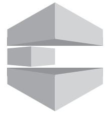


Edge Realty
Analytics

www.edgeanalytics.ca

The Edge Report

April 2023

Compliments of TheMortgageGuyNiagara.com

Hyperlinks:

1) Bank of Canada hints at "higher for longer"

2) Inventory tumbles in March: Have we already peaked for this cycle?

3) Supply and demand: Housing starts tumble, immigration surges to start 2023

4) Credit card borrowing jumps in February

5) Consumer check: Arrears still low but rising

6) Why I'm still very positive on Atlantic Canada

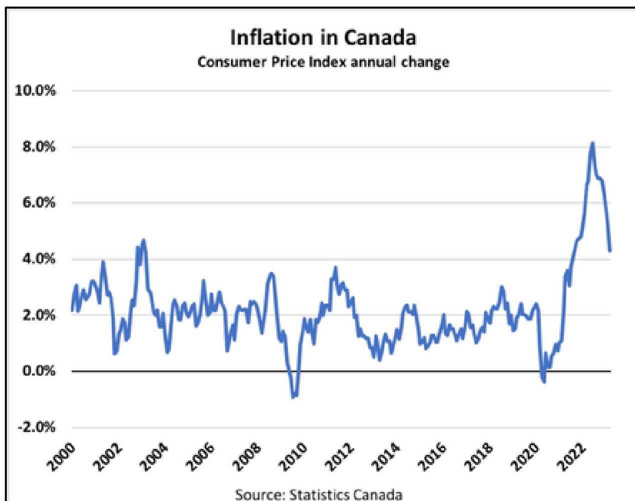
Key takeaways:

- We may need higher rates for longer to get inflation back to target
- New listings sank to 20-year lows, and active inventory sank for a 3rd straight month
- Prices are gaining momentum after registering the first positive monthly increase in a year
- Housing starts are falling hard even as population growth continues to surge
- Arrears are low, but signs of stress are mounting and point to a sharp increase in delinquencies later this year
- Fundamentals in Atlantic Canada look excellent and there may still be good value there

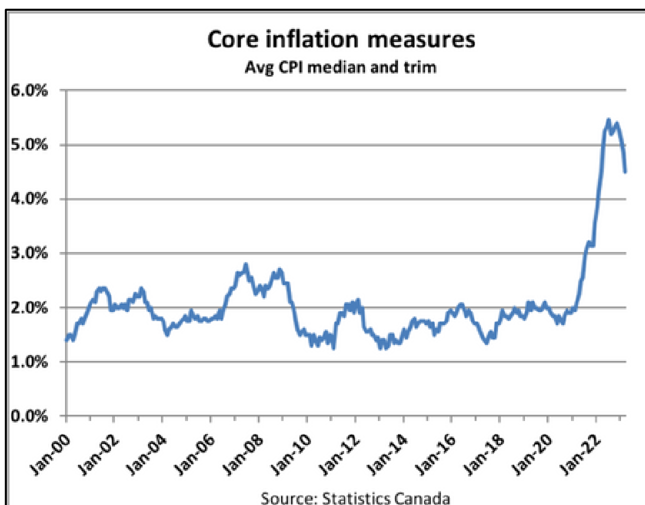
1) Bank of Canada hints at "higher for longer"

I want to once again caution real estate professionals to temper expectations of an imminent return to ultra-low, emergency-level interest rates when the economy begins to cool later this year. My view for some time now is that we are in a structurally higher inflation regime. Not Zimbabwe or anything crazy, but I can see a scenario where core CPI is volatile but settles somewhere around 3% over the next decade rather than the 1% we've been used to for several decades now.

This means that barring a financial crisis, the Bank of Canada (BoC) will begin cutting rates in late 2023 or early '24 and will likely settle in the 2.5%-3% range late next year....and that's true even in a "run of the mill" recession. The good news is that headline inflation continues to trend in the right direction, cooling to 4.3% y/y in March from 5.3% the month prior...



While that's welcome news, measures of core inflation -which strip out volatile food and energy prices and which more heavily factor into interest rate decisions- remain stubbornly high at an average of 4.9%:



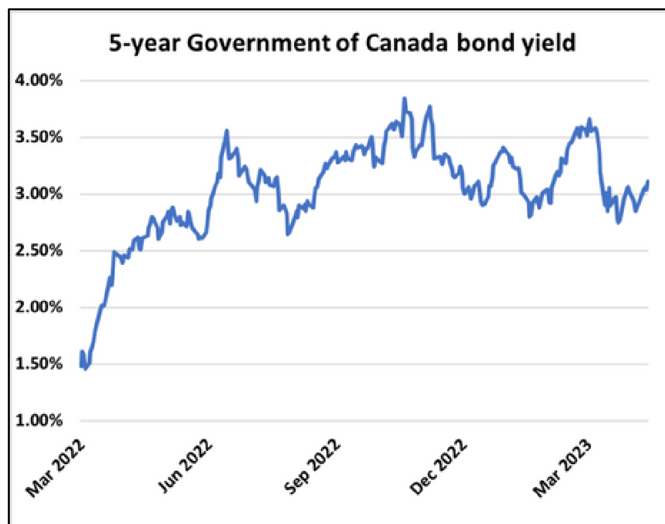
Comments this week from the BoC reinforce the "higher for longer" view. The Bank expects core inflation to move fairly rapidly back to 3%, but getting it all the way back to the target of 2% could take longer than originally anticipated. From the latest Monetary Policy Report:

Getting inflation the rest of the way back to 2 per cent could prove to be more difficult because inflation expectations are coming down slowly, service price inflation and wage growth remain elevated, and corporate pricing behaviour has yet to normalize.

And then in the press conference, Governor Tiff Macklem added this:

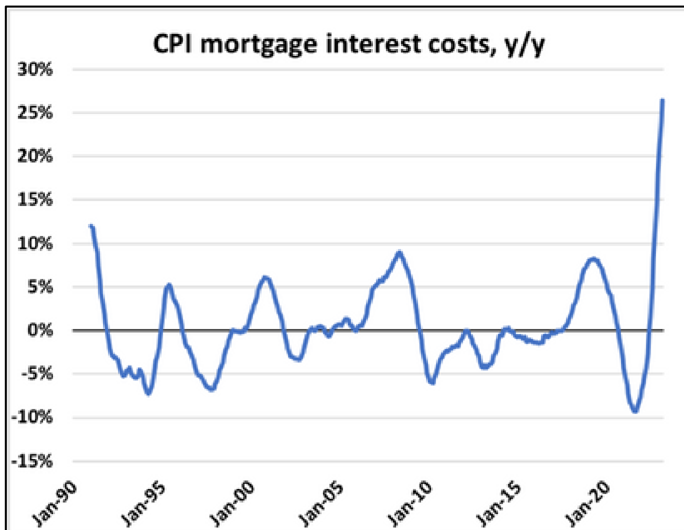
"If monetary policy is not restrictive enough to get us all the way back to the 2 per cent target, we are prepared to raise the policy rate further to get there."
[...] "(Rate cuts later this year) do not look like the most likely scenario".

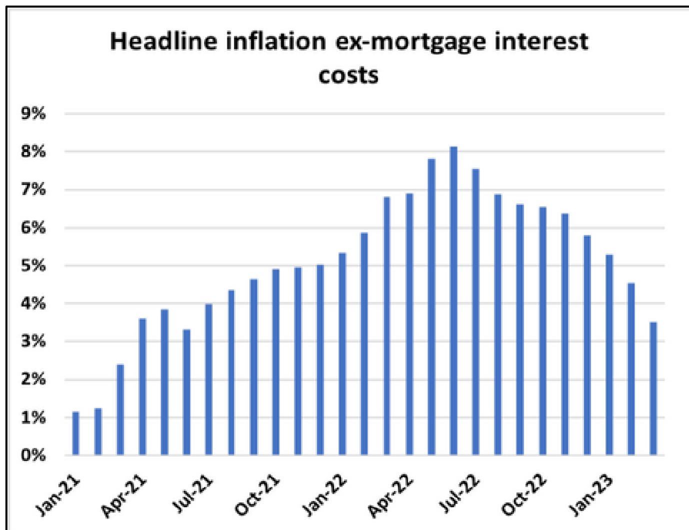
That last comment was a glass of cold water on those expecting a rate cut in the near term. Markets responded by pushing the key 5-yr bond yield up 25bps to hit a 5-week high.



The big takeaway is that there is a good chance that we are in a higher inflation regime, and with it, higher rates than we've been used to.

One more interesting tidbit on the inflation front. I flagged this in last month's Edge Report, but I'd like to revisit it here. The fact that Stats Canada includes mortgage interest costs in the CPI basket is one of those things that bends my brain a little. We're now at the point where interest costs are up nearly 30% y/y, and this one component alone now accounts for 0.8 percentage points of the headline 4.3% CPI. In other words, if we stripped that out, "actual" inflation is running at 3.5%, the lowest since mid-2021:





2) Inventory tumbles in March: Have we already peaked for this cycle?

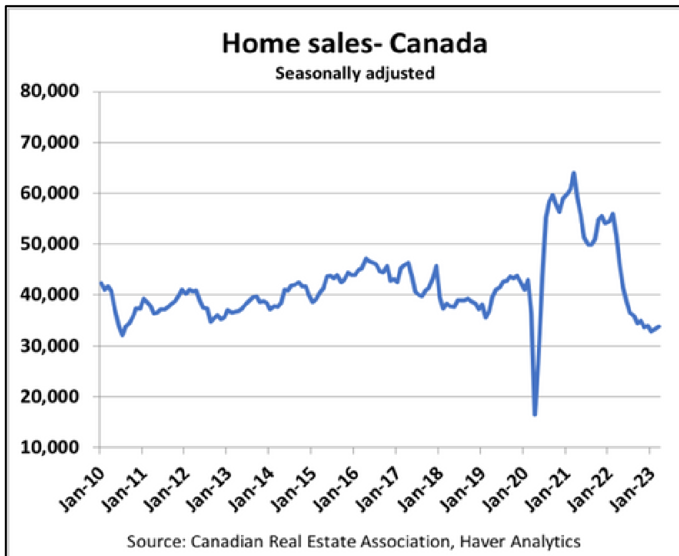
The key data from last month is summarized below. Note the uptick in sales, steep drop in new listings, and falling active inventory trends:

	Sales		New listings		Active inventory		House prices (HPI, seasonally adjusted) y/y m/m	
	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted	y/y	m/m seasonally adjusted		seasonally adjusted
Canada	-34.6%	+1.4%	-29.4%	-5.8%	+26.5%	-2.9%	-15.4%	+0.2%
BC	-37.1%	+10.0%	-33.2%	-8.7%	+21.2%	-4.2%	-12.8%	-0.5%
AB	-42.5%	-1.1%	-36.6%	-10.0%	+0.7%	-0.6%	-1.6%	+0.0%
ON	-36.0%	+1.1%	-35.8%	-6.4%	+41.8%	-9.3%	-18.1%	+0.3%
QC	-24.5%	+0.8%	-7.6%	+0.6%	+50.7%	+2.9%	-5.7%	+0.1%

