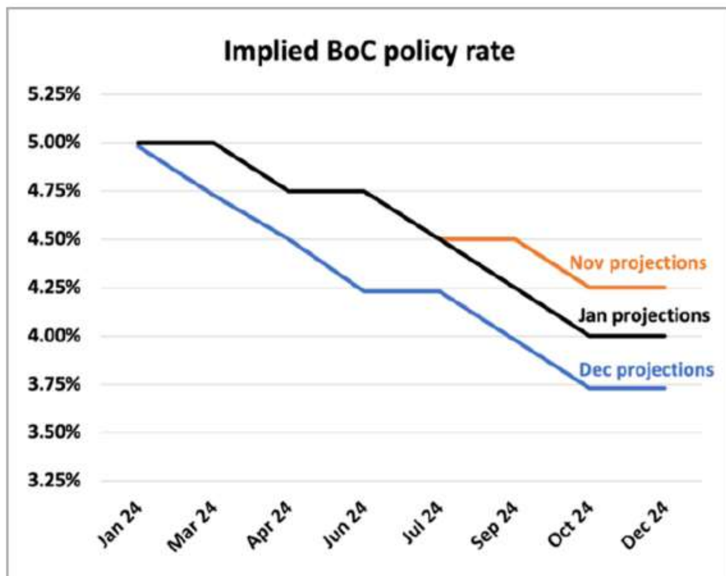
THE EDGE REPORT

January 2024

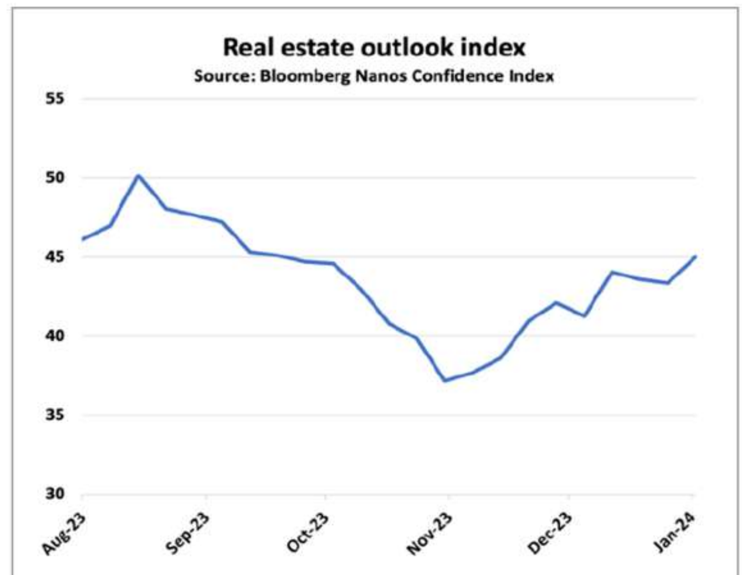
1) *Rate cuts still on deck but timing and magnitude in question*

Rate cut projections have been bouncing around like crazy over the past couple months as economists and traders all try to wrestle with some volatile macro data.

The key takeaway is that markets have pared back rate cut expectations slightly in recent weeks, with the first cut now expected in April (previously it was March) and with 100bps or 1% of cuts expected through 2024 (1.25% of cuts were expected in December).



Still, let's keep the big picture in focus....rate cuts are coming, and real estate sentiment is on a clear uptrend after bottoming in November. That will almost certainly translate into stronger sales in coming months as some prospective buyers come off the sidelines now that they've been given an "all-clear" from the Bank of Canada.



As to what's driving the change in rate projections, there were two main data points in the past couple weeks that point to stickier inflation than expected.

The first is the inflation reading itself. Recall that last month I warned that we would see an uptick in headline CPI simply due to the December 2022 reading falling out of the annual data set (Dec '22 saw CPI drop 0.6% on the month). So the fact that CPI rose from 3.1% to 3.4% is not overly concerning, but what was a tad unexpected was the uptick in CORE inflation measures which rose from 3.5% y/y to 3.7%. These are the metrics the Bank of Canada pays the most attention to:

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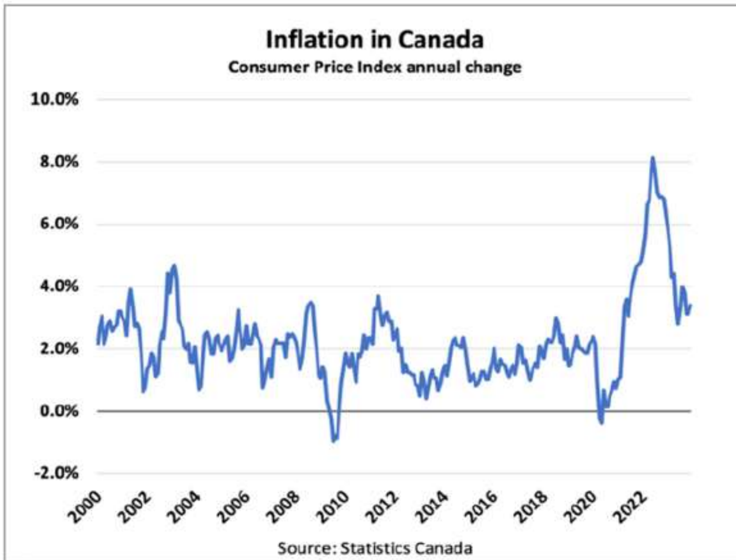
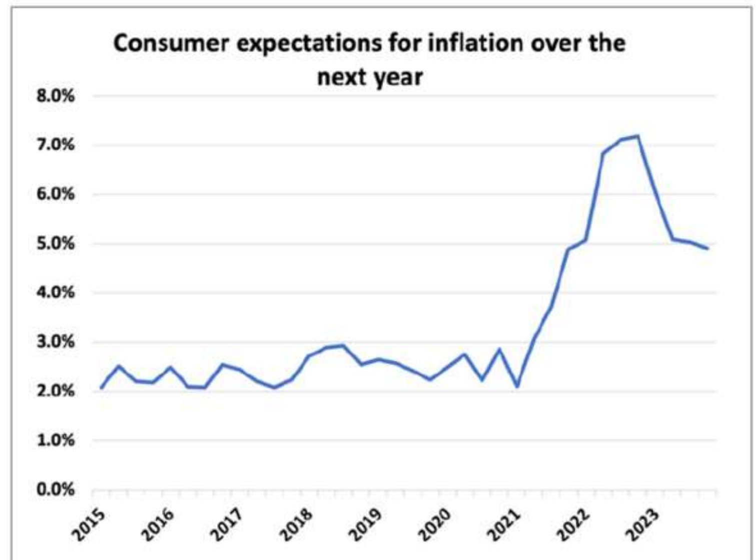
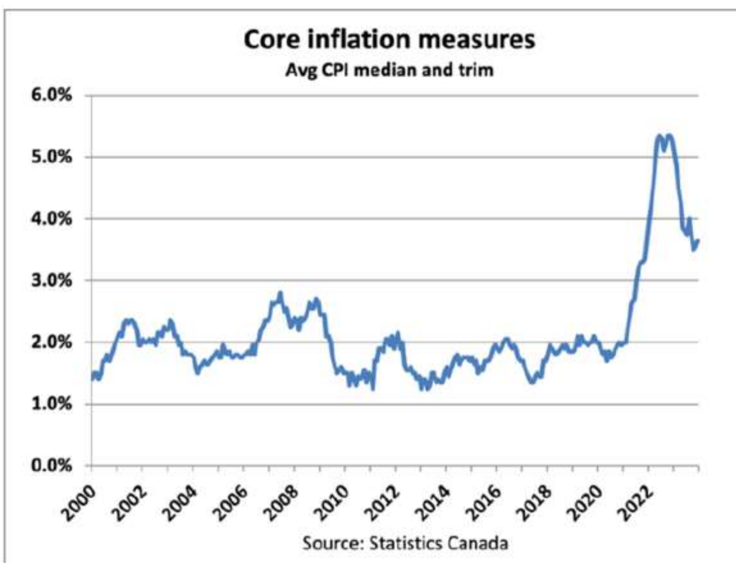
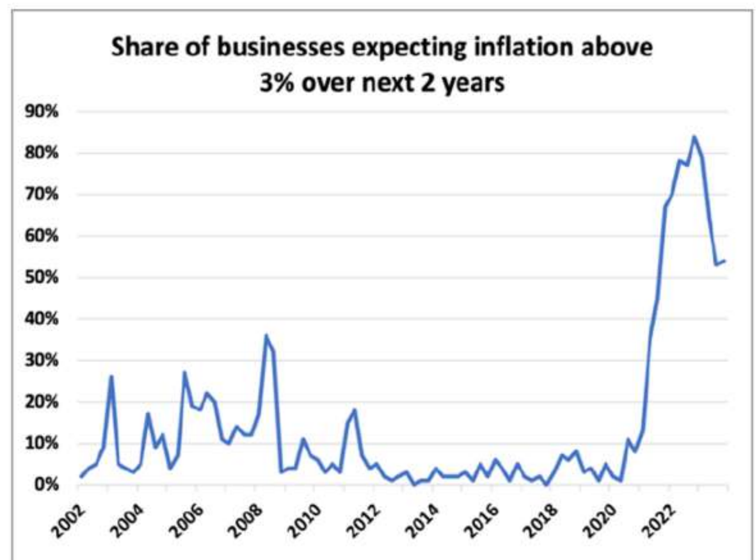


Bank of Canada survey data last week showed consumer and business inflation expectations are still way above normal levels and are staying higher than anyone expected.

