March 2022
Metro level deep-dive- February data

Quick links:

1) Economic commentary: War and recession risk

2) Subtle signs of change in Toronto housing as inventory levels surge

3) Vancouver posts largest ever monthly house price gain even as condo listings surge

4) Calgary home sales keep surging

5) Quebec home sales stall but lack of inventory keeps market tight

Key takeaways:

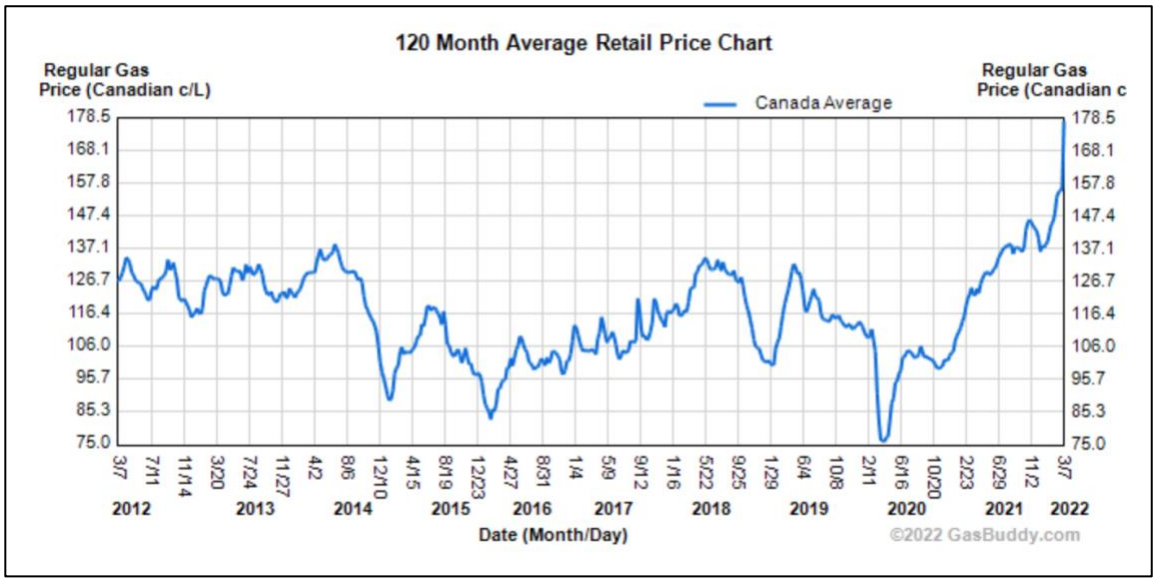
- The war in Ukraine has completely upended my previous assumptions around the state of the Canadian consumer. Recession risks are rising. The silver lining: 6 rate hikes looks even more unlikely this year.
- You wouldn't know it from the headlines, but there's a definite shift in the resale market in Toronto.
- Vancouver just posted the strongest monthly house price increase on record. New listings are ticking up suggesting that we may see a better-supplied market this spring.
- Calgary home sales are booming, and there's no reason to think there will be a material slowdown in the near term.

1) Economic commentary: War and recession risk

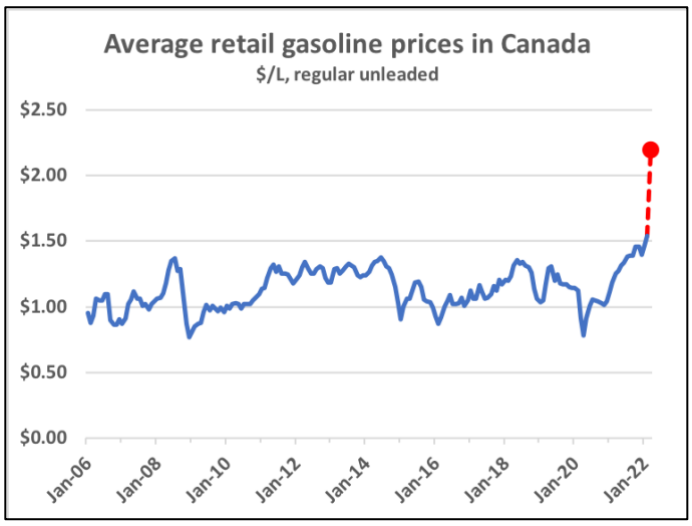
When circumstances and data change, your opinions have to change with it. I've previously laid out a bullish thesis around the Canadian consumer, but clearly the events in Ukraine risk upending what was otherwise a strong tailwind to household spending. Here's what I'm concerned about:

i) Expenditures on food and fuel are set to hit 30-yr highs

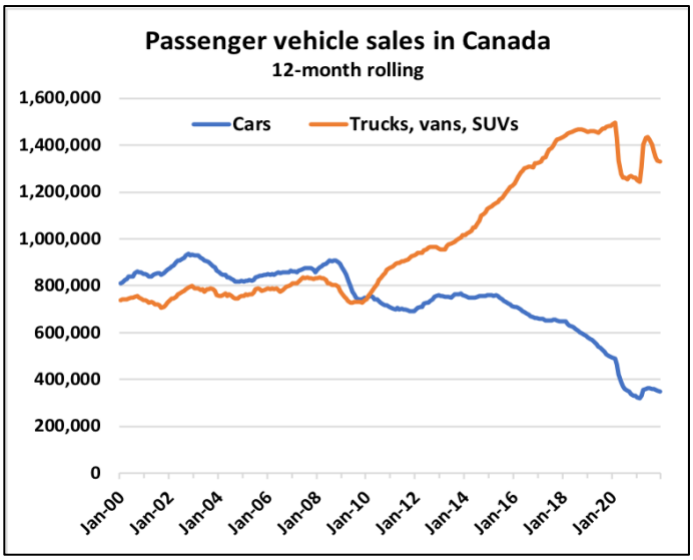
Gasoline prices have hit record highs in Canada in recent weeks at just under $1.80/L nationally. That's right in-line with the inflation-adjusted peak from 2008.



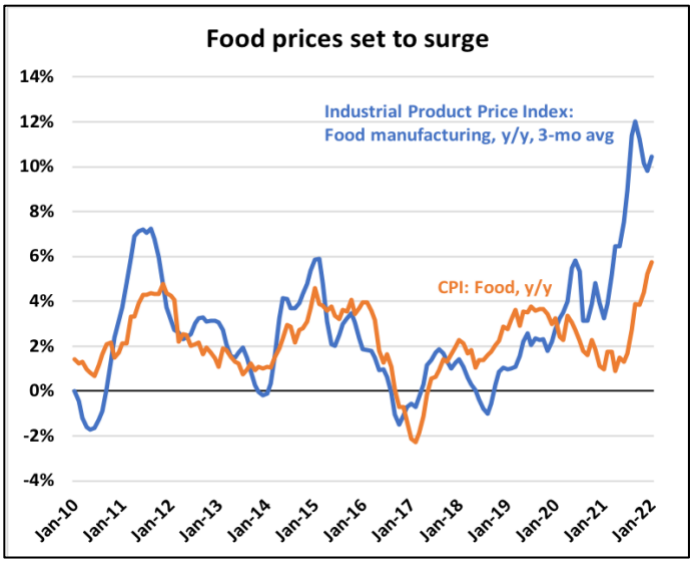
Based on gasoline futures priced in Canadian dollars, it's not outside the realm of possibility that we hit $2.20/L nationally within a few weeks!



Now the typical Canadian vehicle is far more fuel efficient than it was 14 years ago, but Canadians by and large have taken advantage of better fuel efficiency and relatively cheap gas to make a massive pivot into trucks and SUVs since 2010:



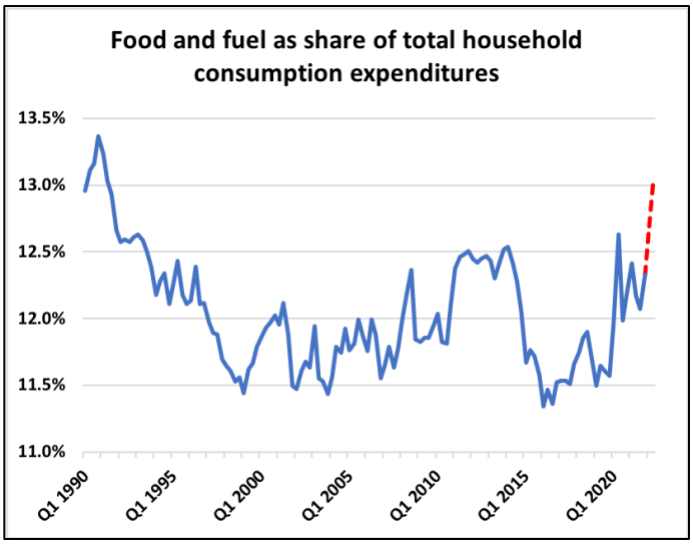
On the food front, even before the runup in agricultural commodities and fertilizer prices, there was reason to believe that food inflation in the CPI was set to hit double digits:



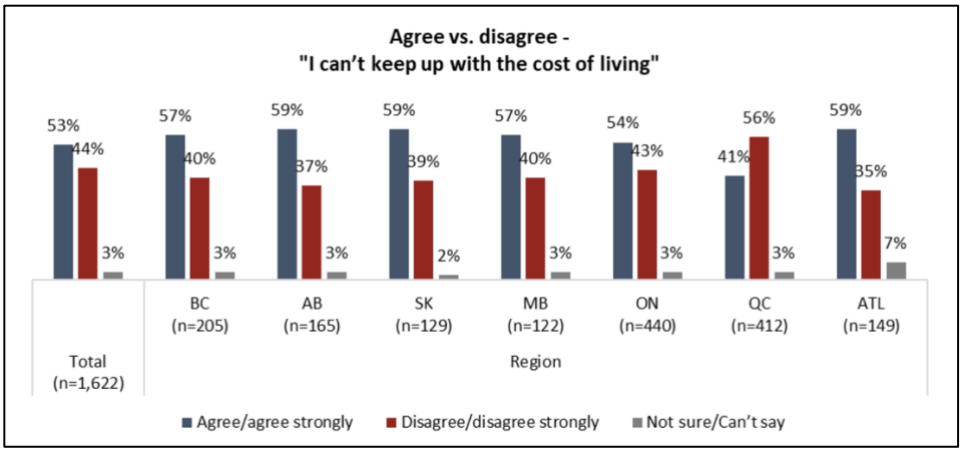
And we may not have even started to feel the effects of the Ukraine conflict yet at the grocery store. Ukraine accounts for 10% of global wheat exports. The planting season is just weeks away. If the conflict doesn't end very quickly, we risk a massive hit to global wheat production. Throw in another almost 20% of global exports from Russia, and we can see why this conflict risks becoming a global food security issue. Already the price of wheat has risen by over 60% in the past month alone.