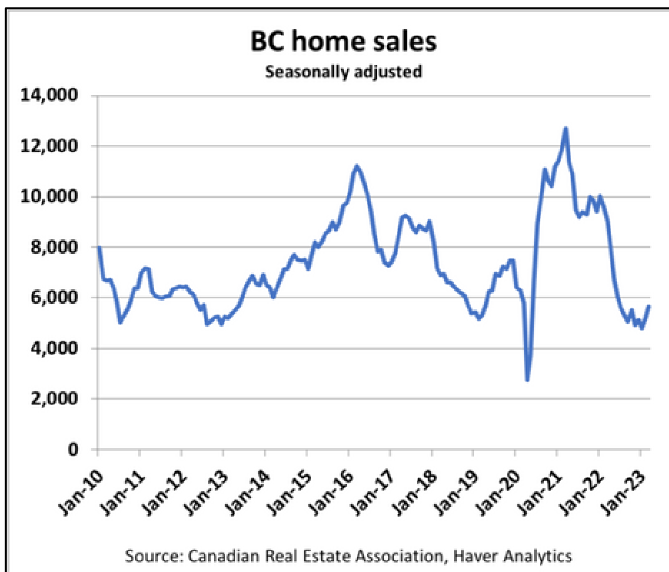
Key takeaways:

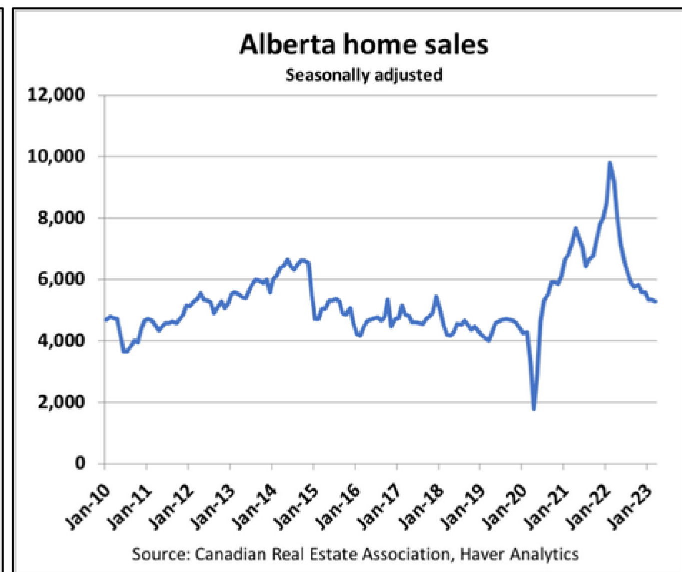
i) Home sales stabilize in March

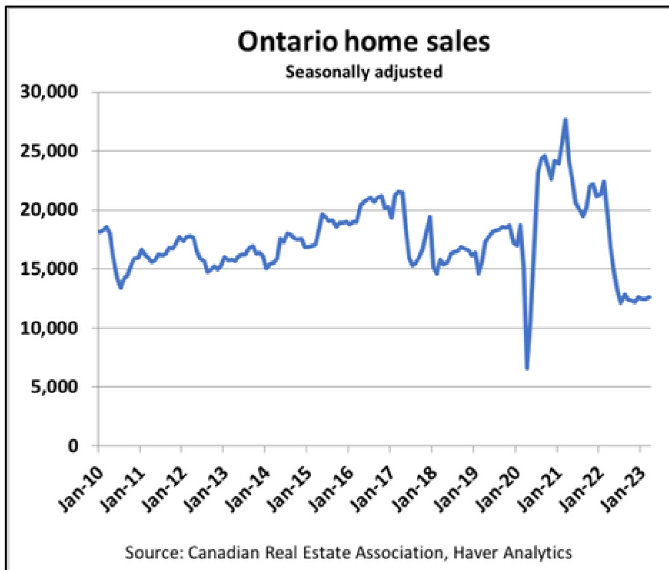
Seasonally adjusted home sales were up 1.4% m/m in March, but that comes off a 0.8% downward revision to the February numbers, so not a particularly impressive reading. That leaves demand down 35% y/y and 47% off the highs.

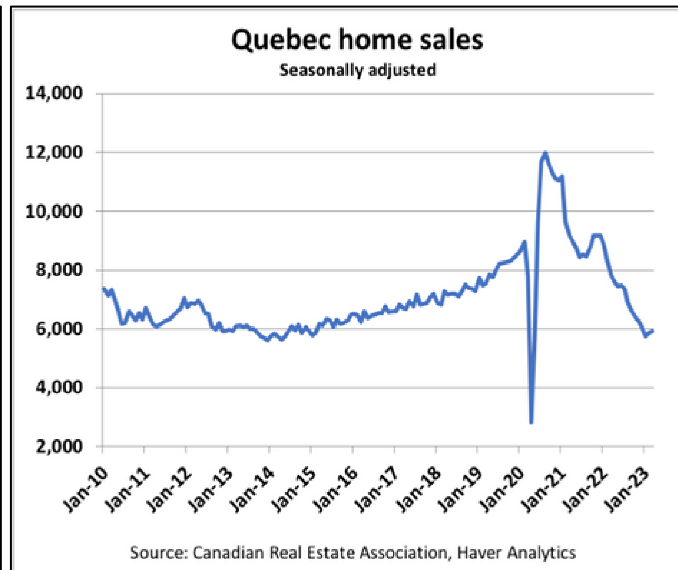


There were notable regional differences in March, with sales surging 10% across BC (building on last month's 7.3% increase) while Quebec and Ontario both saw sales up roughly 1% and Alberta saw a slight decline:



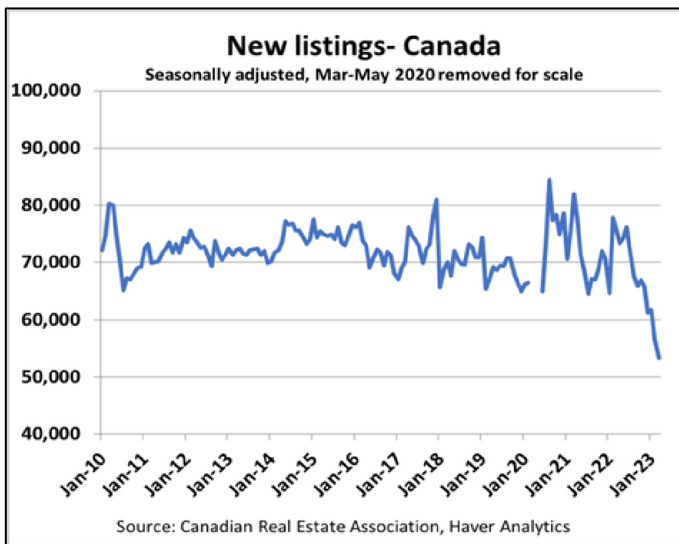






ii) New listings keep making new lows

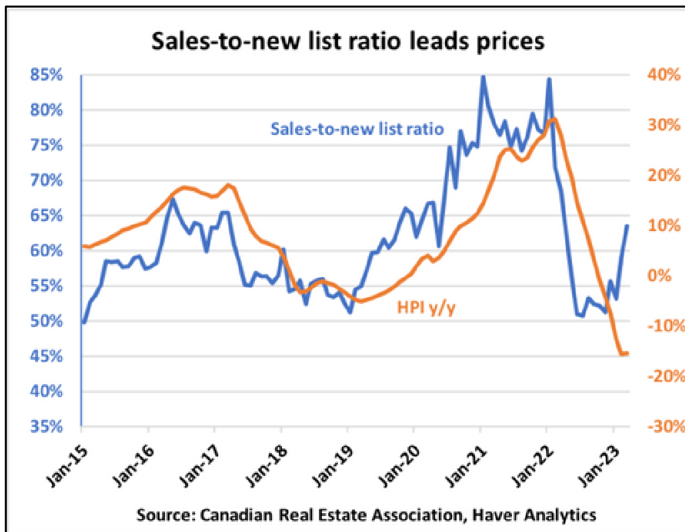
The most notable trend in the latest data is the continued decline in new listings which were down a further 5.8% m/m. That puts the 2-month decline at 14%, one of the largest on record. New listings are now at a level last seen in 2004.



This remains THE trend to watch as we head into the spring selling season. If we don't see an imminent reversal and a strong flow of new supply, house prices have the potential to rise rapidly.

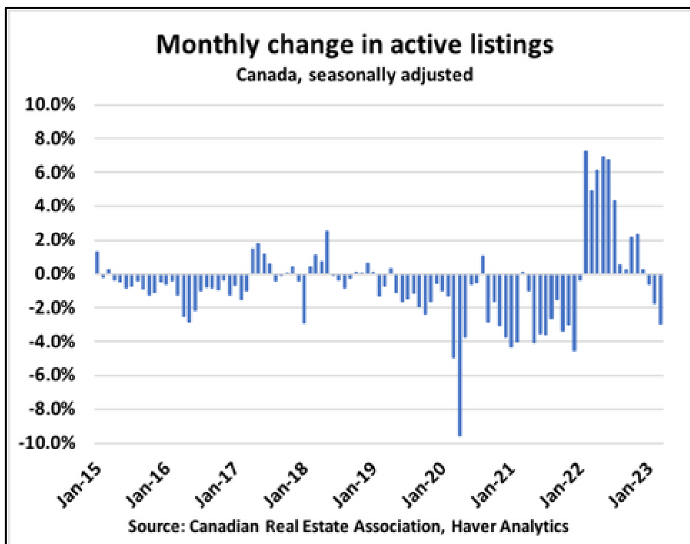
Already we've seen the sales-to-new listings ratio jump above 60%, a line that generally delineates a seller's market.

