The Edge Report

May 2022

Hyperlinks:

1) **Inflation stunner means more tightening ahead from Bank of Canada**

2) **Interest rates are taking a huge bite out of affordability**

3) **Home sales tumble, prices slip in April**

4) **Housing starts jump, immigration hits new record, rental market tightens**

5) **Mortgage growth remains high in March, variable rates still popular**

6) **Consumer check: Insolvencies and delinquencies still low, but probably not for long**

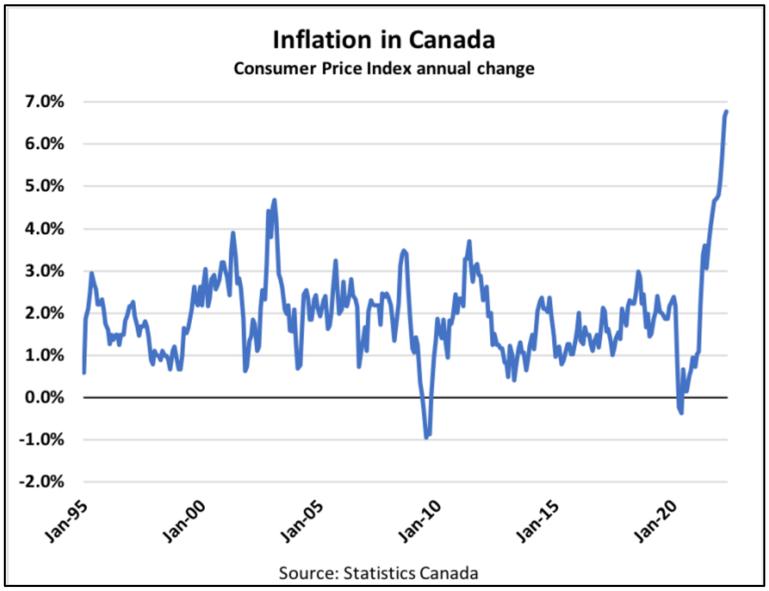
7) **OSFI keeps busy fighting the last battle**

1) Another inflation stunner means more pressure on the BoC

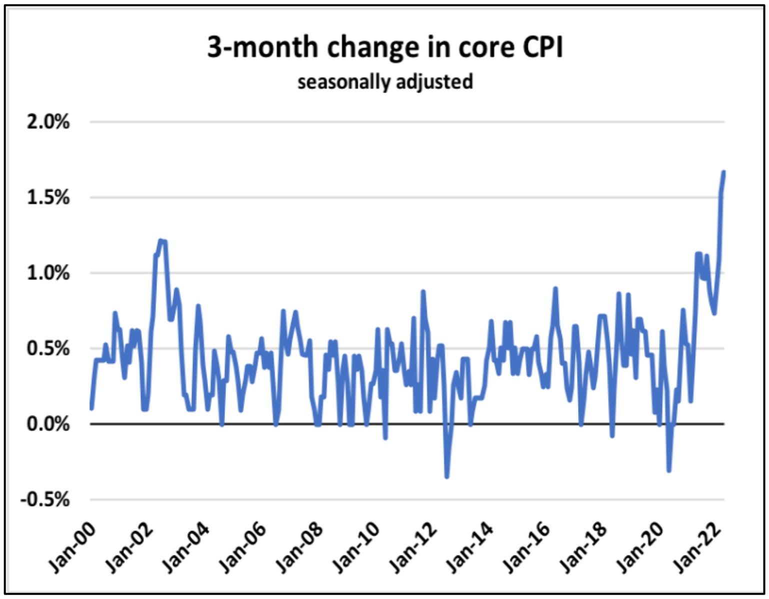
Another month, another surprisingly strong inflation print:

Hey details:

- Headline CPI came in at a fresh 30-year high of 6.8%

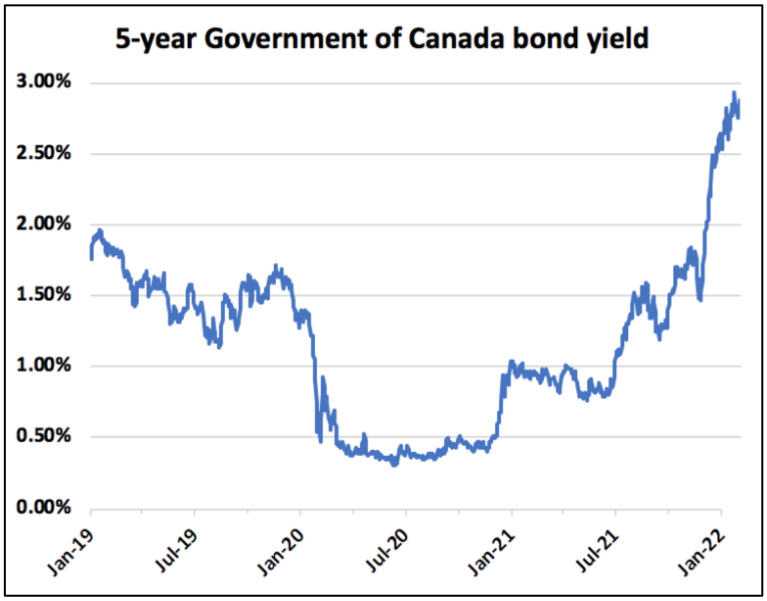


- There are still few signs that inflation is slowing meaningfully. Seasonally adjusted core inflation has jumped 1.7% in 3 months alone!



- Wage growth in April was just 3.3% y/y which puts them negative in real terms by 3.5%. I keep expecting strong wage growth this year based on the tightness in the labour market and just isn't happening. At some point this is going to really hurt consumer spending.

