October 2022
Metro level deep-dive- September data

Quick links:

1) A gut punch from the Bank of Canada

2) Toronto home sales give up August gains, prices slip

3) Vancouver home sellers move to sidelines as new listings plunge

4) Calgary and Edmonton sales under pressure

Key takeaways:

- Comments this week from the Bank of Canada dashed hopes that we may be at the end of the current tightening cycle.
- Population growth hit record highs in Q3 which will eventually help put a floor under housing demand.
- Home sales in Toronto slumped in September, but new listings hit 20-year lows in a sign that sellers are moving to the sidelines almost as quickly as buyers.
- Similar trends in Vancouver where both sales and new listings were down sharply.
- Positive economic momentum continues in Alberta where we're seeing signs that markets there are beginning to outpace the national average….a trend that I think has legs for at least the next couple years.

1) Another gut punch from the Bank of Canada

Forward-looking economic data is clearly rolling over, and that *should* mean that the current interest rate hike cycle is near an end. But these are not normal times. Bank of Canada (BoC) chief Tiff Macklem made that abundantly clear in a speech[1] this week. It was important enough that I wanted to flag a few key takeaways here:

i) Inflation is not just an international supply chain story

From Tiff's speech:

> […] High inflation is making life more difficult for Canadians, especially those with low or fixed incomes. Some of this inflation reflects global developments that we don't control, but inflation in Canada increasingly reflects what's happening in Canada. The demand for goods and services here at home is running ahead of the economy's ability to supply them. Businesses are having a hard time finding enough workers. And what started as higher prices and delays for many internationally produced goods has broadened to many services.

This is the first explicit admission that the inflation we're seeing is indeed an excess domestic demand story. Tiff is telling us clearly that this is not a Russia/Ukraine story, and it is not a China manufacturing or global shipping story. This is a story of an overheated economy, drunk on policy rates that are still too stimulative.

ii) They are closely watching CORE inflation…

As I've written about previously, the two key metrics that the BoC will be watching are core inflation and inflation expectations among consumers and businesses.

> […] As we look for a more fundamental turning point in inflation, measures of core inflation are becoming increasingly relevant

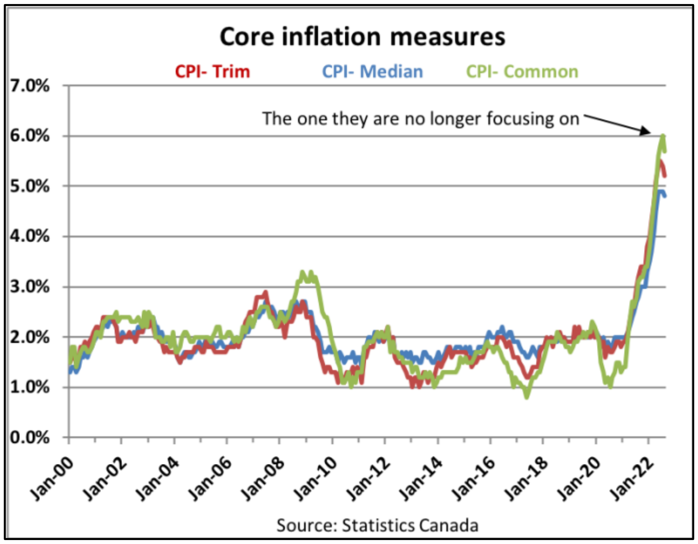
The Bank has 3 key core inflation measures they watch closely: CPI Trim, CPI Common, and CPI Median. All are meant to strip away the highly volatile components to give a better sense of "sticky" inflation in the broader economy.

But this is interesting:

> […] Of our three measures, CPI-common is becoming more difficult to use in real time because it has been subject to large historical revisions.

In other words, CPI Median and Trim will be getting more consideration going forward. A skeptic might note that CPI Common happens to be signaling the highest inflation rate at the moment:

[1] https://www.bankofcanada.ca/wp-content/uploads/2022/10/remarks-2022-10-06.pdf



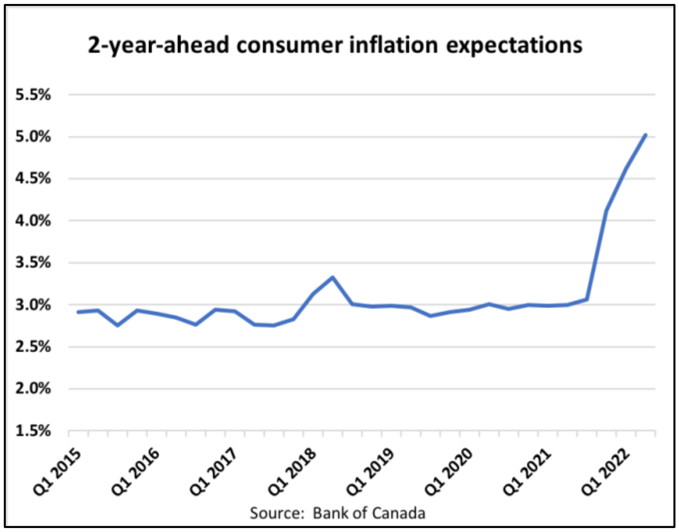
Removing CPI Common from the average drops core inflation rates by 0.2% which means they are giving themselves some additional flexibility to *eventually* be able to justify a pivot.

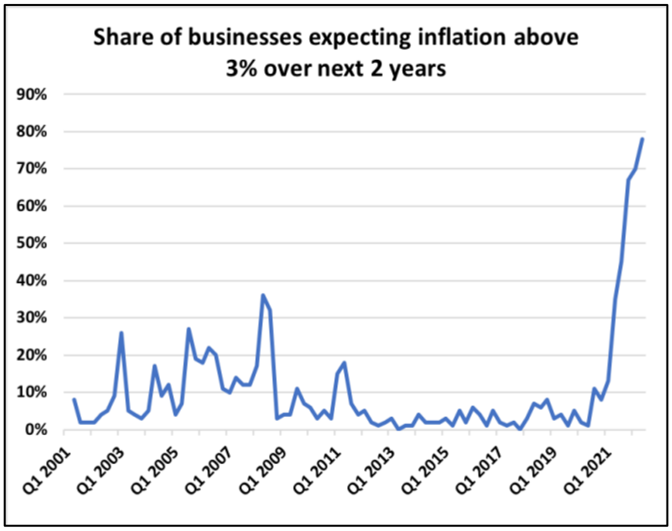
iii) …**and they're watching inflation expectations**

From the speech:

> […] In addition to measures of inflation, we are also closely watching inflation expectations. Keeping longer-term expectations of inflation well anchored is paramount so that, as inflation pressures ease, inflation returns to the 2% target.
>
> The longer high inflation persists and the more pervasive it becomes, the greater the risk that high inflation becomes entrenched.

We'll be getting the latest consumer and business inflation expectation data next week. The Bank sees it as their mission to get these trends back to their long-term…or at least well on their way:





iv) The zinger…

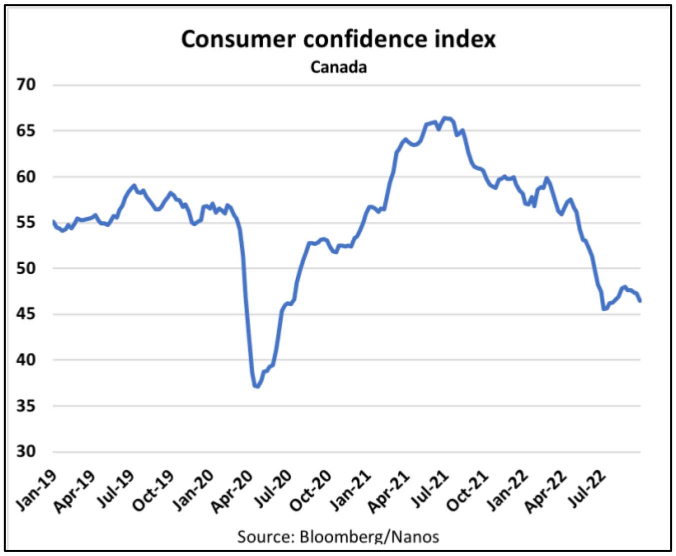
Tiff was not mincing words here:

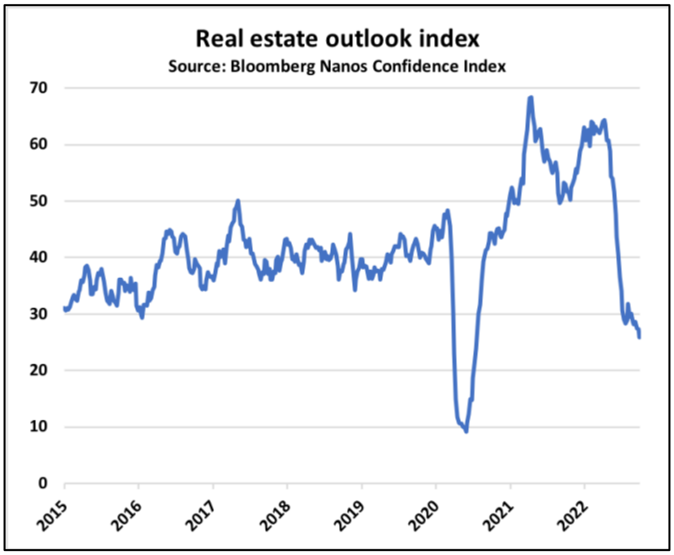
> […] the clear implication is that further interest rate increases are warranted. Simply put, there is more to be done.