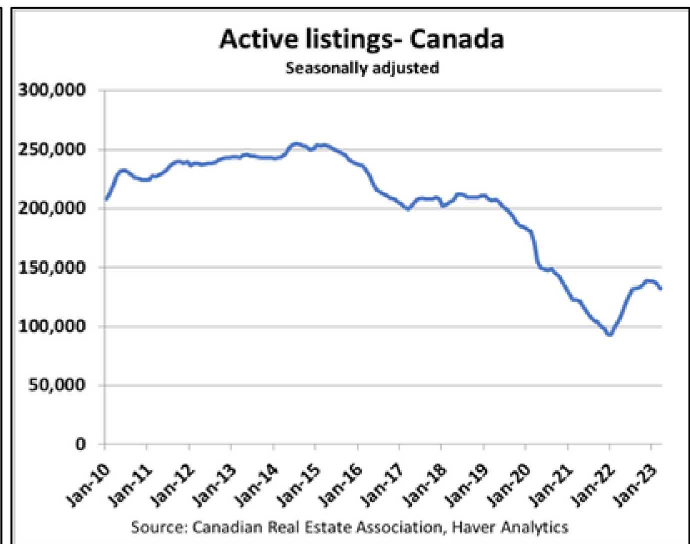
This is a leading indicator for prices, and history has shown that when this ratio holds around this level, prices gains pick up momentum over the next 3-6 months:



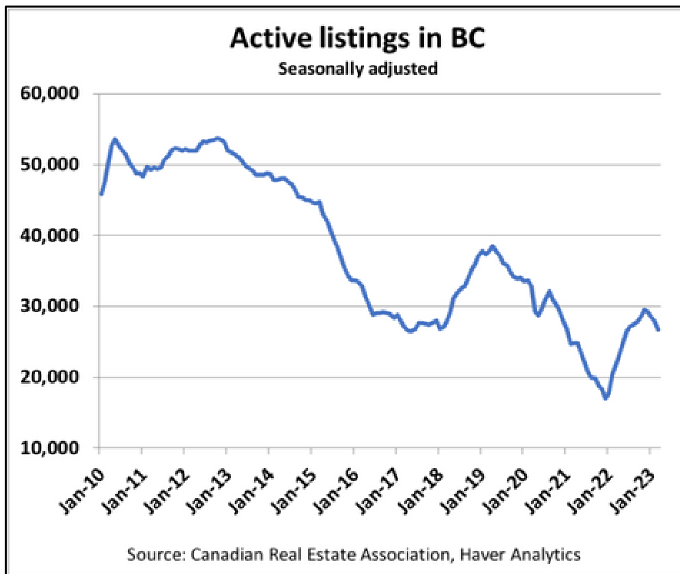
iii) Has inventory already peaked for this cycle?

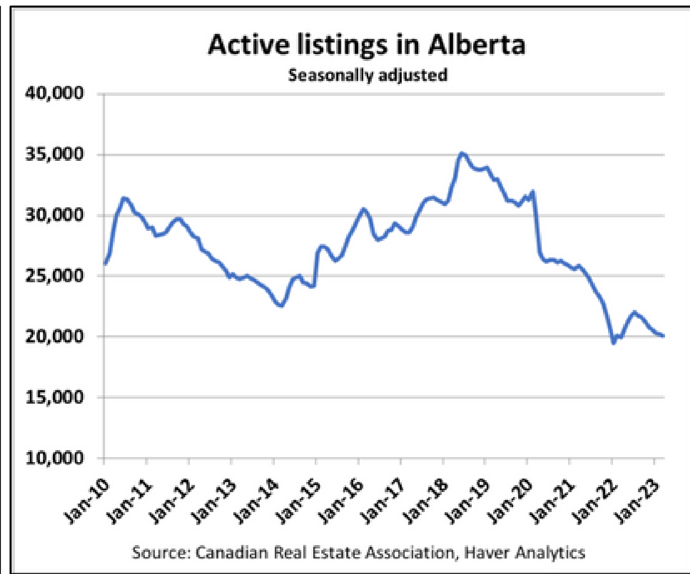
Let's hope not, but the trend here is becoming clear. We've now seen three consecutive months of declining resale inventory levels nationally (on a seasonally adjusted basis), including a whopping 9.3% drop last month in Ontario.

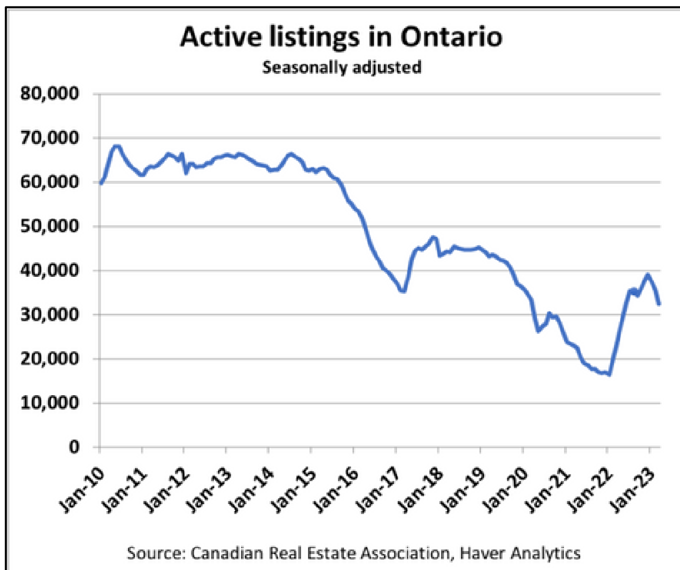


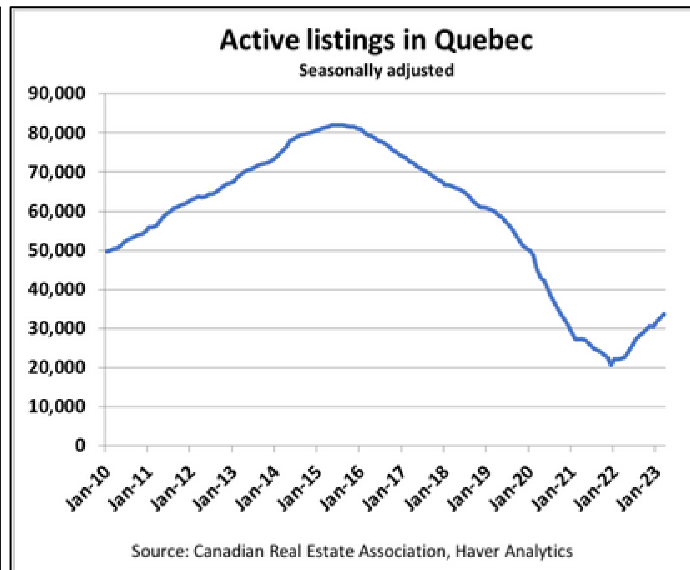


It's surprising and frankly a bit disconcerting that after a full year of extremely weak resale activity, we're still nowhere near "normal" inventory levels in any province:



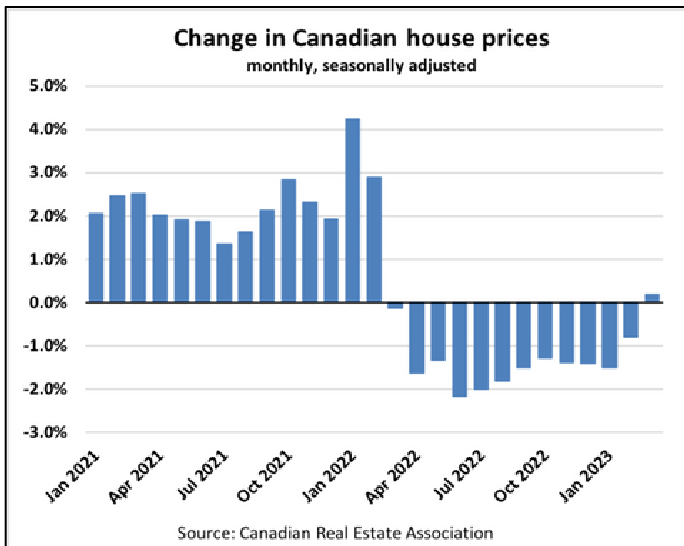


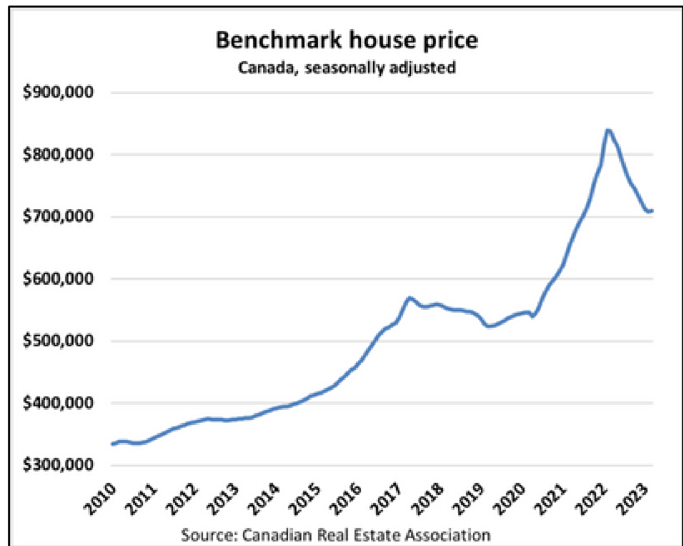




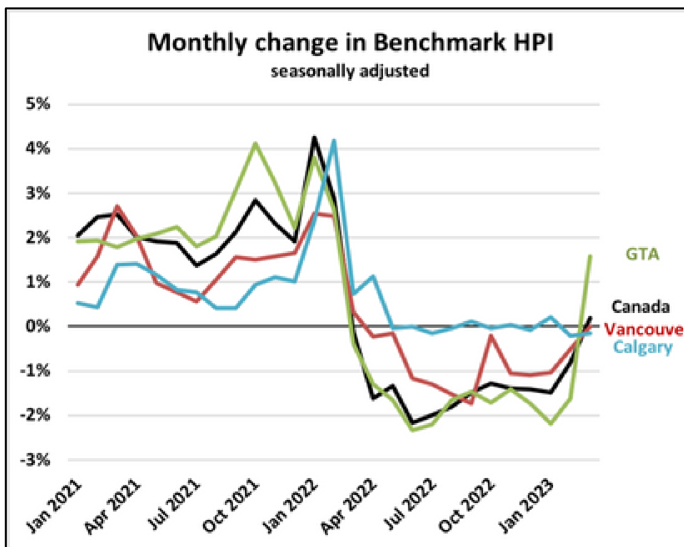
iv) Prices increase for the first time in a year

Last month's Edge Report predicted positive prices in either March or April, and indeed that's what we saw The dramatic tightening in resale markets across the country led to the first seasonally adjusted monthly price increase in a year. Still, that leaves prices down 15.4% from peak levels nationally and down 18% in Ontario, so there's some work to do to recapture prior highs:

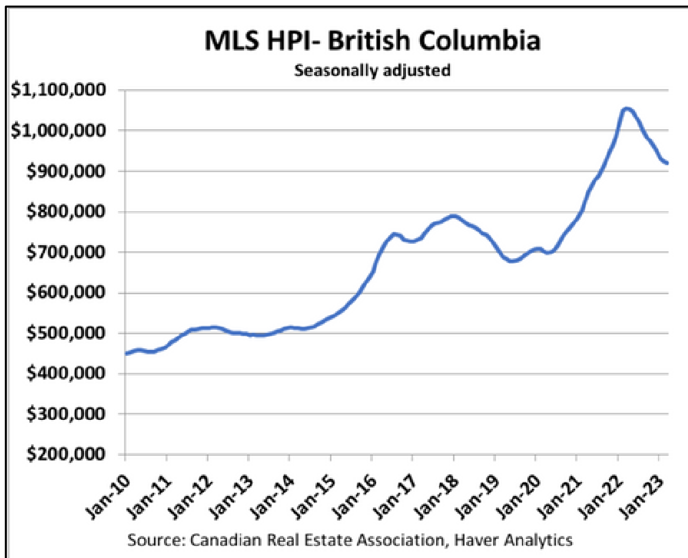


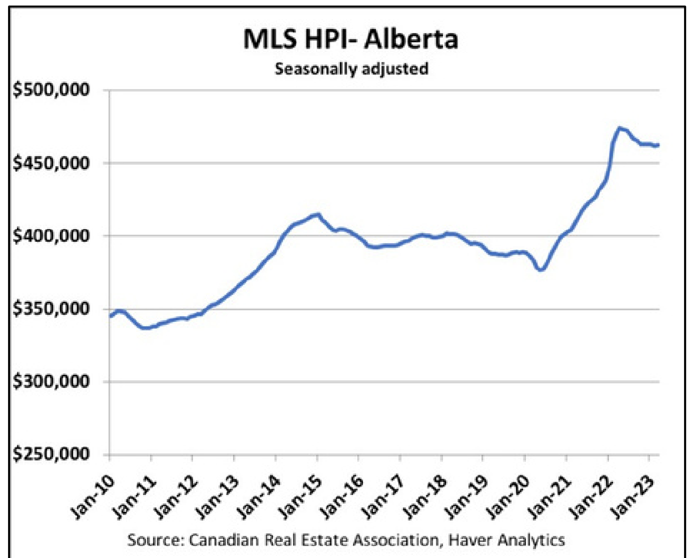


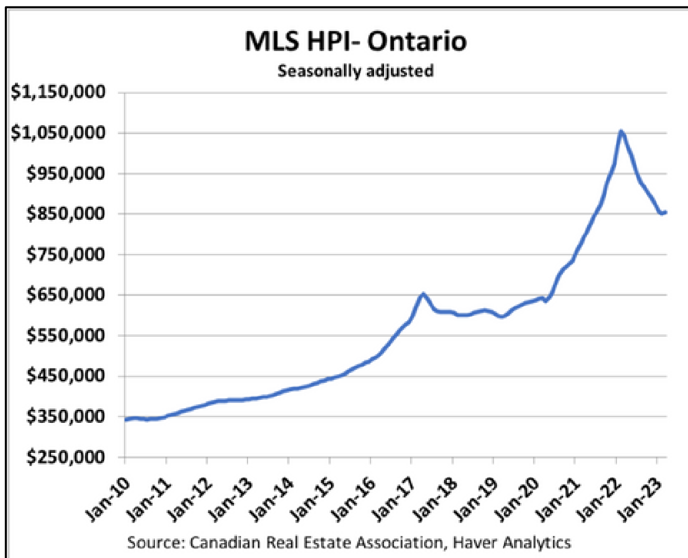
The national increase in house prices in March was largely driven by an outsized monthly jump in the GTA where prices were up 1.6%. In contrast, Vancouver was flat while Calgary was slightly negative:

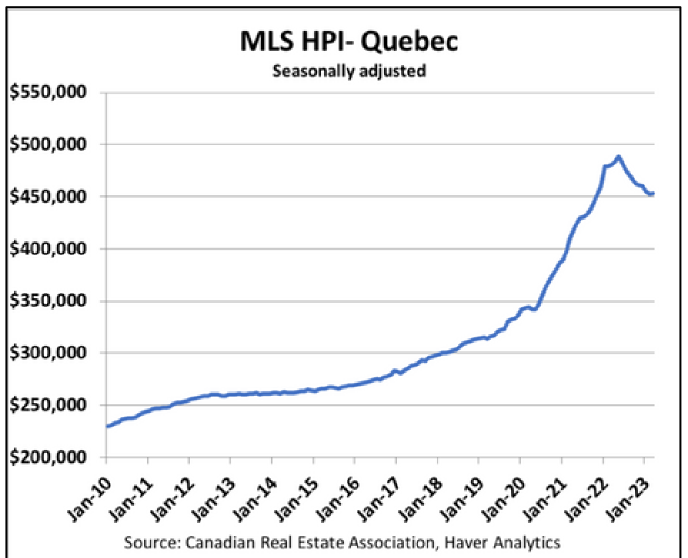


If there's one fly in the ointment it's that condo prices were down again in March (-0.8% m/m). That segment is beginning to considerably underperform the broader index, which raises risks of closing issues in late '23 or into 2024. HPI for the big provinces are shown below:



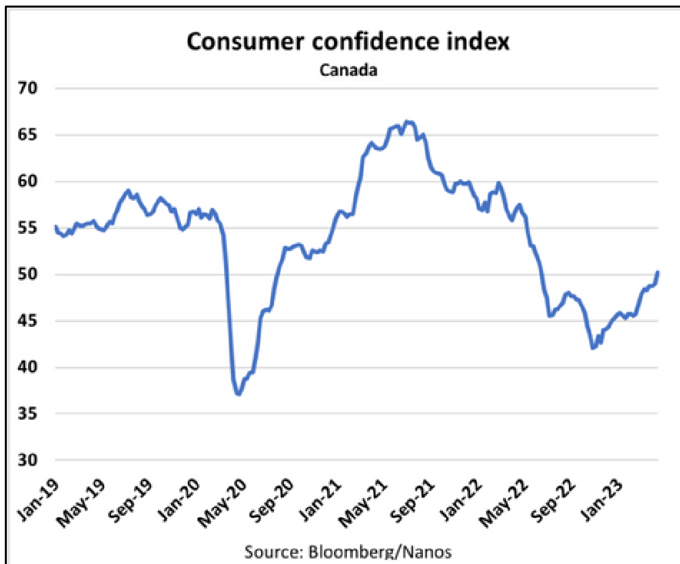


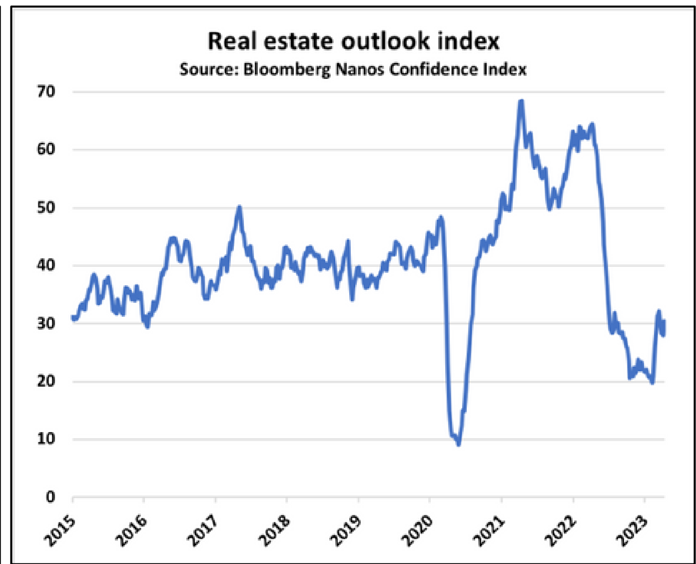




v) Sentiment improves

Consumer confidence continues to improve. The Bloomberg-Nanos Confidence Index rose above the neutral level of 50 for the first time since June of last year, pulled higher by real estate sentiment that continues to recover from near-record lows.

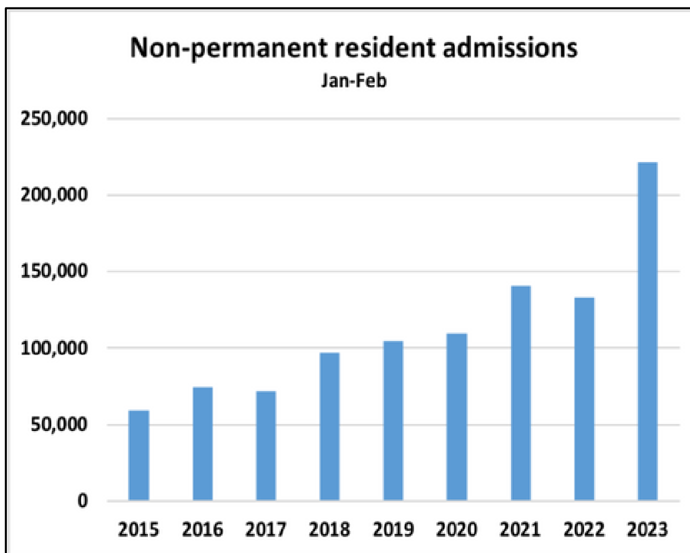


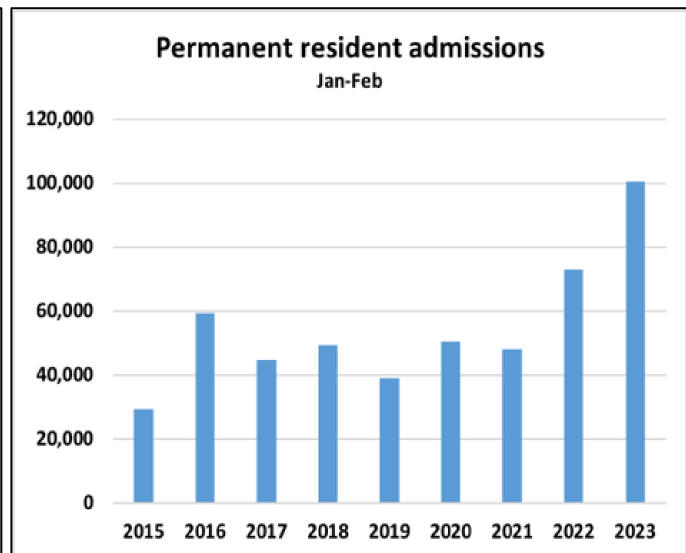


3) Supply and demand: Housing starts tumble even as immigration surges to start 2023

i) Record population inflows to start 2023

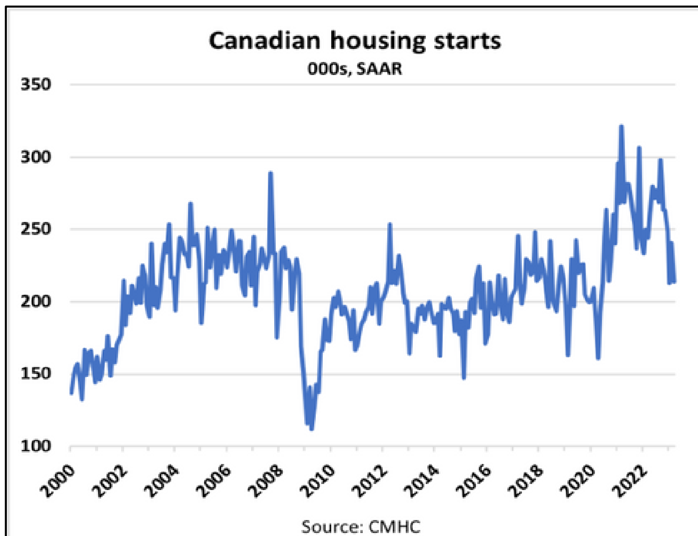
We're starting 2023 right where we left off last year with record admissions of both permanent and non-permanent residents in the first 2 months of the year:



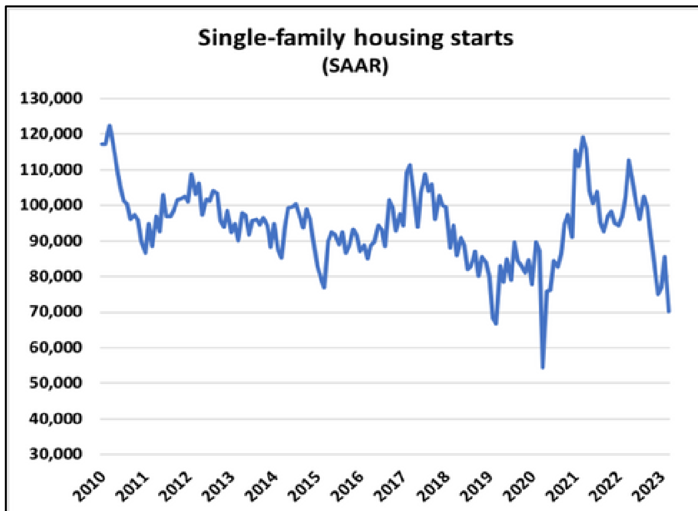


ii) Housing starts tumble

While population growth looks set to keep surging, housing starts tumbled 11.2% m/m in March to hit 214,000 on an annualized basis, the second lowest monthly reading since mid-2020. This was the fourth decline in 5 months.