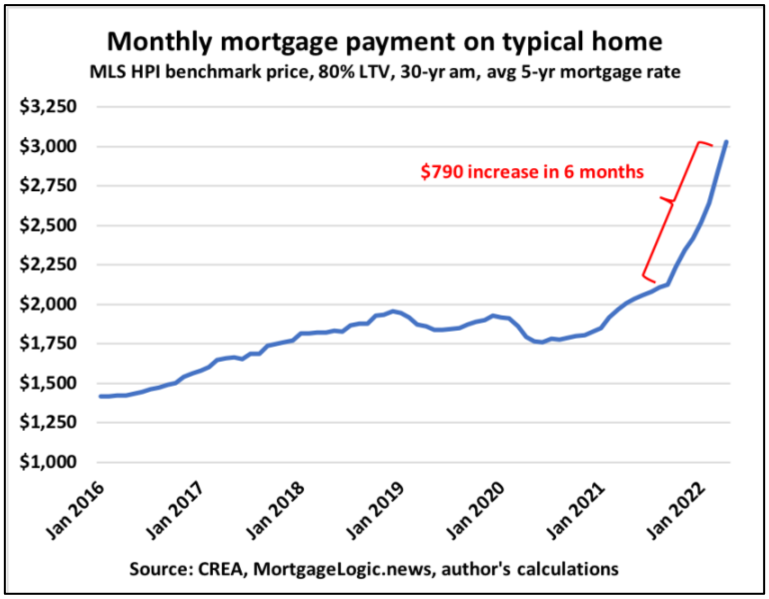
- Markets didn't have a strong reaction to the CPI print. 5-year bond yields drifted up slightly and remain around 2.85% at time of writing.



- With inflation still high and inflation expectations surging, we can expect that Bank of Canada to continue hiking until both of those things change. In simple terms, that means another hike in June (likely another 50bps / 0.5%) and they will continue to hike until Canadians begin to fear recession more than they fear inflation.

2) Interest rates are taking a huge bite out of affordability

This remains the #1 chart in Canadian macro land right now. Given the runup in prices AND rates, the mortgage payment needed to purchase the typical home at 80% LTV has surged by almost $800 in the past 6 months alone.



Something has to give here. It will either be interest rates or house prices, and right now it looks like the latter.

3) Home sales tumble, prices slip in April

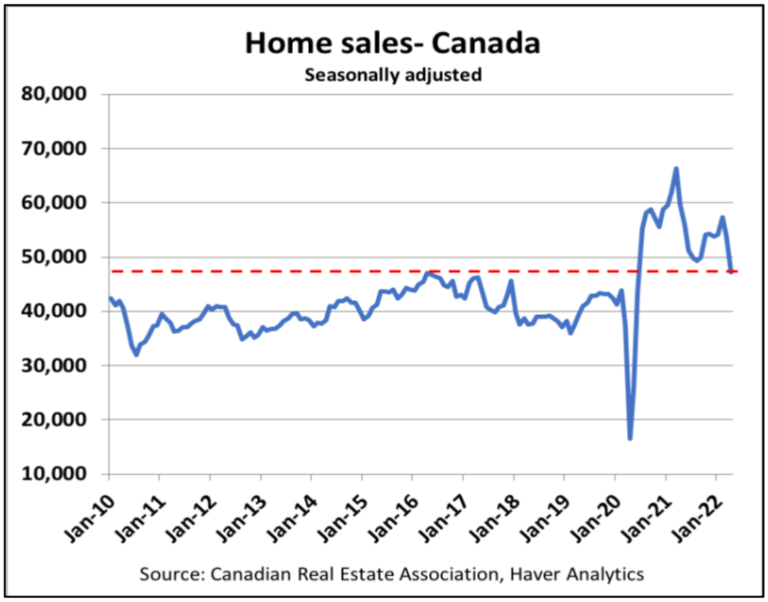
First, the high level summary. Notice in particular the trends in Ontario where sales are way down, inventory is way up, and prices are starting to slip:

	Sales		**New listings**		**Active inventory**		**House prices (HPI for Canada, average for provinces)**	
	y/y	**m/m seasonally adjusted**	**y/y**	**m/m seasonally adjusted**	**y/y**	**m/m seasonally adjusted**	**y/y**	**m/m seasonally adjusted**
Canada	-21.0%	-12.6%	-7.4%	-2.2%	-11.3%	+4.1%	+23.6%	-0.6%
BC	-28.4%	-12.6%	-14.4%	-3.4%	-7.3%	+4.8%	+12.1%	+0.0%
AB	+4.5%	-10.0%	-2.0%	-5.8%	-20.6%	+2.9%	+5.5%	+0.5%
ON	-30.0%	-20.9%	-1.8%	-1.2%	+13.3%	+11.1%	+13.3%	-6.3%
QC	-14.4%	-1.8%	-17.0%	+0.1%	-16.9	+0.3%	+14.1%	+2.0%

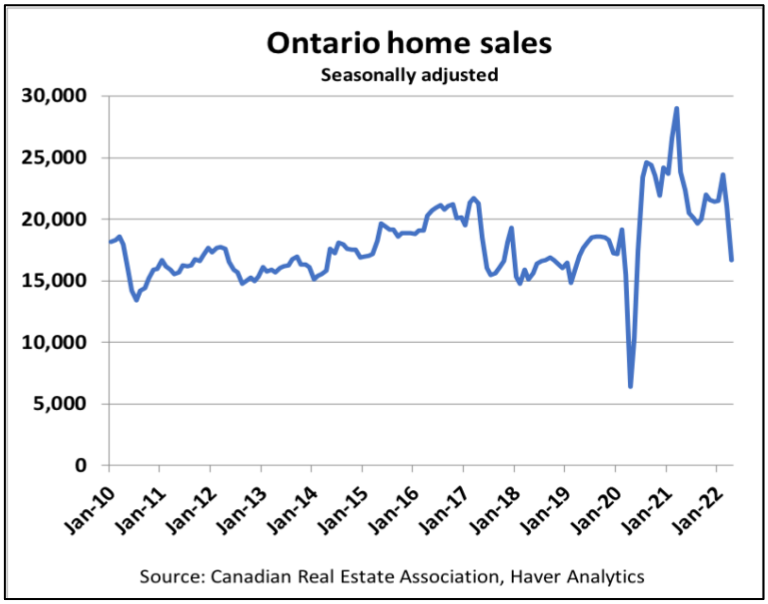
Now to some of the main highlights:

Sales tumble:

- Sales fell 12.6% seasonally adjusted in April. Outside of the COVID lockdowns in Apr/May 2020, this was the steepest monthly decline since the implementation of OSFI's B20 mortgage guidelines in January 2018:

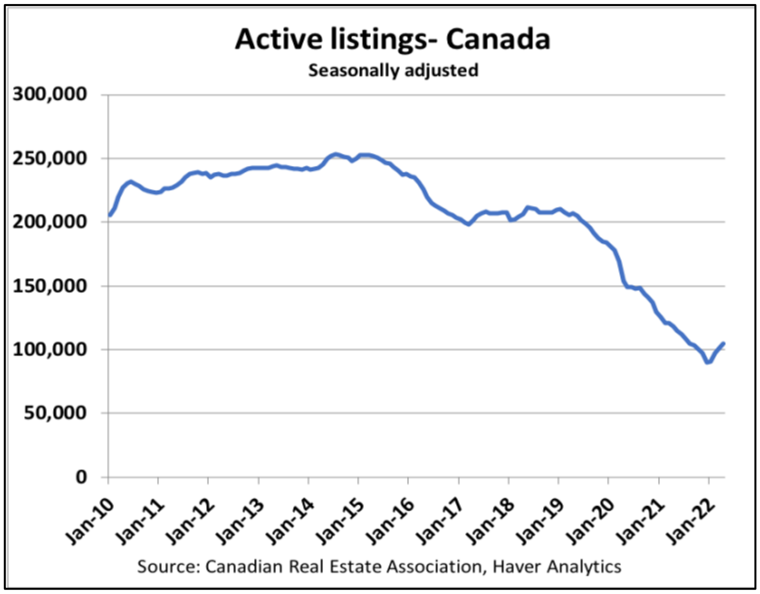


- Sales declines were most pronounced in Ontario where they've now fallen 30% in the past 2 months. Setting aside April 2020, that's the steepest 2-month decline since the Financial Crisis in 2008.

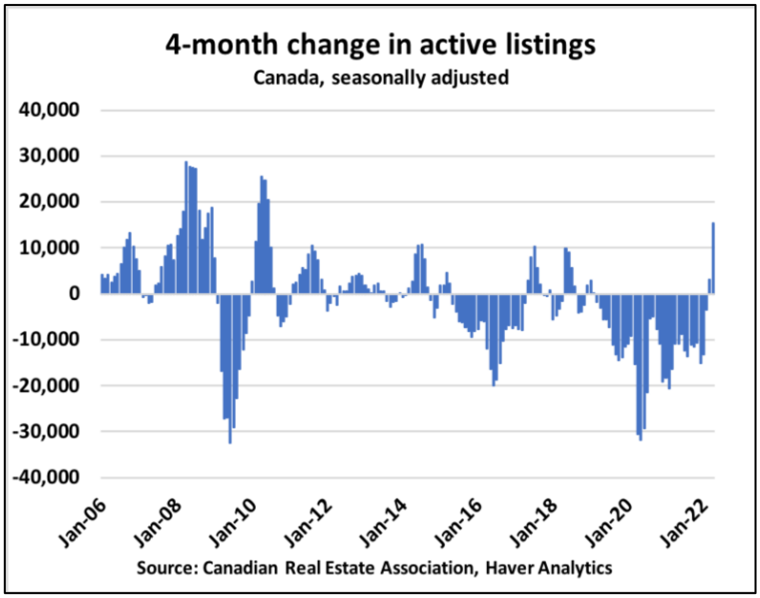


Inventory keeps building:

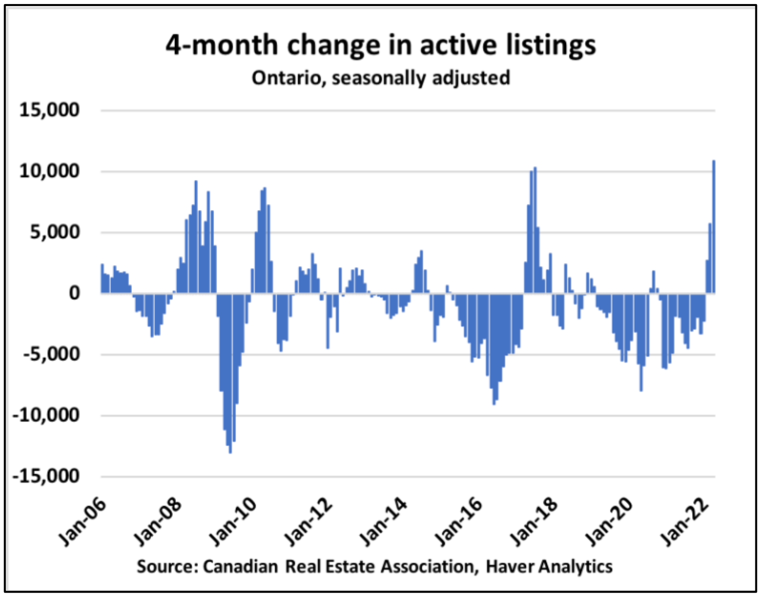
- Even with new listings falling 2.2% m/m, the steep drop in sales active inventory is rising quickly….albeit off a low base.



- Since bottoming 4 months ago, we've now seen the steepest increase in inventory since 2010:

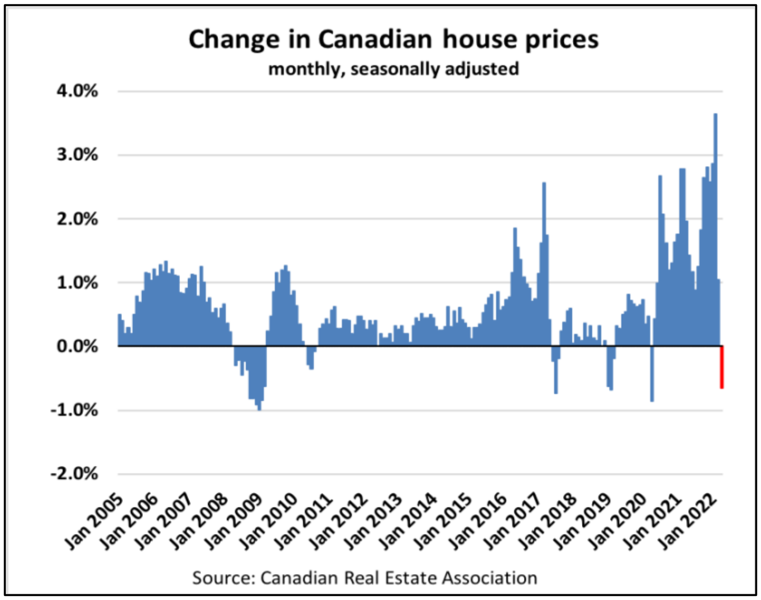


- The inventory build is most pronounced in Ontario where it's now increasing at a faster rate than during the 2017 mini correction:

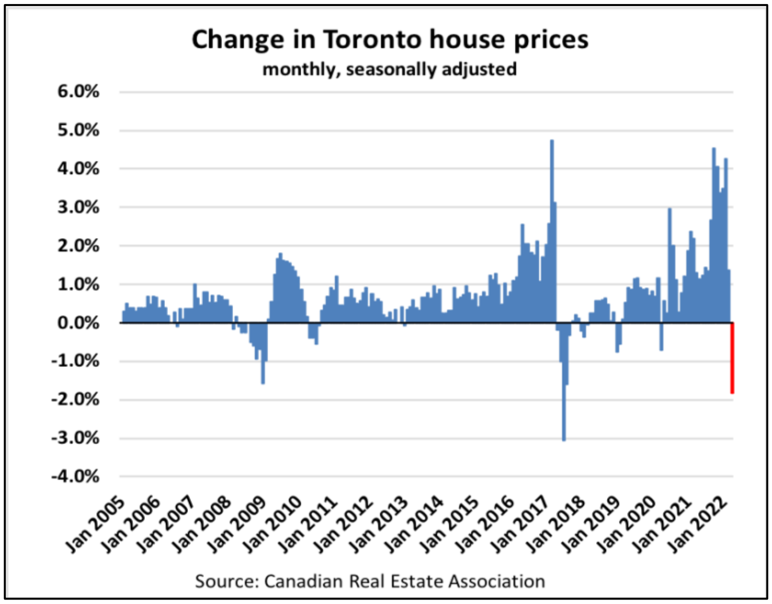


Prices slide:

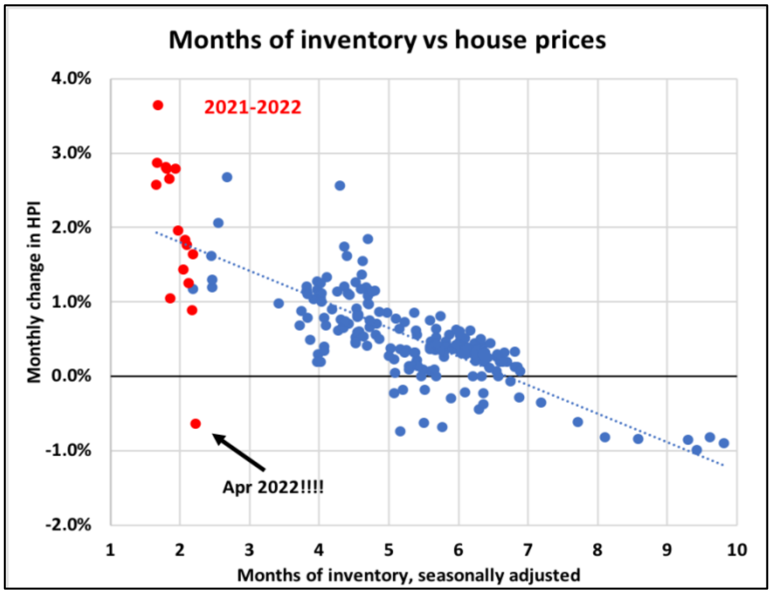
- We just saw the first monthly decline in the MLS House Price Index since April 2020:



- Once again, the issue is primarily in southern Ontario for now. Yes, the GTA saw the largest monthly decline since 2017, but it wasn't alone. Seasonally adjusted prices fell in Barrie, Cambridge, Guelph, Kingston, Kitchener, London, Niagara, and Peterborough.



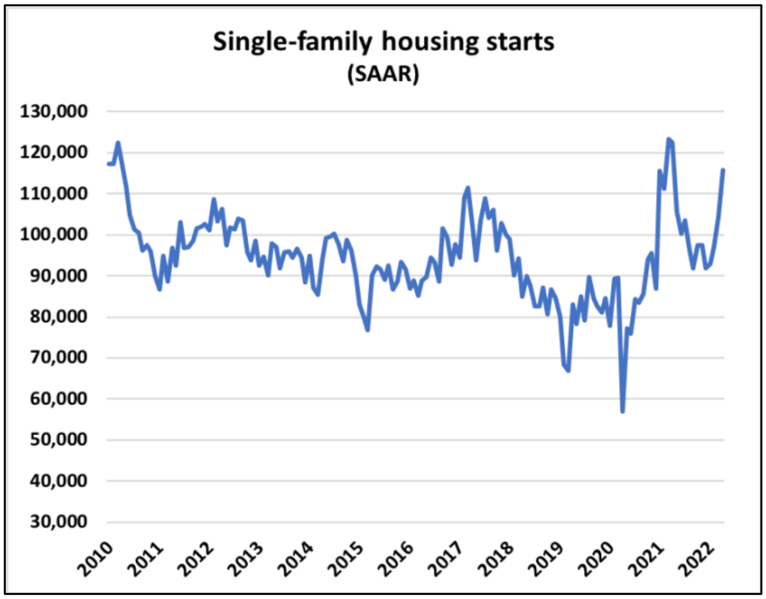
- My house price model broke in April. We've never before seen a decline in prices with months of inventory so low. Distressed selling in Toronto from failed appraisals and financing issues has caused a decline in prices that is not consistent with the overall market balance. This may persist for a few more months until these distressed sales clear the system.