Ouch! Bond yields ripped higher on those words, with 5-yr rates closing in on the June highs:

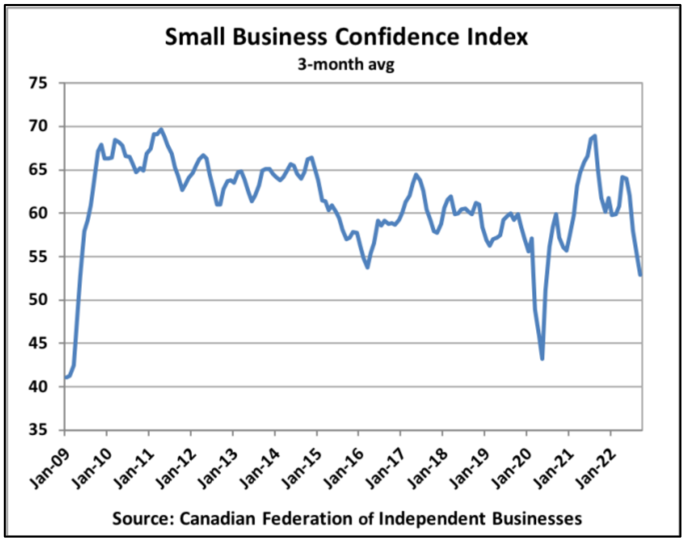
It certainly looks like another 50bps is coming our way on October 26.

That's not going to help consumer confidence which continues to grind lower on plunging real estate expectations.



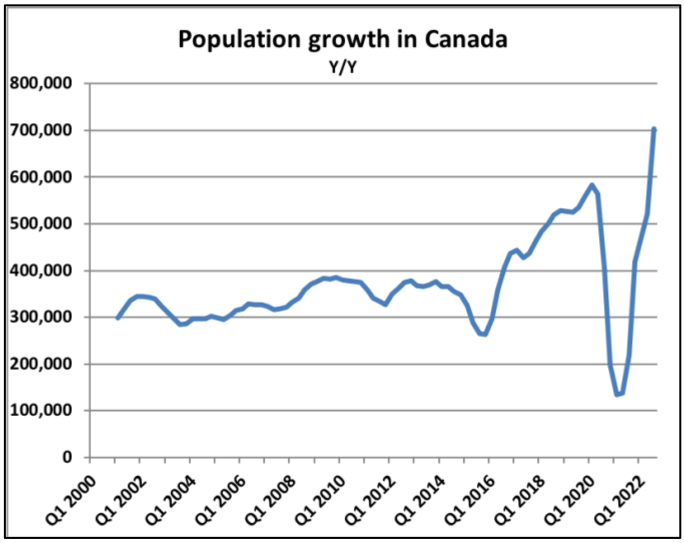


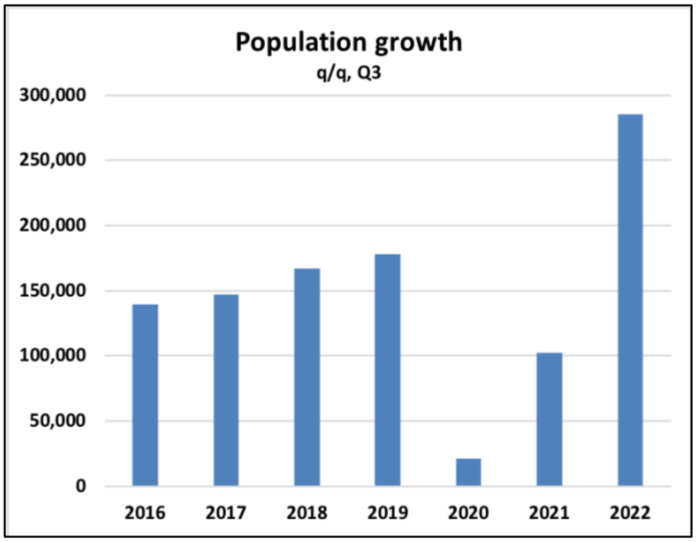
And consumer confidence will come under further pressure too. Already it's at levels that have signaled prior recessions in 2009, 2015 and 2020:



The economy is cooling very quickly. Every forward-looking indicator I follow is flashing red. A lot can and likely will change between the October meeting and the next one in early December. By then I expect there will be ample cover for the BoC to signal a "wait and see" approach while rate hikes work through the system….ut I'm starting to feel like a broken record on that one.

To end this section with a more upbeat data point, just look at population growth last quarter. Good lord!... 700,000 y/y and the strongest quarterly increase on record! It's a good reminder that rates and affordability may drive the bus for perhaps the next year or two, but longer term fundamentals are still exceptionally solid.



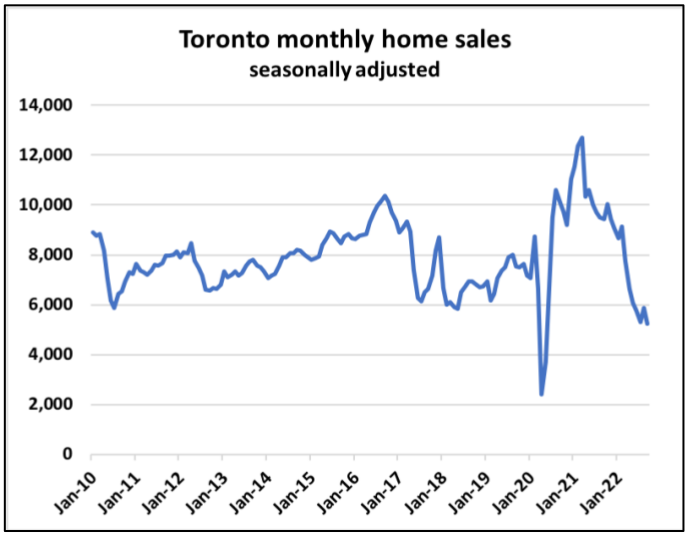


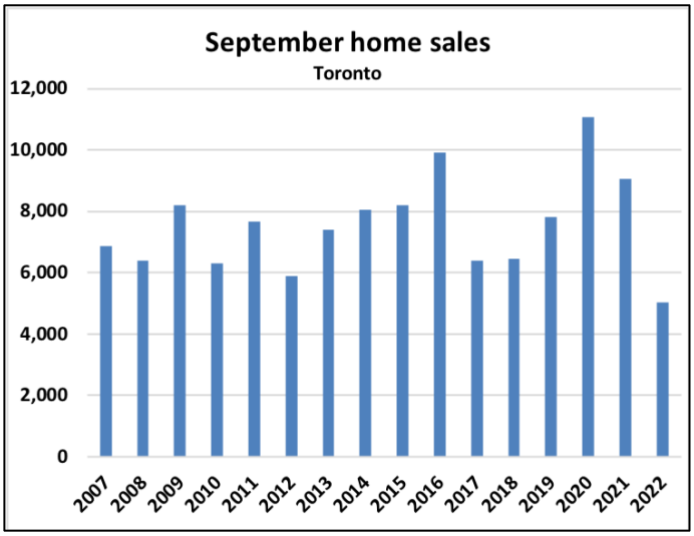
2) Toronto home sales slump in September, but sellers move to sidelines

Some key takeaways:

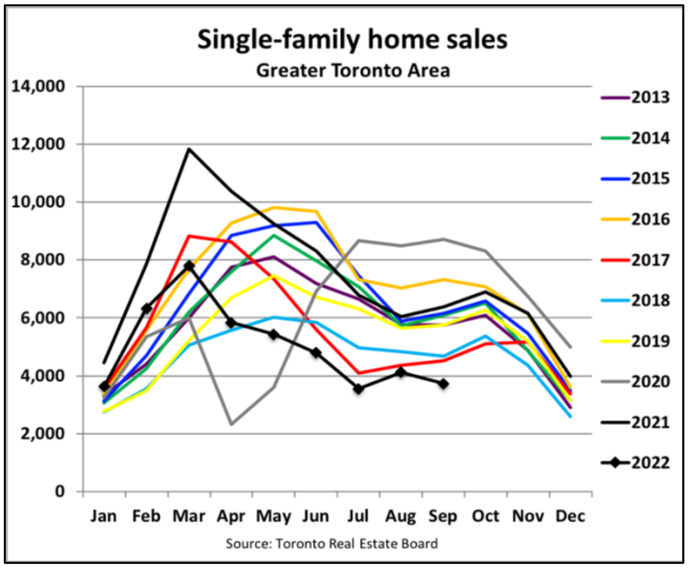
i) Market gives back August gains

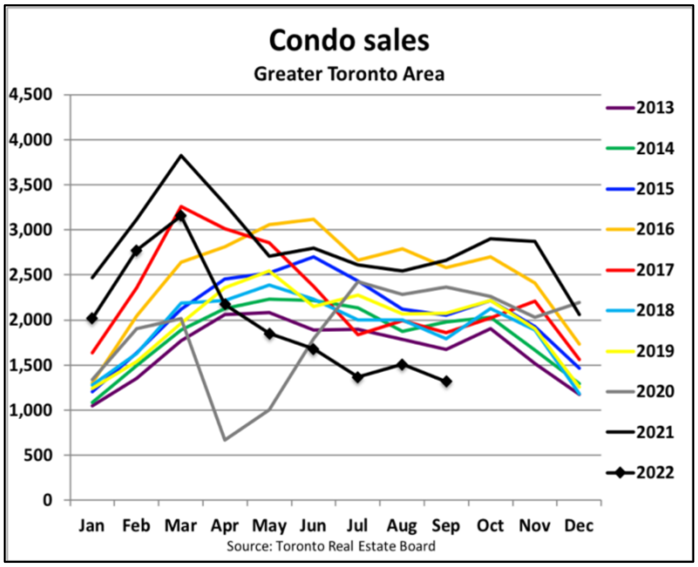
Seasonally adjusted home sales in Toronto plunged 10.8% m/m, giving back all of the August gains and then some. Outside of April and May 2020, this was the lowest level of demand since the early 2000s.





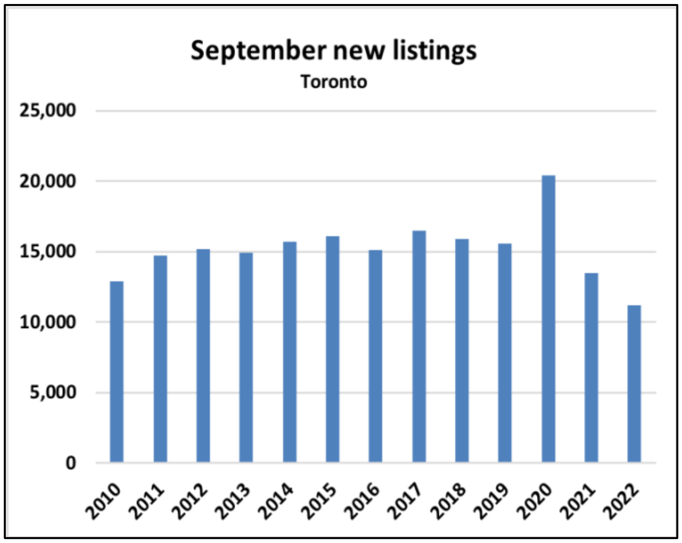
Sales were down 44% y/y but down a whopping 51% in the condo segment:





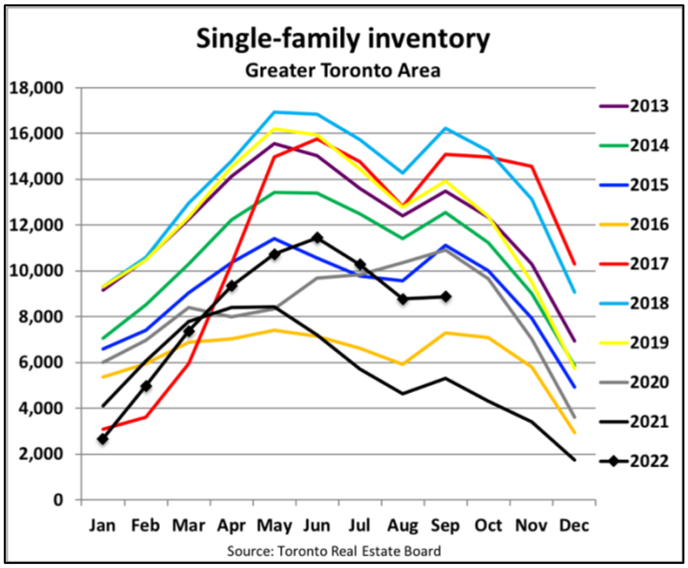
ii) Sellers move to the sidelines

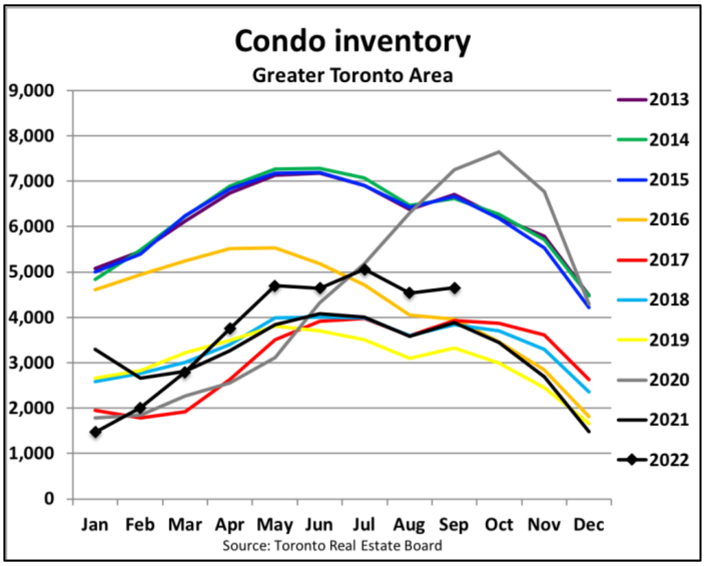
New listings plunged 16% y/y and came in at the lowest level for the month in the past 20 years. A big question now is whether the slowdown in new supply is temporary and will reappear next spring. Anecdotally, I'm hearing from realtors that many of their clients are expecting to relist into what is hopefully a stronger market early next year.



iii) Inventory growth slows

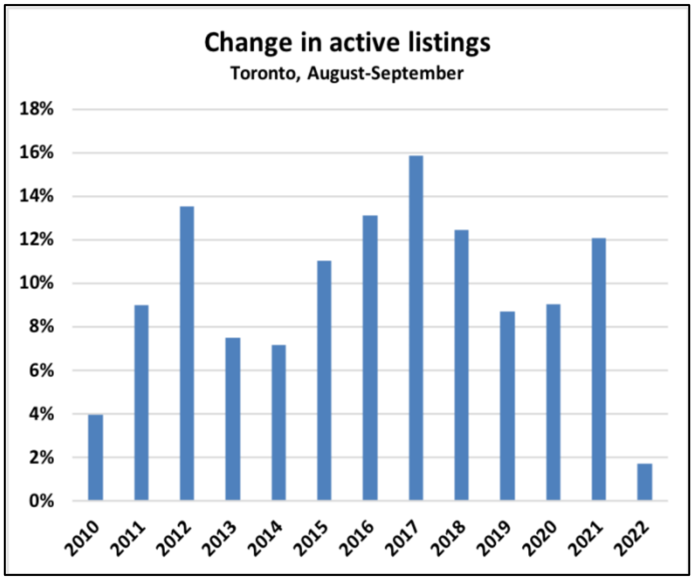
Active listings were up in Toronto (+47.3% y/y), but that hardly tells the whole story. For starters, inventory levels are not "high" by any means:





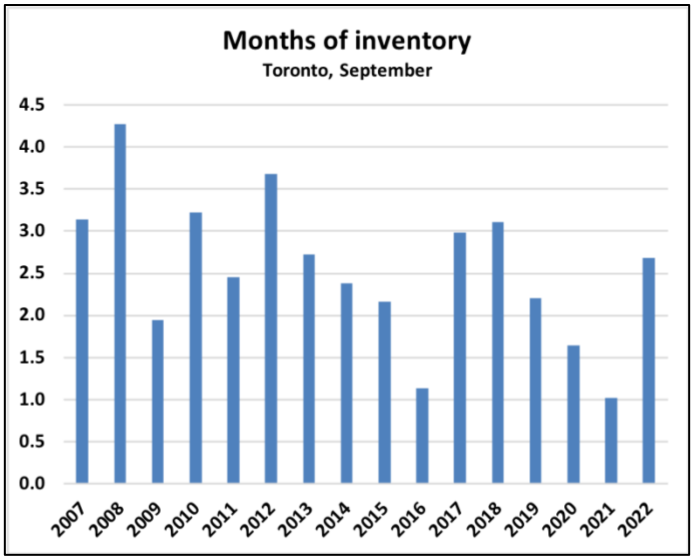
More importantly, the PACE of inventory growth has slowed to a crawl. <u>Toronto normally sees active listings rise about 8% on average between August and September. This year, listings grew less than 2%....the lowest reading for any September in the past decade.</u>

This was a result of the steep drop in new listings as well as an unusually high number of cancelled listings as prospective sellers continue to pull their homes off market.