Now for the fortunate residents of Canada we may pay higher prices, but it shouldn't be a food security issue. That's a very different risk in emerging economies, and any student of history will tell you that food crises often usher in revolution and war. When people get hungry, they get desperate. And when they get desperate, all bets are off. It's worth remembering that the Arab Spring in 2010 kicked off because of the rising cost of bread.

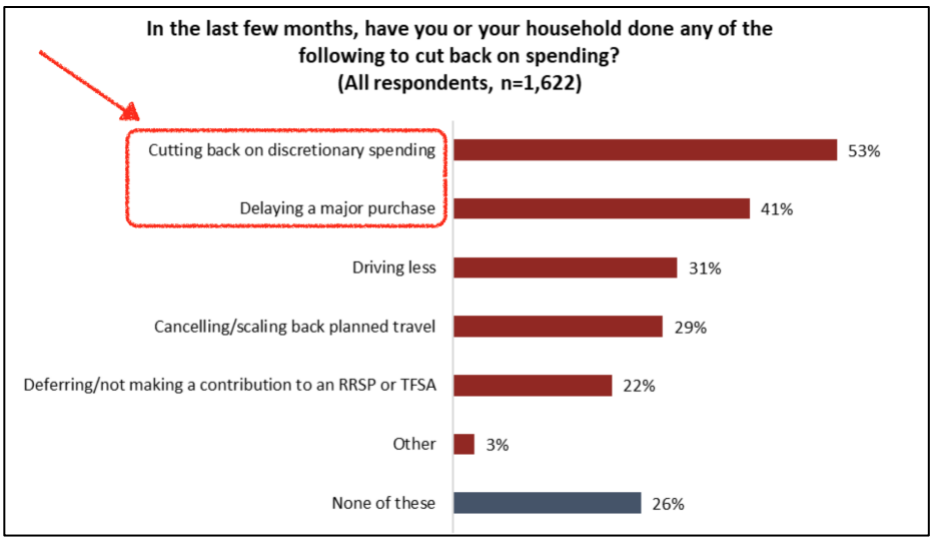
Here's where all of this matters for us here in Canada. The latest household expenditure data for Q4 shows that the share of spending on food and fuel expenditures has risen sharply off levels from 2015-2020. When I model out a mere 10% increase in food and fuel expenditures from current levels over the next 2 quarters and assume a 2% quarterly increase in total consumption spending, by mid-year Canadians will be allocating the highest share of consumption to food and fuel since the early 1990s:



Related, Angus Reid released the results of a survey[1] this week looking at inflation in Canada. More than half of Canadians report being unable to "keep up" with the cost of living:



But what jumps out is that over half of respondents report cutting back on discretionary spending in recent months:

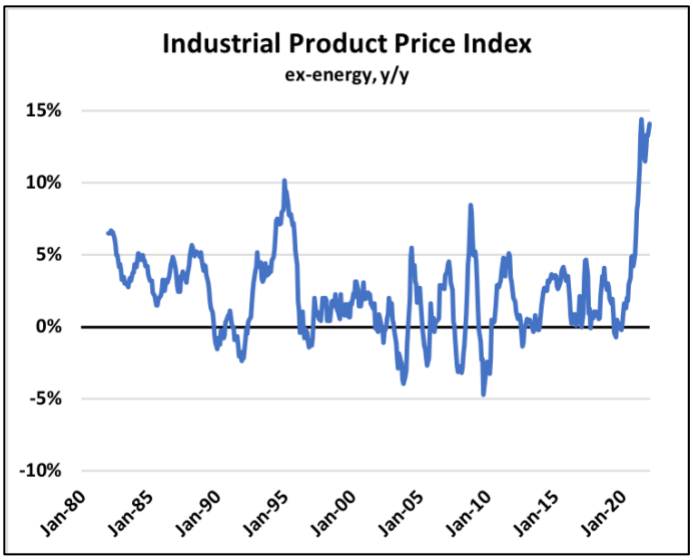


[1] https://angusreid.org/canada-cost-of-living-inflation/

This aligns with the December retail sales report which was particularly weak. In the last note I expressed skepticism that it was entirely an Omicron story for the following reasons:

- Declines were widespread across Canada including in regions where there were no new public health measures.
- Ecommerce sales plunged 10.3% m/m, which is the opposite of what happened during prior waves.
- Declines were most pronounced in highly discretionary segments like furniture and home furnishings (-11.3%), building materials and garden equipment (-5.0%), clothing and accessories (-9.5%), and sporting goods and hobby retailers (-2.5%).

The overall inflation picture is not getting any better either. We learned this week that the Industrial Product Price Index (IPPI), which measures the price of goods leaving factory gates, jumped 3.0% m/m in January and was up 2.4% even once energy was stripped out….the second highest monthly increase since the data started being collected in 1981. The y/y increase in the IPPI remains nearly 15% ex-energy, the highest in at least 40 years:



ii) Disposable incomes decline, real wages negative

The latest current and capital account data for Q4 showed the second consecutive quarterly decline in aggregate household disposable income which fell 1.3% q/q and is now down 1.7% over the past 2 quarters.

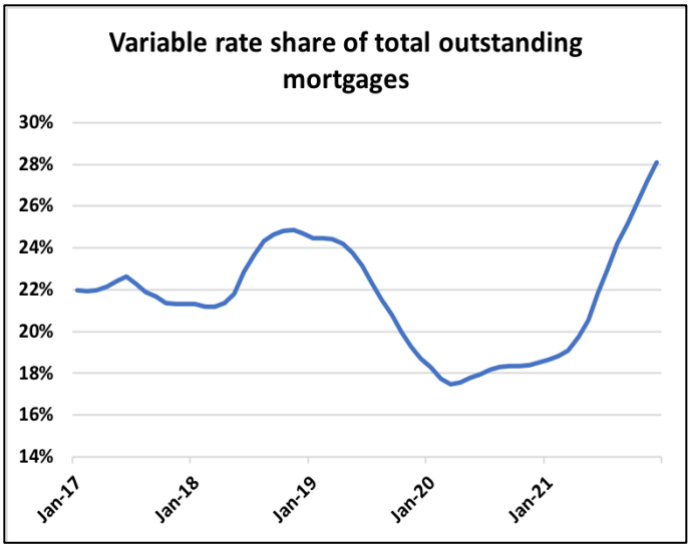
This is more than a little unusual. Outside of mid-2020 when incomes fell after being artificially inflated by massive government transfers during the initial COVID lockdown, this was the largest quarterly decline since 2016 and the first back-to-back decline in income since the financial crisis hit in Q4 2008-Q1 2009.

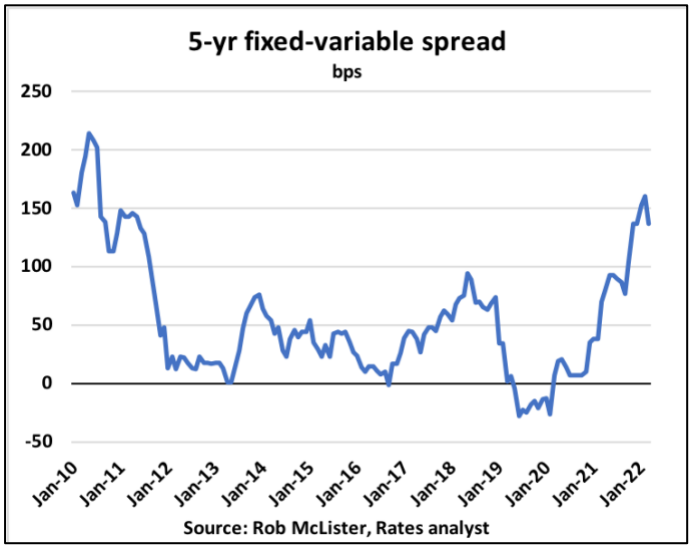
The latest data from the Canadian Federation of Independent Businesses (CFIB) is not particularly encouraging on the real wage front. Wage plans over the next year remain a record 160bps below pricing plans which suggests negative real wages through the remainder of the year:

iii) Household effective interest rates rise, up 50bps over last year

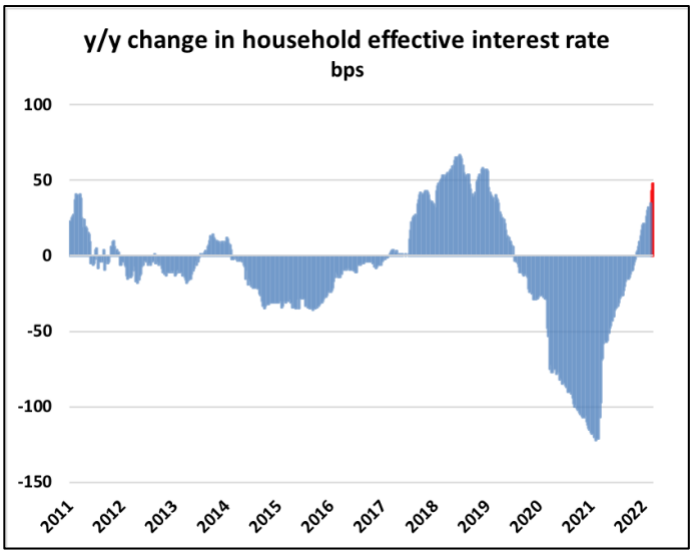
The Bank of Canada bumped the overnight rate to 0.50% last week, a 25bp increase. Variable rate loans are already being repriced as banks raise the prime lending rate to 2.7%.