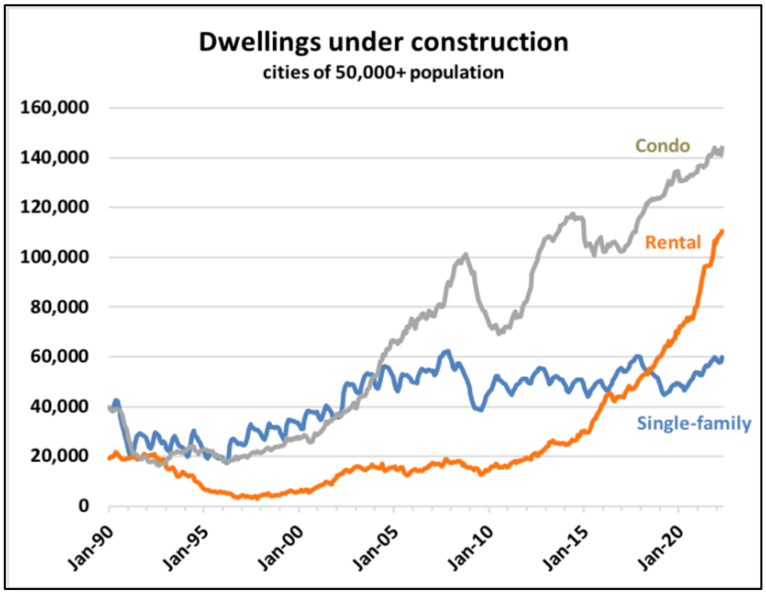
4) Housing starts jump, immigration hits new record, rental market tightens

Housing starts still solid:

- Housing starts jumped 7.6% m/m in April to hit 267k on an annualized basis. This is much higher than the 20-year average of 211k. What's interesting is that we're now seeing a significant jump in the single-family segment just as resale demand cools.

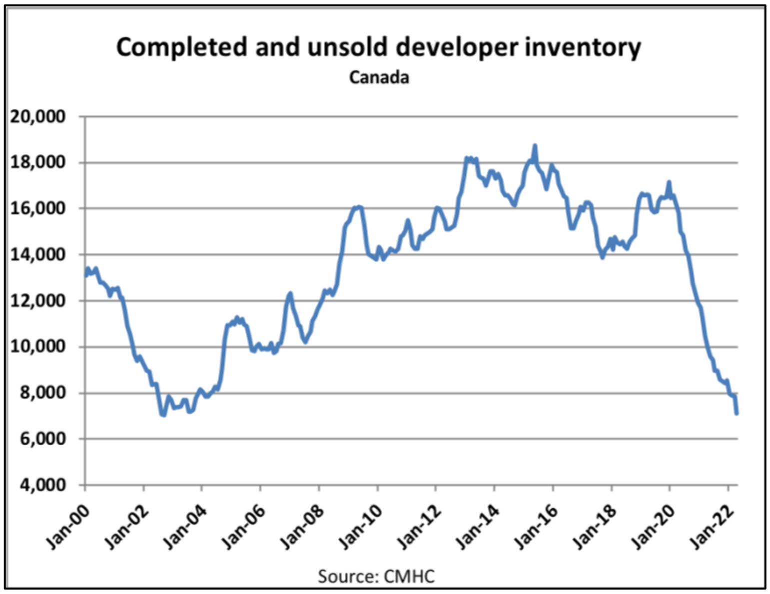


- The number of dwellings under construction jumped another 2% in April to hit a new record high. Condos and rentals continue to drive most of the increase.



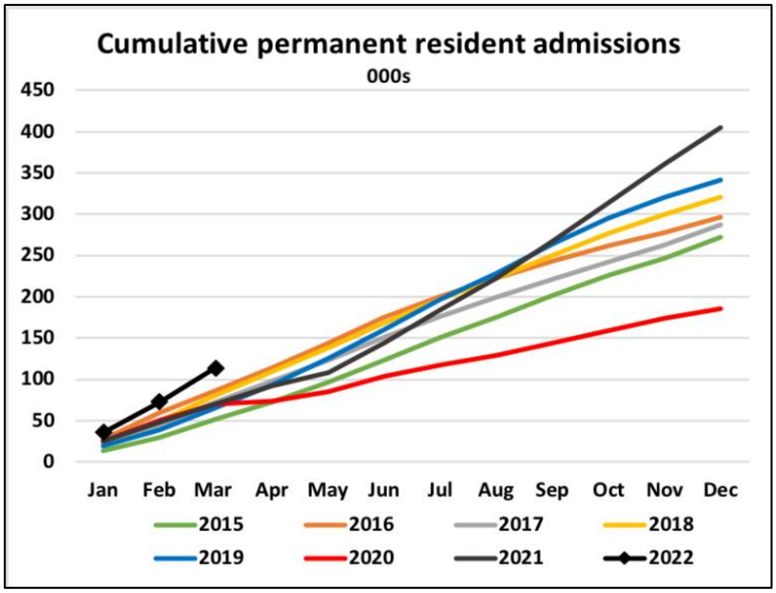
No unsold developer inventory:

- Still absolutely no signs of overbuilding in the new housing market. At least not yet. Unsold developer inventory keeps falling. That may change if the resale market becomes very well supplied at a time when completions jump later this year, but for now that's just not the case.



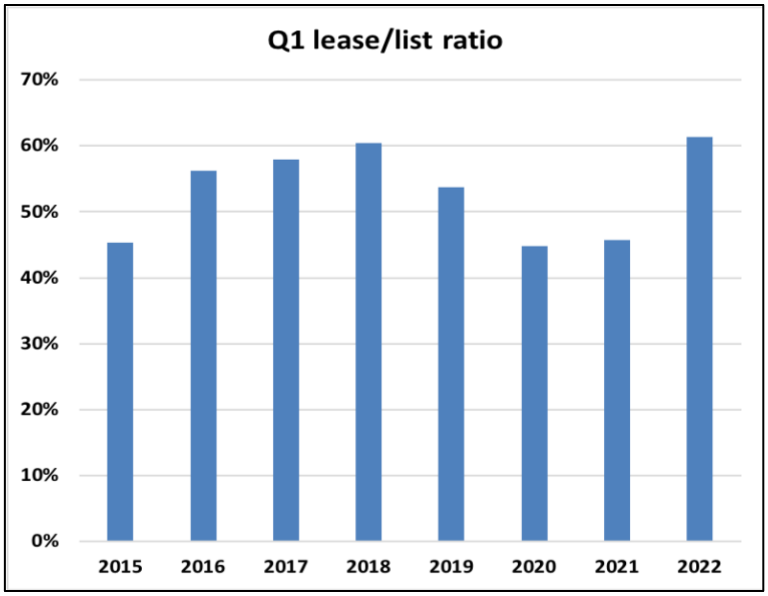
Population growth still very solid:

- Canada admitted another 41,000 permanent residents in March, a record by a wide margin. That brings the cumulative total this year to 114,000.



