March 2023
Metro deep-dive- February data

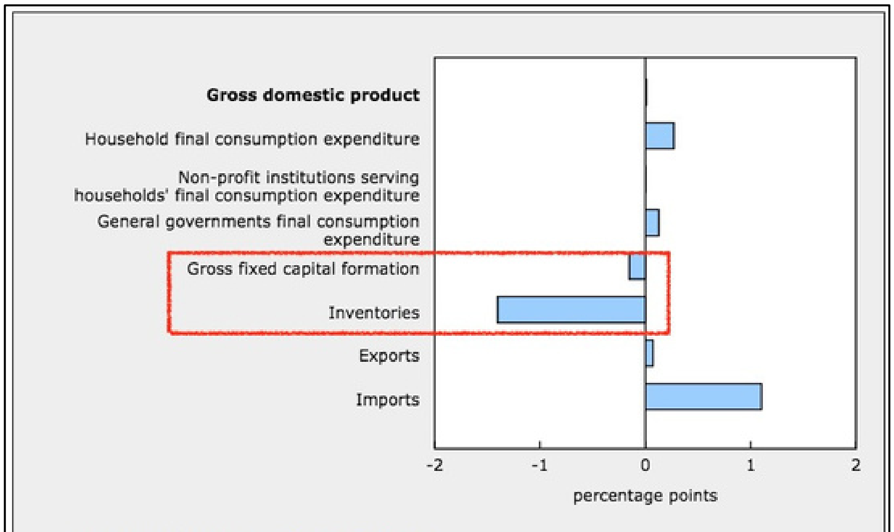
Compliments of Steve Dainard, Mortgage Broker
TheMortgageGuyNiagara.com

Quick links:

1) Canada's economy hits stall speed in Q4

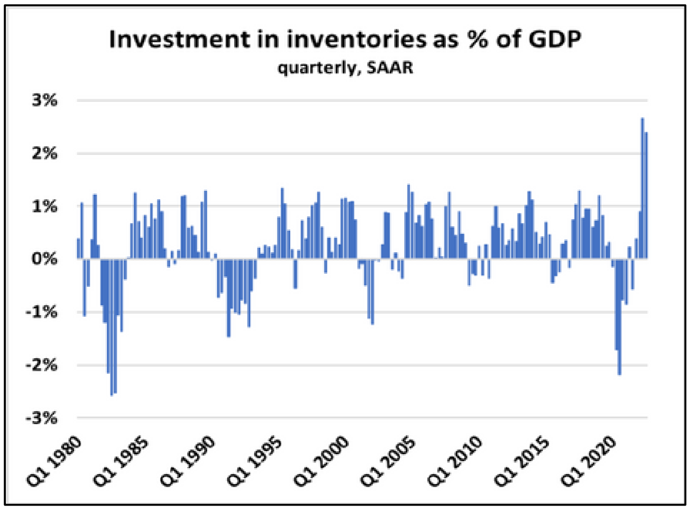
Canada's economy slowed to a standstill in Q4, with GDP flat on the quarter against expectations of 1.6% annualized growth.

The big drag was from inventories and gross fixed capital formation- primarily residential investment.

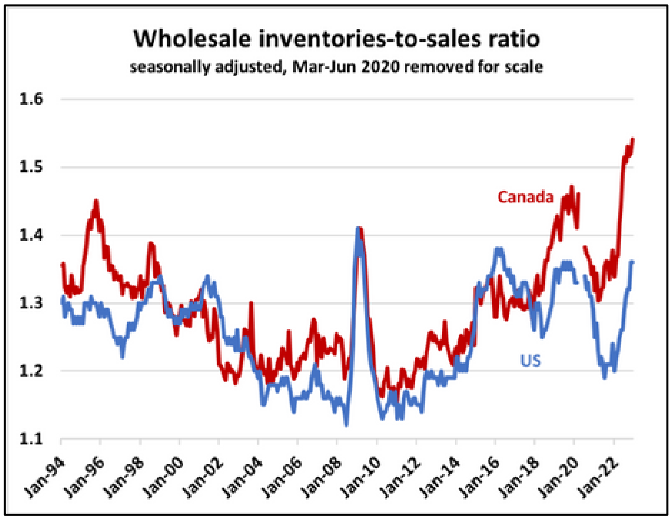


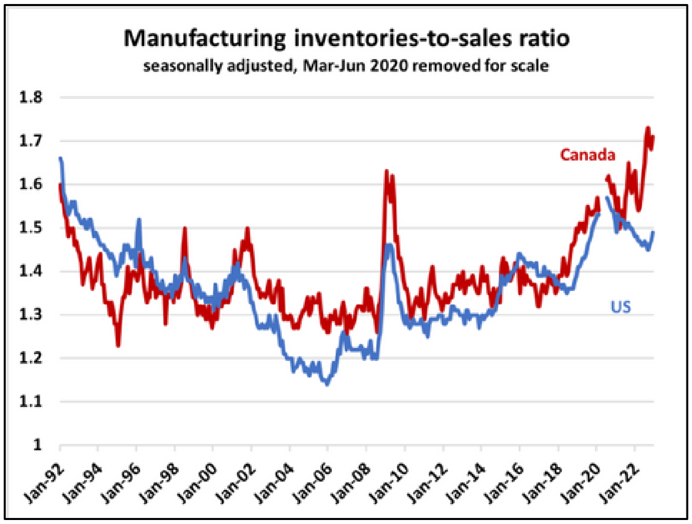
Source(s): Table 36-10-0104-01.

Inventories are always a bit of a crapshoot, but regular readers will recall that the prospect of inventory drawdowns, and the associated drag on growth, was addressed in previous notes. As a refresher, we saw the two largest inventory builds on record in Q2 and Q3...



...at the same time, we saw inventory explode to record levels at wholesalers and manufacturers.

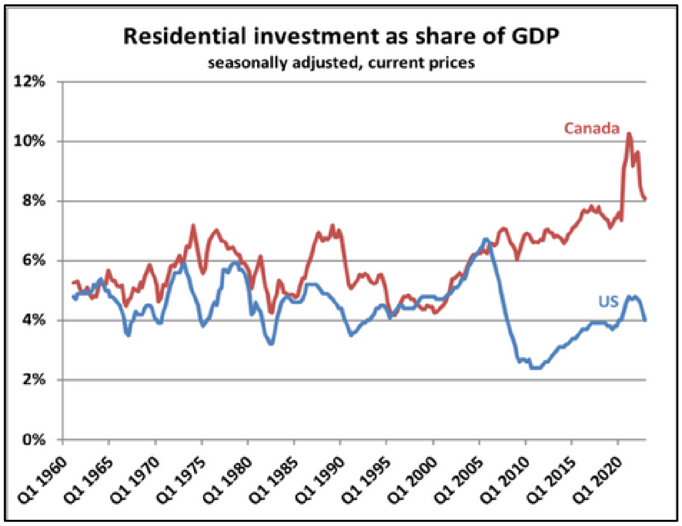




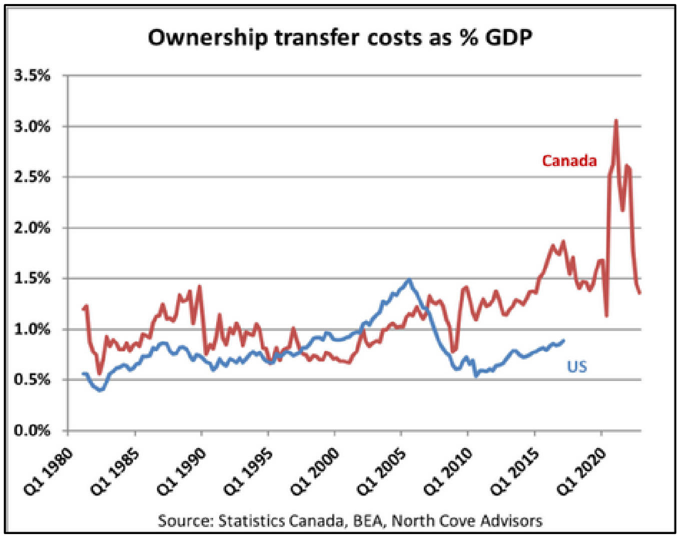
So it stood to reason that we'd see a drawdown in inventories which would cause "surprise" weakness in the economic accounts.

This de-stocking trend may have a couple quarters to run simply based on the magnitude of the build and the amount of inventory still stockpiled, particularly at wholesalers who act as the "middleman" between manufacturers and retailers. All else equal, it means a headwind to growth this year at a time when key areas like consumption and residential investment will likely continue to struggle.