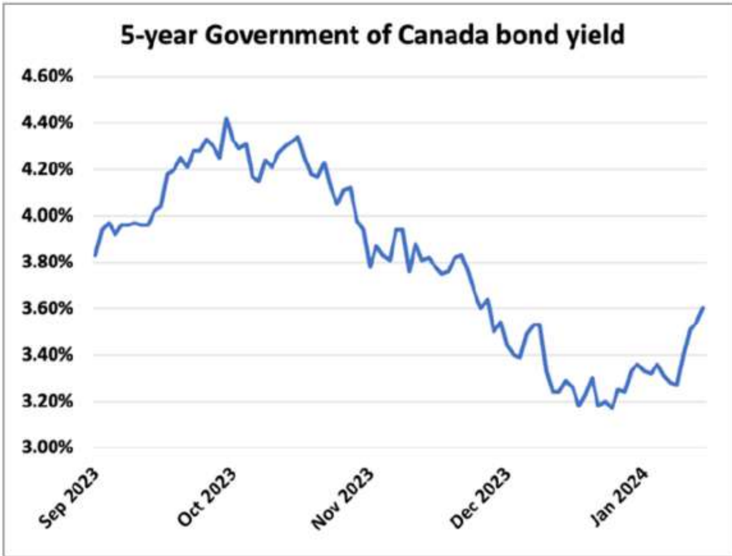






The second key data point was related to inflation expectations. Remember, when people and businesses THINK inflation is going to be high, they spend more today....which runs the risk of CAUSING higher inflation in a self- feeding dynamic. It's difficult for the Bank of Canada to aggressively cut when inflation expectations are high.

Hence, a rethinking of a March cut, and a repricing of total rate cuts in 2024. It also forced bond yields higher, with the bellwether 5-year bond yields now up 40bps or 0.4% in a straight line to start the year:



Since bond yields are a main determinant of fixed mortgage pricing, this will put a floor under fixed mortgage rates for now. It's still possible to find some 5-yr fixed rates under 5%, but they won't be going materially lower until we see 5-yr bond yields back closer to 3% again... which may not be until the spring.

2) *Supply and demand: Scary decline in building permits points to supply crisis*

Scary decline in single-family building permits

> If I had clients waiting on the sidelines to buy a single-family home or hoping to "trade up" to detached, I would be marketing the hell out of these charts

(feel free to snip these and send them around).

First, check out the trend in single-family building permits nationally:

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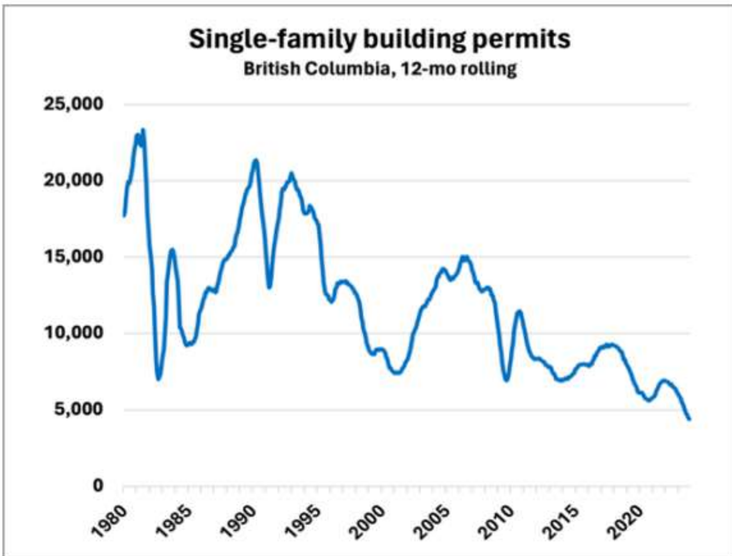
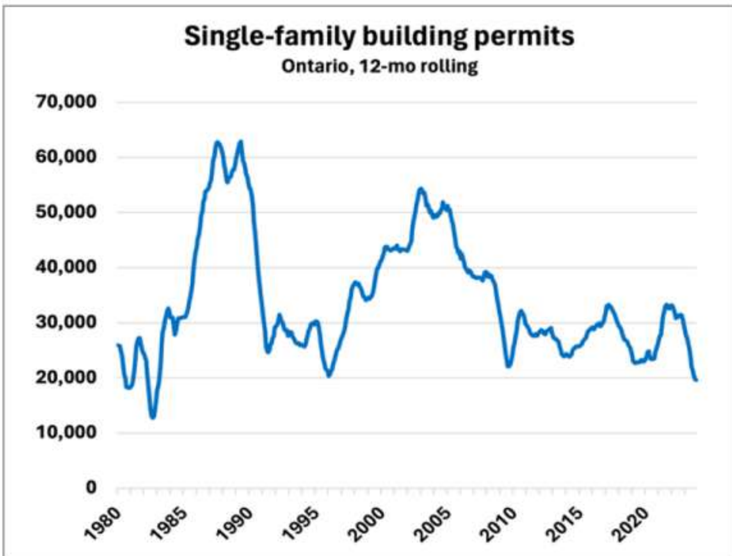
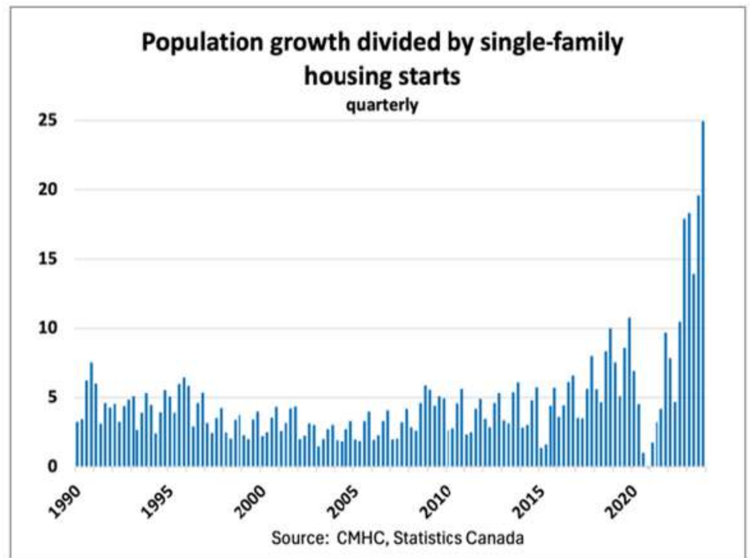
Yes, you are reading that correctly. Single-family building permits across Canada have fallen to levels last seen in the early 1980s! It's true in Ontario, but the chart is especially scary in BC where we have no precedent going back 45 years for single-family starts being this low:





Since permits always lead housing starts, you can expect construction activity to slow sharply in coming months. And that's a scary thought when we consider that

in Q4 we started building only one new single-family home for every TWENTY FIVE people added to the population.



You don't have to overthink this: New supply will be very low over the next couple years.

And resale inventory is not high by any means. HighER than last year, sure, but not HIGH. Consider Toronto and Vancouver...and keep in mind this is after 18 months high rates and crappy sales:

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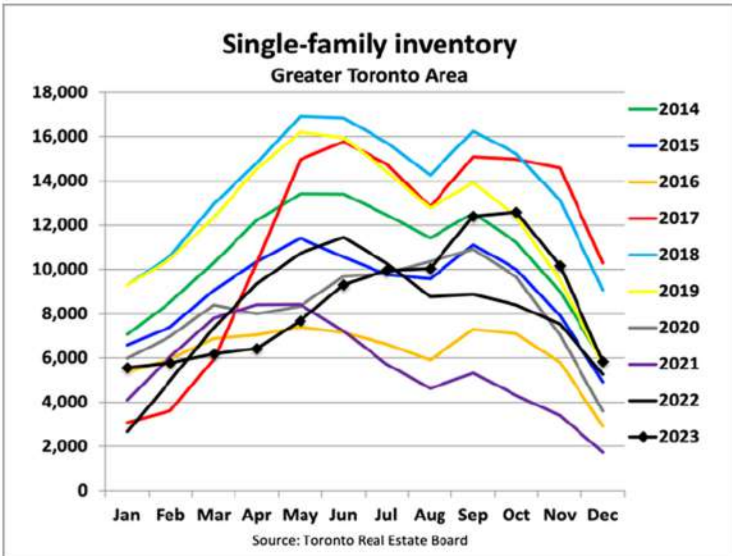