Rental market heats up:

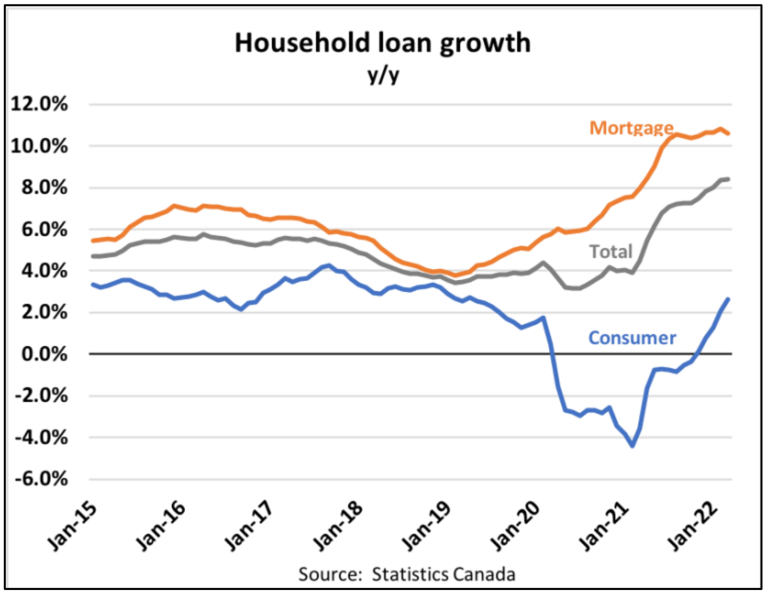
- People have to live somewhere. If the resale market cools, demand by necessity shifts into rentals. Throw in strong population growth, and we end up with a dramatic strengthening in the rental market in major metros. In Toronto, the lease-to-list ratio (a measure of supply and demand) in the condo rental market hit the highest since at least 2015 in Q1.



5) Mortgage growth remains high in March, variable rates still popular

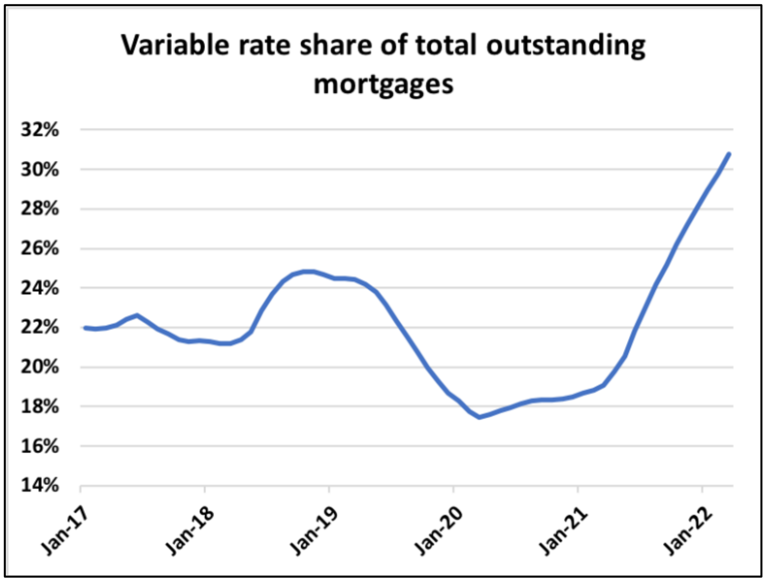
Mortgage growth still running at nearly 11% y/y:

- Mortgage debt outstanding rose 0.6% m/m in March. That puts the y/y growth rate at 10.4%. We've almost certainly seen the peak in credit growth. Rising rates and slowing resale demand will put a serious dent in mortgage demand going forward.



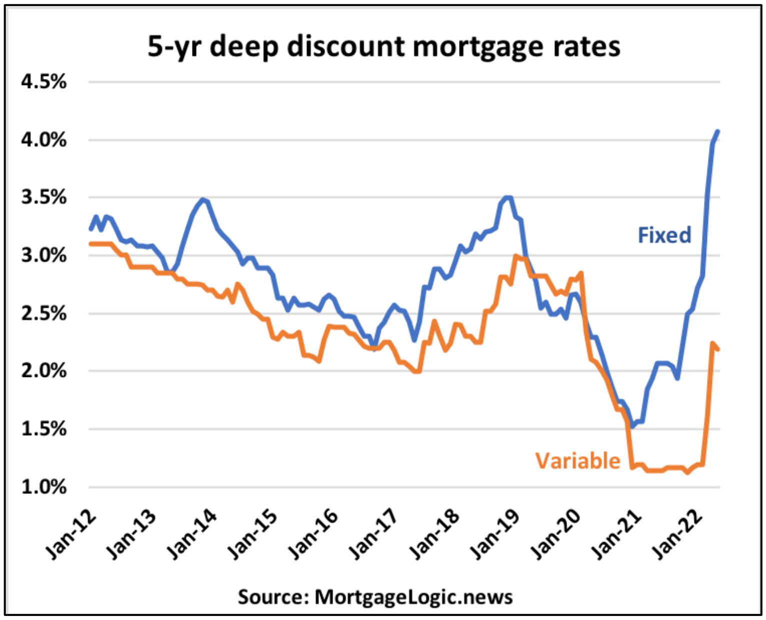
Variable rate popularity keeps growing:

- Variable rate mortgages accounted for 55% of all new originations in April. That pushed the total share outstanding to 31%.