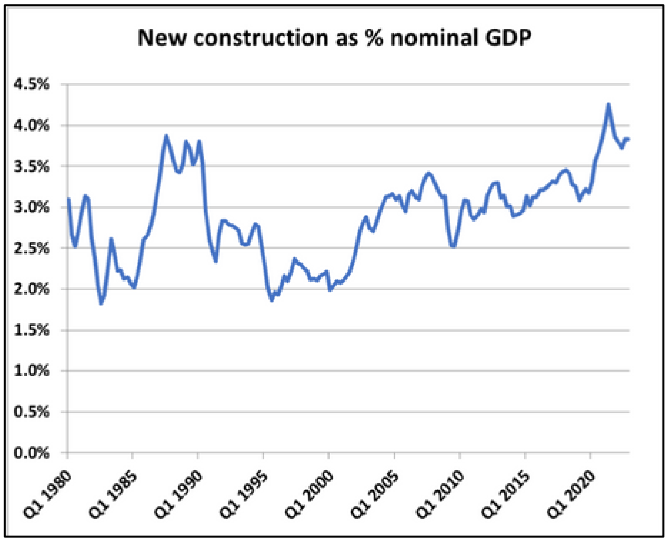
On that point, gross fixed capital formation fell in Q4 on the back of a 2.3% quarterly decline in residential investment which fell to 8.1% of GDP from the all-time high of over 10% in 2021. That still leaves it above all prior cyclical peaks and nearly two points above the US peak in 2005. As a reminder, residential investment is made up of new construction, renovation expenditures, and ownership transfer costs:

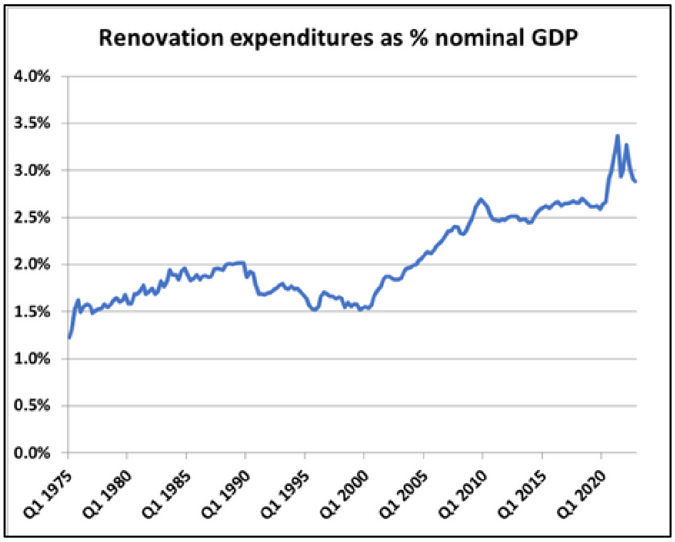


What's notable is that the only component of residential investment to post meaningful declines so far is ownership transfer costs -a straight feedthrough from resale housing activity- which was down 4% q/q and 39% y/y.



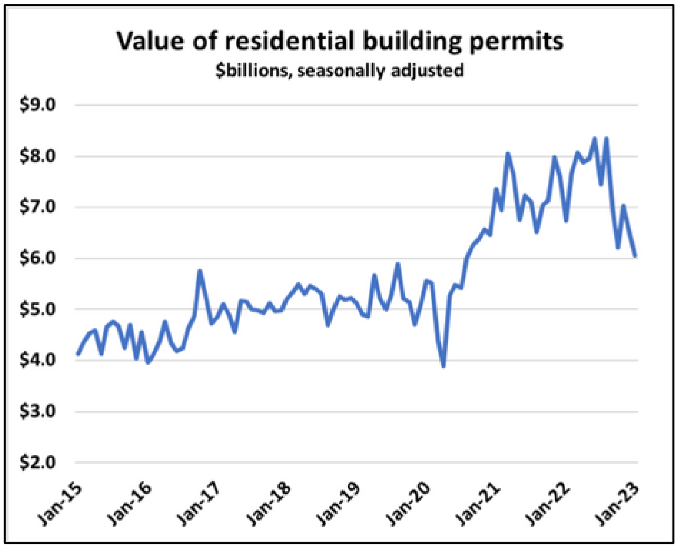
While transfer costs are plunging, new construction and reno expenditures are holding in well:



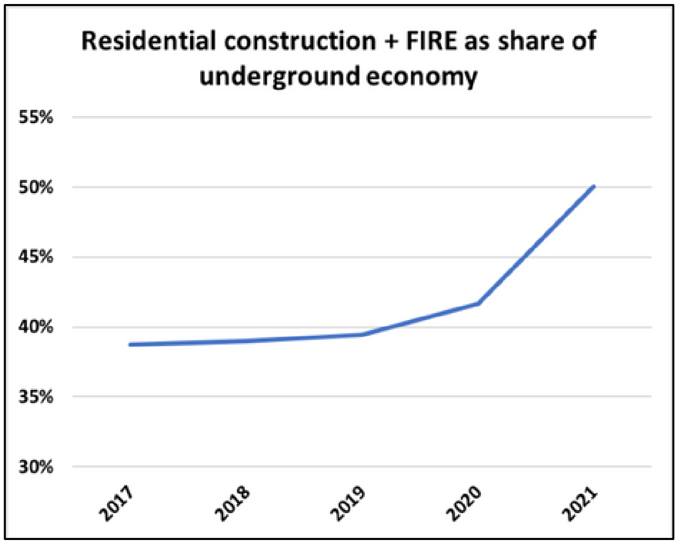


But that's set to change. Building permits slumped 4.0% m/m in January vs estimates of a 1.5% gain. And that comes on the heels of a 7.3% drop in December. The residential component was hit even harder, down 6.6% m/m to hit the lowest level since Aug 2020. And in real terms, it was the lowest month since April 2020 and the second weakest month since the data set begins in 2011.

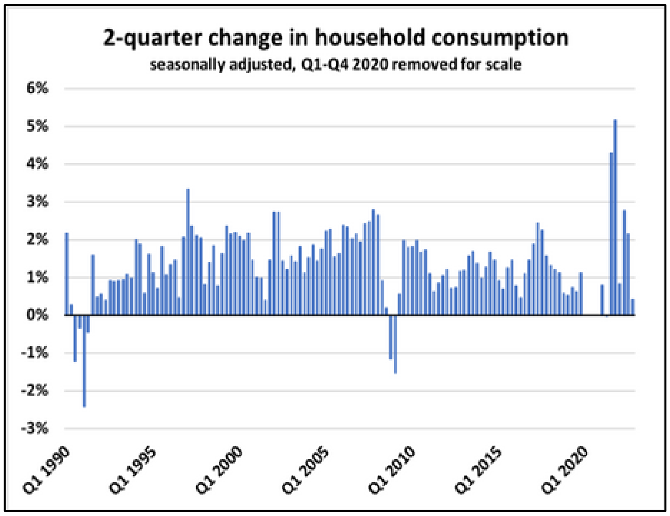
In other words, residential construction activity is about to get hammered. As I've noted previously, this has the effect of weighing on economic growth and employment in the near term, but will put a floor under housing and potentially set the stage for an even worse supply crisis down the road:



The hit to economic growth from a construction slowdown may be even greater than it would appear at first blush. Statistics Canada released their estimates for the size of the "underground economy" in Canada and pegged it at roughly $70B as of 2021....and half of that is in Construction and the FIRE industries (finance, insurance, real estate services). This intuitively makes sense. Construction is a heavily, and particularly contracting and renovation work, is often a "cash" business.



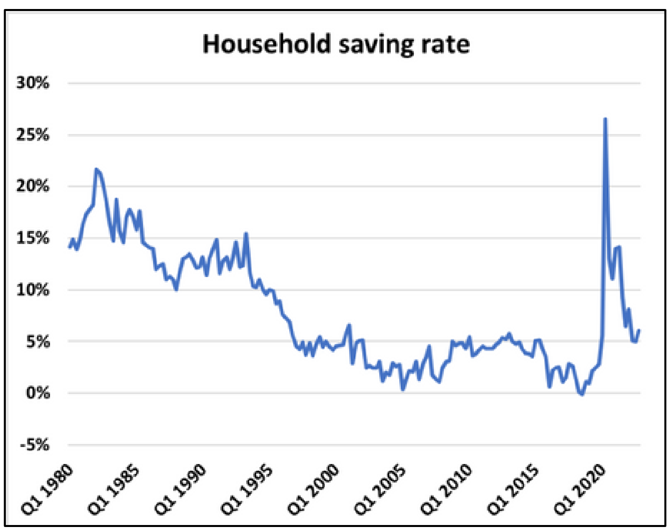
On the household consumption side, we did see a 0.5% increase which helped offset the 0.1% decline in Q3. Still, that leaves the 2-quarter change at a mere 0.4%...the weakest since the Financial Crisis if we set aside quarters affected by pandemic-related lockdowns:



Consumption was buoyed by an unexpectedly strong 12.4% annualized surge in disposable incomes, which Statistics Canada attributed partly to "enhancements in government benefits"[1]:

> *Household disposable income rose 3.0% in the fourth quarter, almost double the rate of increase for nominal household spending (+1.6%), due in part to enhancements in government benefits, such as a one-time Goods and Services Tax credit top-up and a 10.0% increase in Old Age Security payments for seniors aged 75 years and over...*

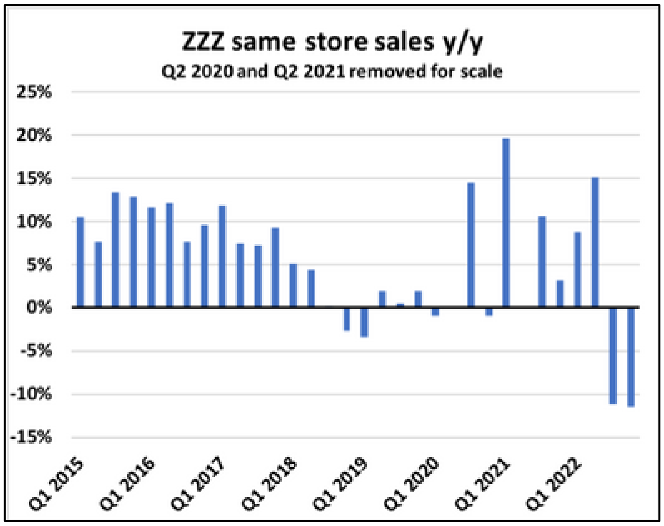
Rising income growth fed through to an uptick in the household savings rate which rose to 6% from 5% previously and 2.1% at the onset of the pandemic:

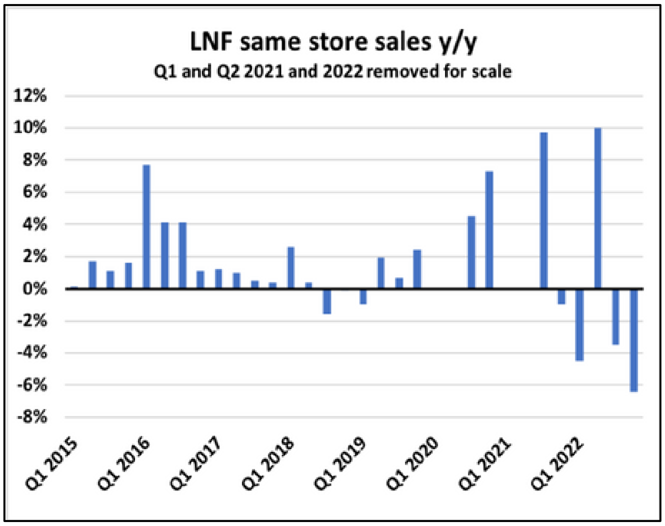


While on the surface that points to resilient consumption for a bit longer, I suspect the better explanation is a renewed emphasis on frugality driven by weak consumer confidence and the largest decline in net worth since the Financial Crisis.