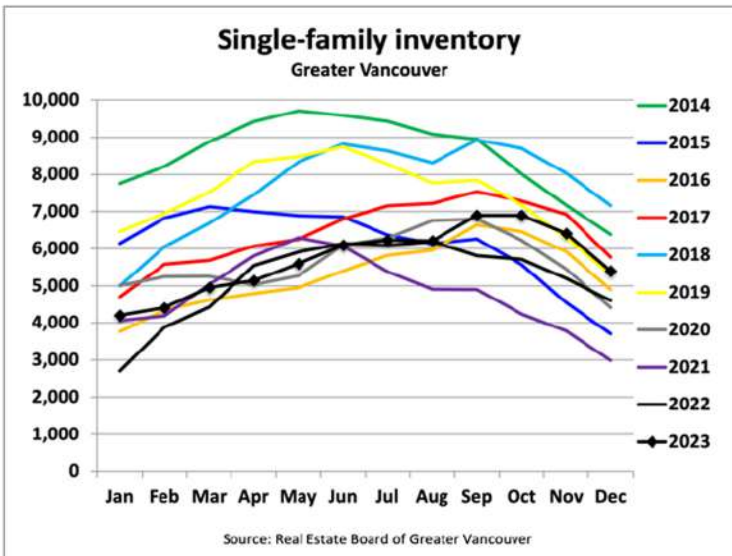

<u>My pitch to those clients would be very simple: Sure, you may get lucky and get another few percent off prices if you wait and time it perfectly, but you're playing with fire given the supply backdrop. At some point demand will stabilize. and when it does, prices can quickly run away on you.</u>

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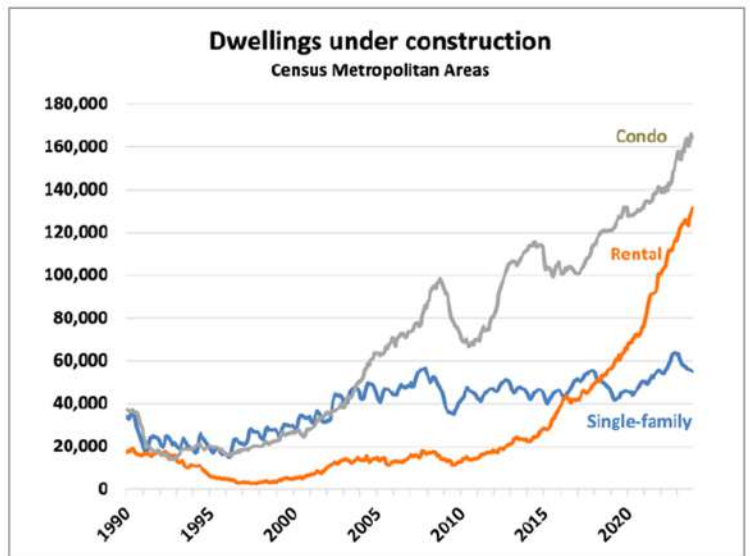
Housing starts slide

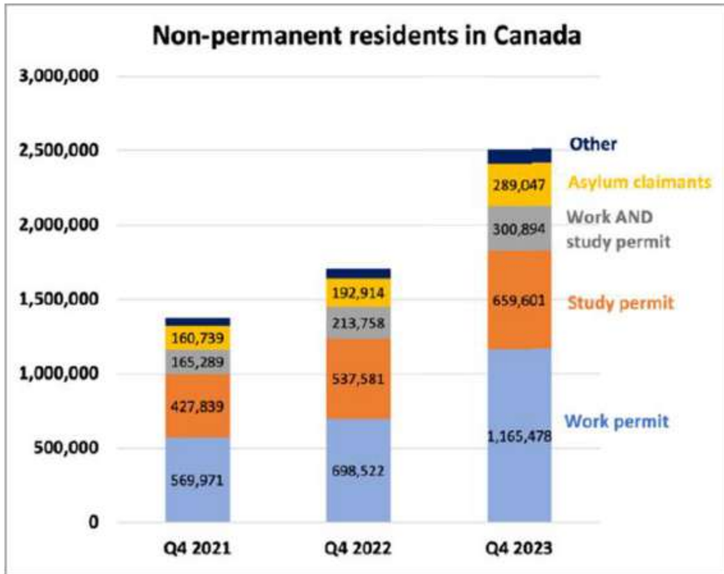
Housing starts fell 3.4% (seasonally adjusted) in December after falling 6.7% in November. The 12-month total now looks like this (note the steep decline in single-family, which will only get worse from here):

There is still a record number of dwellings in the construction pipeline, but that supply is increasingly skewing towards rentals and condos while single-family construction dwindles.

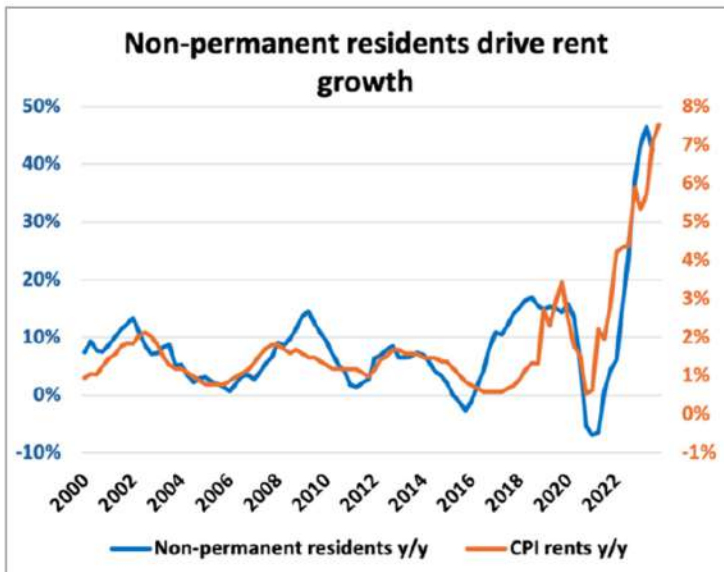


Feds finally clamp down on international students

The number of international students in Canada grew by 200,000 in the past year when we include both study permits and folks with study AND work permits:



The feds have finally had to reckon with the reality that the growth in non-permanent residents is the root cause of the rental crisis in Canada. I challenge policy makers to find a cleaner correlation than this:



https://nationalpost.com/news/canada/ottawa-international-student-visas

It intuitively makes sense: International students and work permit holders are almost exclusively renters. When their numbers swell, it creates pressure on the rental market. It's not rocket science- unless you're running the government...apparently.

Facing massive scrutiny over a system that has clearly run amok, Immigration Minister Marc Miller announced this week that student visas would be capped at 35% below current levels for the next 2 years

Ottawa to reduce new international student visas by 35%[1]

[...] The number of approved study permits will be reduced to 364,000 in 2024, CTV reports.

The move comes as the federal cabinet is in the midst of a three-day retreat in Montreal preparing for the upcoming sitting of Parliament.

[...] More than 800,000 international students were issued temporary study visas in 2022, and Miller said last fall the numbers were tracking to hit 900,000 in 2023.

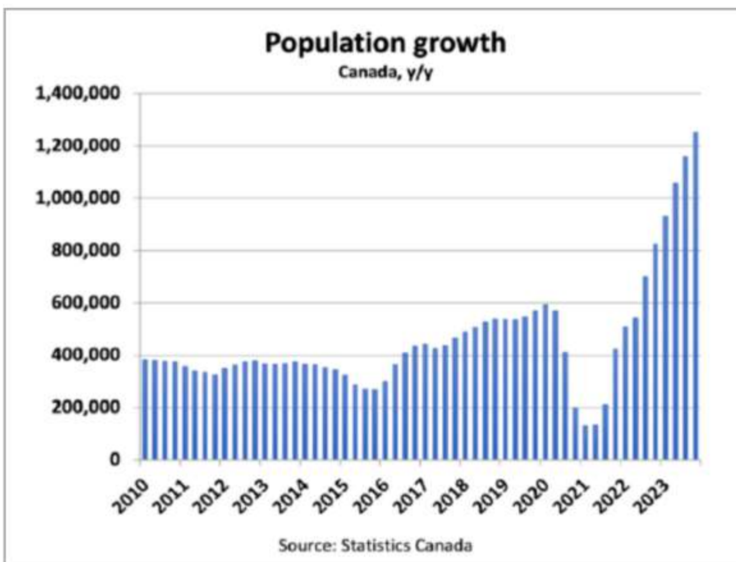
That is more than triple the number just 10 years ago.

It's a hike Miller blames in part on unscrupulous schools bringing over students as a source of revenue with little regard for providing a solid education or ensuring their well-being while in Canada.

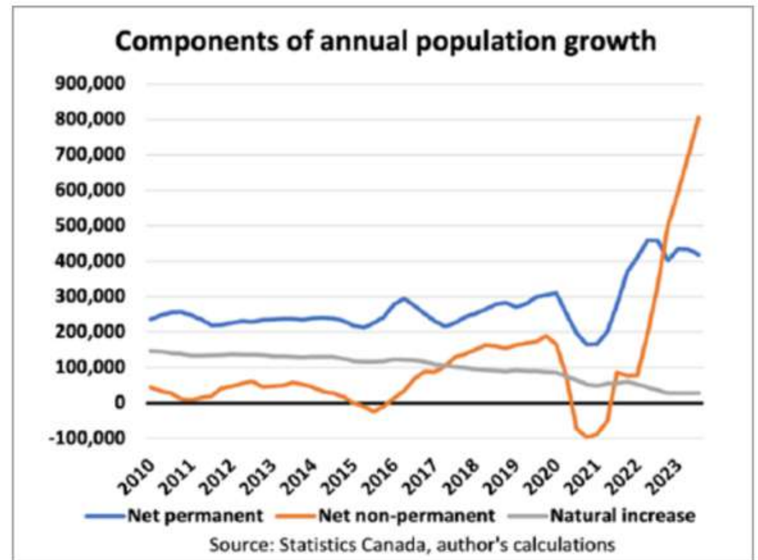
That includes housing, with many reports in recent years of international students being unable to find safe and secure housing.