5-yr fixed rates poke through 4%

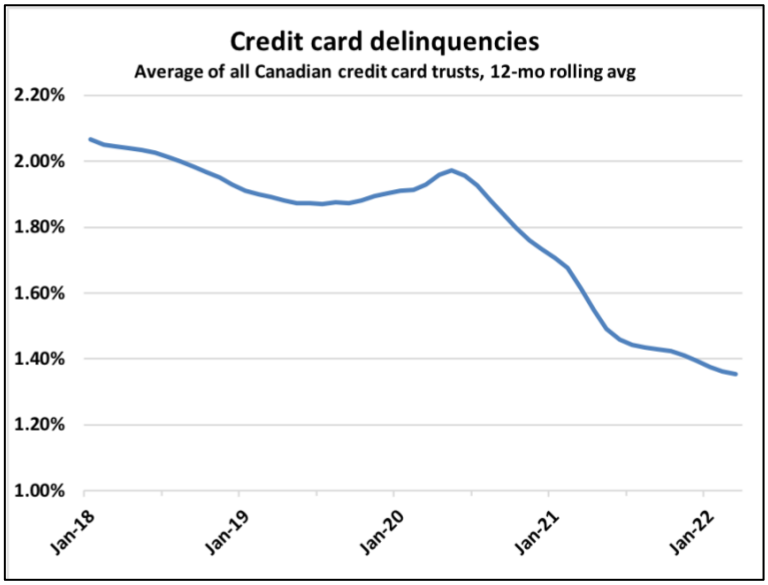
- The last time we had fixed rates this high was 2010.



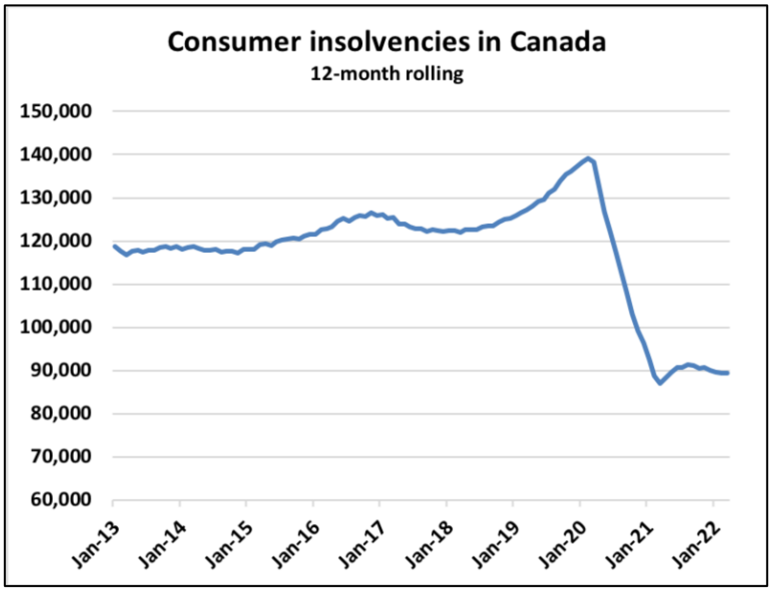
6) Consumer check: Insolvencies and delinquencies still low, but probably not for long

Credit card trends still look excellent

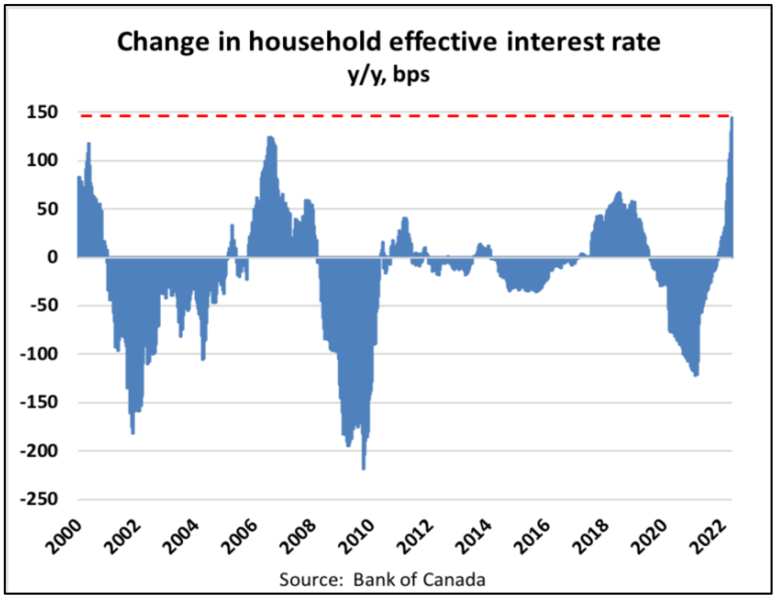
- Mortgages won't go bad before trends in credit cards turn sharply, and there's still no signs of that happening yet. Delinquencies remained at record lows in March, but it's perhaps notable that they were flat m/m for the first time since the start of the pandemic. We're likely looking at the lows right now.



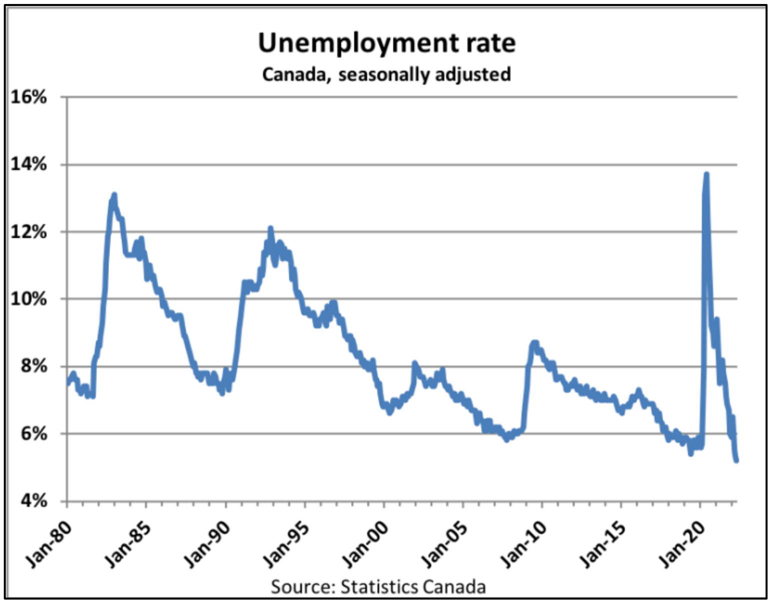
- Consumer insolvencies are still 40% below pre-COVID levels. I'm hearing from trustees that phones are starting to ring again, so I expect this trend will turn sharply in coming months.