As a reminder, variable products account for 28% of all mortgages in Canada and that will likely continue to increase. Even accounting for a 25bp increase in variable rates, the spread between fixed and variable remains near the highest in 10 years:





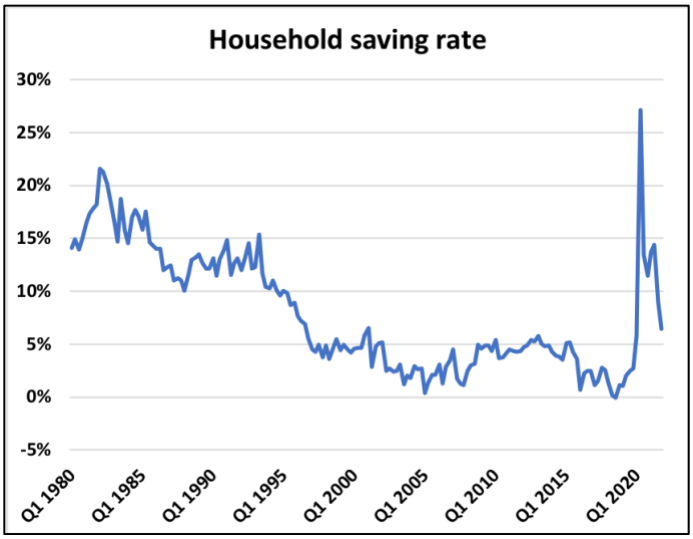
This matters since it affect the speed at which BoC rate hikes flow through to household income statements. Based on trends in the last rate cycle in 2017-2018, we should expect the household effective interest rate (ie the blended rate across all credit products) to rise by 15 bps over the next 3 weeks. This would push the effective rate to just under 3%, a nearly 50bp increase from where it was one year ago. Already this is close to the steepest 1-yr increase over the past decade with the Bank signaling several more hikes to come before the end of the year:

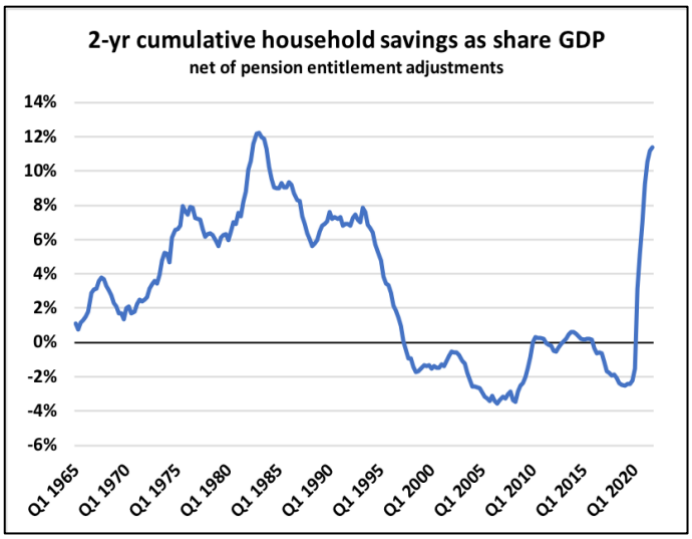


iv) Savings still high but falling quickly

All of the above points to a slowdown in discretionary spending as we move through this year, but households have amassed considerable savings that should help buffer rising costs for at least a little while.

The headline household savings rate slipped to 6.4% in Q4, but once pension entitlement adjustments are stripped out it fell to just 3.3%. Still, that leaves cumulative 2-year savings at over $280B, which represents over 11% of GDP…the largest since 1980:





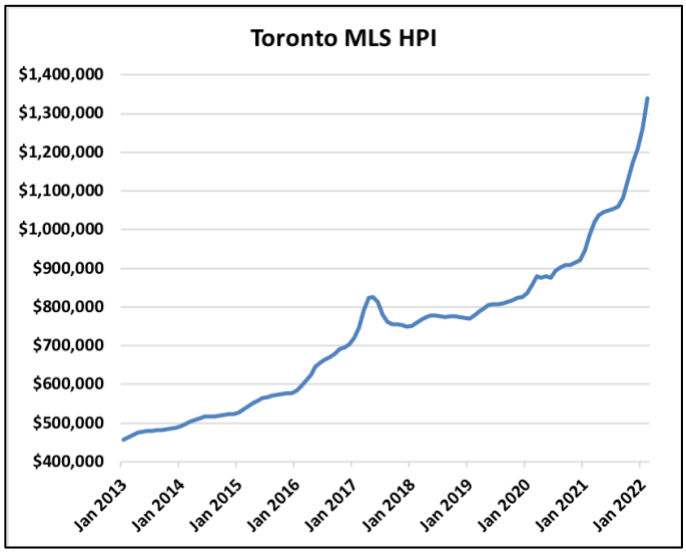
The bottom line is that households are under pressure which could matter a lot to an economy like ours which has relied on housing and consumer spending to drive 85% of GDP growth over the past 5 years.

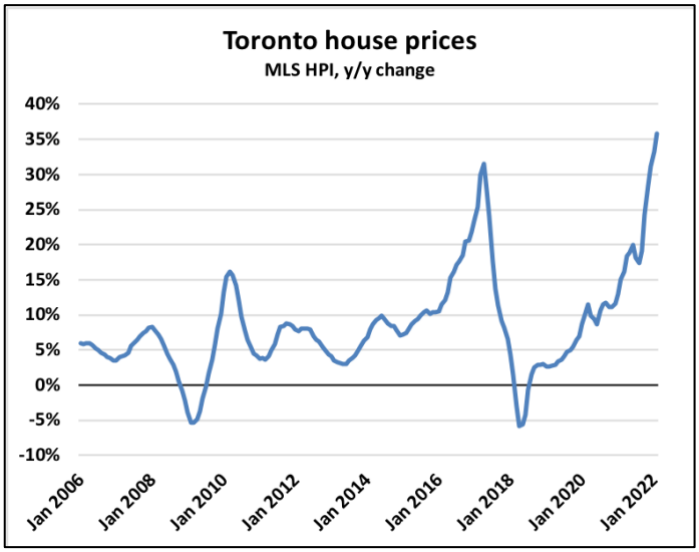
If there's a silver lining in all of this it's that the consensus call for 6 rate hikes in 2022 is looking more and more like a pipe dream.

2) Subtle signs of change in Toronto housing as inventory levels surge

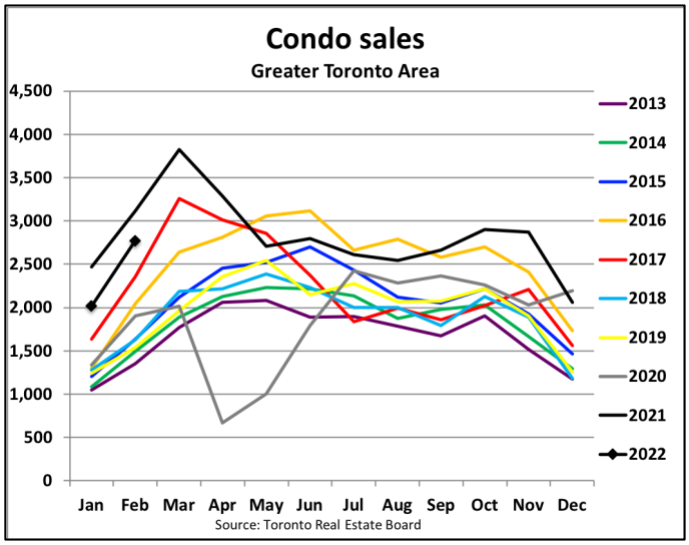
You wouldn't know it from the headline numbers, but there are signs under the surface that the market in Toronto is beginning to shift.

