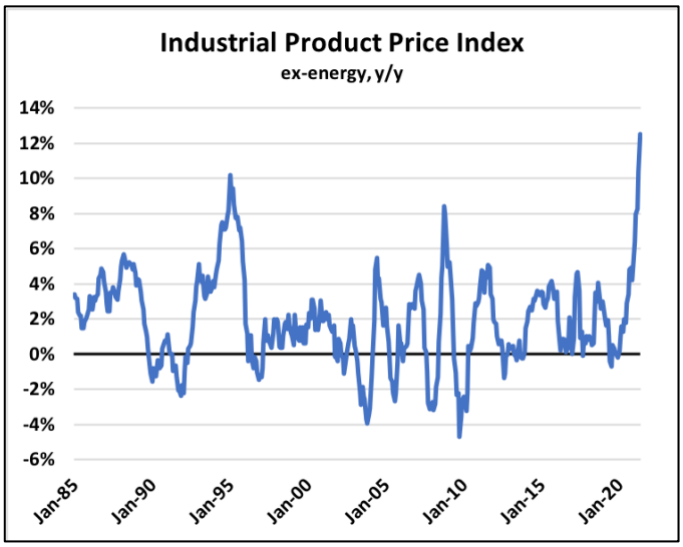


Other inflation indicators continue to flash red. The Raw Materials Price Index jumped 3.2% in May and was up 3.5% ex-energy. It's now up nearly 25% y/y. Meanwhile the Industrial Product Price Index, which measures the price of finished goods as they leave the factory gates, rose another 2.7% m/m and is now up 16.4% y/y overall (the highest since the 1970s) and 12.5% once energy is stripped out:





Businesses either have to eat these rising costs in their margins or pass them on to consumers. They're telling us it'll be the latter, but the bond market isn't buying it.

Some of these low rates are a function of the distorting effect of ongoing asset purchases by the Bank of Canada. As of the latest tally, the BoC held $414B in government bonds. They've now gobbled up 82% of the total increase in government bonds outstanding in the past year and hold 40% of the total stock.

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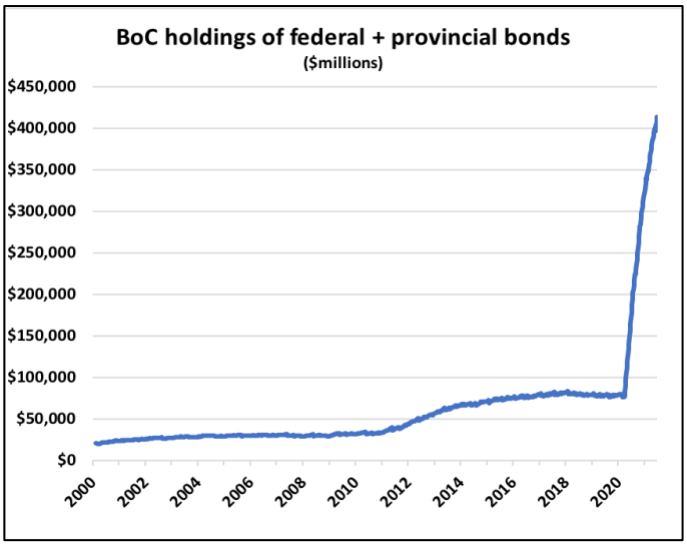

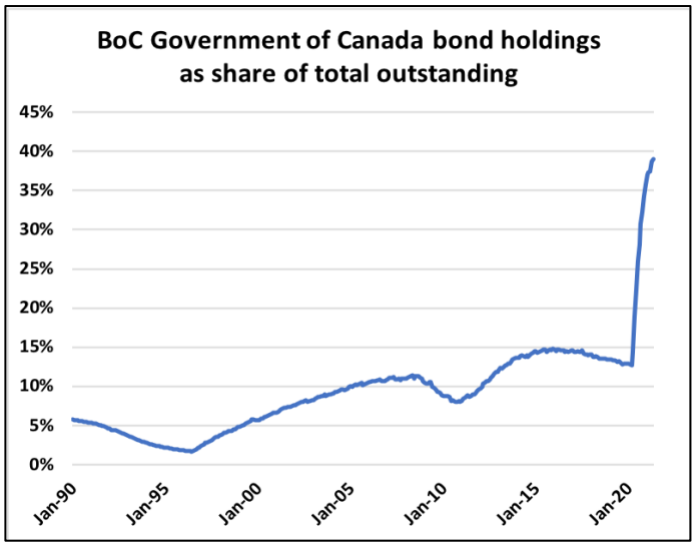

The BoC just announced a taper of these bond purchases to a run rate of $2B a week. That's a big decrease from the current run rate of $4.1B they've averaged over the past 6 weeks. We'll see if that has any effect on bond pricing going forward.

Recent trends aside, a significant increase in bond yields remains a key risk to housing in the near term, particularly as the BoC attempts to extricate themselves from the market without creating distorting effects in the opposite direction.

Regards,
Ben

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