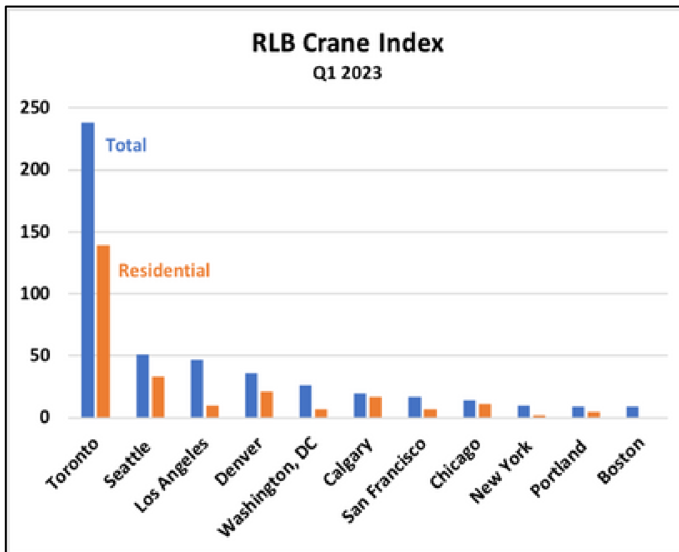
Particularly notable was the decline in the bellwether single-family segment which fell 18% on the month and registered the fourth lowest monthly reading since the Financial Crisis:

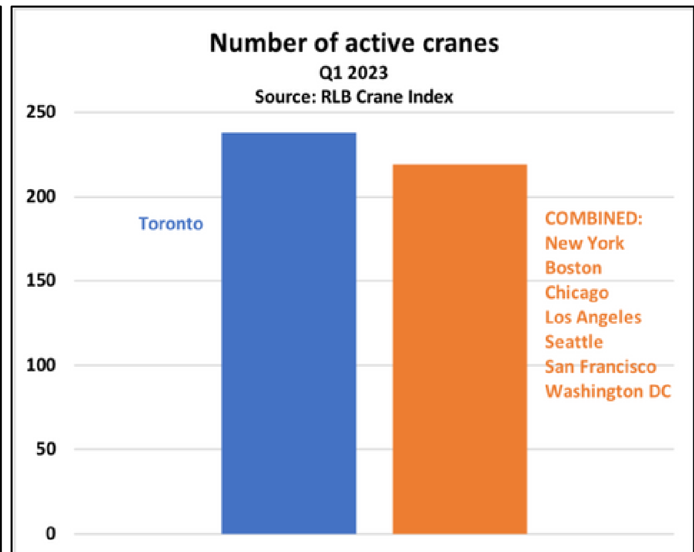


It’s not an issue for this year, but if we roll forward these two trends of surging population and declining new supply, it sets up for an even worse affordability crisis down the road. Something’s gotta give here.

iii) Crane craze

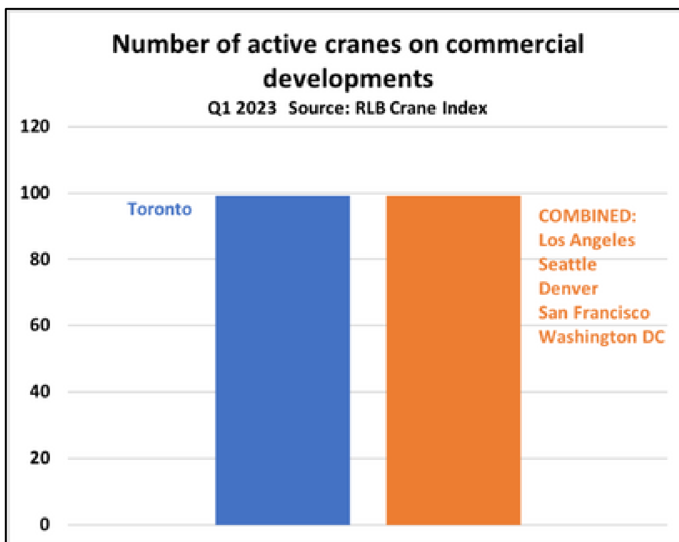
While housing starts are rolling over, there’s still plenty of residual construction activity happening for now. RLB’s latest Crane Index for Q1 (which shows that number of active cranes working on residential and commercial developments in major metro regions) shows just how much of an outlier Toronto is relative to its North American peers.



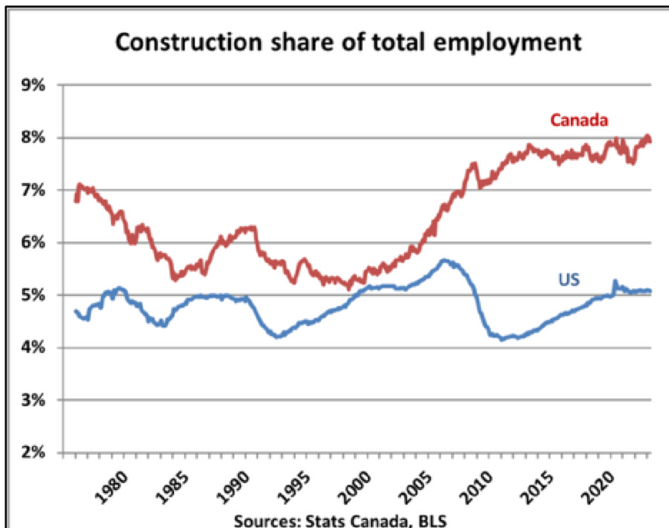


It's not a perfect measure of overall construction activity due to longer construction times, for example, but it's still notable.

Given the looming fallout in the commercial real estate sector, it's also interesting that Toronto has as many cranes operating in non-residential developments than the top 5 US cities combined:

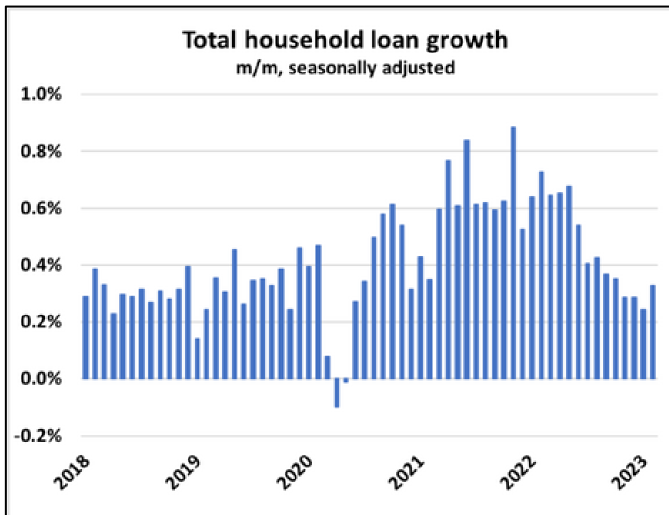


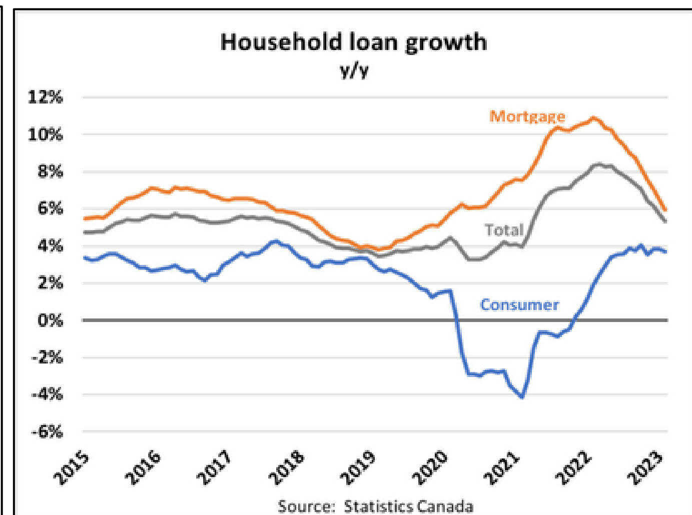
It's also a good reminder that there's tremendous labour market leverage to this construction boom which will likely come under pressure as higher rates and lower housing starts filter through to a construction slowdown later this year:



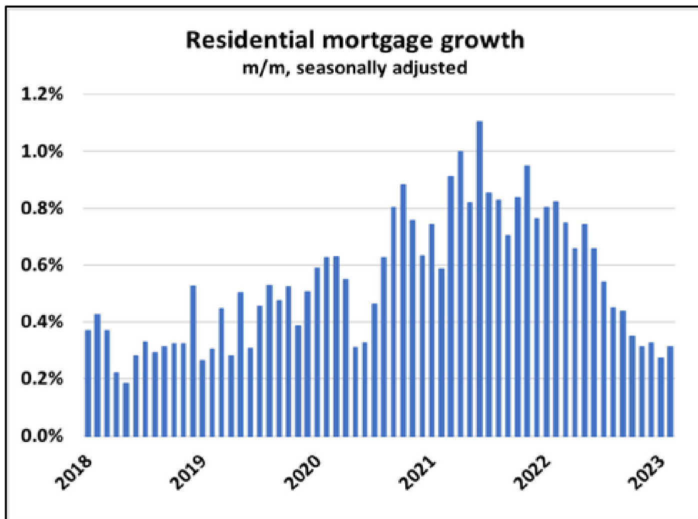
4) Credit card borrowing jumps in February