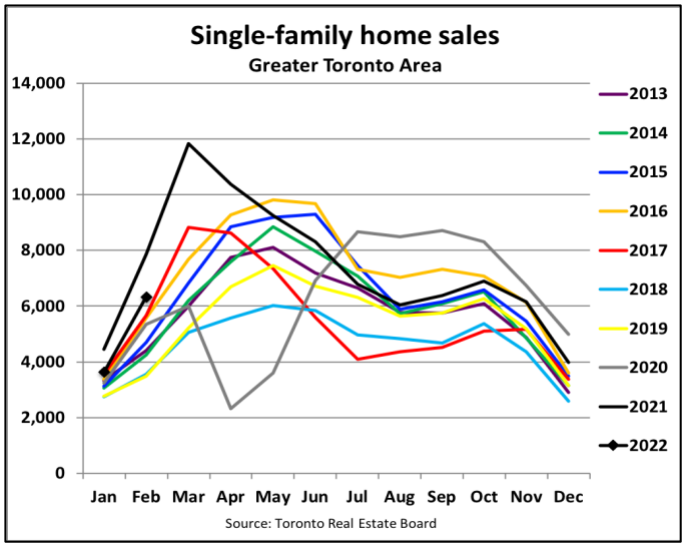
There's no question this market is outright bubbly right now. The MLS HPI just posted the largest monthly increase on record at 6.5% m/m, and it's averaged an absurd 4% monthly gain over the past 6. That's helped push the y/y increase to a record 35.8%, which represents an increase in value of $354,000 for the typical home.



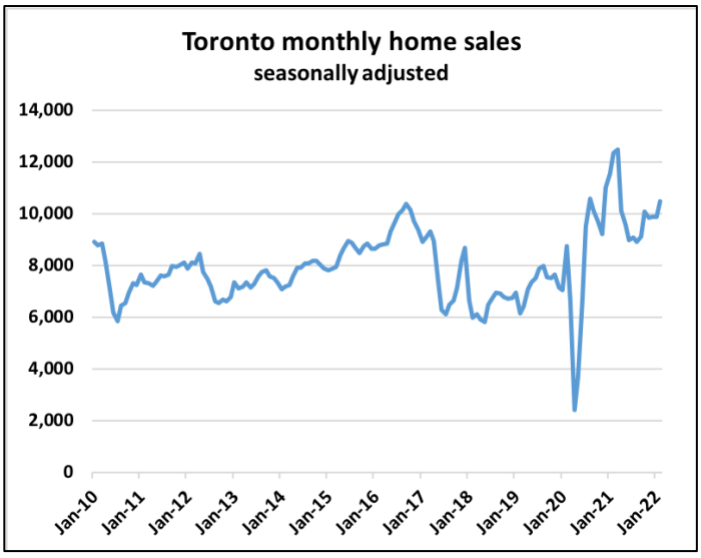


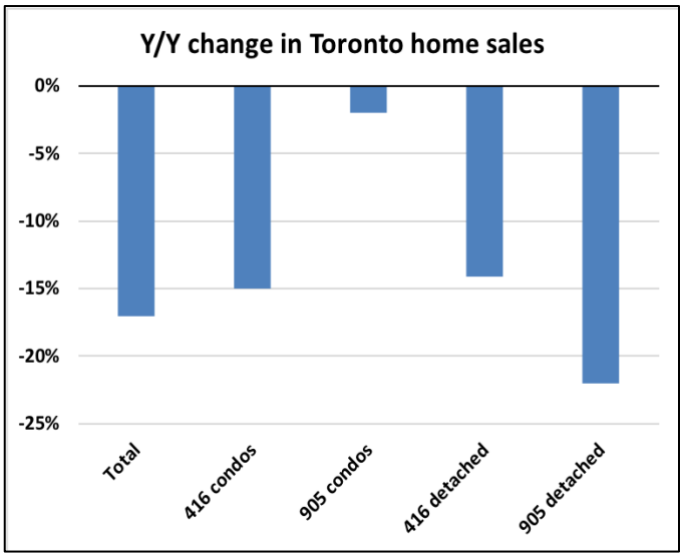
Sales are well off the pace from last year, down nearly 17% y/y, but that's more a function of how absurdly strong they were in 2021. Demand is still very strong for both condo and single-family:



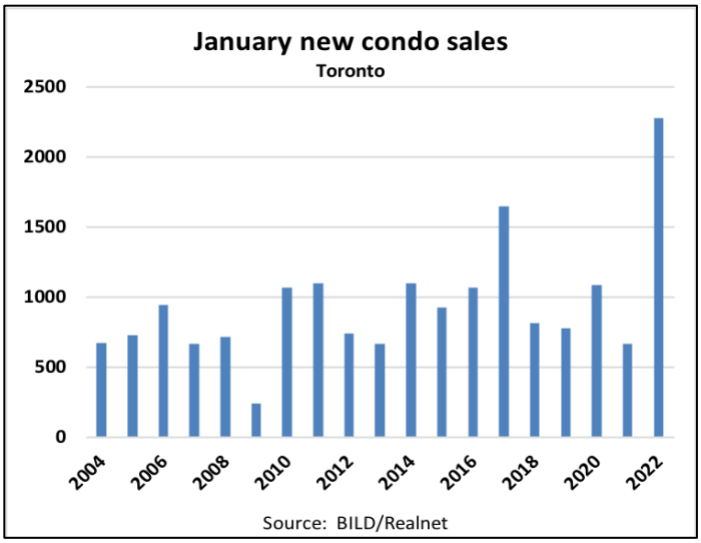


Seasonally adjusted sales rose by 5.9% on the month and remain nearly 30% above pre-pandemic levels.





In no small part is the demand being driven by investment activity. Preconstruction condo sales are always a good barometer of speculative demand since as much as 80% of these sales go to investors and not end users. It's telling that January sales set a record by a wide margin, significantly eclipsing the prior record from 2017. From BILD:



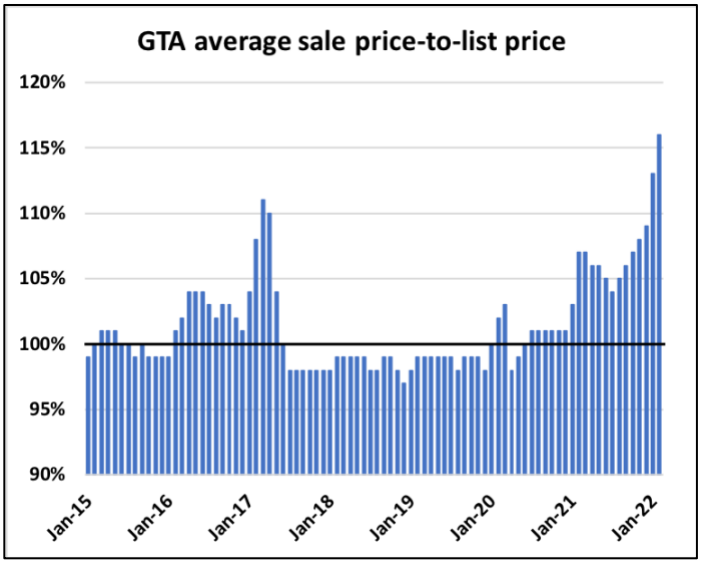
The anecdotes of widespread investor participation are everywhere. Consider this from the Globe and Mail last week:

> **Real estate investing frenzy rips through Canadian housing market**[2]
>
> […] Businesses that support real estate investing are seeing a surge in demand. Since the pandemic started, Keyspire has seen enrolment double for its real estate investing courses. The company is currently drawing 3,000 to 5,000 new registrants from across North America every week compared with about half that volume prepandemic.
>
> Real estate investing clubs are taking off. Realtors with investing businesses are being inundated with requests.
>
> […] Jacqueline Francis, 41, and her partner Leo, 40, started seriously getting into real estate investing in 2020. They did it to give their three children a better life..

[2] https://www.theglobeandmail.com/business/article-real-estate-investing-is-off-the-charts-ramping-up-demand/

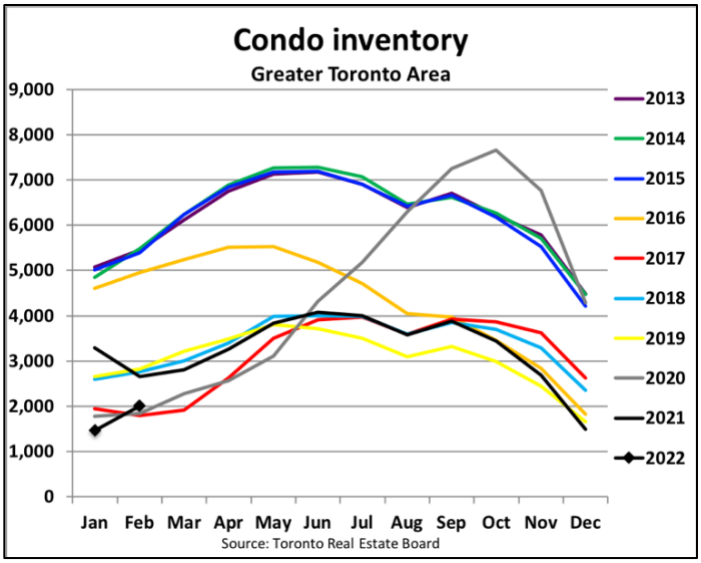
> […] Before they started investing, Mr. Francis worked full time as a dump truck driver, hauling material out of construction sites.
>
> […] The couple, who live in a house in Durham, Ont., own a condo in Toronto, two multi-residential buildings in Niagara – a 16-unit building and a six-plex – and have made deposits on two preconstruction units. They are also expected to close on a 12-plex in London. They used their home equity line of credit to buy the first multi-residential property in 2020 and raised cash from friends and family to buy the smaller one in 2021.