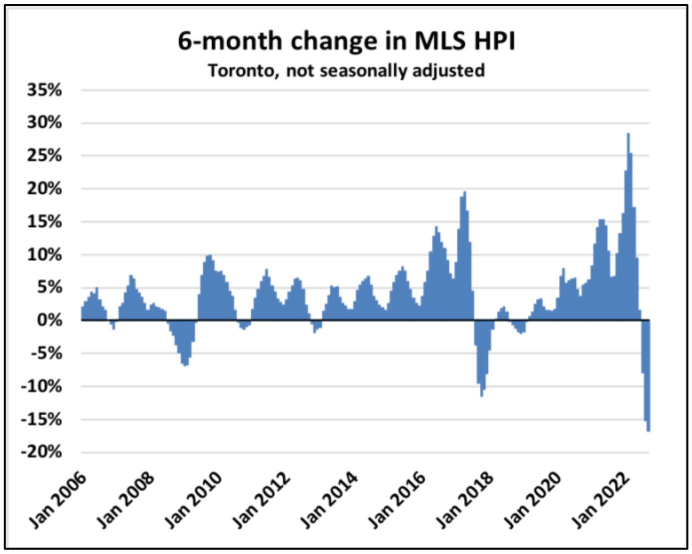
iv) Market is still reasonably well balanced…..really!

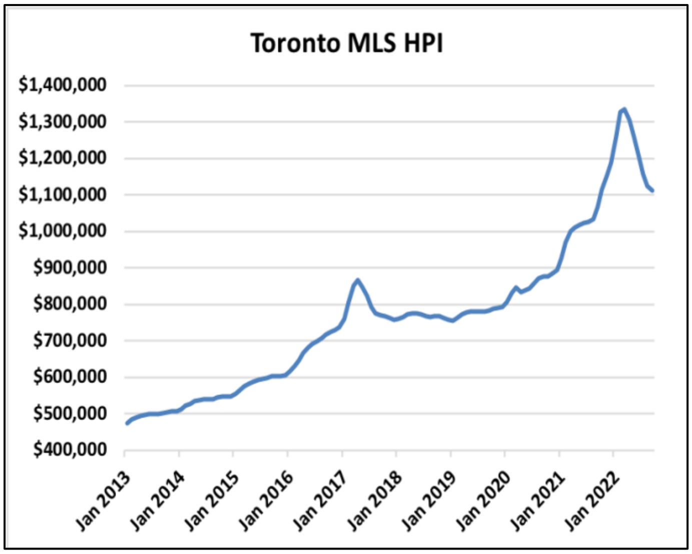
It may feel like the market's falling apart, but it really isn't. Yes, months of inventory are much higher than in the past few years, but it's still below 3 for crying out loud!



v) Price declines continue for now

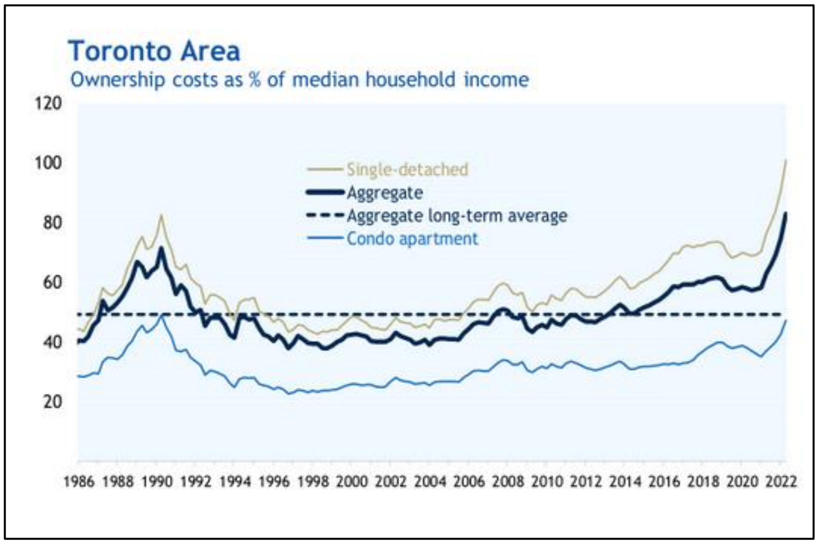
Seasonally adjusted average house prices dropped 2.7% in September while the HPI dropped 1.2% and has now posted the largest 6-month decline in index history:



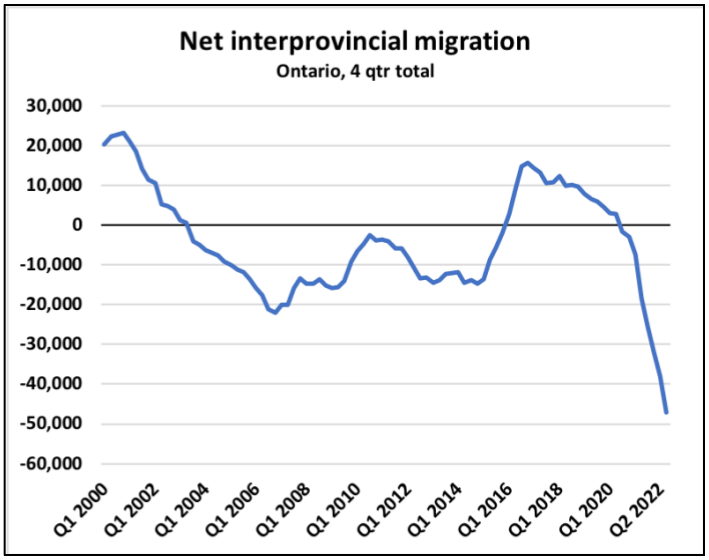


vi) Affordability "off the charts"

That's the conclusion of the latest RBC Housing Affordability report. The chart for Toronto is striking! Until this changes….either via falling price, declining rates, or a flat market while incomes catch up…we should expect sales to remain weak.



The affordability constraints no doubt account for a large part of the record out-migration of Ontarians fleeing to more affordable provinces…namely Alberta and Atlantic Canada:

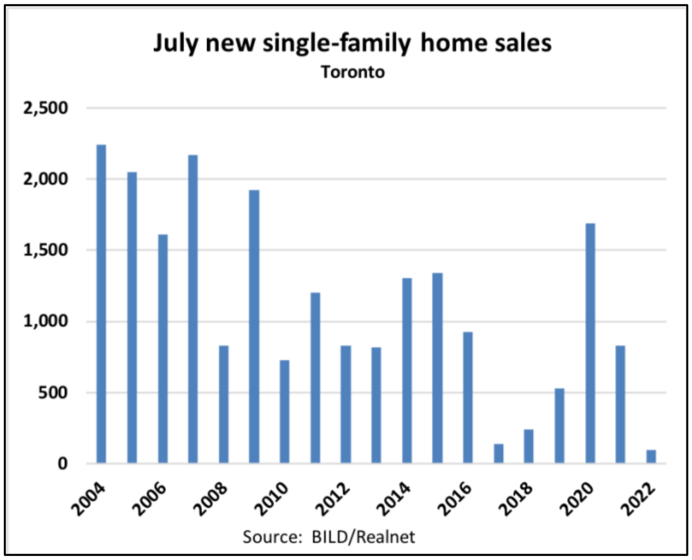


vii) Assignment concerns

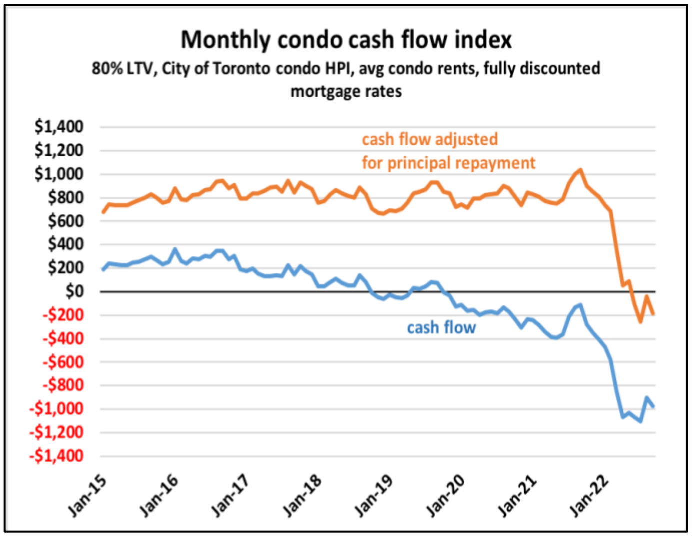
I think closing risks are mounting in the preconstruction market. We know that a non-trivial share of preconstruction buyers purchased with no intention (or even ability!) to close on their purchase. In a market with ample assignment market liquidity, this isn't a problem as the option is always there to flip the contract to another buyer.