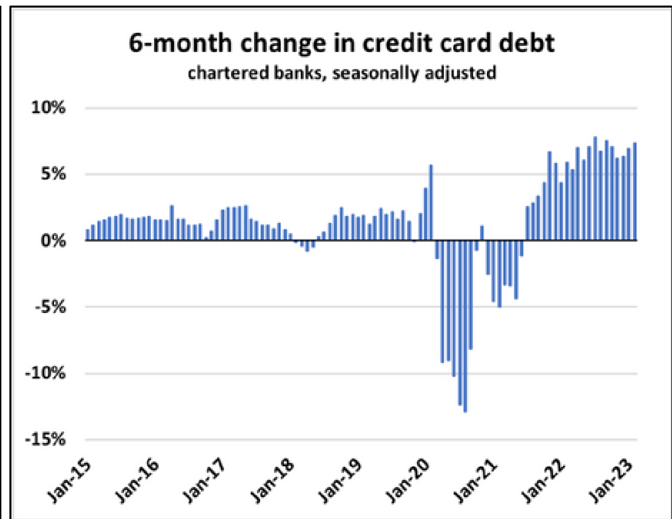
Lending to Canadian households grew at a seasonally adjusted 0.3% m/m clip in February (+0.2% prev). On an annual basis, mortgage lending slowed to 6% while overall household loan growth slowed to 5.7%:



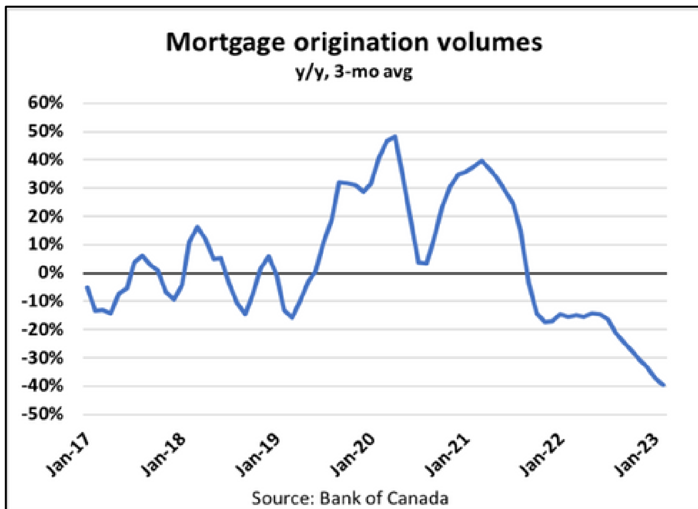


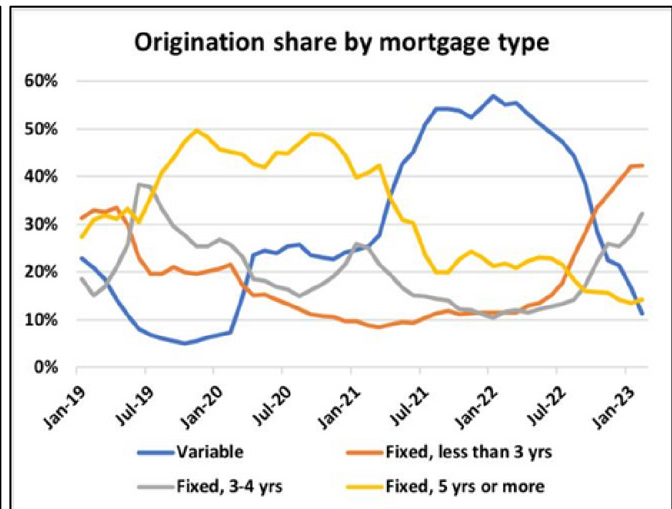
The monthly uptick was driven by slightly stronger mortgage growth relative to January and very strong growth in credit cards where balances jumped 1.5% on the month and are now up 7.3% in the past 6 months. It seems to me that if OSFI is concerned about household vulnerability, this is perhaps a good place to look rather than the mortgage market where debt is now growing slower than incomes:





Mortgage origination remain extremely weak, down 41% y/y as of February with new loans now skewing heavily to shorter term fixed rate products:





OSFI hints at higher capital requirements on variable mortgages

This week we also got OSFI's latest Annual Risk Outlook[1]. The report itself was not particularly notable: They worry about a deepening housing downturn, liquidity risks for banks, and the fallout from weakening commercial real estate trends.

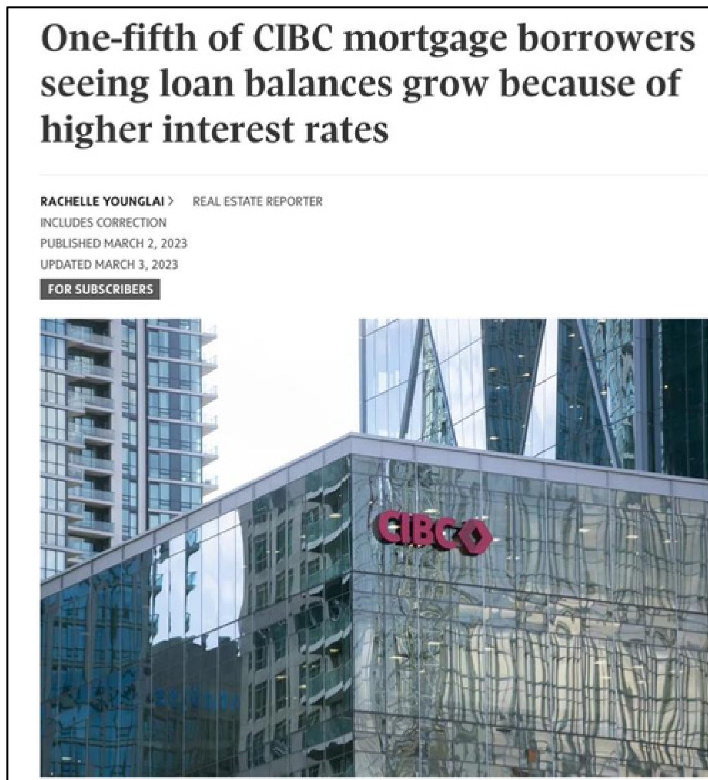
There was no mention of risks associated with widespread income document fraud and a potential loss of confidence in institutions, akin to the HCG fiasco, but OSFI did dedicate a whole section to the looming impact of climate change on Canadian banks. In case it wasn't already clear, our regulator is every bit as interested in virtue signaling as they are in tackling real issues.

[1] https://www.osfi-bsif.gc.ca/Documents/WET5/ARO/eng/2023/aro.html

The more interesting takeaways came from the media Q&A in which OSFI head Peter Routledge commented on potentially revising capital requirements on static payment variable rate mortgages given the recent trend in low/negative amortization of these loans:

"...We are actively assessing the risks posed by variable rate fixed payment mortgages to determine whether the current capital treatment is fit-for-purpose or revisions are warranted."

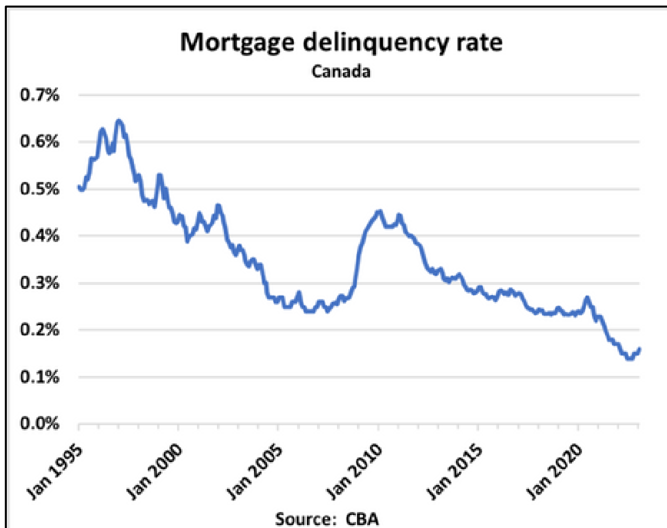
Having banks hold more capital against negatively amortizing mortgages seems only logical. CIBC and BMO are the two that allow outright negative amortization and would likely be the two most affected by any such change:


One-fifth of CIBC mortgage borrowers seeing loan balances grow because of higher interest rates

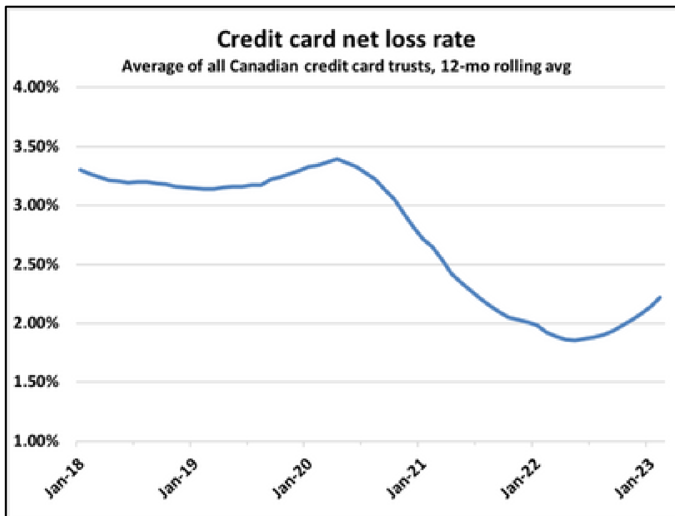
RACHELLE YOUNGLAI REAL ESTATE REPORTER
INCLUDES CORRECTION
PUBLISHED MARCH 2, 2023
UPDATED MARCH 3, 2023
FOR SUBSCRIBERS

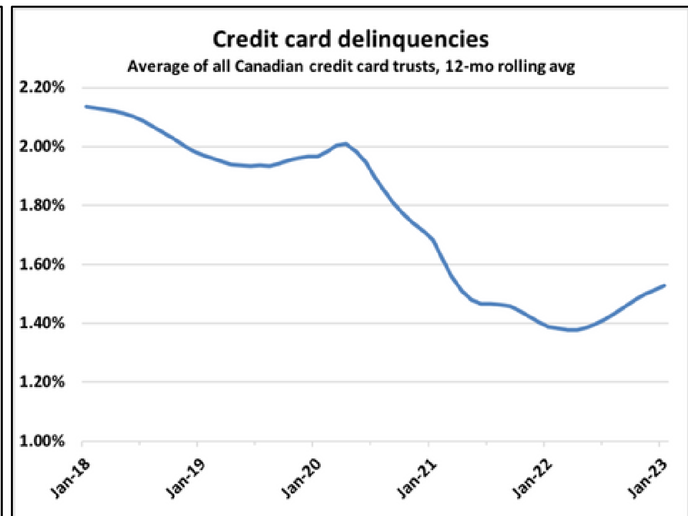
5) Consumer check: Arrears still low but rising

The Canadian consumer still remains in fairly solid shape overall. Official data from the Canadian Bankers Association data shows only a modest uptick in mortgage arrears nationally as of January, but overall they remain at barely 1/3 of long-term levels:



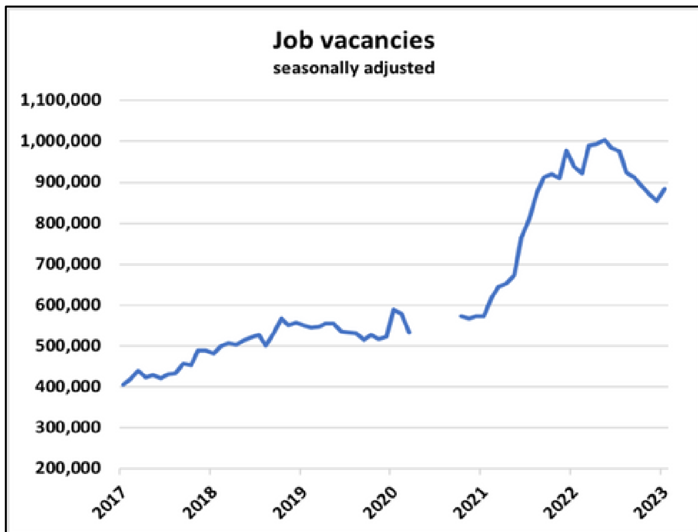
But as I regularly point out, mortgage delinquencies tell us more about the state of the economy 6-12 months ago than they do about things today. A better indicator is credit card delinquencies and charge-offs, and here the trend decidedly upwards.