Here's I would point to weakness in discretionary spending, a strong leading indicator of broad consumption trends. Sleep Country (ZZZ) reported a 11.5% decline in same store sales in Q4, which comes on the heels of Leon's Furniture's (LNF) 6% drop...and these are non-inflation adjusted figures:

[1] https://www150.statcan.gc.ca/n1/daily-quotidien/230228/dq230228a-eng.htm





Further, consider the announcement from Nordstrom this week2:

[...] "We regularly review every aspect of our business to make sure that we are set up for success," said Erik Nordstrom. "We entered Canada in 2014 with a plan to build and sustain a long-term business there. Despite our best efforts, we do not see a realistic path to profitability for the Canadian business. We want to thank our team for their performance and dedication in serving customers in Canada. This decision will simplify our structure, intensify focus on our growth and profitability goals and position us to create greater value for our shareholders."

Accordingly, Nordstrom Canada has commenced a wind-down of its operations, obtaining an Initial Order from the Ontario Superior Court of Justice under the Companies' Creditors Arrangement Act ("CCAA") earlier today to facilitate the wind-down in an orderly fashion.

Nordstrom Canada intends to wind down its Nordstrom and Nordstrom Rack stores across Canada, with the help of a third-party liquidator, and its Canadian e-commerce platform. The e-commerce platform will cease operations on March 2, 2023. The in-store wind-down is anticipated to be completed by late June 2023.

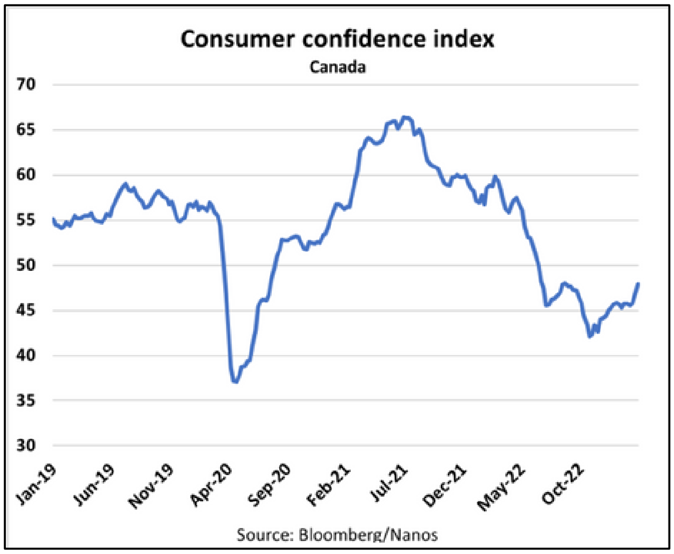
Putting it all together, the Q4 GDP numbers were disappointing. But the dynamics at play this quarter look set to continue well into 2023, namely inventory draws and pressure on household consumption and residential investment.

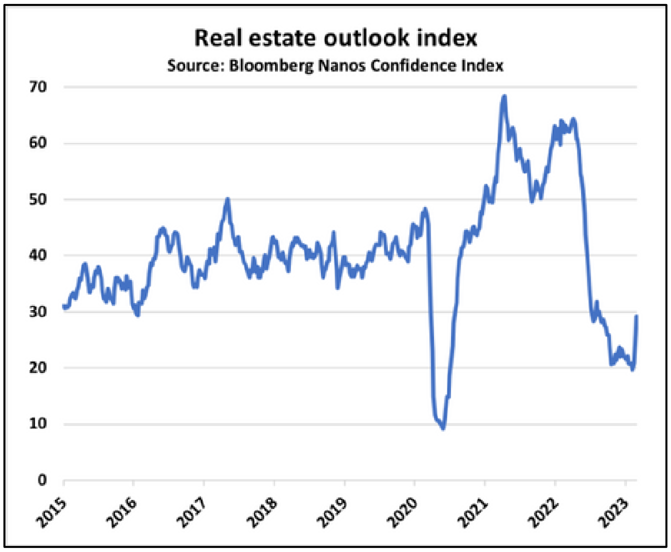
[2] https://press.nordstrom.com/news-releases/news-release-details/nordstrom-reports-fourth-quarter-2022-earnings-announces-wind

2) Are animal spirits and FOMO returning in Toronto?

I've been expecting a decent bounce in home sales nationally this spring as well-qualified buyers come off the sidelines now that the Bank of Canada is giving some clarity around the eventual peak in rates. A bounce of 20% off the seasonally adjusted lows should be expected. Much more than that, or if it's not accompanied by an equally strong surge in new listings, and we run the risk of seeing a price squeeze simply as a function of thin inventory numbers.

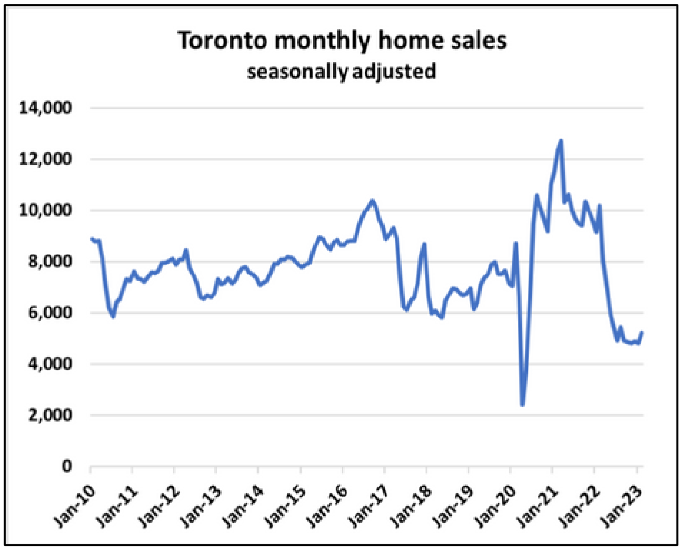
With that as a backdrop, I'd point to the latest consumer confidence index from Bloomberg/Nanos. The headline is interesting (two straight solid weekly increases to hit the highest level since September) but what really caught my eye was the real estate outlook index which just posted the largest two-week increase since coming out of the COVID lockdowns:

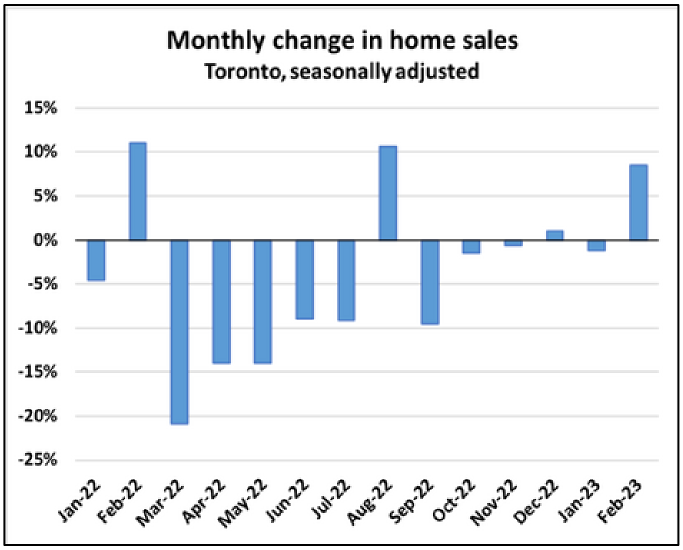


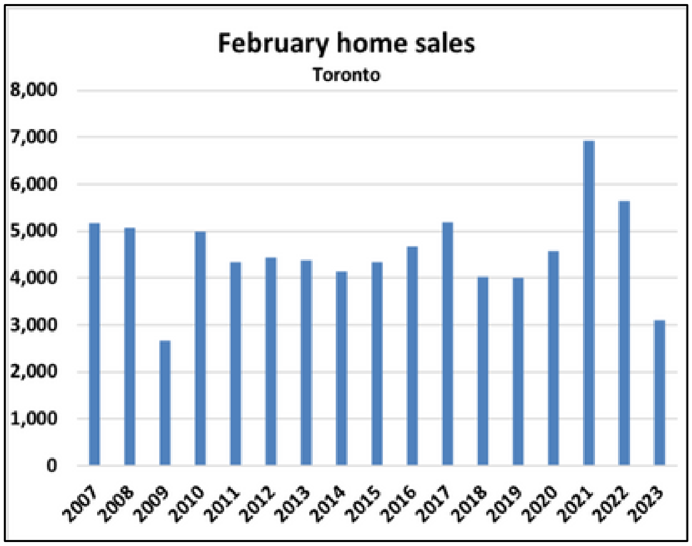


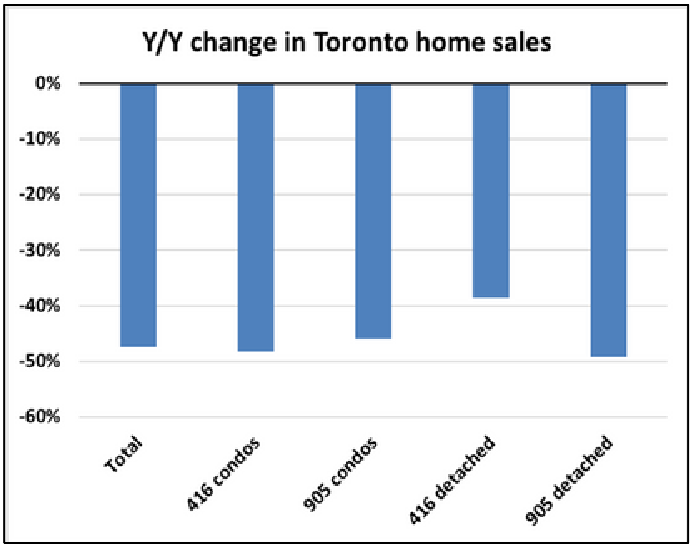
It's a bit surprising but not entirely out of line with anecdotes from front-line contacts pointing to a strong uptick in demand over the past month.

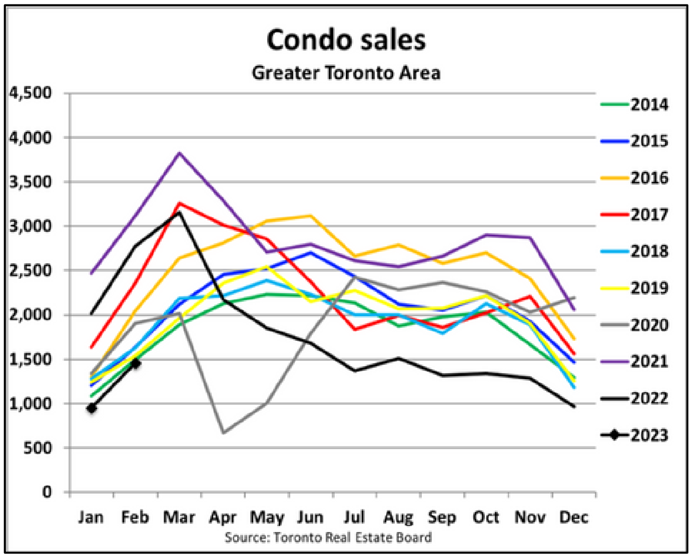
That brings us to Toronto where home sales jumped 8.5% m/m seasonally adjusted in February. Granted, that left them down 47% y/y and only slightly above 2009 levels, but that's still a solid one-month increase:

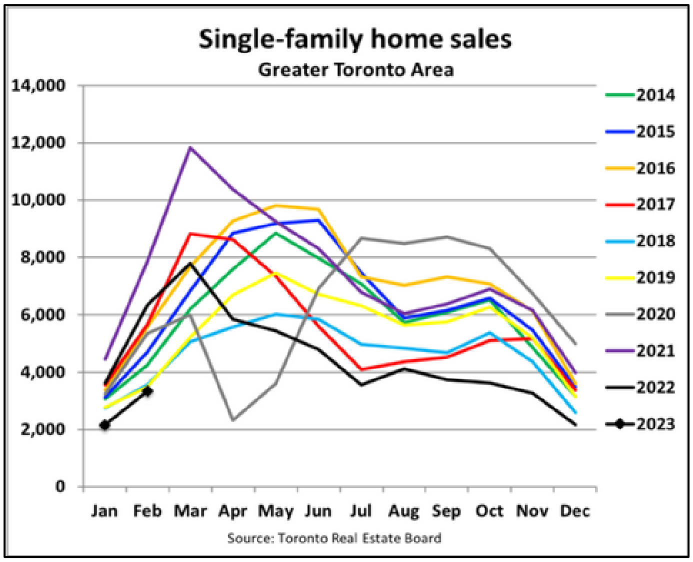




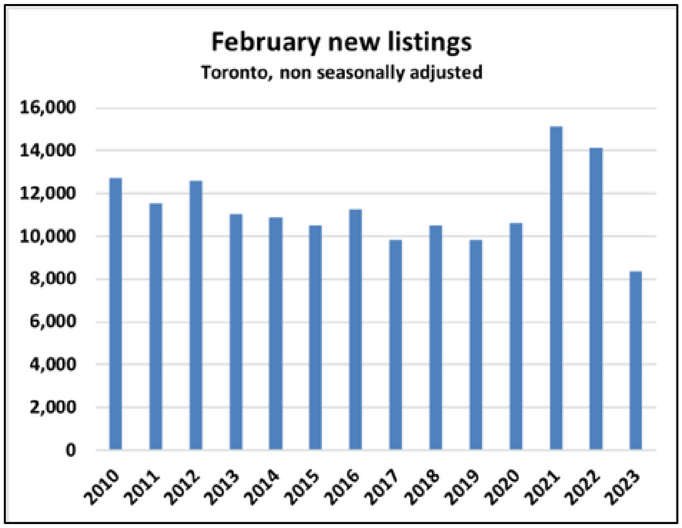


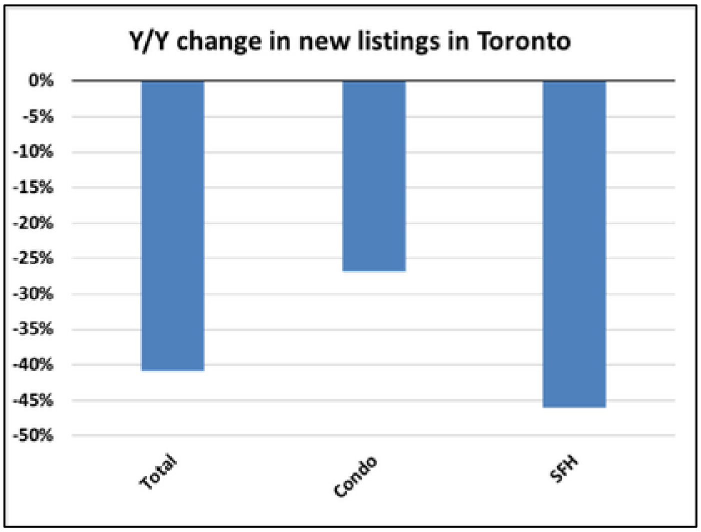




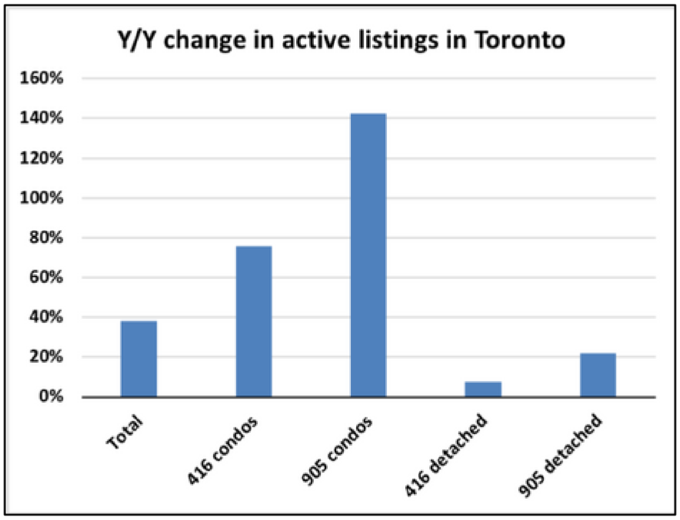


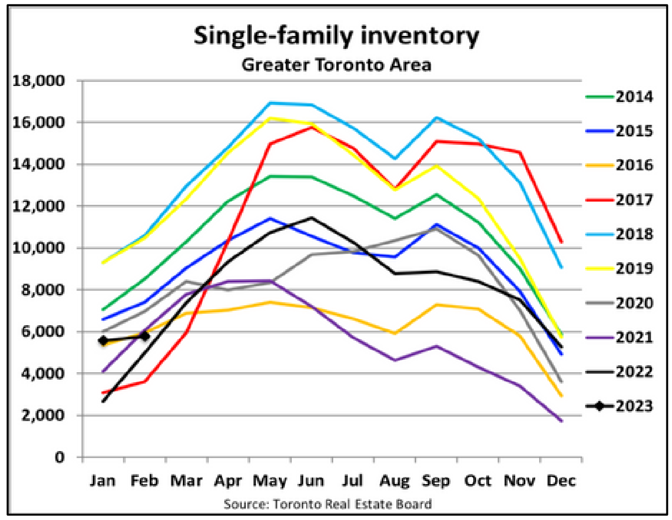
Even more surprising is the 41% y/y drop in new listings which hit the lowest level of any February since the 90s. Sellers are stubbornly holding the line even as demand picks up.