This was well-telegraphed ahead of time. We knew SOMETHING was coming, and I don't think it will stop here. Next up the feds will have to address the massive abuses of the temporary worker programs. Expect announcements on that front this spring.

Ultimately it gets back to a point I've made repeatedly: Population growth of 1.2 million in one year is both a policy failure and an aberration. It was never sustainable since it relied on an impossible expansion in the non-permanent resident cohort that could not be maintained over time. A year from now we'll be looking at population growth that is still very strong historically but certainly well under the 1 million mark:



Source: Statistics Canada



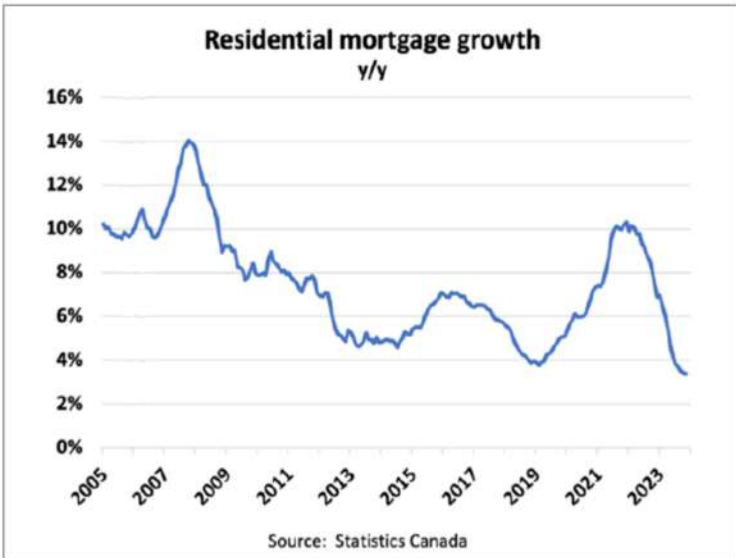
Source: Statistics Canada, author's calculations

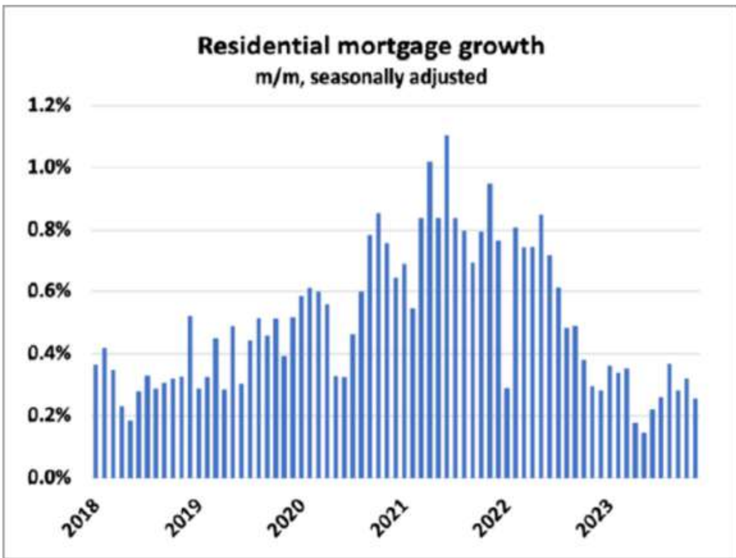
That should help take some steam off the rental market, particularly given the record new supply set to be delivered in 2024 and 2025. It does NOT, however, help the single-family market which will still be woefully undersupplied in coming years.

3) *Mortgage market update: Variable rate gains popularity*

i) Mortgage grow slows, but variable gains popularity

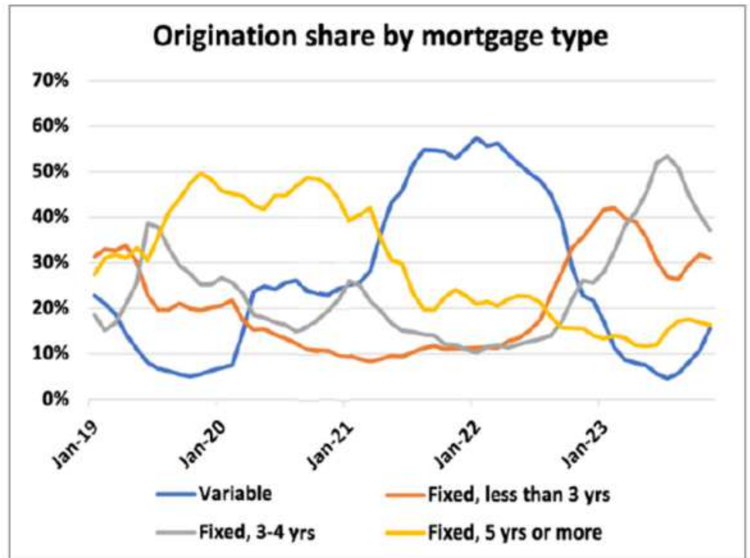
Mortgage debt outstanding grew just 0.25% m/m in November and was up just 3.4% y/y... the lowest rate of growth since 2001.

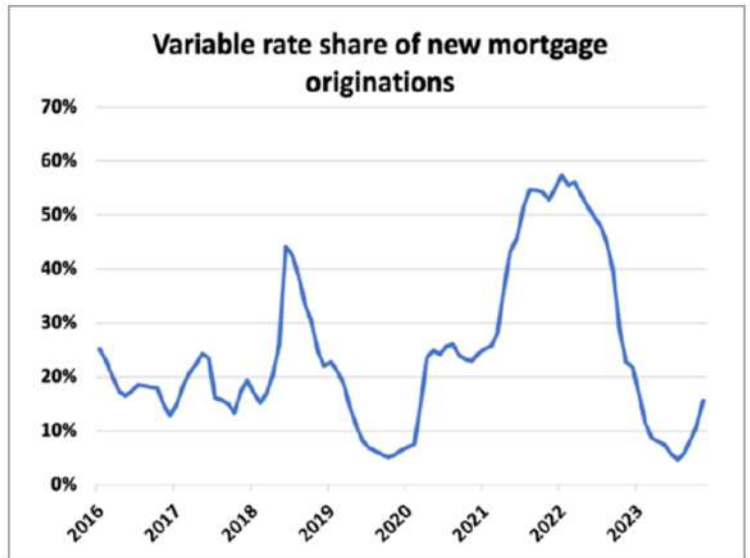




It's important to remember that residential mortgage growth today largely reflects home sales from 60-90 days ago (since that's the typical closing time). What we're seeing here is the lull in sales from late summer/early fall following the back-to-back rate hikes from the Bank of Canada in June and July. With seasonally adjusted home sales rising in December, and channel checks indicating a notable uptick in inquiries at mortgage brokers, we should expect this data to start to turn back up later this winter.

Mortgage originations were down 9% y/y in November, but there was notable uptick in variable rate loans to 16% of total. Discussions with mortgage contacts suggest that it's likely now north of 25% as borrowers increasingly position for Bank of Canada rate cuts in 2024:





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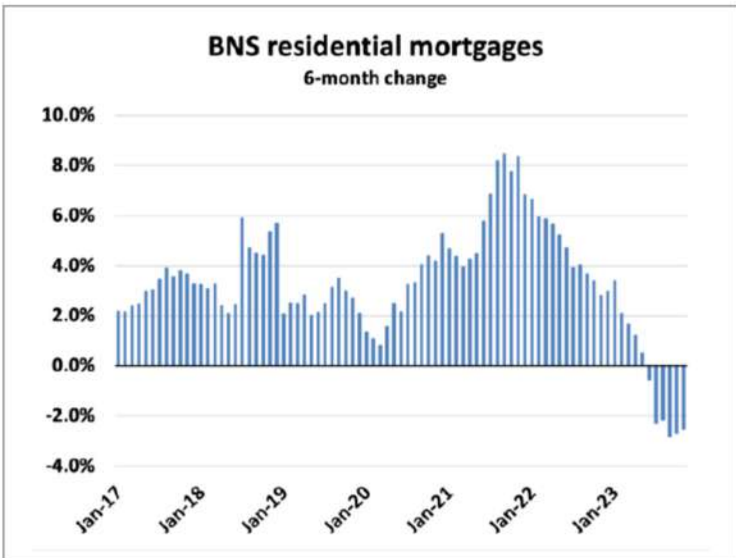
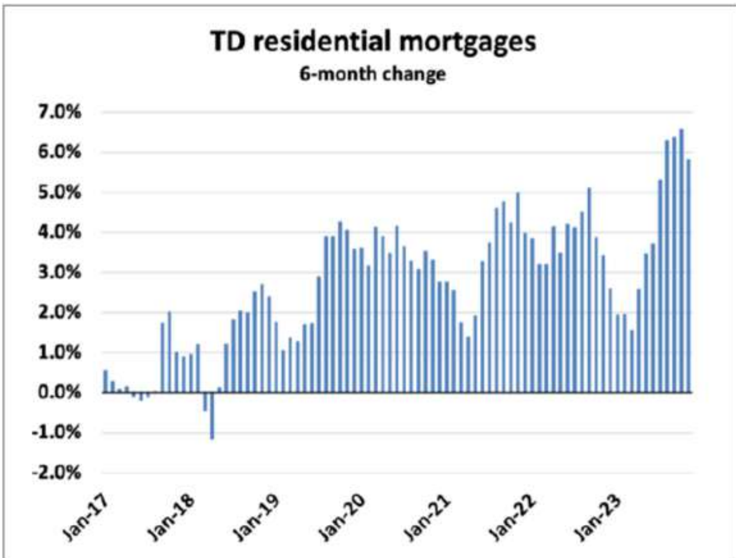
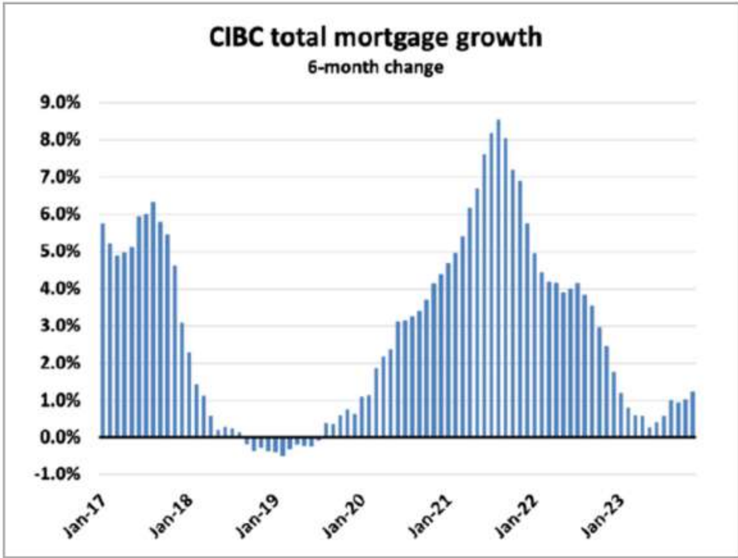
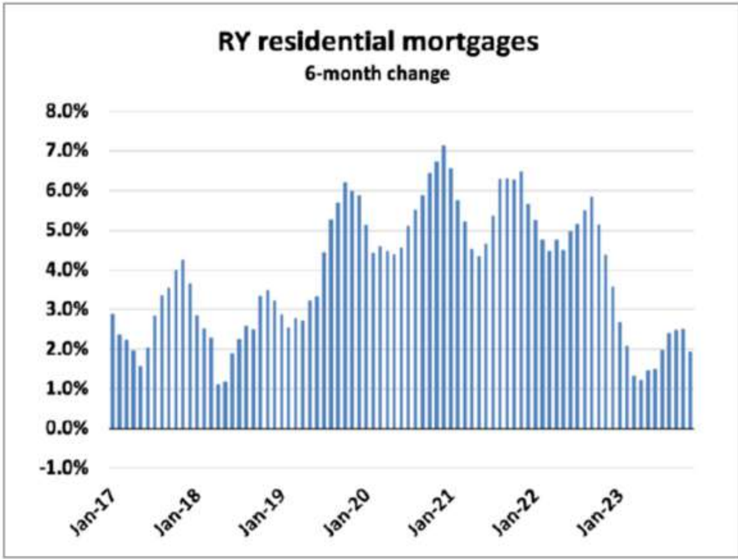
ii) BNS still lagging their peers

Looking at the latest OSFI balance sheet filings, we continue to see a significant divergence between residential mortgage growth at BNS and the rest of the big banks. And it's a particularly big gap when compared to TD which is currently growing at 3x their peers on this front:









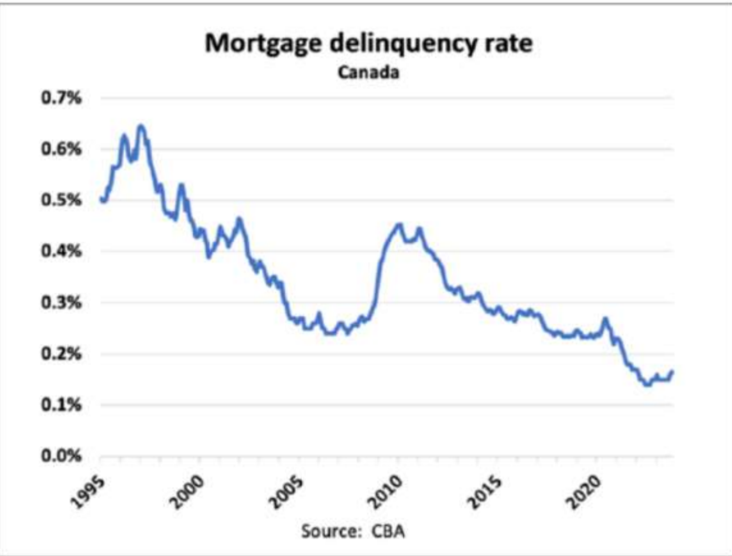
Now that may change in coming months. We're hearing that BNS' mortgage offerings have gotten much more competitively priced in the past few weeks. Rob McLister recently interviewed BNS' new VP of real estate secured lending in his excellent MortgageLogic.news publication (https://www.mortgagelogic.news/).

- "In 2023, we took a pause to strengthen our balance sheet... because the cost to fund a mortgage was much higher. We were trying to rebalance capital.. 2023 was a distinct year versus what we've seen over the last 15 years from Scotia."

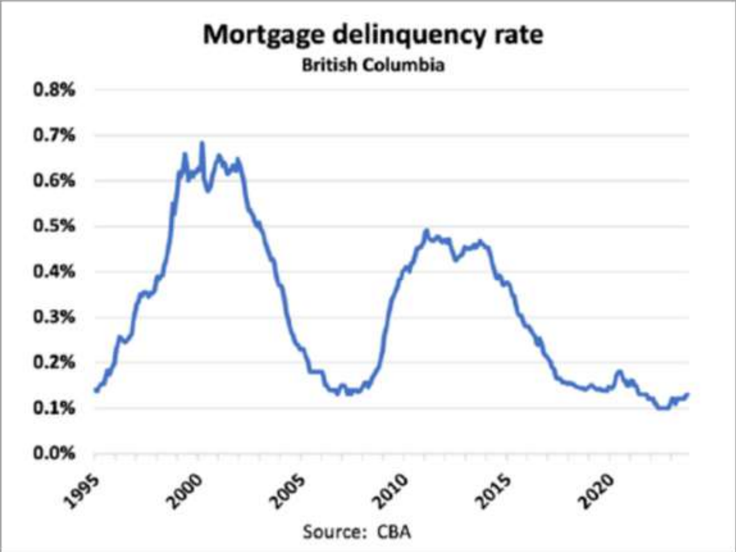
- "In 2024, we are absolutely back with a rate competitive stance."

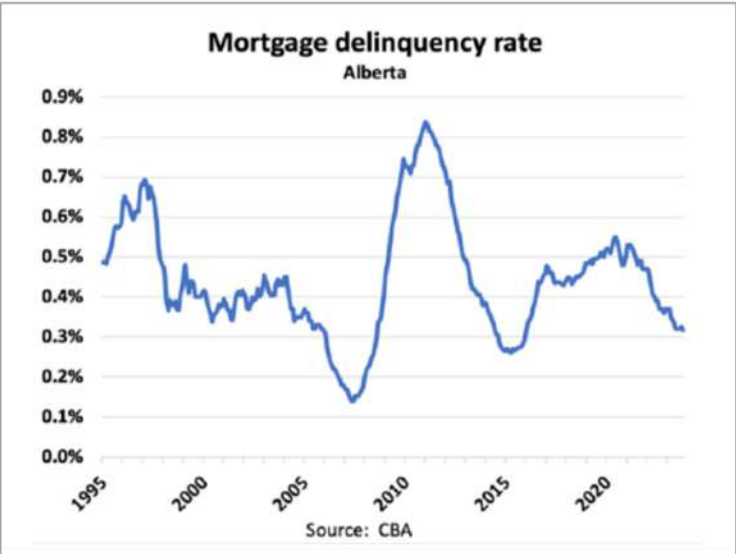
iii) BNS still lagging their peers

The number of borrowers currently delinquent on their mortgage continues its shockingly slow grind higher. As of October, the arrears rate was just 0.17% nationally...barely off the all-time lows. That equates to just 8,400 delinquent mortgages out of a pool of 5.1 million nationally:



With the exception of Alberta, all provinces are in a modest uptrend in insolvencies, but all are well below normal levels for now. We should expect these to trend back towards more normal levels as we move through 2024:





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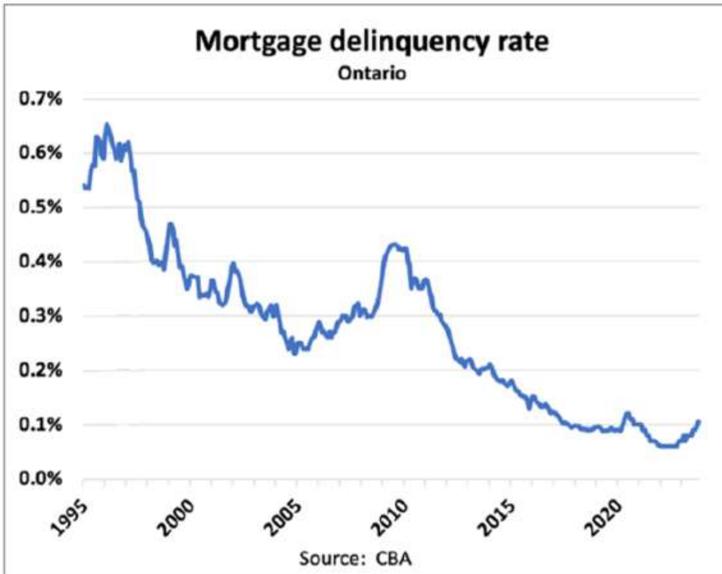
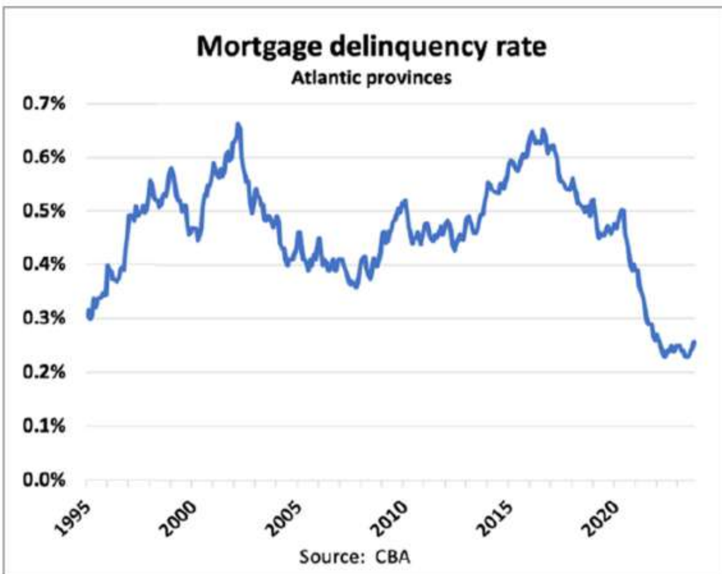
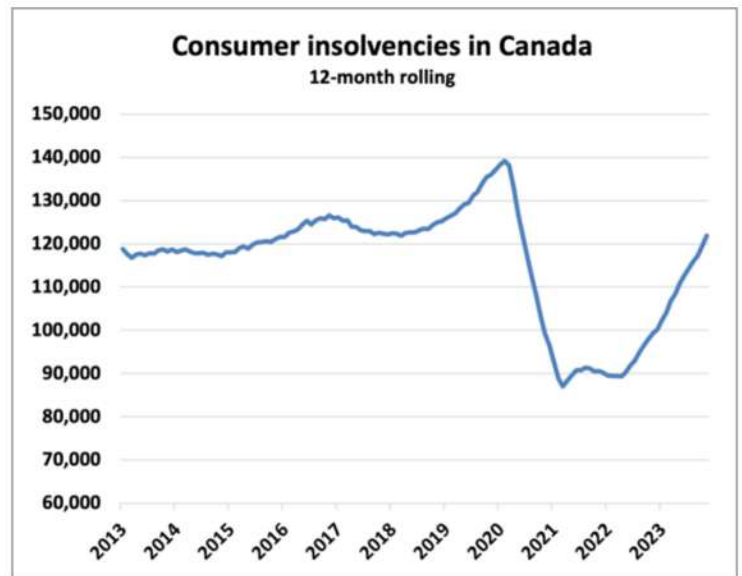
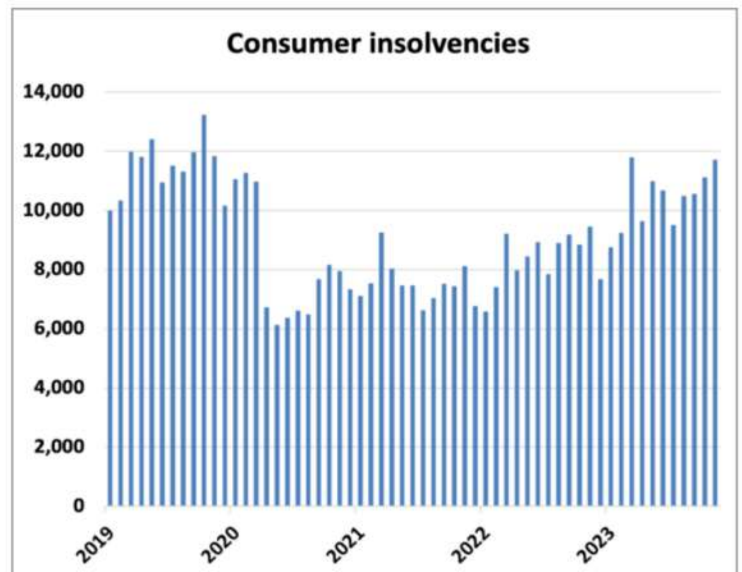




vi) Insolvencies continue to rise in November

Chartered bank mortgage arrears might be low, but consumer insolvencies are on a notable uptrend. The 12-month total is moving sharply higher- albeit still below pre-COVID levels, and the stand-alone November tally was the highest of any month since 2019:





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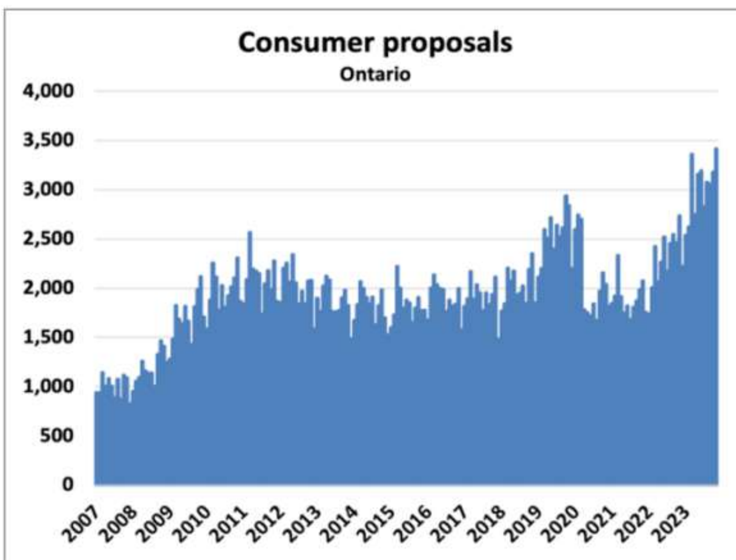
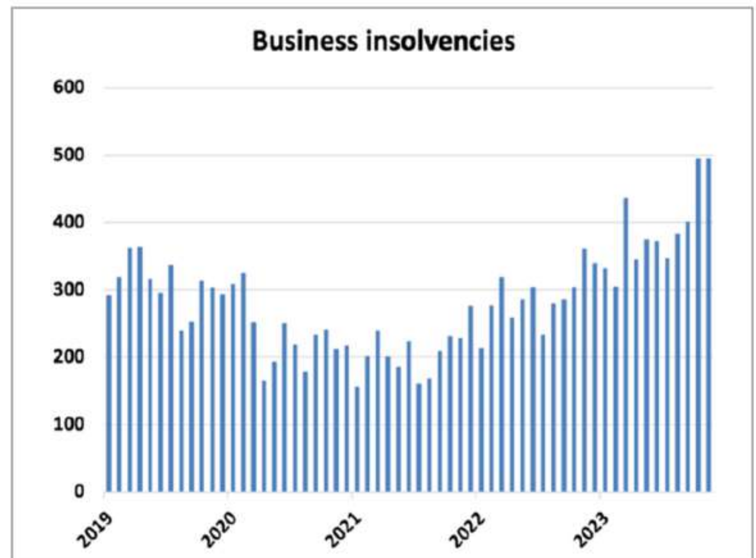
There are 2 types of insolvencies in Canada: Bankruptcies and proposals:

- Proposals are a restructuring of unsecured debts (eg...I owe $1,000 to a credit card company but instead we agree that I will pay them $500 spread out over 5 years).
- Bankruptcies are more complex and involve a complete "wiping of the slate" and starting over. Certain unprotected assets come into play (ie most of your housing equity goes to your creditors), and then the debtor pays a certain amount of "excess income" to the creditors over a period of time (typically 3 years but can be as little as 9 months if income falls below a certain threshold)

I highlight this because proposals are often a "leading indicator" of broader financial stress among homeowners. The data is a bit muddled by the fact that the maximum amount of debt that can be included in a proposal has risen considerably over the past decade (hich means they are naturally more popular) but I still think it's notable that consumer proposals just set a record in Ontario. This is something to watch:



It's even scarier on the business side where we just had the two busiest months for insolvency filings in the past decade....and that was BEFORE the CERB payment deadline this month.



All that to say, don't be fooled by the low mortgage arrears rates. High interest rates are clearly hurting consumers and businesses, and we'll see it in the official arrears data before long. Rates at these levels will break things, and the Bank of Canada is well aware of that.