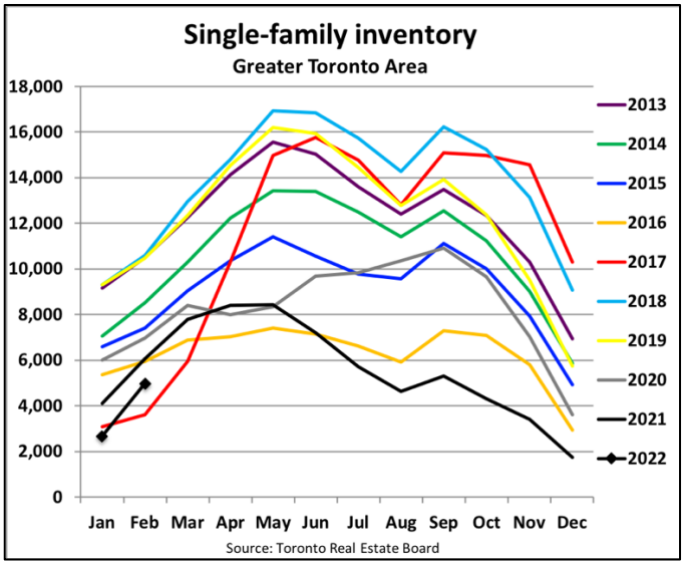
Bidding wars are still common, with the average home selling for a record 115% of list price last month.



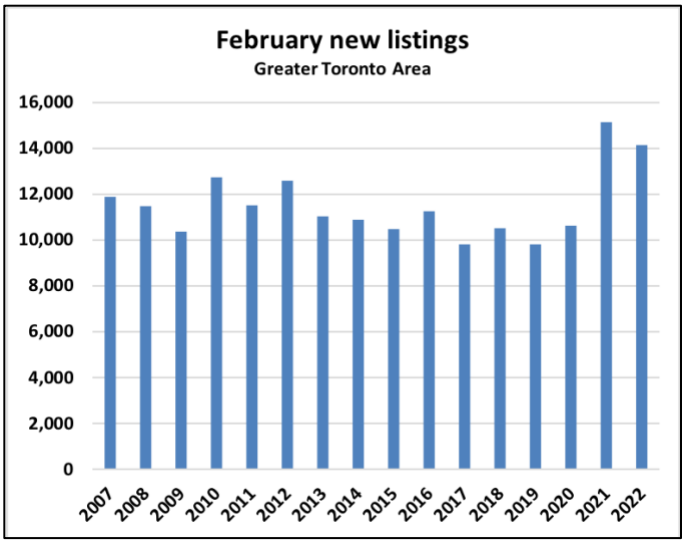
While it's not yet showing up in the data, realtor contacts are widely reporting a significant decline in the number of bidders on properties as well as an increase in the number of failed bidding wars.

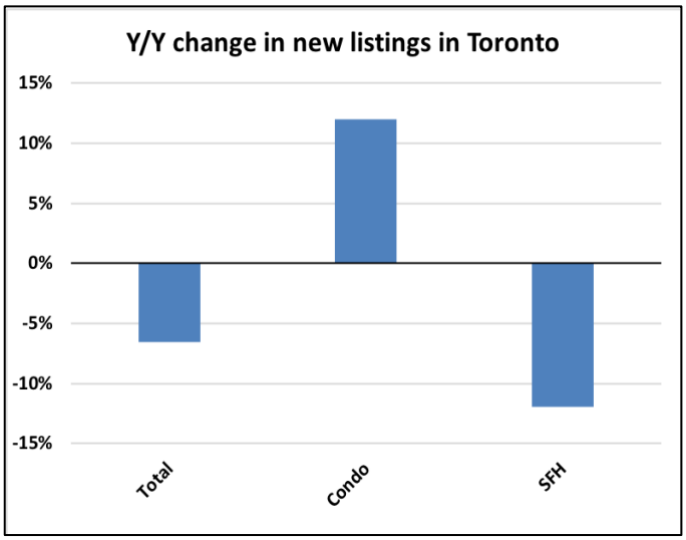
Inventory levels are still low, but here's where the story gets interesting…



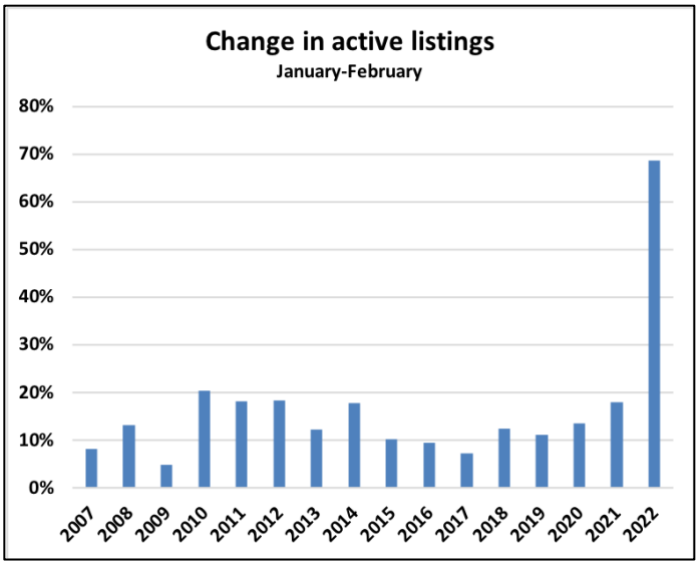


New listings were quite high in February…down from record levels in 2021, but more than 20% above decade norms. They were particularly high in the condo segment:





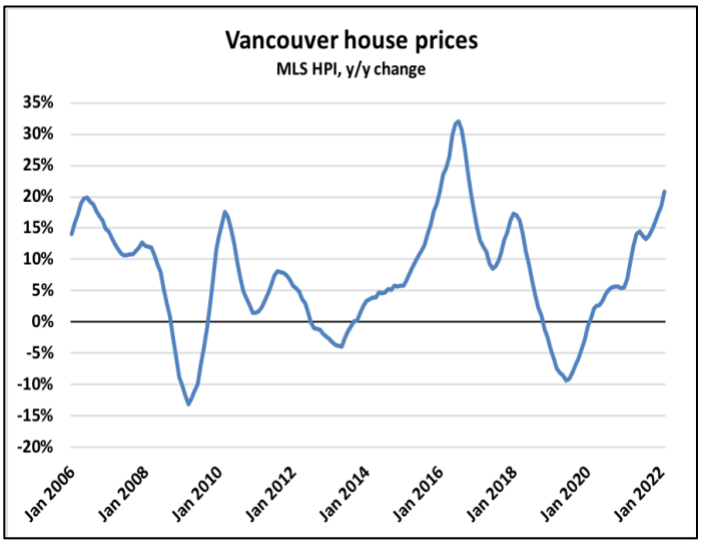
The sales/new listings ratio fell sharply compared to the prior 2 years, and that allowed for an unusually large build in inventory. How large? Active listings at the end of the February were 2,800 higher than at the end of January. That's nearly double the typical monthly build for this time of year. And when we express that change in percentage terms, the chart speaks for itself:

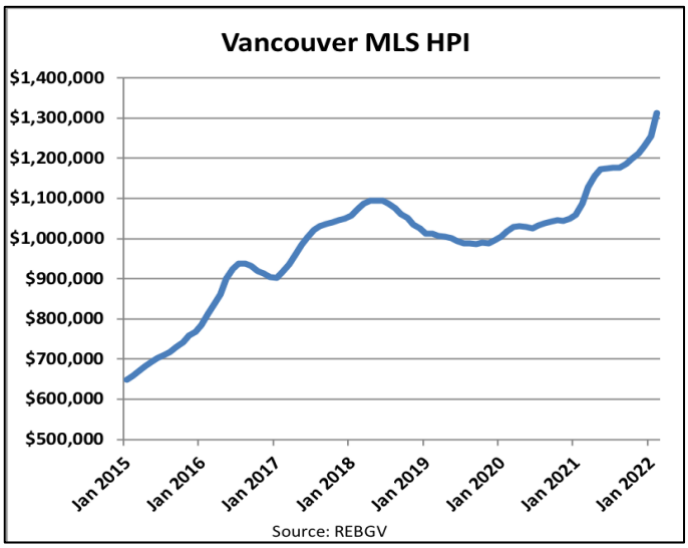


Demand remains artificially inflated (home sales per 100,000 Canadians remains at record highs) and supply has been constrained via new listings kept artificially low. Both of those dynamics look set to reverse.