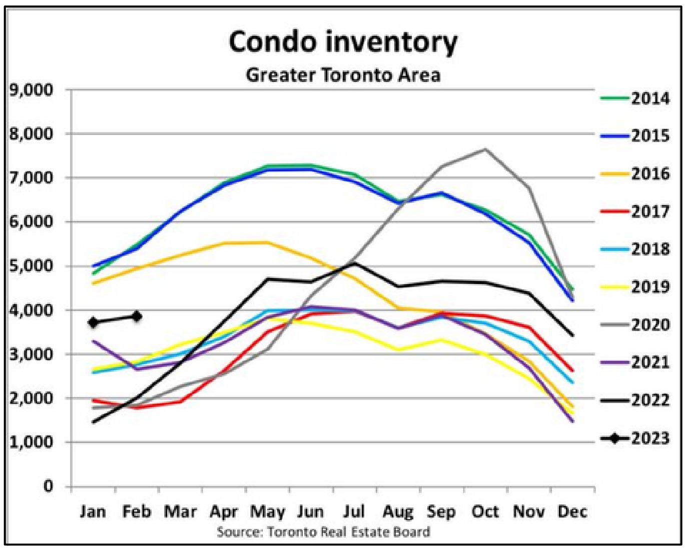




Active listings were up 38% y/y and closer to 100% in the condo segment, but note that inventory was nearly flat overall relative to January levels at a time when we normally see strong seasonal builds. This is particularly true for the single-family segment.

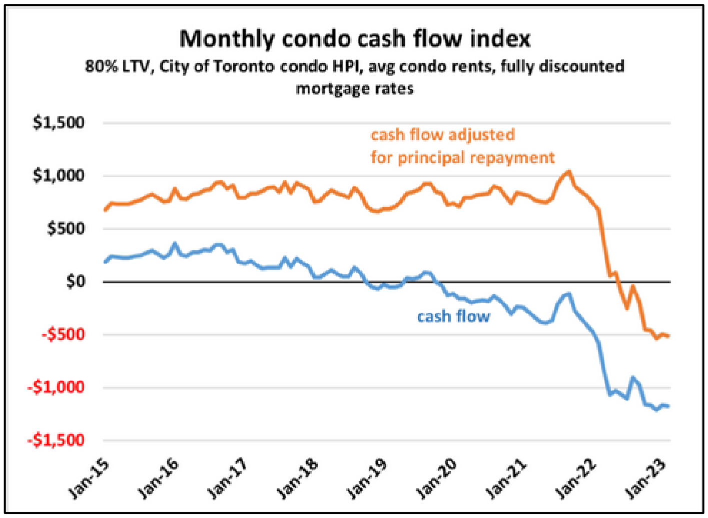




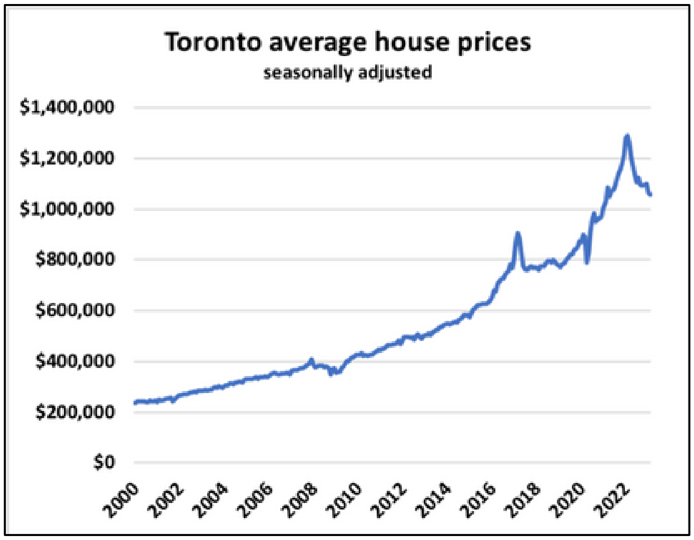


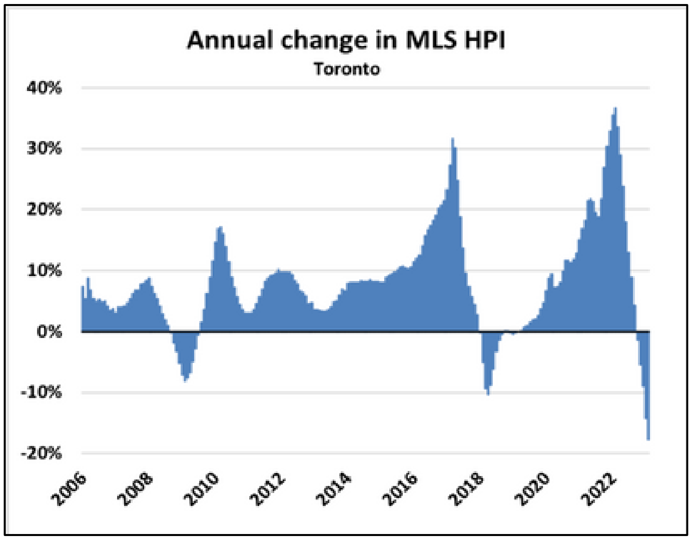
There's a growing divergence between trends in single-family and condos, with single-family seeing stabilizing demand, flat inventory, and firming pricing last month while condos look weak across those same metrics.

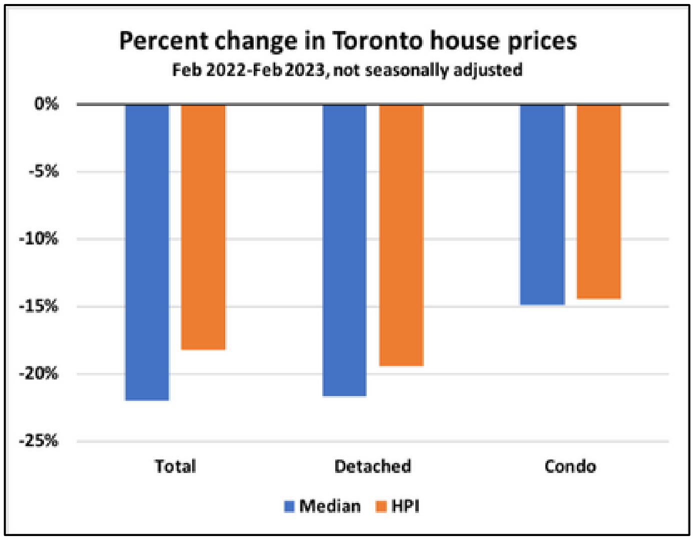
I suspect what we're seeing is a reappearance of end users for single-family while investors remain sidelined and largely out of the condo market where they used to dominate. After all, rental economics continue to look terrible. Even with a very strong rental market, resale condos in Toronto financed at 80% LTV face negative cash flows of nearly $1,200 per month by my math:



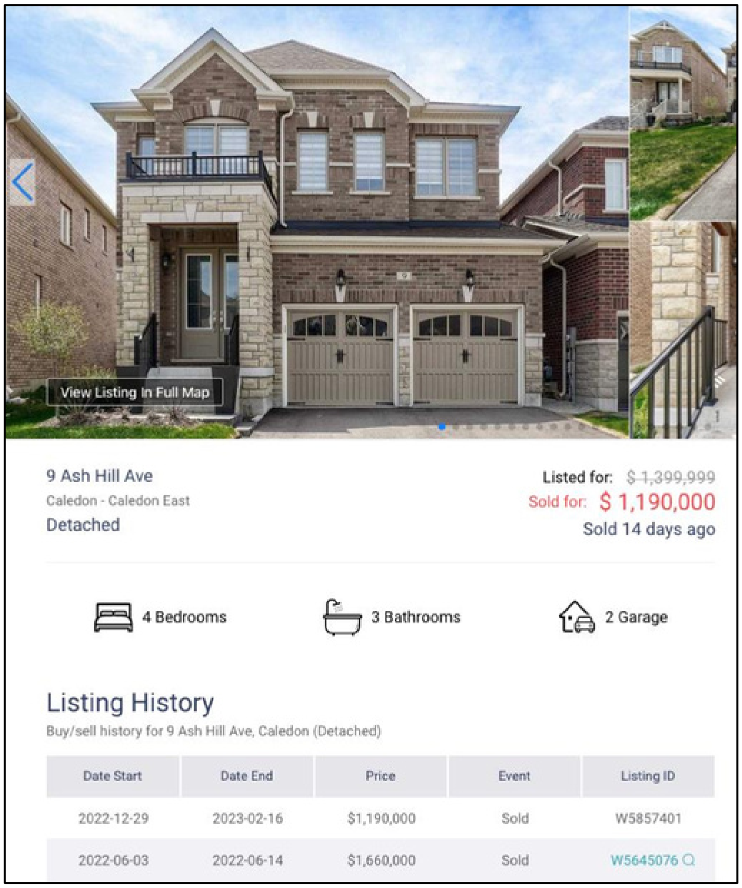
On the pricing front, the HPI rose 1.1% m/m but that's unadjusted for seasonality. In contrast, average house prices (seasonally adjusted) fell 0.7% on the month. There's data here for both the bulls and bears depending on your framing. On a y/y basis, the HPI was down a record 17.7% and down 22% on median pricing:





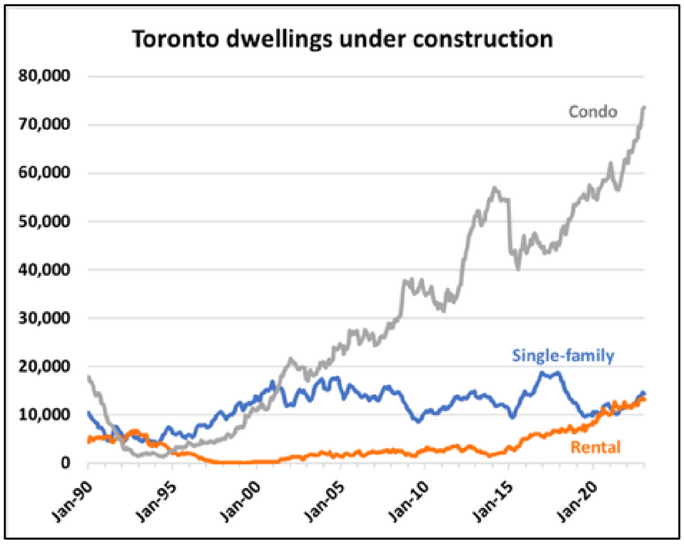


Even with an uptick in demand, there are still some eye-watering losses on recent sales. Consider the one below which managed to lose nearly half a million dollars in just 8 months:



Date Start	Date End	Price	Event	Listing ID
2022-12-29	2023-02-16	$1,190,000	Sold	W5857401
2022-06-03	2022-06-14	$1,660,000	Sold	W5645076

The pipeline of new supply still looks quite robust, particularly for condos, but dwellings under construction were down 0.5% in January relative to December:

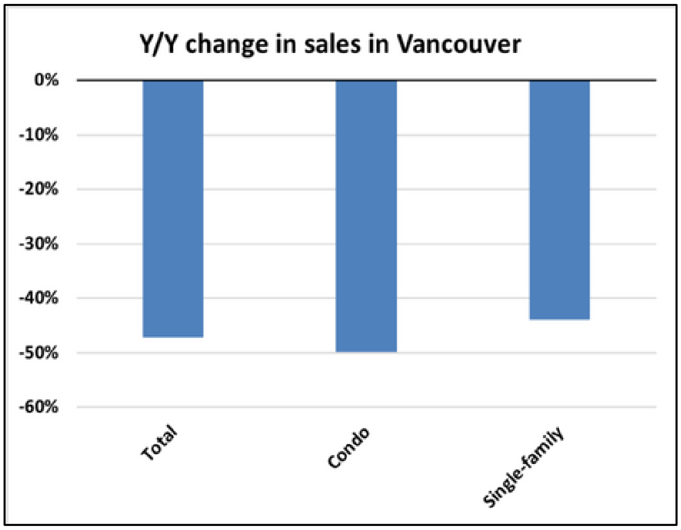


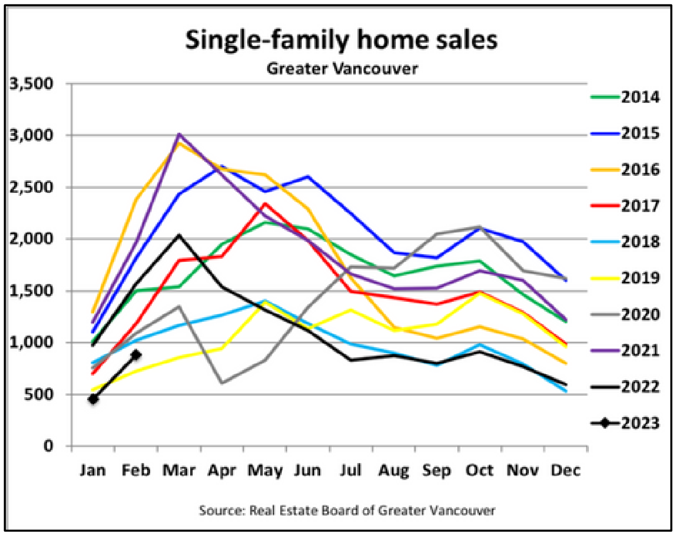
Bottom line, sales are rebounding as anticipated, and I still think new listings will materialize in size in coming months, but it won't take many more months like we just saw (rising sales, falling inventory) to see prices stabilize and start to really move again.

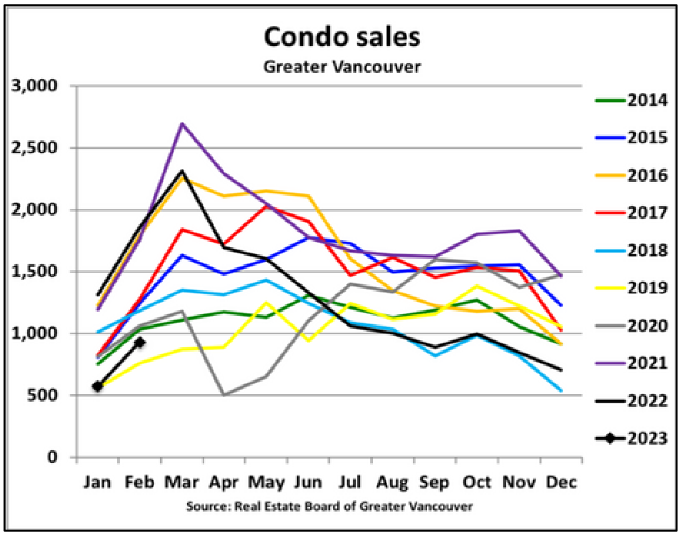
3) Vancouver housing demand springs to life

Preliminary data out of Vancouver points to a +20% monthly surge in seasonally adjusted home sales in February. If my math is correct (we'll know when we get official seasonally adjusted data from CREA on the 15th), it means we just saw the largest monthly increase in demand since Q2 2020 when the world was emerging from the COVID lockdowns.

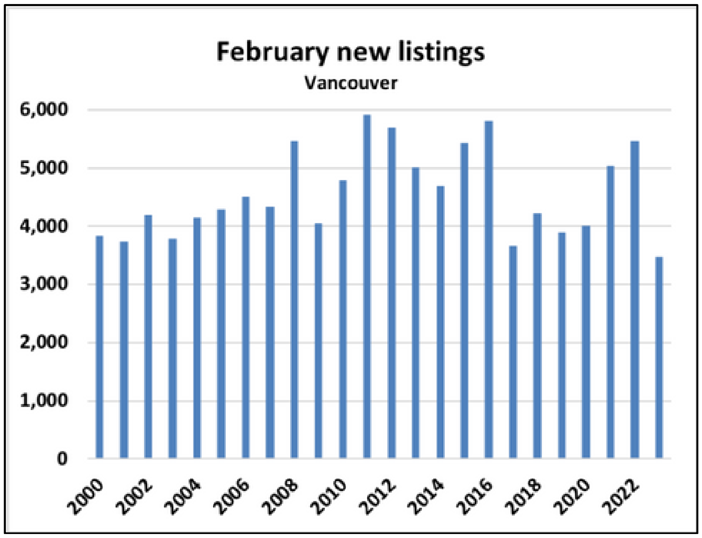
That does still leave sales down 47% y/y:

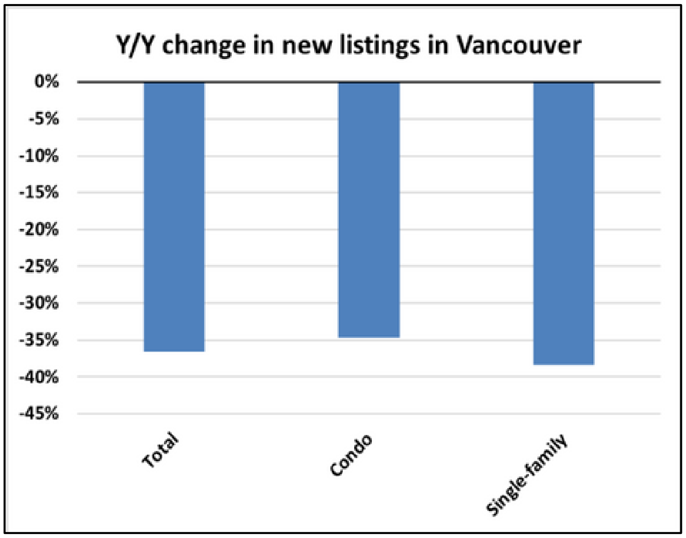




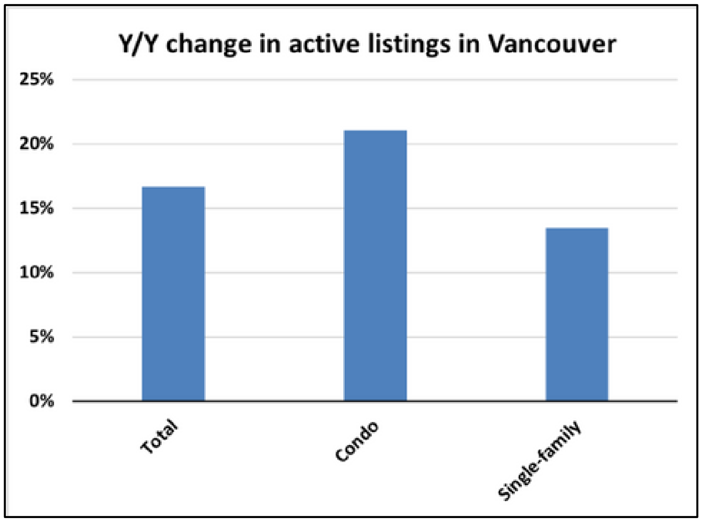


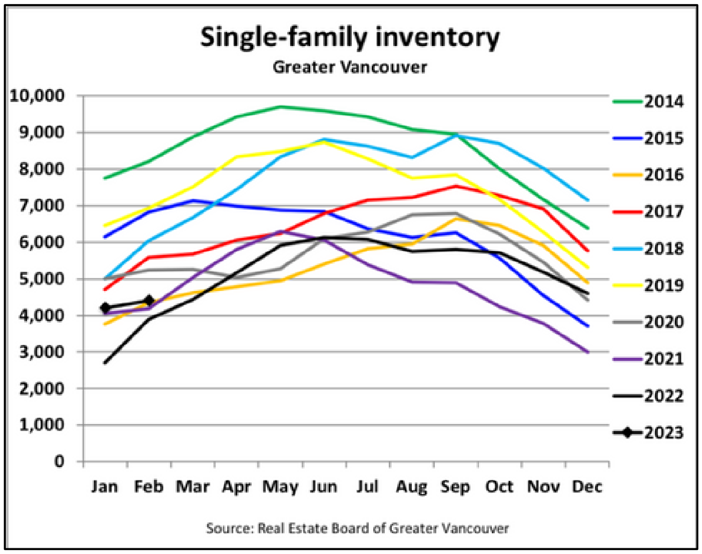
New listings plunged 36% y/y to hit the lowest level for February in over 20 years!