4) *Monthly resale analysis: Sales surge, inventory stabilizes*

The key data from last month is summarized below. Pay particular attention to the trend in Ontario where sales surged and new listings tumbled. It certainly looks like things may have turned a comer in that province:

	Sales		New listings		Active inventory		House prices (HPI, seasonally adjusted)	
	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	+9.4%	+8.7%	+6.5%	-5.1%	+7.8%	+0.0%	+0.8%	-0.8%
BC	+8.1%	+7.0%	+17.1%	-5.7%	+10.7%	+3.4%	+4.0%	-0.6%
AB	+24.1%	+5.7%	+12.3%	+0.6%	-10.0%	+1.0%	+8.5%	+0.3%
QN	+8.1%	+16.6%	-3.8%	-11.1%	+13.3%	-5.4%	-0.3%	-1.1%
QC	+3.4%	+1.9%	+19.5%	+2.2%	+19.7%	+3.4%	+3.7%	+0.1%

Key takeaways:

i) Home sales jump in December

Home sales rose 8.7% m/m in December, slightly below my estimate for a 10% national gain based on preliminary metro-level data. It was the largest monthly increase since April of last year at the height of the spring market, and it was led higher by the two provinces that had been the laggards through the back half of 2023, namely Ontario (+16.6% m/m) and BC (+7.0%):

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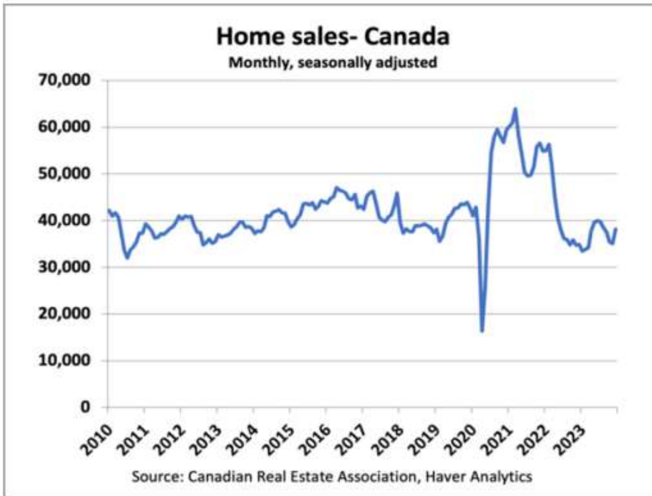
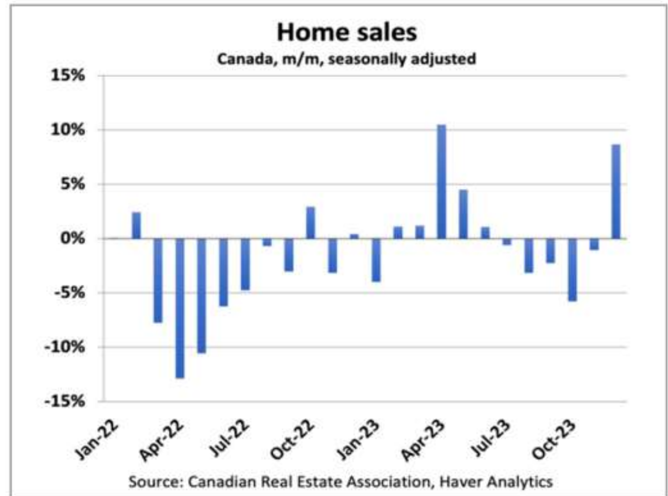
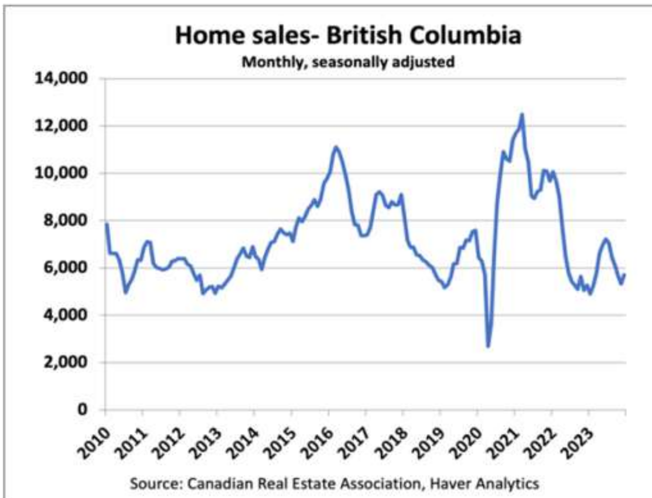
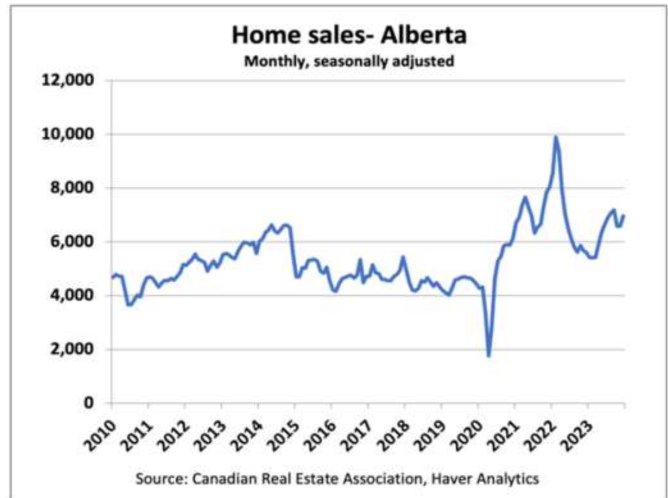
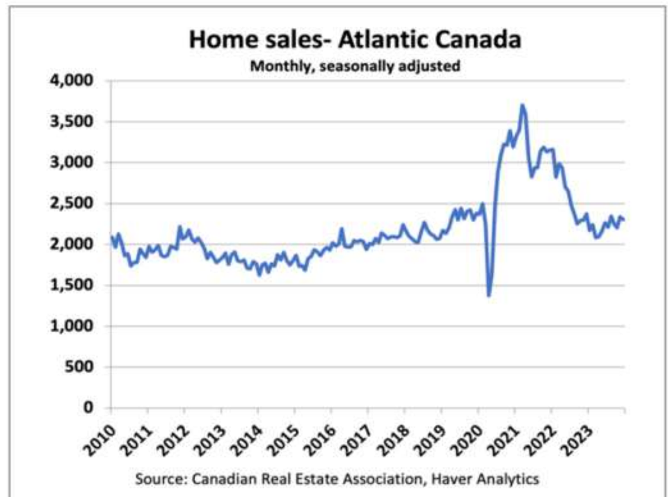

Home sales- Canada
Monthly, seasonally adjusted
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
Source: Canadian Real Estate Association, Haver Analytics


Home sales
Canada, m/m, seasonally adjusted
15%
10%
5%
0%
-5%
-10%
-15%
Jan-22
Apr-22
Jul-22
Oct-22
Jan-23
Apr-23
Jul-23
Oct-23
Source: Canadian Real Estate Association, Haver Analytics


Home sales- British Columbia
Monthly, seasonally adjusted
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
Source: Canadian Real Estate Association, Haver Analytics


Home sales- Alberta
Monthly, seasonally adjusted
12,000
10,000
8,000
6,000
4,000
2,000
0
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
Source: Canadian Real Estate Association, Haver Analytics

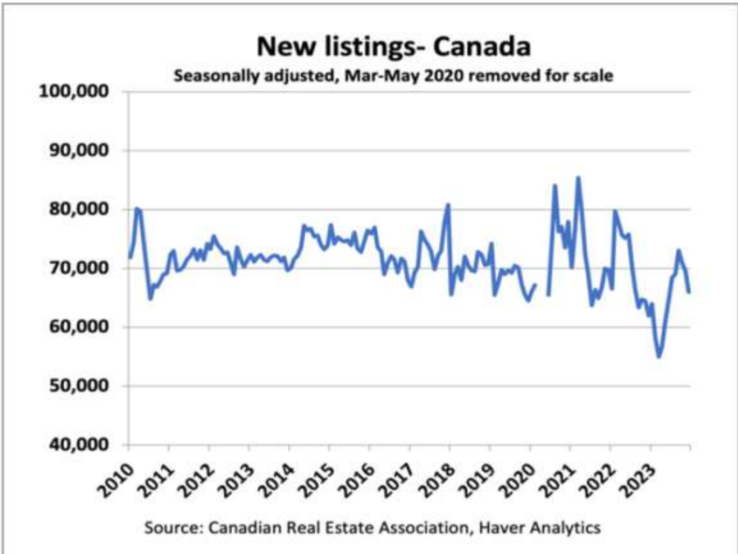
Home sales- Ontario
Monthly, seasonally adjusted
30,000
25,000
20,000
15,000
10,000
5,000
0
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
Source: Canadian Real Estate Association, Haver Analytics