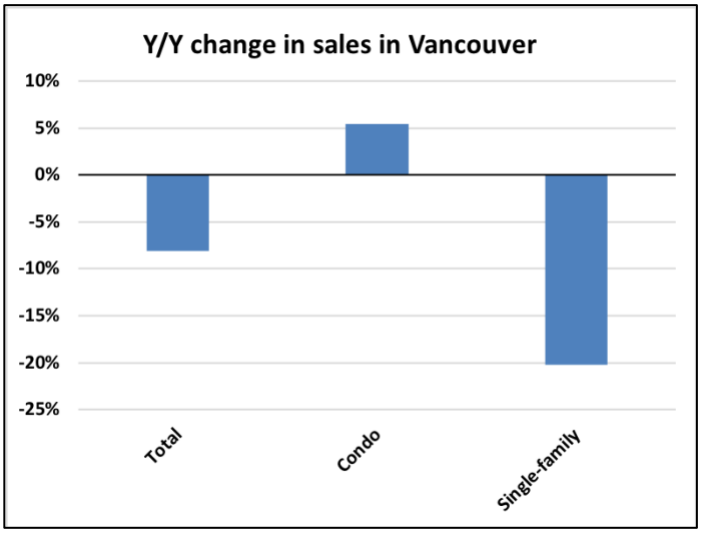
3) Vancouver posts largest ever monthly house price gain even as condo listings surge

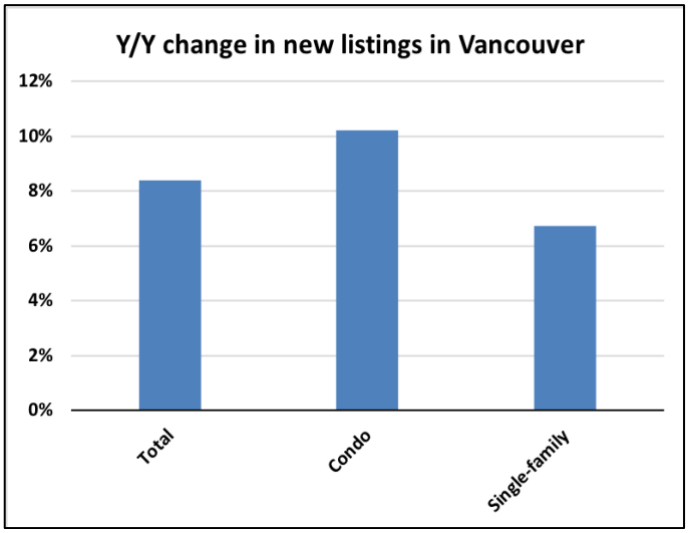
Vancouver house prices also posted the largest monthly increase on record, jumping 4.6% m/m and up over 20% y/y:



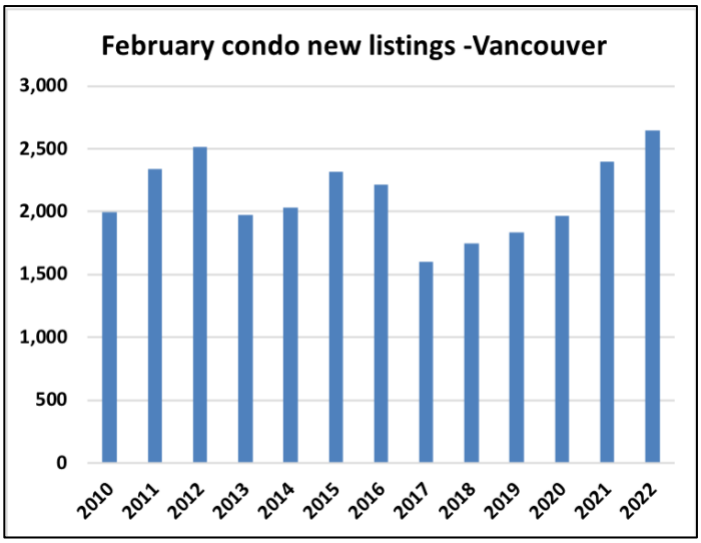


Sales were down 8.1% y/y and new listings were up 8.4%, so here too the sales/new list ratio deteriorated relative to prior years.

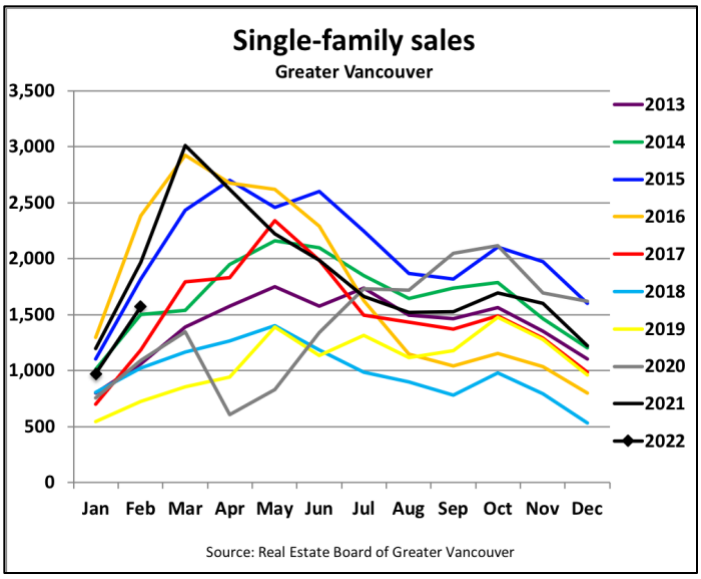


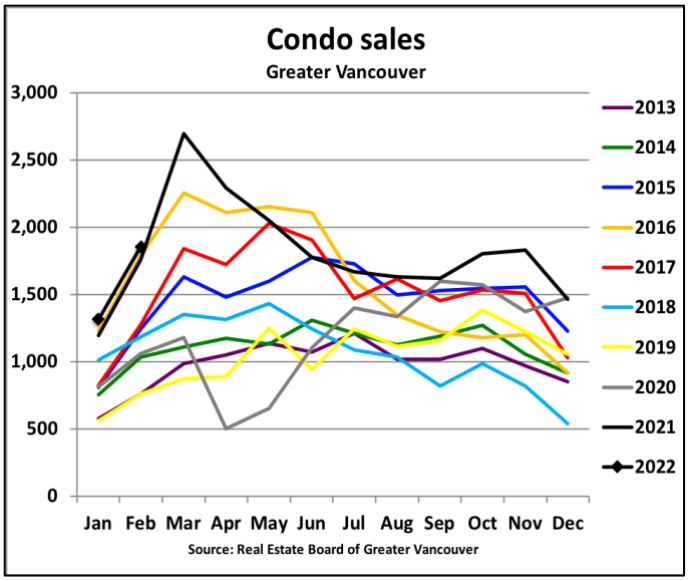


New listings in the condo segment set new record highs for the month:

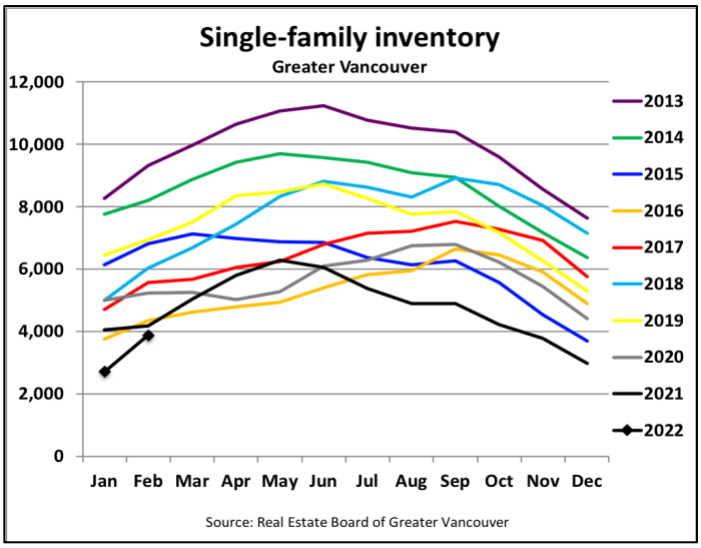


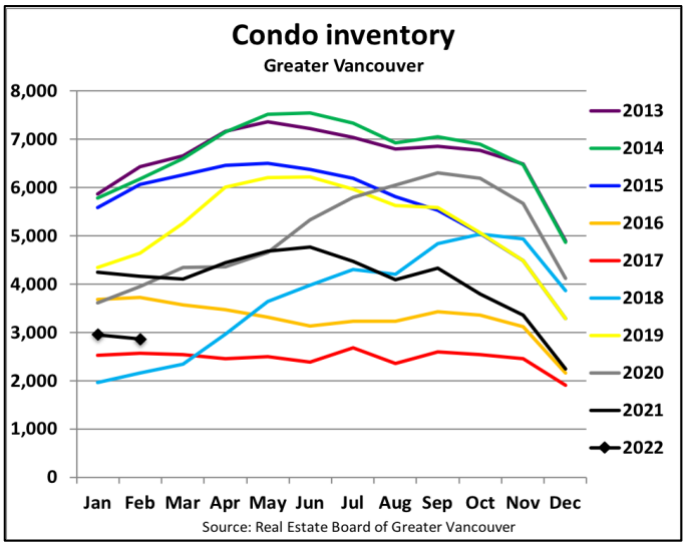
Still, sales are very strong historically, particularly in the condo segment….which is good considering there are currently 32,000 condo units under construction across the metro:





Inventory remains very low for now but we did see an unusually large monthly build in the single-family segment.