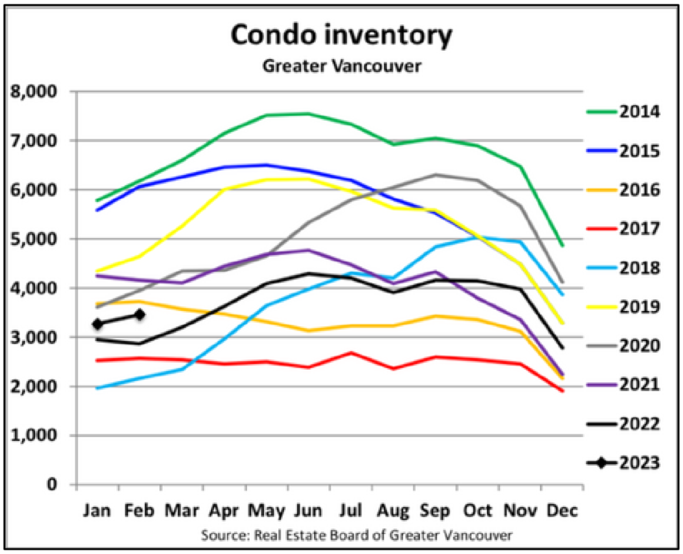




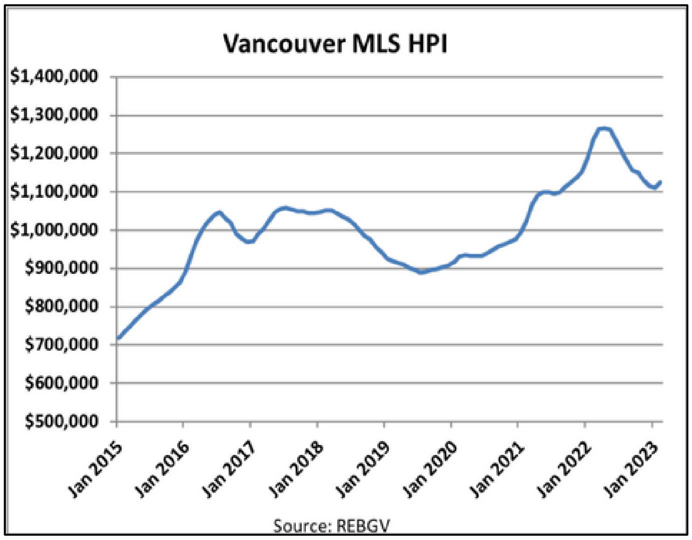
Active listings were up 17% y/y led by a 21% increase in condos, but supply remains well below normal levels. Single-family supply in particular remains low historically and saw an unusually small monthly increase for February:

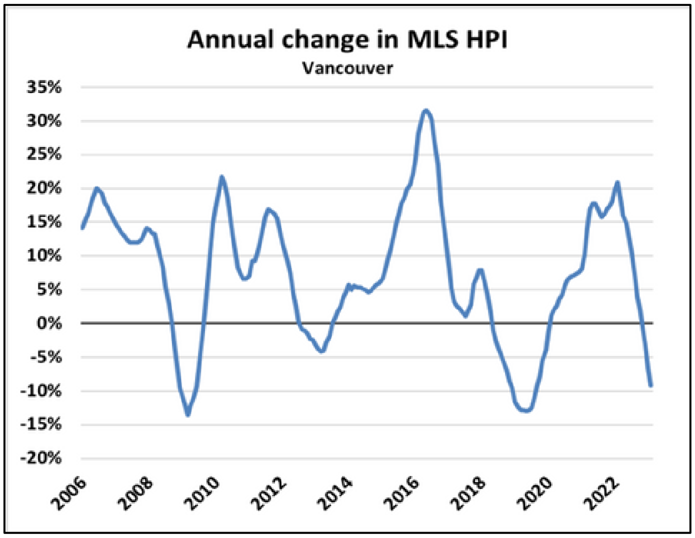




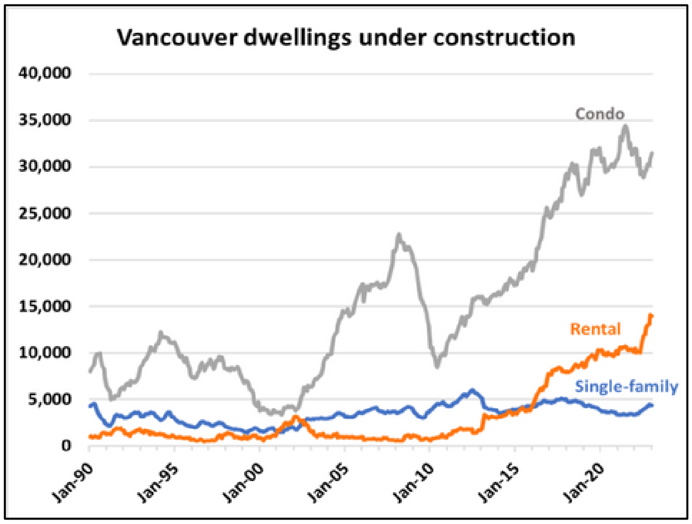


The MLS HPI ticked up 1.1% m/m in February and was 9.2% below 2022 levels. The declines are even more pronounced in the single-family segment where prices are off nearly 15%.





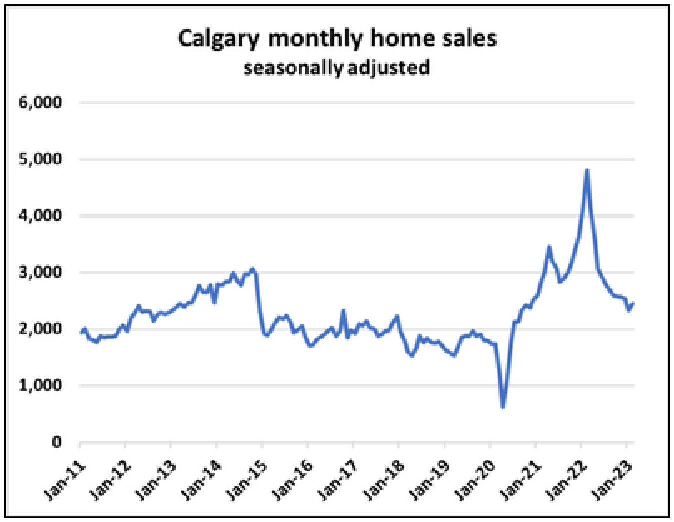
The pipeline of dwellings under construction rose 1.2% last month to a record high of just under 50,000. Particularly notable is the recent surge in apartment construction, notably in the rental space where there are nearly 50% more units in the pipeline than one year ago:

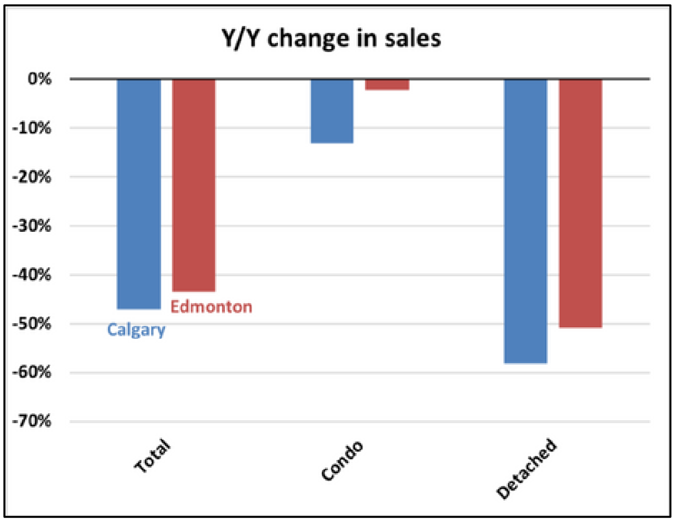


Vancouver needs more supply, particularly in the single-family segment. I think we'll get it this spring, but there are now very real risks that FOMO takes hold and this market tightens significantly...an unexpected development given that mortgage rates are still near decade highs.