These are very different times. In Toronto, demand for resale condos down by half, and this is now the segment of the resale market seeing the steepest price declines.

And demand is no better in the preconstruction market, which historically has been dominated by investors. We just saw the lowest levels of new sales since at least the 1990s:



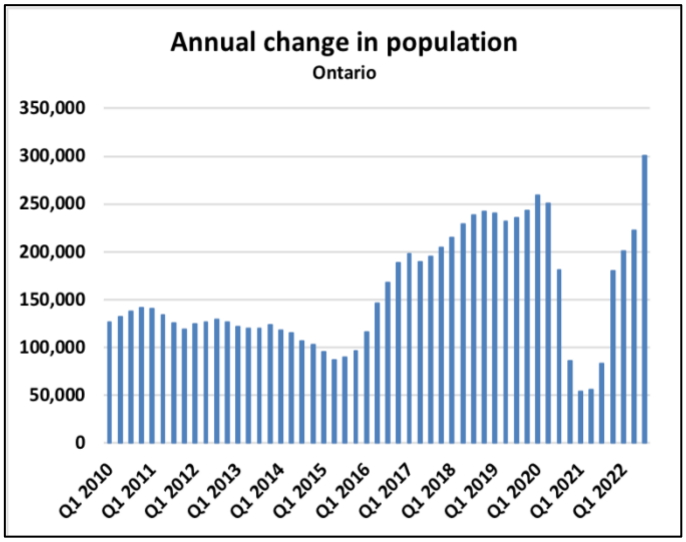
Clearly investor demand is plunging as rental economics have deteriorated sharply. Yes, rents are up and prices are down, but even accounting for those, headline cash flows for resale condos purchased today are steeply negative, and that's true even when we add back principal repayments. There is no economic return to owning a condo at these prices, and until that changes, it's hard to see investor demand returning.



With fewer investors, the assignment market is effectively frozen, and that raises the risks that buyers will be forced to either fire-sale these contracts to the highest bid or walk from their deposits….something we haven't seen on any scale since 2009.

viii) Provincial population growth hits 300,000!

Ontario's population growth hit a stunning 300k y/y in Q3. That's a record by a wide margin and triple the levels we saw in 2015:

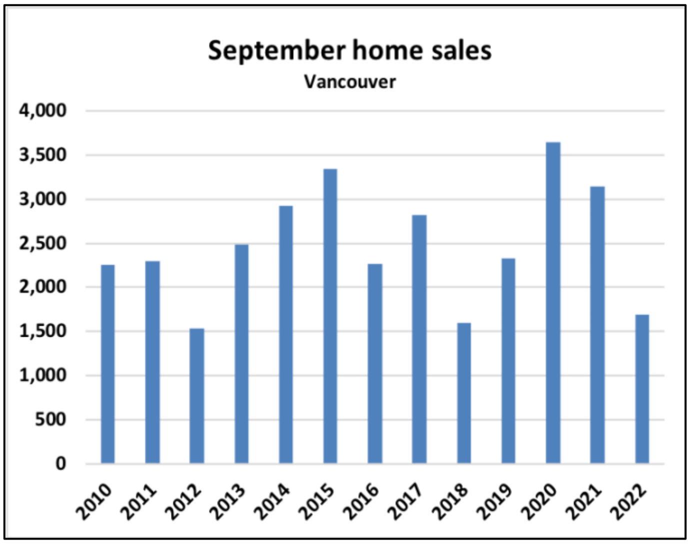


3) Vancouver home sales down slightly

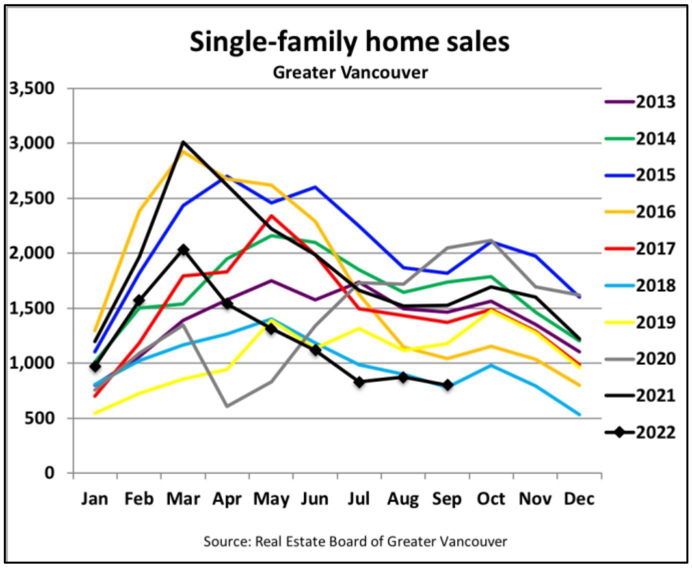
The key takeaways:

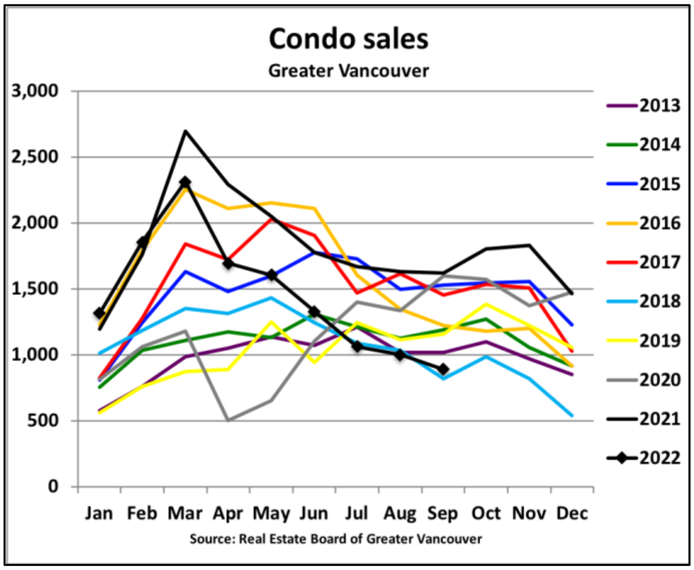
i) Sales fall sharply

Home sales in Vancouver fell 5.3% m/m seasonally adjusted in September and were down 46% y/y from last year:



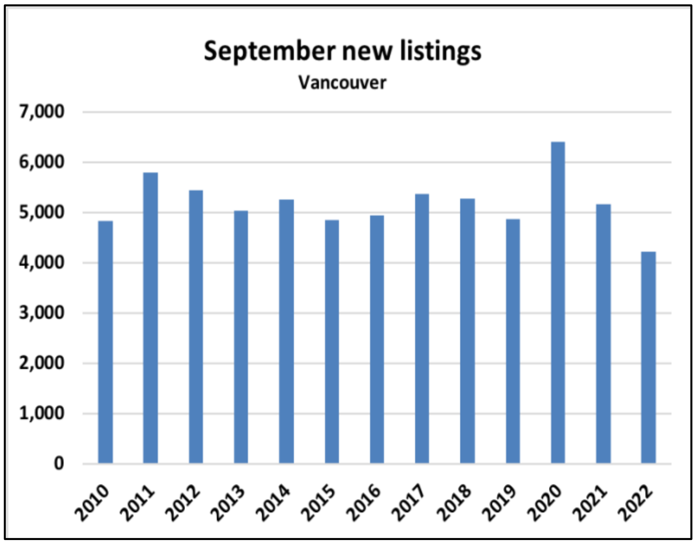
Condo sales led the decline, down 48% y/y:





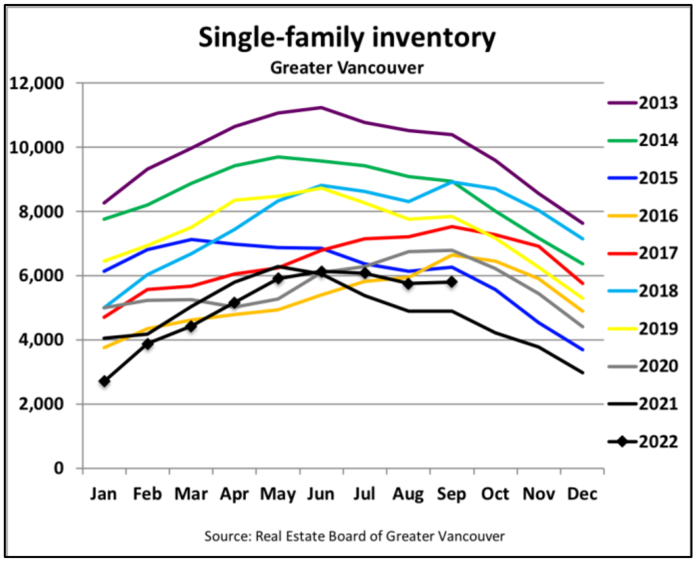
ii) New listings hit decade lows

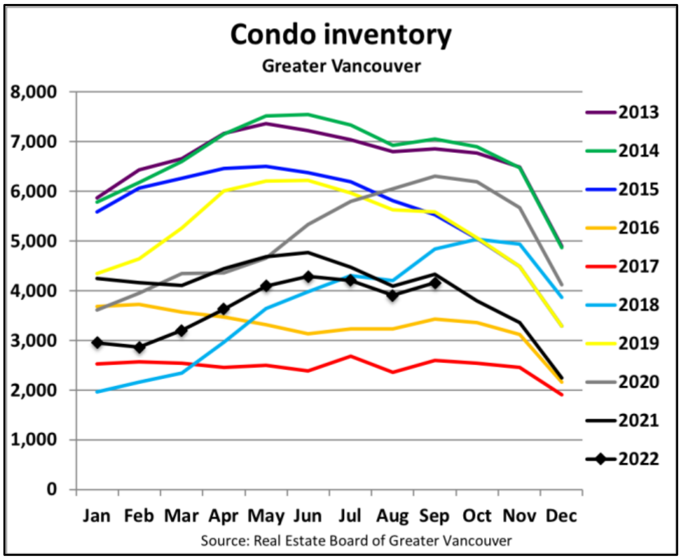
No signs of a “rush to the exits” in Vancouver either where new listings plunged 18% y/y to hit the lowest level in a decade.



iii) Inventory growth grinds to a halt

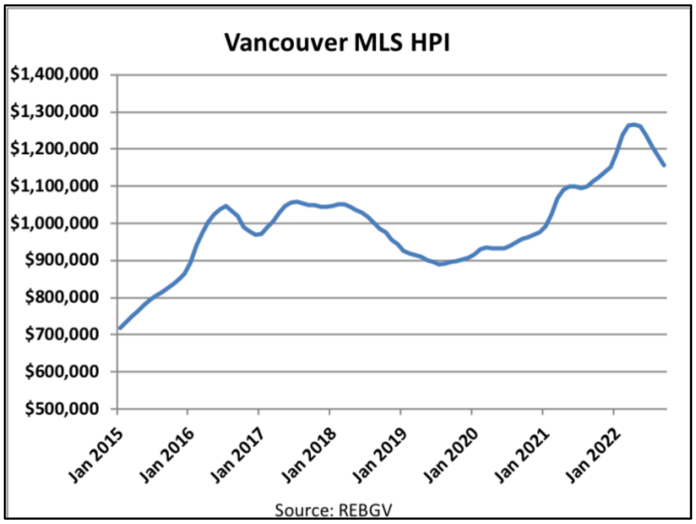
Active listings across metro Vancouver were up 8.0% y/y but remain well under historical averages. This is particularly true in the single-family segment where inventory is up from last year but still sitting at the second lowest level in a decade:

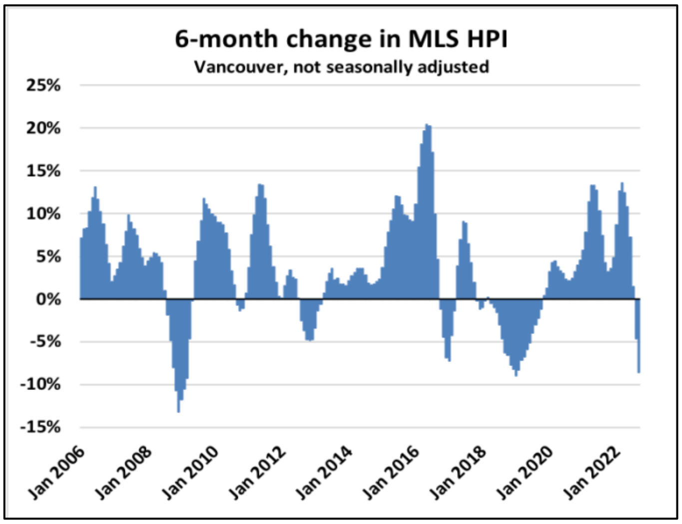




iv) Prices tick lower

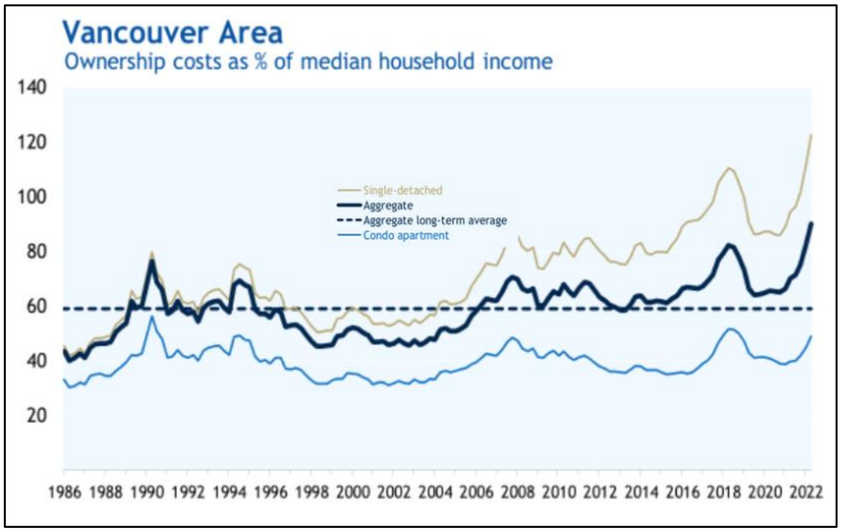
Prices remain under pressure, with HPI down another 2.1% m/m which pushed the cumulative 6-month decline to 8.6%.





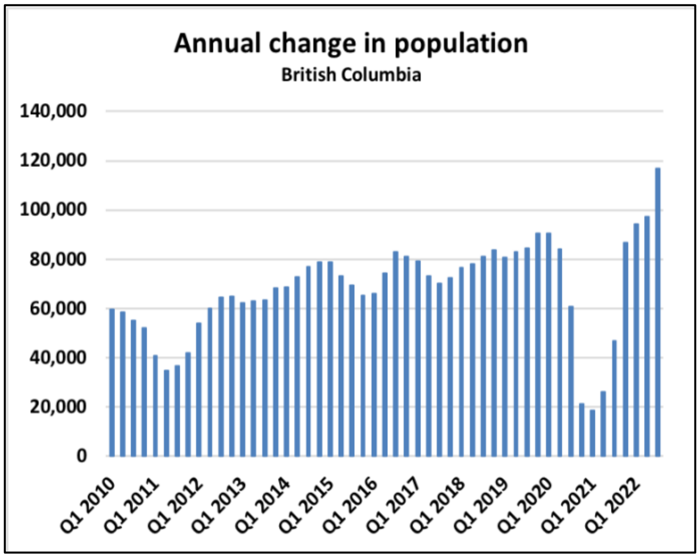
v) Affordability deteriorates

Chart below is from RBC Economics and really needs no commentary. This is nuts!



vi) Record population growth in Q3

Nearly 120,000 people were added to BC's population in the past year…a record by a wide margin:

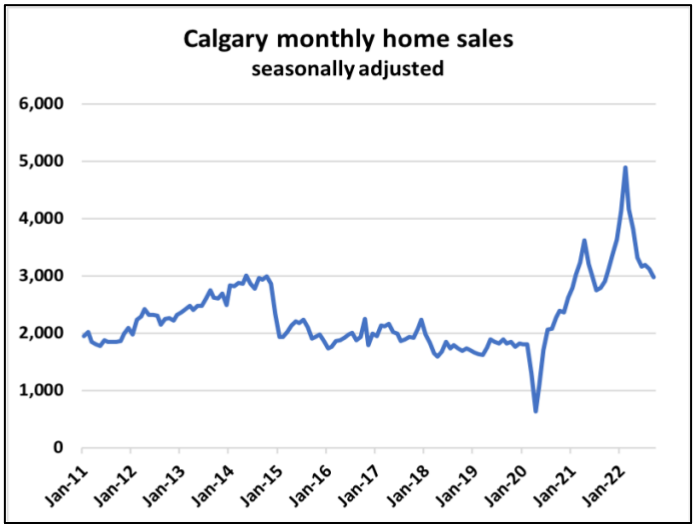


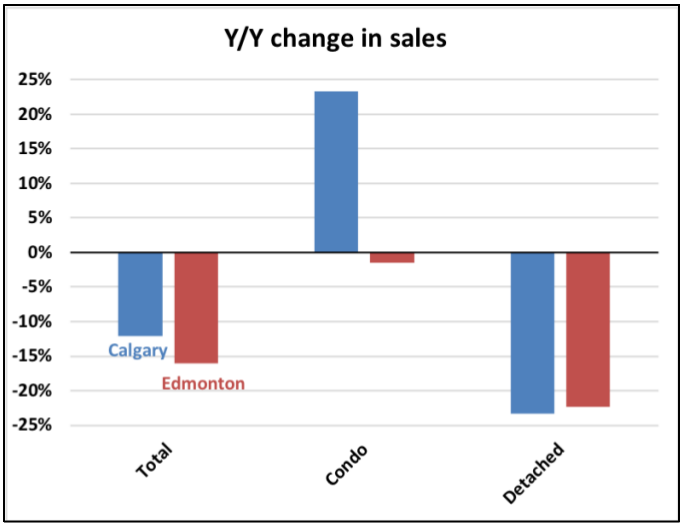
4) Calgary and Edmonton sales cool but macro trends still look solid

Some takeaways from the big Alberta markets:

i) Sales slide but remain elevated historically

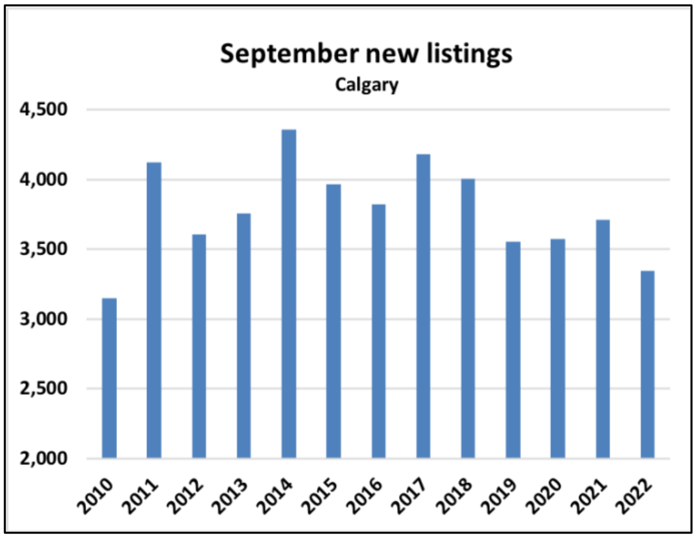
Home sales in Calgary fell 4.6% seasonally adjusted in September but still remain 50% above 2015-2020 average levels. On a y/y basis, sales fell 12% in Calgary and 16% in Edmonton. Of note, the 23% y/y increase in condo sales in Calgary is still a bit of a head-scratcher in the context of weak demand in all other segments.





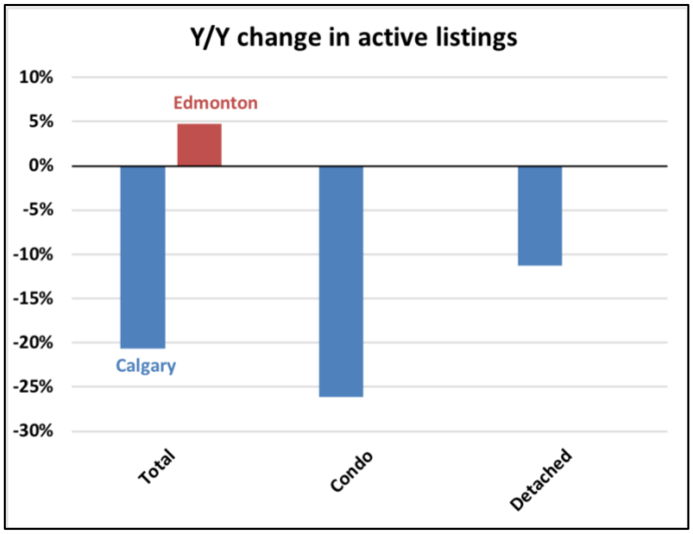
ii) New listings plunge

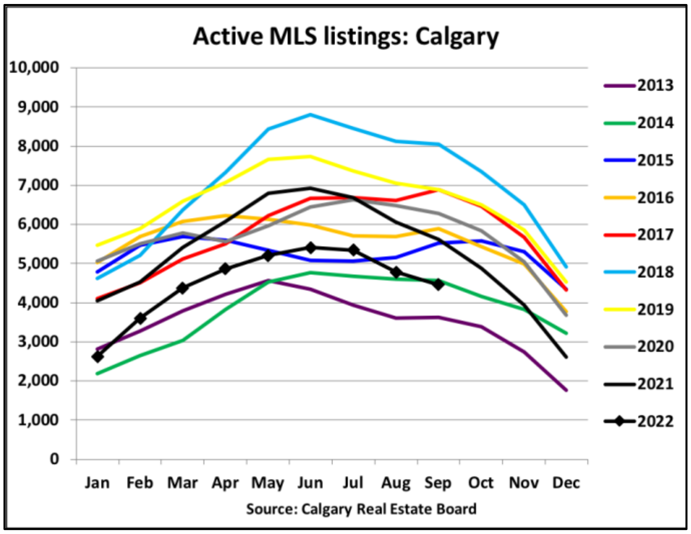
New listings in Calgary fell 9.7% y/y to hit the lowest level since 2010. In Edmonton, new listings ticked up 3.7% compared to last year.



iii) Active inventory continues to fall in Calgary

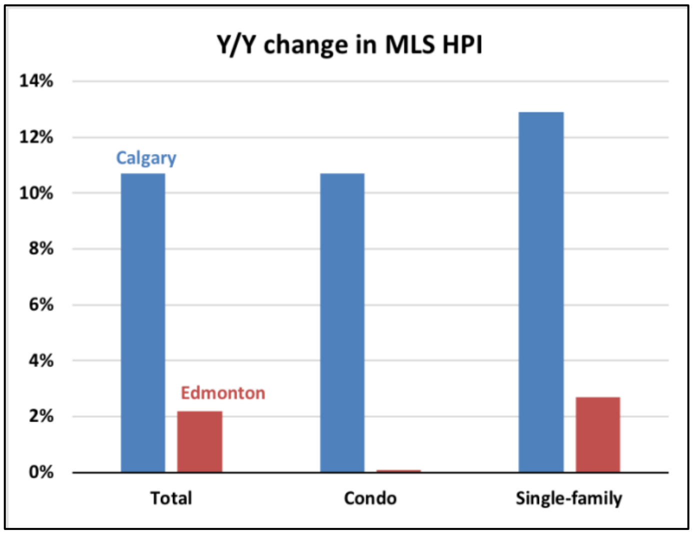
Inventory levels continue to fall in Calgary, down by 20% compared to last year while Edmonton saw active listing rise by 5%.

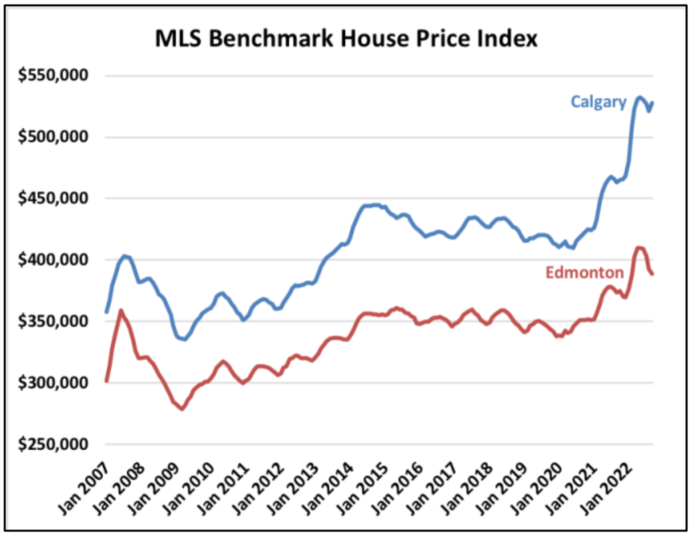




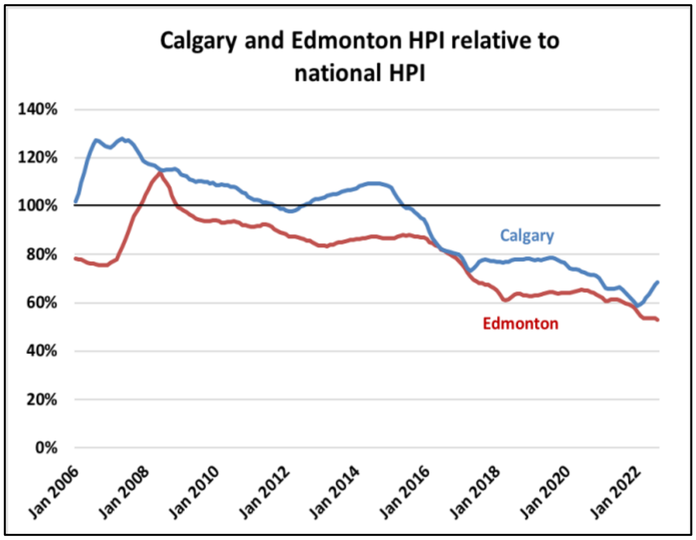
iv) House prices in Calgary begin to outpace national averages

House prices are still up sharply in Calgary compared to last year, up almost 11% overall and nearly 13% for single-family.