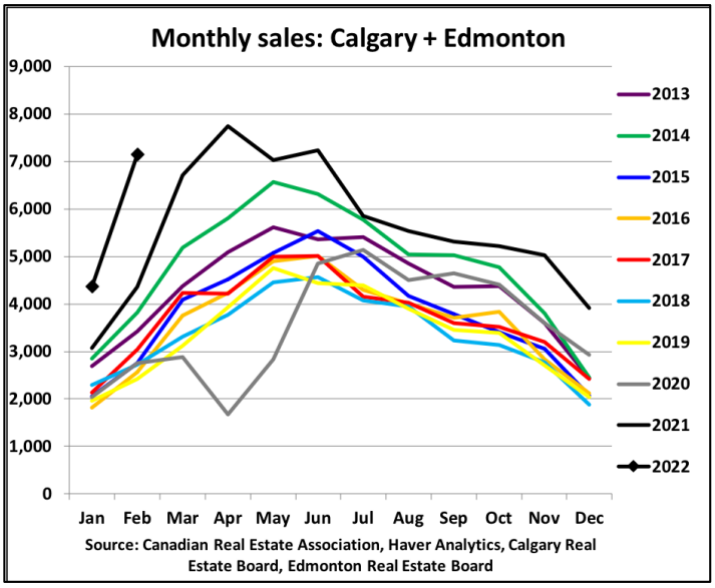




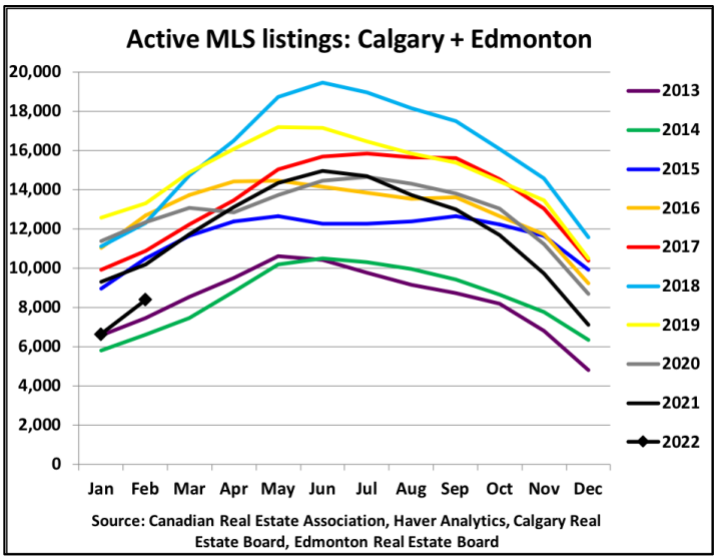
4) Calgary home sales keep surging

As wild as things are in Toronto and Vancouver, the most interesting market in the country in my opinion is still Calgary.

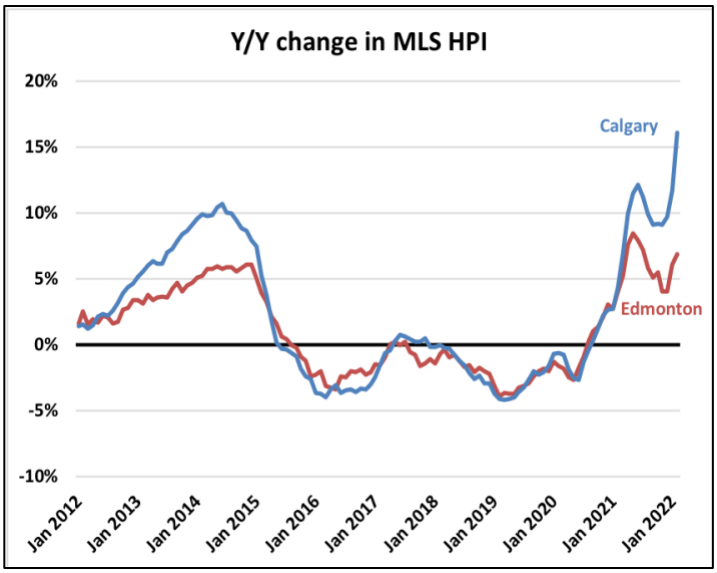
Home sales in Toronto were off by 17% y/y and in Vancouver they were down 8% but in Calgary they were up 81% y/y and were up 42% in Edmonton. Just look at this chart!



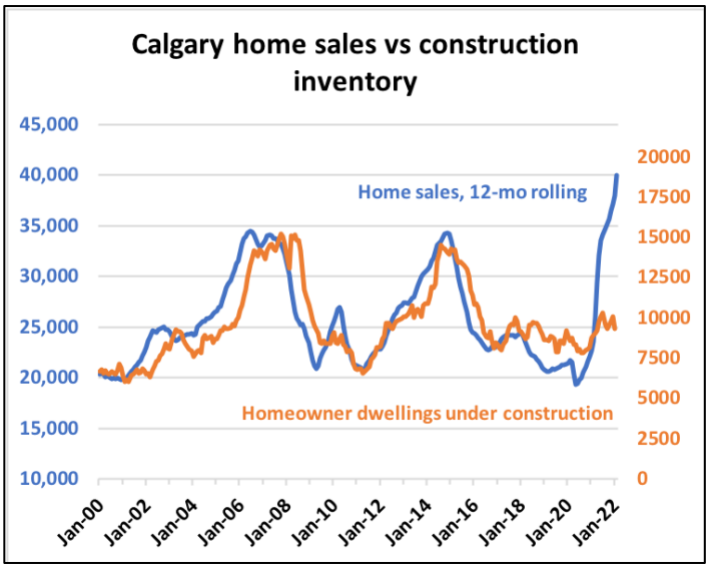
Now we did see new listings surge in Calgary by a massive 63% y/y last month, which is further indication that this spring might see a deluge of listings across the country. But inventory overall remains very low:



House prices are starting to pick up momentum, with Calgary's HPI posting a 16% y/y gain…the largest since 2007:

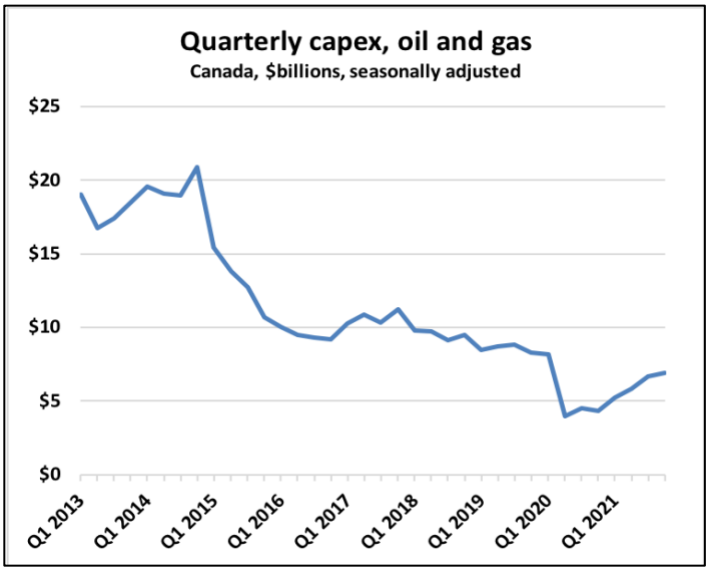


Where things get really interesting is when we look at what's happening with new construction. Home sales are at record levels by a wide margin, but under construction inventory in Calgary is nowhere near levels seen in prior booms in 2004-07 and 2015. **This is perhaps the most bullish chart you'll see today and is one of the main reasons I think this market has room to run:**



Now this is not investment advice in any way, but I will point out an interesting publicly traded equity name that readers may want to look into if they wish to take advantage of what appears to be an inevitable and major upswing in construction activity. There's a tiny Calgary developer named Genesis Land Development (GDC.TO), whose market cap today is significantly less than the net value of its land holdings, is very close to a net cash position, and is trading at less than half of the levels seen in the last Calgary boom in 2007. It's interesting given current market dynamics, but it is tiny. **THIS IS NOT A RECOMMENDATION. Do your own due diligence**.

More broadly, I think there are a lot of opportunities in Alberta given what I think is a long runway for economic growth relative to other parts of the country. The February Edge Report detailed a number of reasons why I think Alberta has a lot going for it. One more to add to the mix: Capital expenditures in the oil sector are no longer declining and will likely rise significantly from here. This matters a lot. Remember that GDP is a rate of change measure. That means that when something like oil investment simply stops falling and flips to a positive contribution to GDP, it can really move the needle on economic growth.

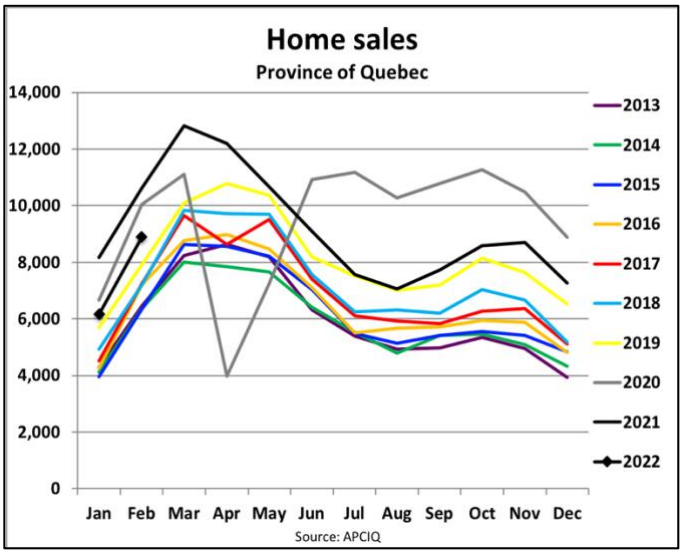


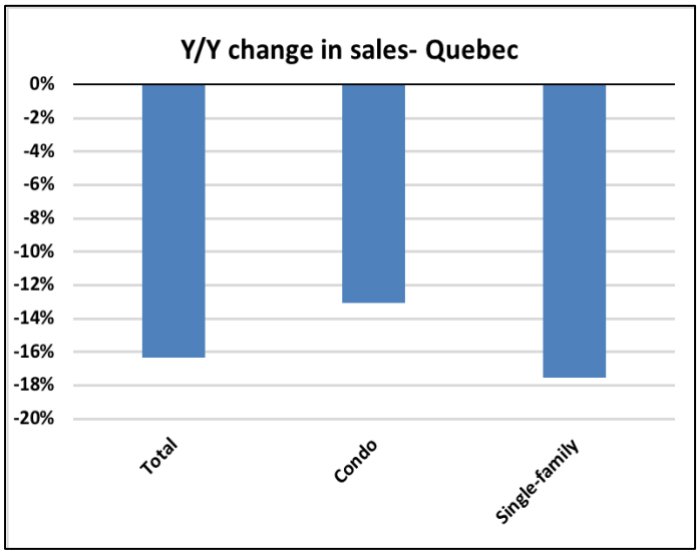
The fundamentals are looking good in Alberta. For most of the past 20 years, house prices in Calgary traded at a premium to the national average. They now trade at a 40% discount. I think that trend will reverse sharply in coming years.