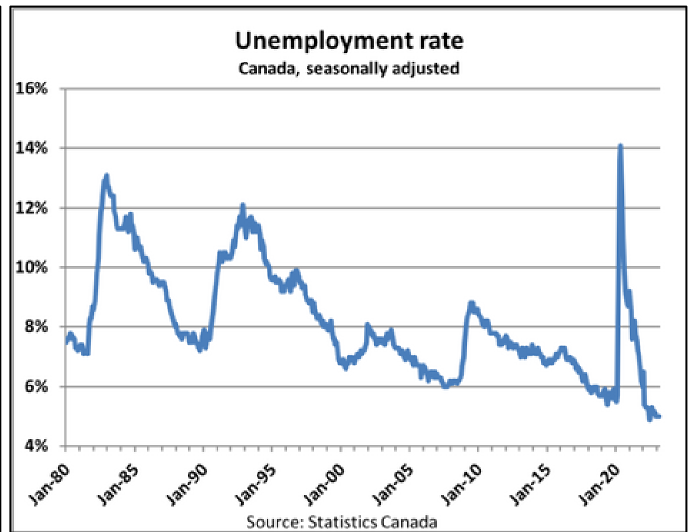




Of particular interest is the 43bp sequential increase in credit card charge-offs last month, the largest such increase in 2 years. There are clear signs that some borrowers are beginning to run into problems, and I expect that to be reflected in a mortgage arrears rate that is almost double its current rate by this time next year. That may sound extreme, but it would leave arrears at less than the long-term norm.

To get to truly stressed levels from here, we need an increase in unemployment, and we're very far from that at present. We still an unemployment rate that is effectively at all-time lows as well as 900,000 vacant positions across the country, which means employers can shed unfilled jobs without shedding actual positions for a while yet:

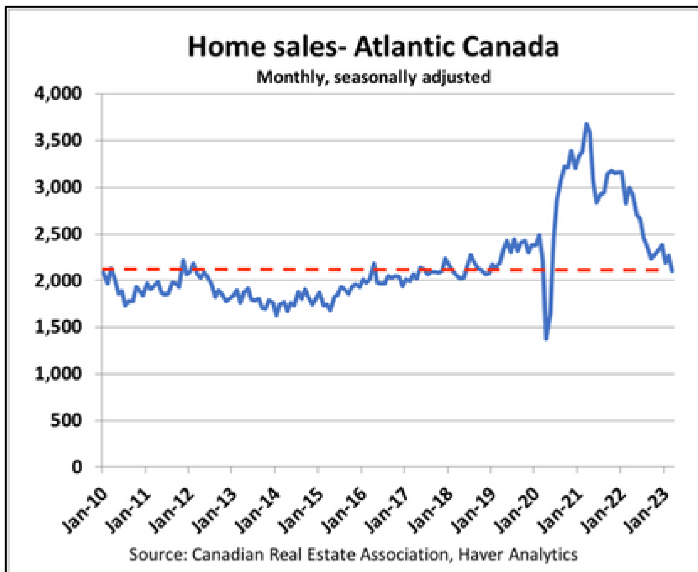




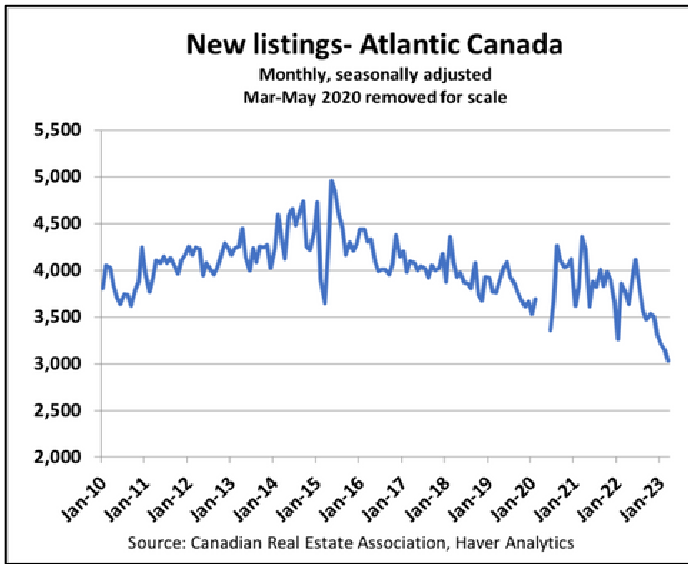
6) Why I'm still very positive on Atlantic Canada

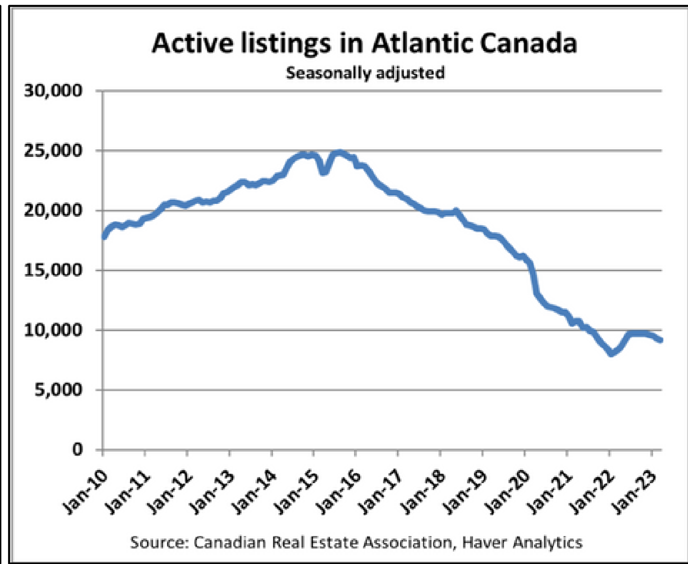
A few bullet points on why I still see value in the east coast, particularly for larger centres like Halifax.

• Demand is down but still above decade averages....i.e. no froth, no "FOMO"

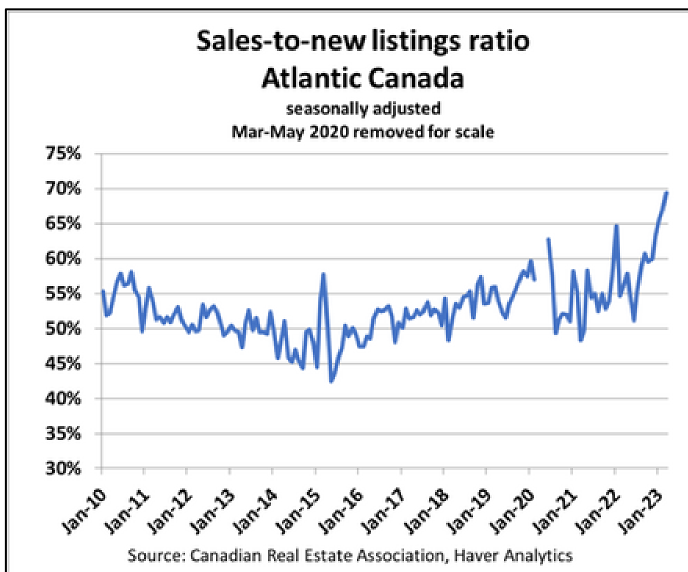


- Resale inventory is still tight. New listings at multi-decade lows, total active inventory is still near 20-year lows.

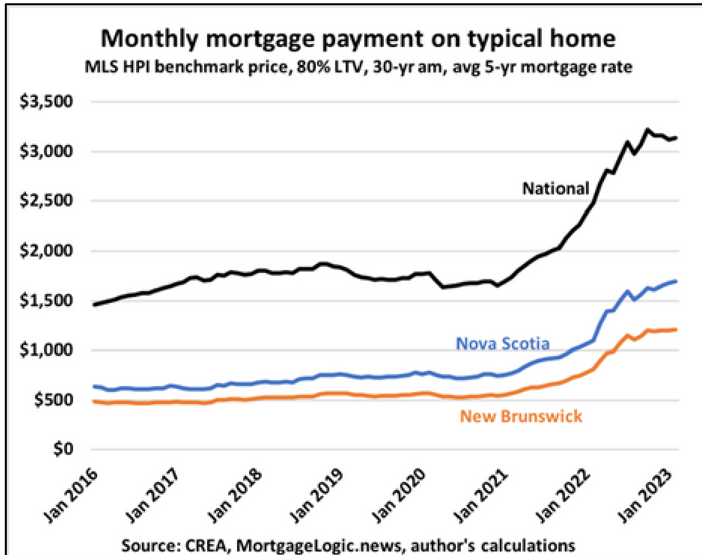




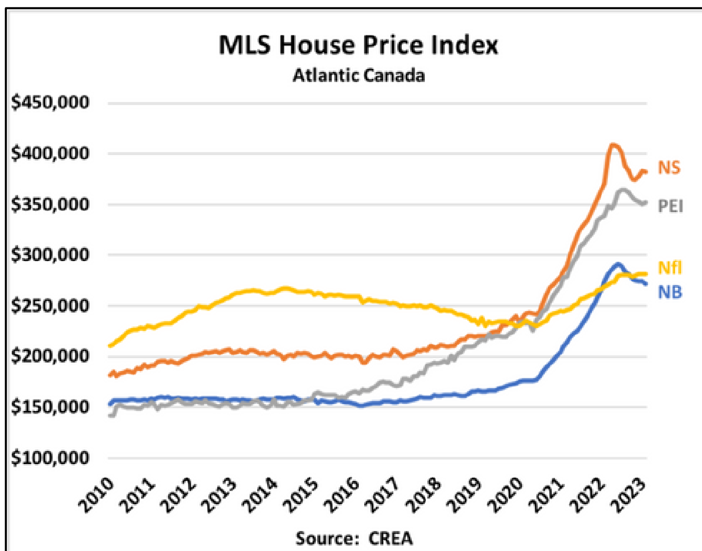
- Resale market is still remarkably tight and getting tighter but it's not yet being reflected in strong price appreciation.