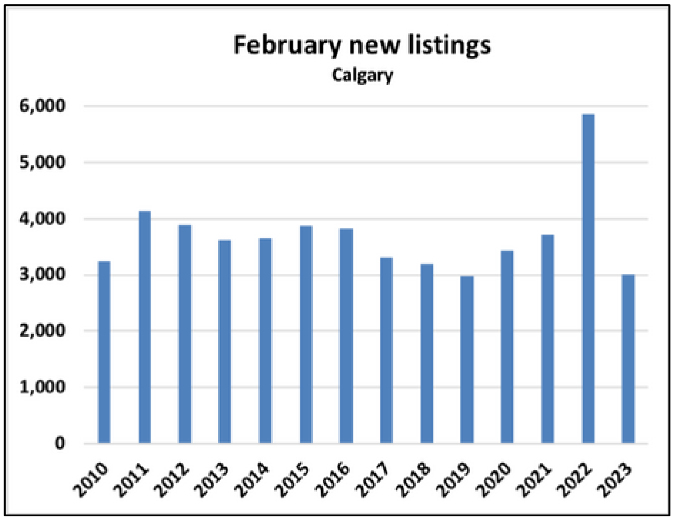
4) Calgary sales tick up, inventory falls

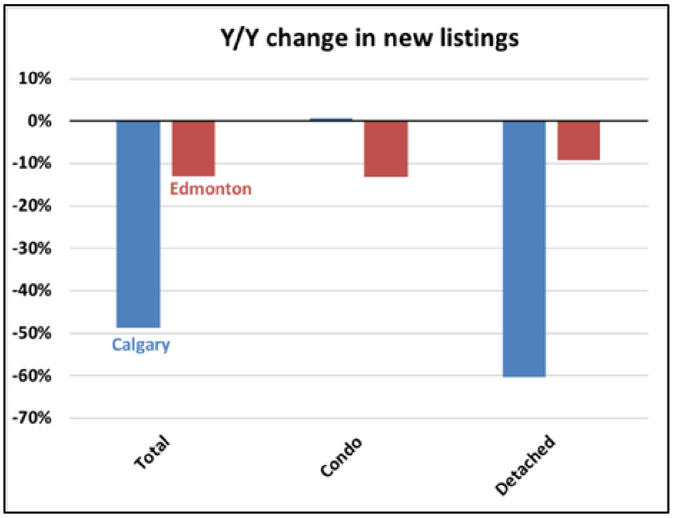
Preliminary data suggests that home sales in Calgary surged nearly 6% seasonally adjusted in February. That still leaves sales down 47% y/y overall and closer to 60% in the detached segment:



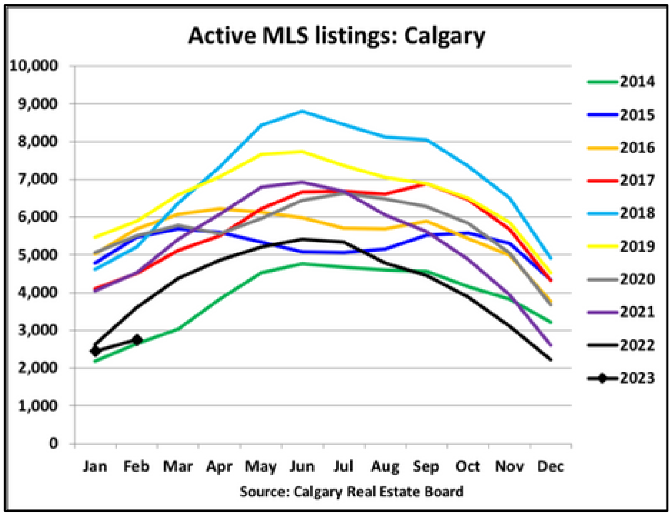


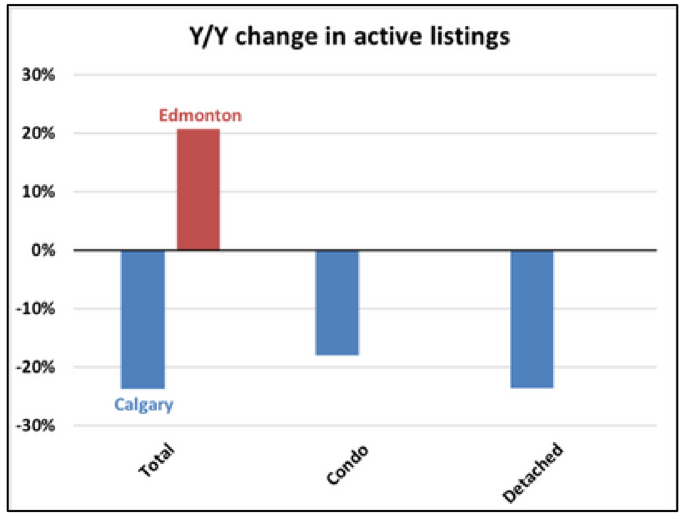
New listings were down by almost 50% compared to February 2022, but that one month was a massive outlier compared to most years:



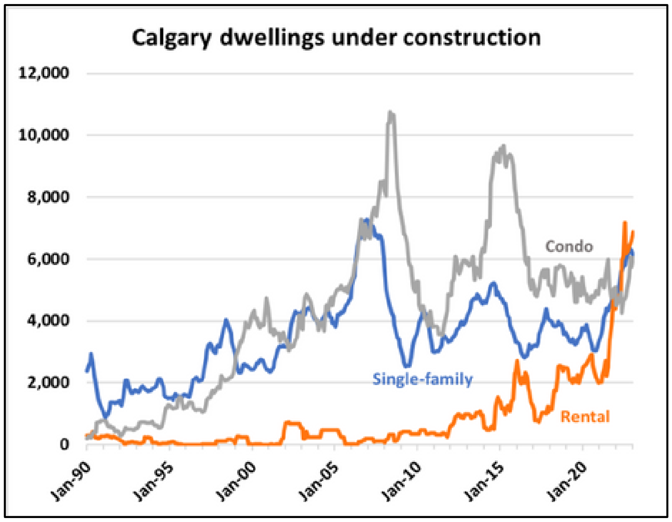


Active listings were 23% below 2022 levels in Calgary and are just slightly above the 2014 lows of the past decade. There’s simply not a lot of supply in this market at present:

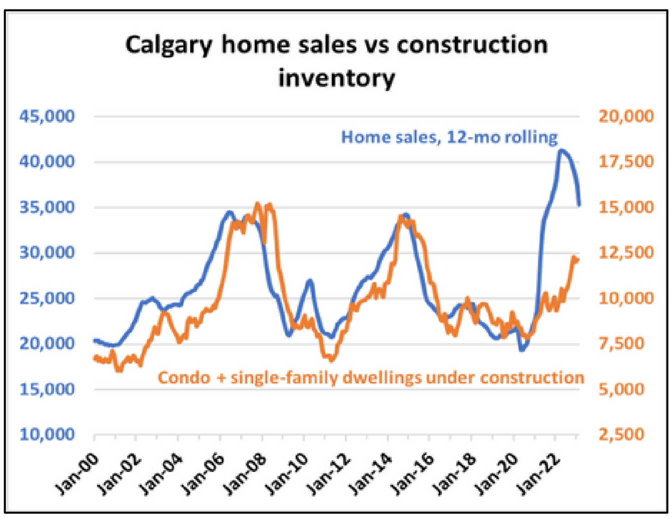




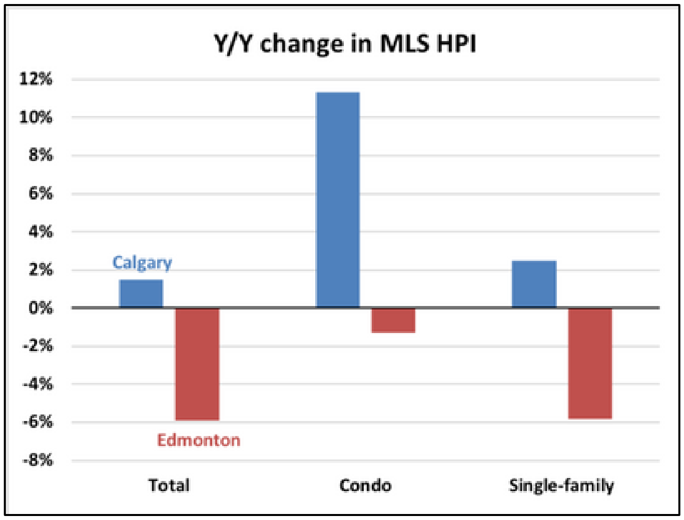
Developers are doing their part to try to bring supply to market. Under construction inventory edged up 2.3% m/m and is now 77% above from January 2021 levels. Of note, there are now nearly 7,000 purpose-built rentals under construction across the metro.

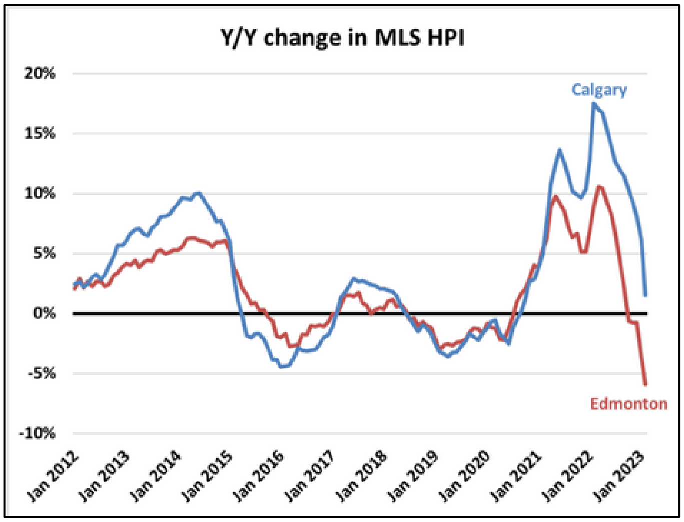


The gap between resale activity and construction levels continues to narrow, suggesting that the significant “underbuilding” of the past couple years is starting to subside:



The MLS HPI was up 1.3% m/m in Calgary and 0.8% in Edmonton last month. On a y/y basis, Calgary is barely holding onto gains while Edmonton is seeing prices fall at the steepest rate in over a decade:





Regards,
Ben