5) Quebec home sales stall but lack of inventory keeps market tight

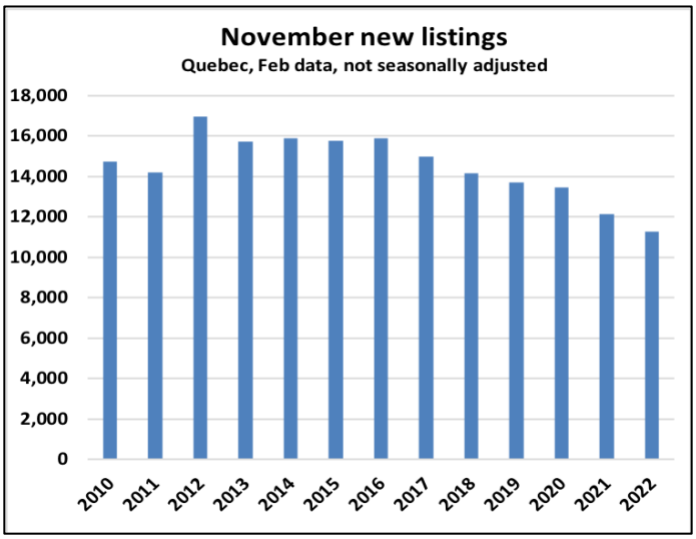
Yes, home sales in Quebec continue to come in lighter than 2021 and even 2020, but the market here remains stubbornly undersupplied.

Sales were down 16.3% y/y in February, including a steep decline in the single-family segment:

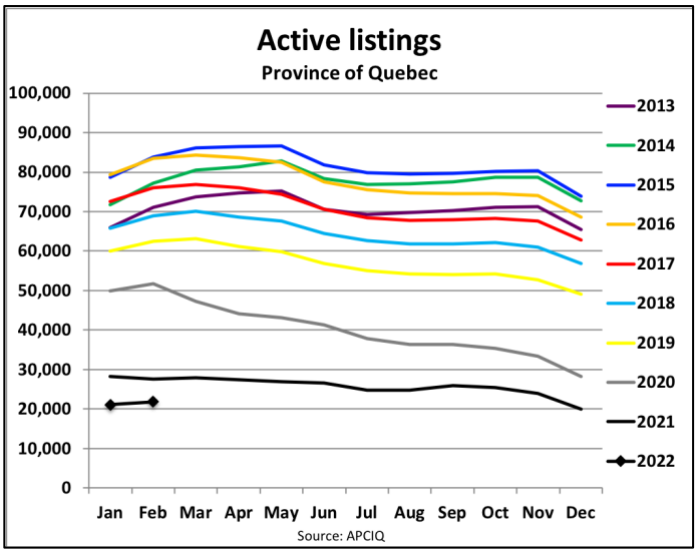


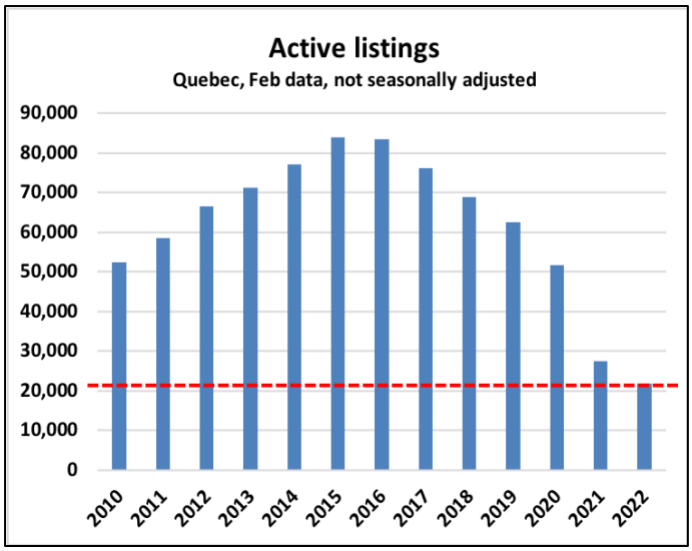


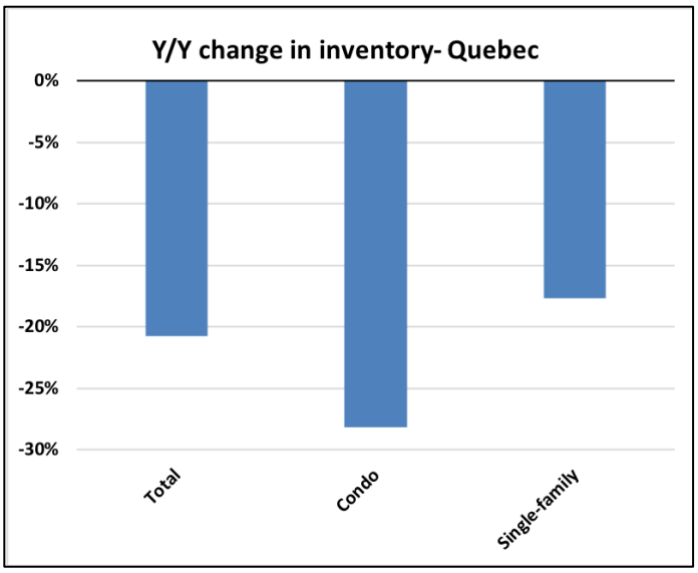
But new listings continue to be weak, down another 7.1% y/y to hit fresh decade lows for the month:



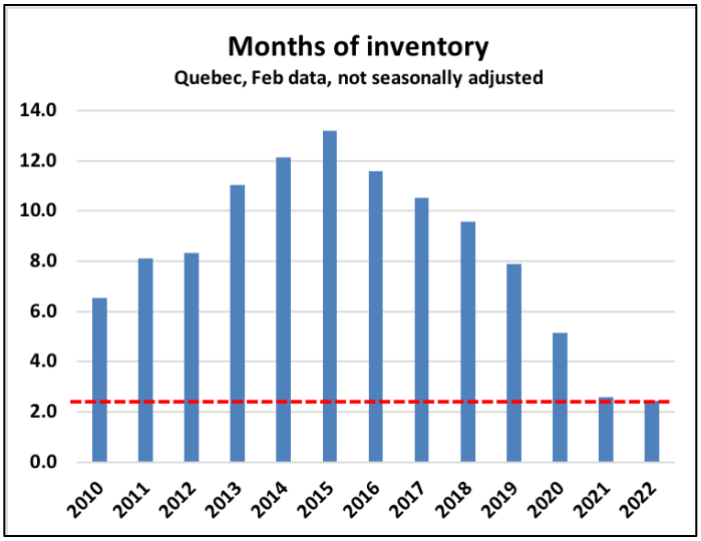
Active listings remain exceptionally low, down over 70% from 2015 levels:

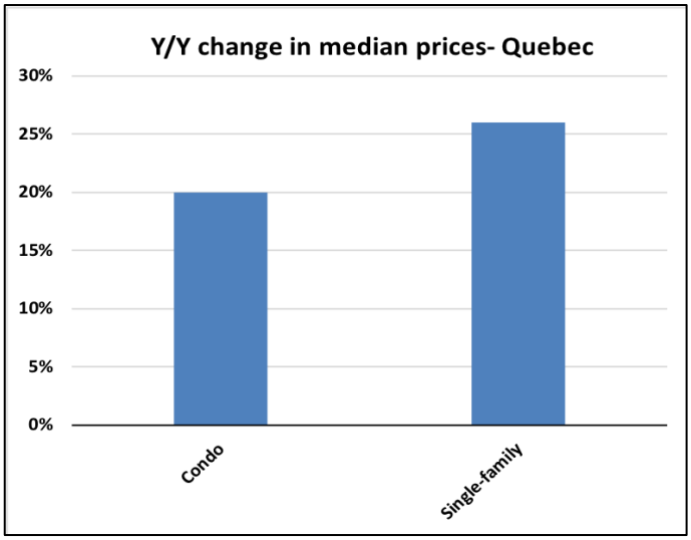






The chronic shortage of supply has pushed months of inventory to barely 2 in February, a record low and a country mile from the high of 13 back in 2015. Prices keep squeezing higher, with the cost of the median single-family home surging 26% y/y:


Months of inventory
Quebec, Feb data, not seasonally adjusted
14.0
12.0
10.0
8.0
6.0
4.0
2.0
0.0
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022


Y/Y change in median prices- Quebec
30%
25%
20%
15%
10%
5%
0%
Condo
Single-family