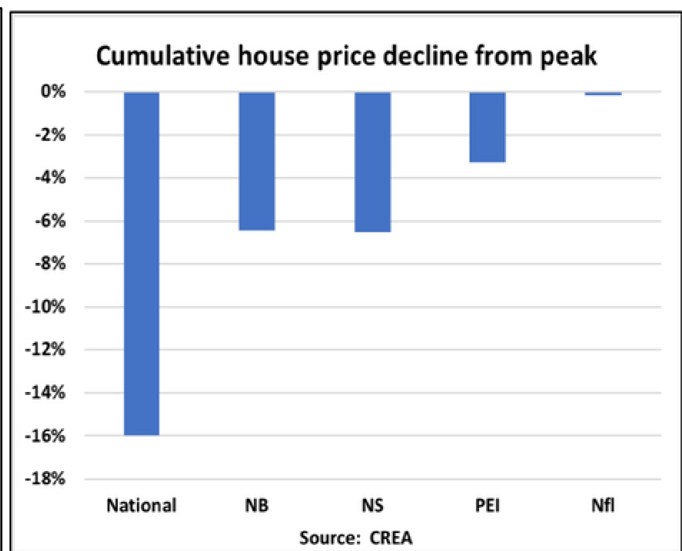


- Affordability is still *relatively* good relative to the rest of the country.

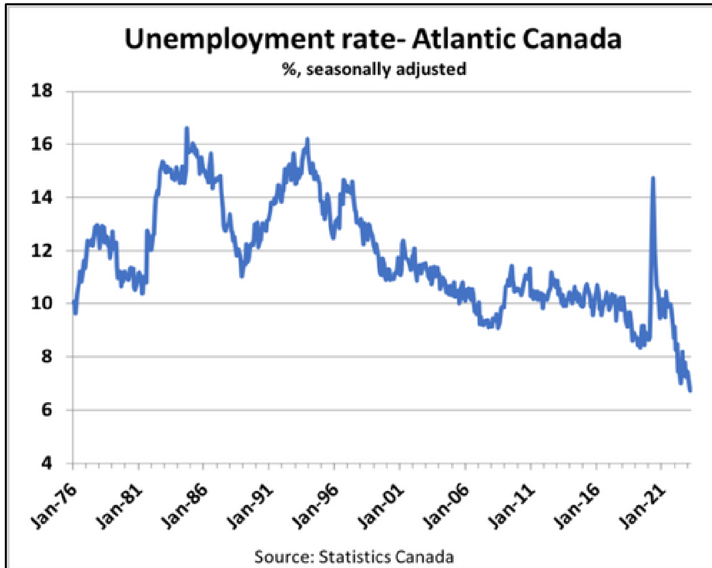


- House prices are performing much better than other parts of the country

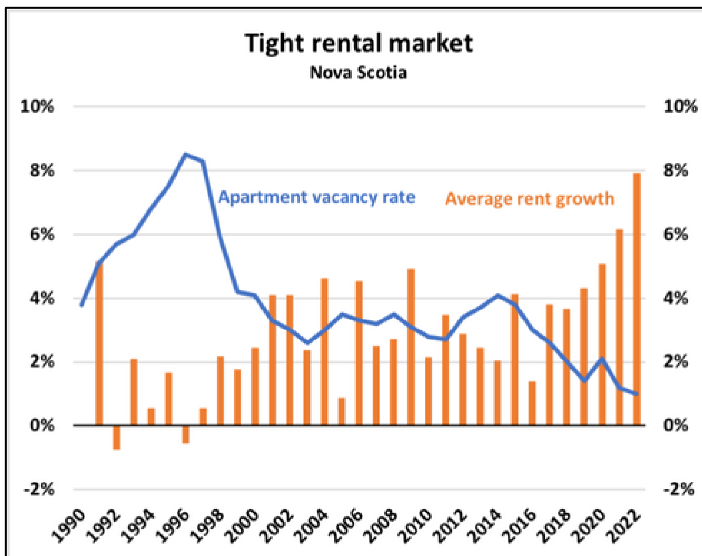


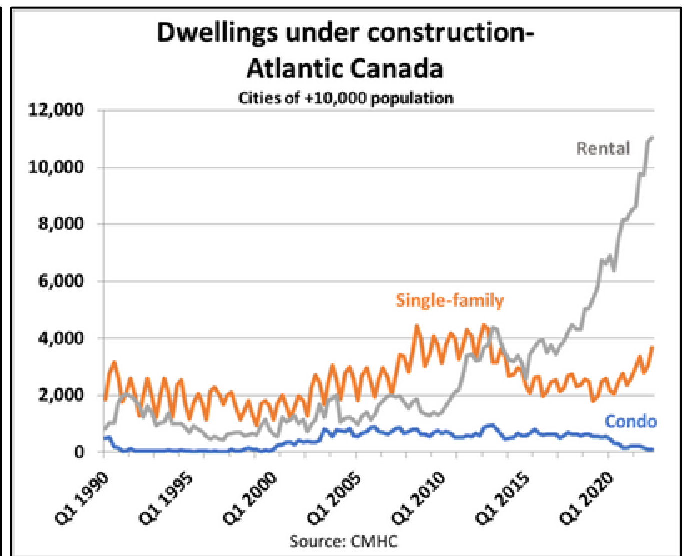


- Macro backdrop looks excellent. Unemployment rate is at all-time lows

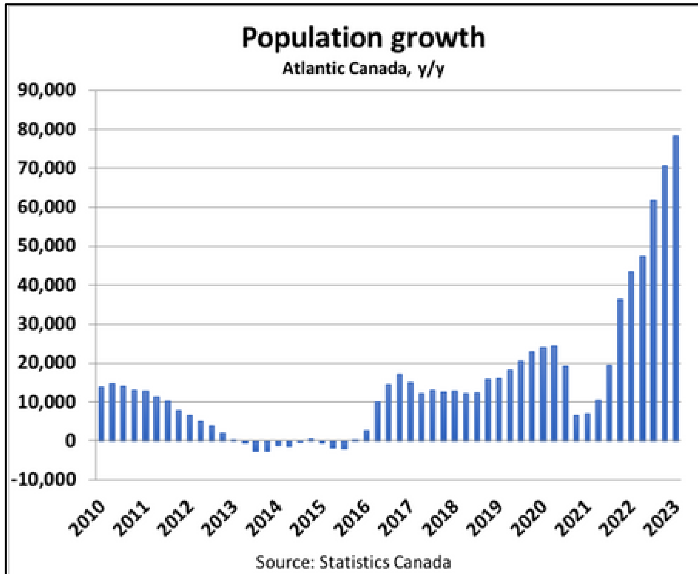


- Rental market is extremely tight, record low vacancies...but keep an eye on new supply in the pipeline

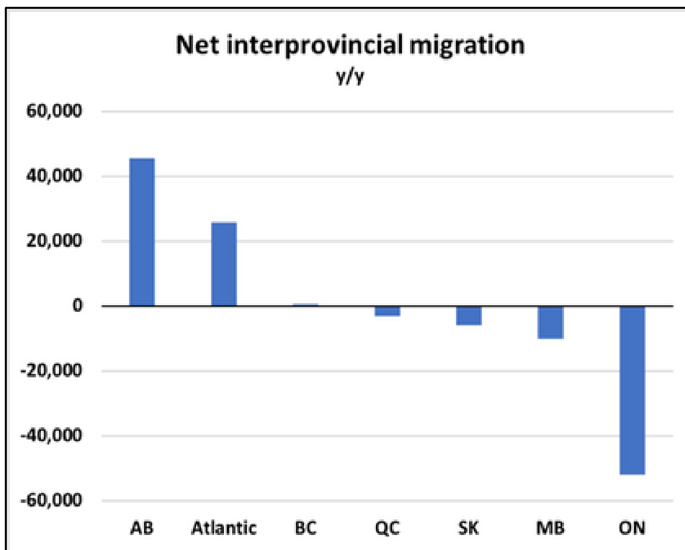


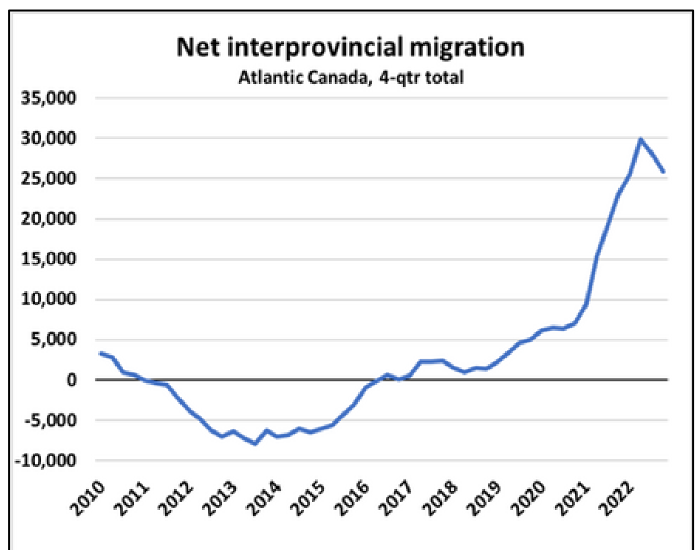


- Record population growth

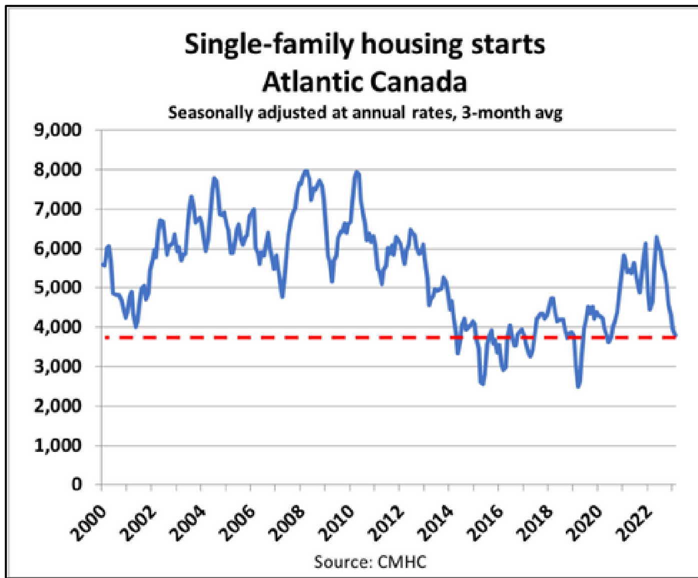


- Canadians keep movie east from other provinces





- New single-family supply is insufficient to meet growing population, raising risk of future supply crisis and price squeeze.



Regards,
Ben