- Rising interest rates continue to flow through to households at the fastest rate in at least 20 years. The average interest rate paid across all credit outstanding hit 4% for the first time since 2019. A year ago it was 2.5%. This is obviously going to move further if we do get a 50bp rate hike on June 1.



- The good news is that the labour market is still remarkably tight. The unemployment rate hit a record low of 5.2% in April.



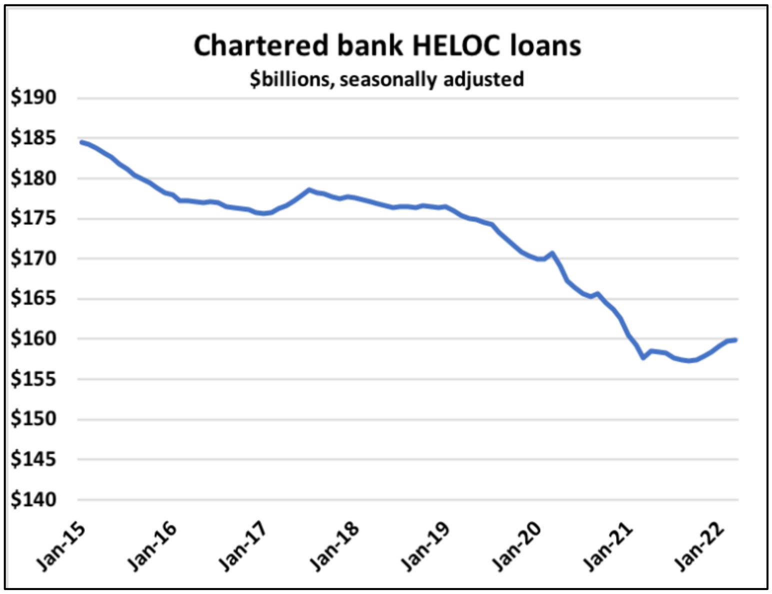
7) OSFI keeps busy fighting the last battle

HELOCs are a big concern all of a sudden?

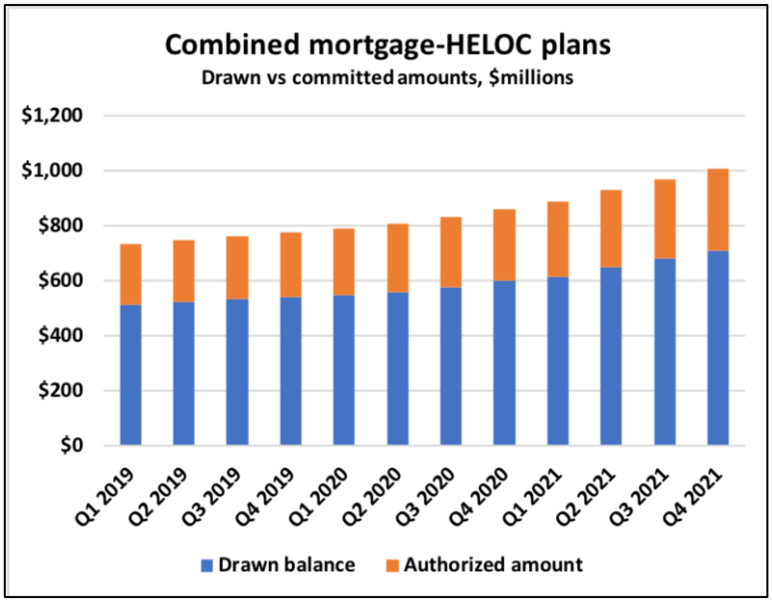
- The headline this week from the Globe and Mail:

> **Canada's banking regulator to tighten mortgage-HELOC rules to curb rising homeowner debt**
>
> JAMES BRADSHAW > BANKING REPORTER
> RACHELLE YOUNGLAI > REAL ESTATE REPORTER
> PUBLISHED YESTERDAY
> FOR SUBSCRIBERS

- Evidently OSFI is going to give a pass to investors and not tighten up LTV guidelines on second property purchases (as I had expected) and instead is going to focus on…..HELOCS? Ummm…okay? This feels very much like fighting the last battle. HELOC growth absolutely surged from 2009 until 2015 but then rolled over sharply. Today, HELOC balances are considerably below peak levels:



- The new boogeyman is the readvanceable HELOC attached to a standard mortgage. Indeed these products are gaining popularity. My read of the Bank of Canada data is that there is roughly $700B outstanding in these products with another $300B in undrawn capacity.



- The main concern here is apparently that tapping HELOC balances can mask underlying credit risk and create a surge in credit growth in a recession, and that's probably true. It's entirely anecdotal, but look at what popped up on Reddit recently:

reddit PERSONALFINANCECANADA comments

125 Parents want to "take out equity" from their house to pay for their mortgage (self.PersonalFinanceCanada)
submitted 21 hours ago * by No-Description-7400

I want to understand what my parents are doing here, because it seems incredibly dumb to me.

They bought their house in March 2020 for $1.2 mil. I think their mortgage was between $600-800k. Their real estate agent told them last year that the value of their house had risen to $1.8 mil.

Now they apparently can't afford their mortgage payments, so they've decided to "pull out their equity" from the house to pay for the mortgage. What? Isn't this just borrowing against your house? And for some reason they think it makes sense to pay a higher mortgage payment (and more interest) to help their cash flow problems. Apparently because they are in their early 70s, they want to prioritize cash flow over building equity, but borrowing your equity to make higher payments doesn't seem like the right approach.

I am I missing something here or is this as stupid as I think it is?

EDIT: a lot of people have asked is this a HELOC or reverse mortgage. I don't know, unfortunately. They had mentioned this plan to me a couple of months ago and I told them at the time that it didn't make sense to me. Then I was away and now they are away. I just saw a mortgage document at their house with three 2 year term options on it for around 4% interest, and one option for 8.5% interest. The 8.5% option was circled. Really freaked me out. I didn't read it closely enough for further details or take a pic of it.

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- So what's the solution? To take away that emergency liquidity in order to "force" distress so we get a better sense of real underlying trends? That seems a bit….counterproductive. But alas, here we are. It seems like what we have here is this sort of deductive reasoning:

  "We should do something. This is something. Let's do this"

  Seems to be Modus Operandi of Canadian regulators these days!

Have a great weekend!
Ben