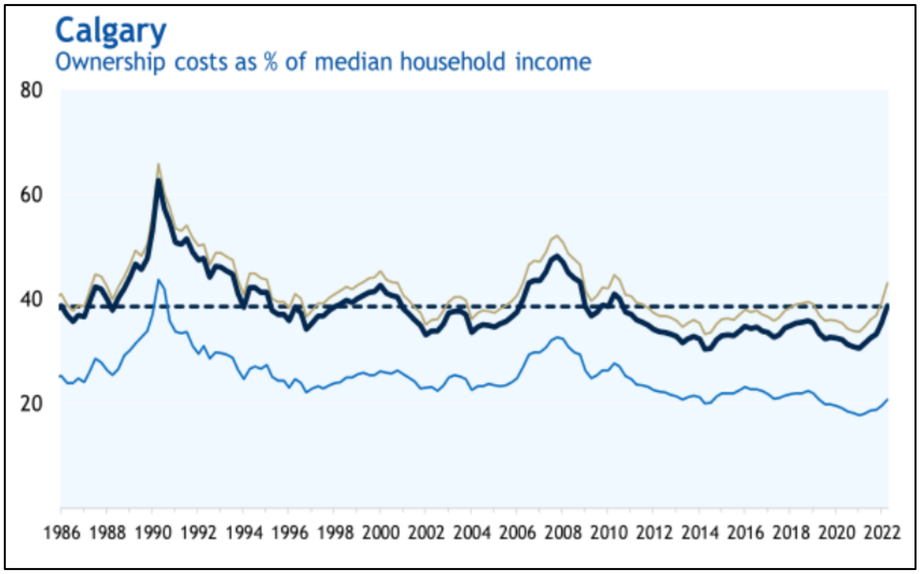


One prediction I've had for a while now is that house prices in Alberta would outpace the national average and close the discount gap over the next few years. We are indeed seeing house prices begin to close that gap, at least in Calgary. I think this is the start of a multi-year trend:



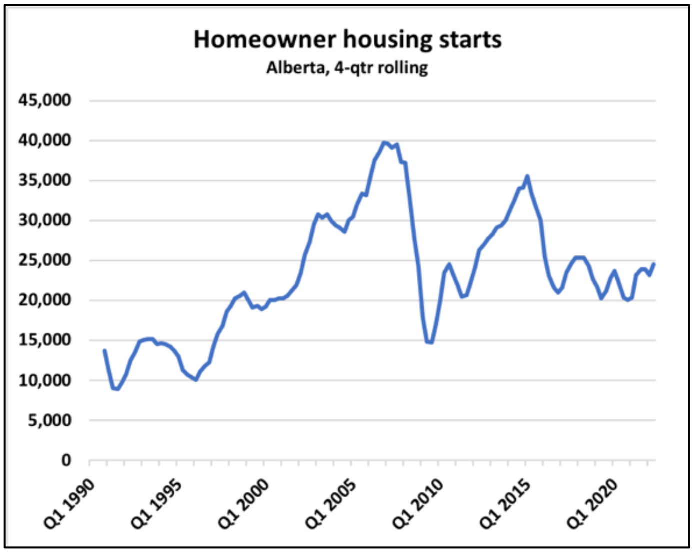
v) Affordability only marginally worse than long-term norms

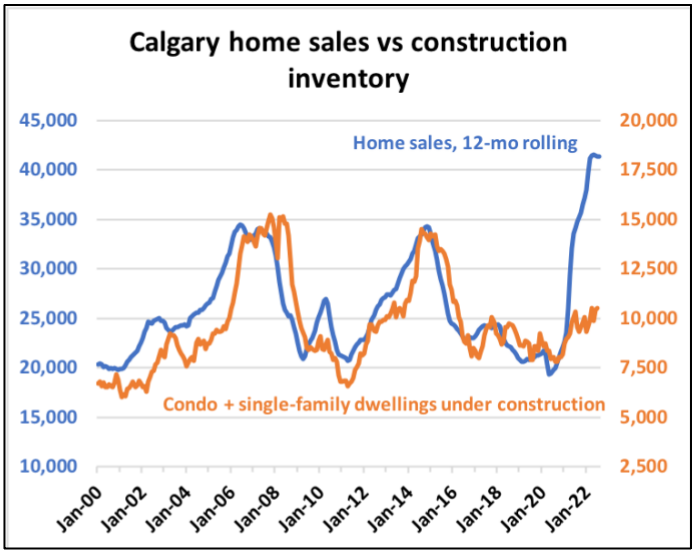
Unlike many other parts of the country, affordability in Edmonton and Calgary remains at fairly normal levels:



v) Still no signs of overbuilding

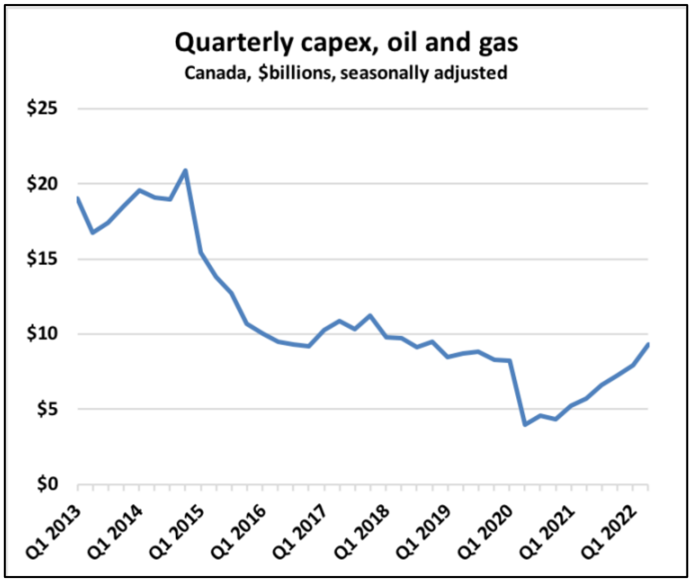
Alberta developers have a long history of overbuilding in good times only to lead to a bust when the economy weakens. We are not seeing any signs of overbuilding this cycle. Despite home sales that remain very solid historically, housing starts have not moved since 2015. Moreover, the normal relationship between sales and under construction inventory in Calgary has completely disconnected and shows no signs yet of converging:

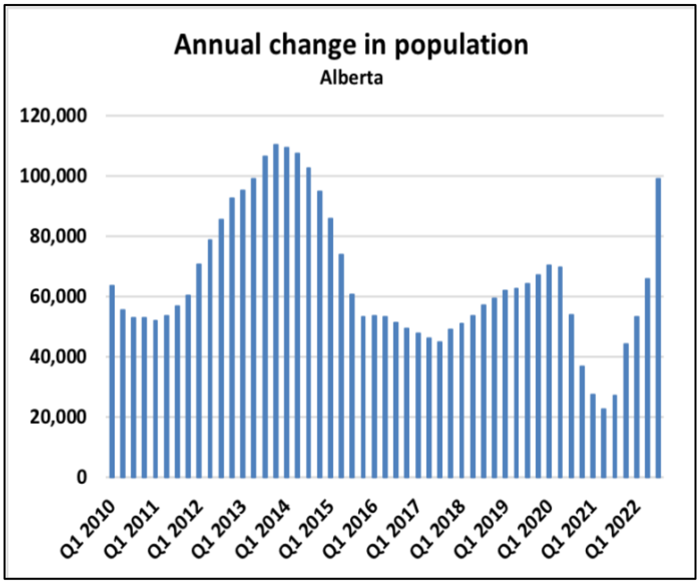




vi) Positive macro tailwinds

Two solid macro tailwinds for Alberta from the data this week: Investment in the energy sector continues to tick up and has now doubled off the Q1 2020 lows, while population growth in the province hit 100,000 in Q3 for the first time since 2014.





Regards,
Ben