Home sales- Atlantic Canada
Monthly, seasonally adjusted
4,000
3,500
3,000
2,500
2,000
1,500
1,000
500
0
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
Source: Canadian Real Estate Association, Haver Analytics

ii) New listings fall, market balance stabilizes

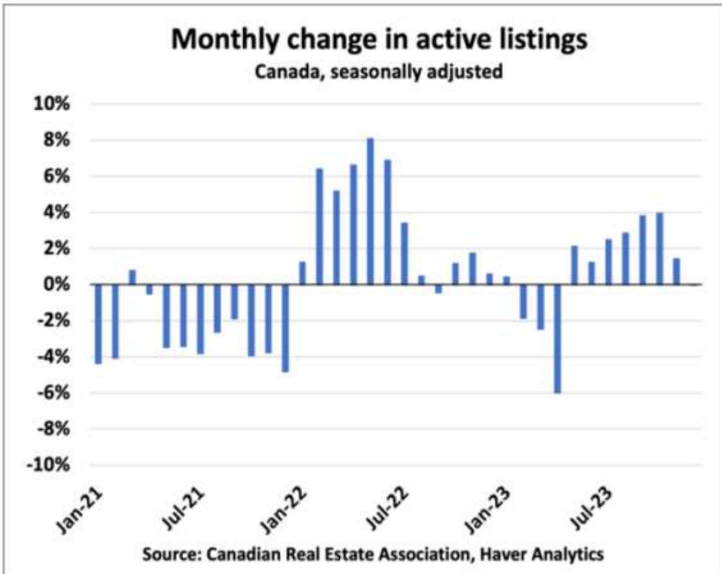
The big story remains on the supply side. New listings fell 5.1% m/m including a 11.1% drop in Ontario. That pushed the sales-to-new listings ratio nationally to 58% from 50% previously, and it puts the market well into balanced territory. If it holds here for a couple months, we should expect prices to stabilize ahead of the spring market.

Notable among the provinces is Alberta and the Atlantic Provinces with sales-to-new listings ratios above 65... which is still very hot. It's a good reminder that there is no "Canadian housing market". We are a "market of markets", and that's particularly true right now.

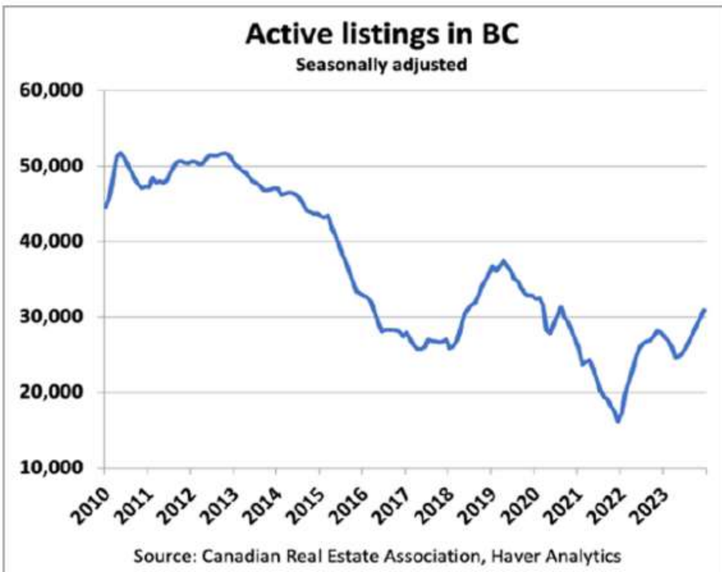


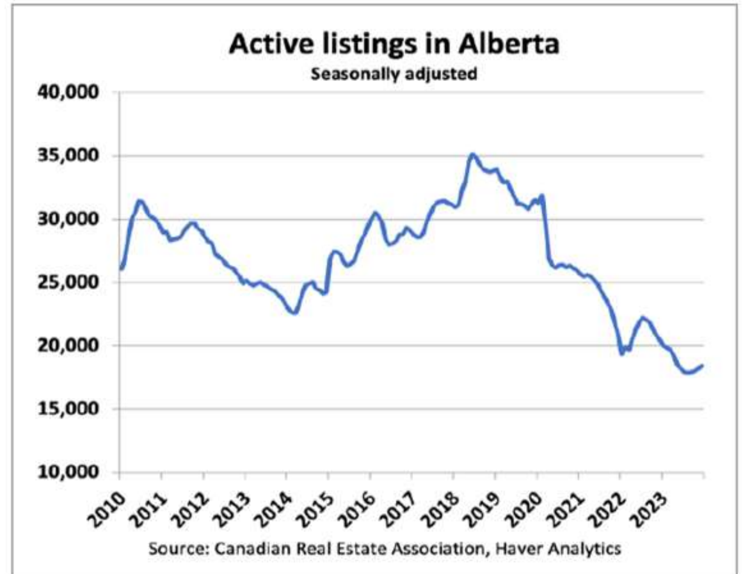
iii) Inventory flat

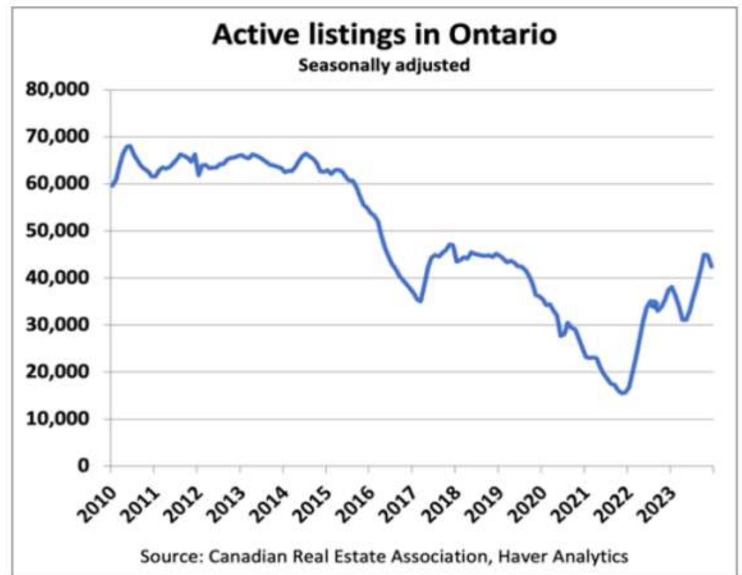
Seasonally adjusted inventory levels were flat m/m nationally after building for 7 consecutive months. Ontario saw a decline of 5.4% while BC and Quebec both saw inventory rise 3.4% on the month:

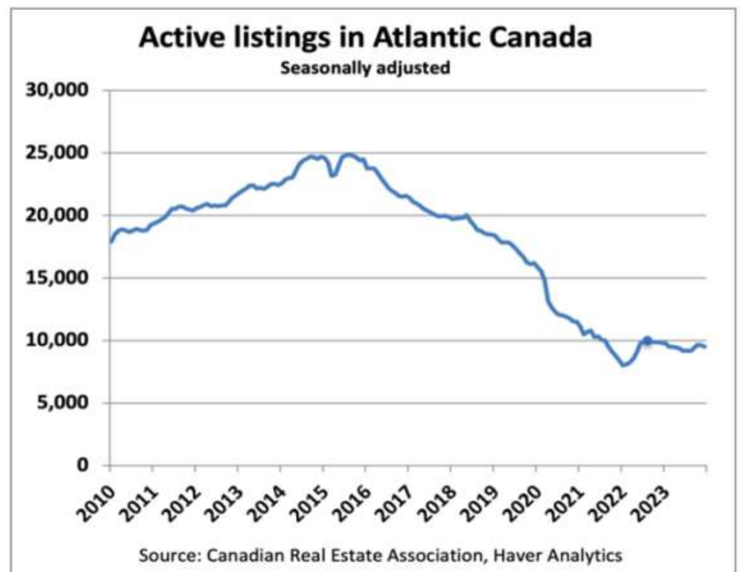


Note that Ontario and BC have seen seasonally adjusted inventory levels more than double off the lows while Alberta and the Atlantic Provinces remain effectively at record lows:









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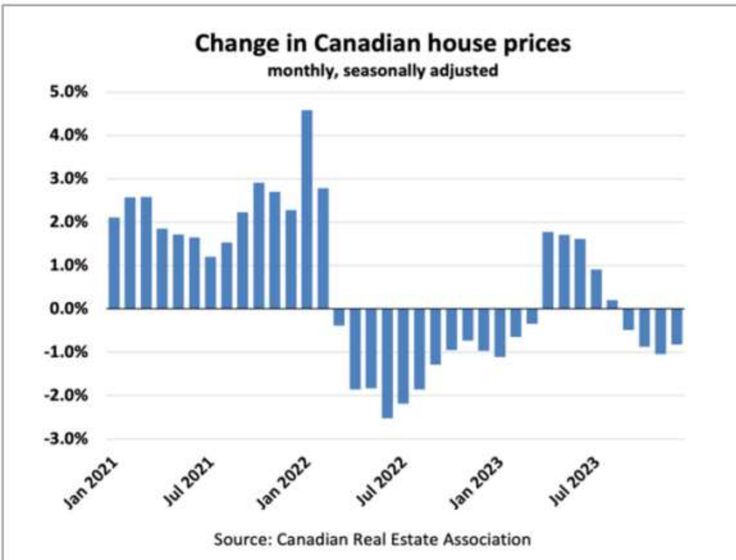
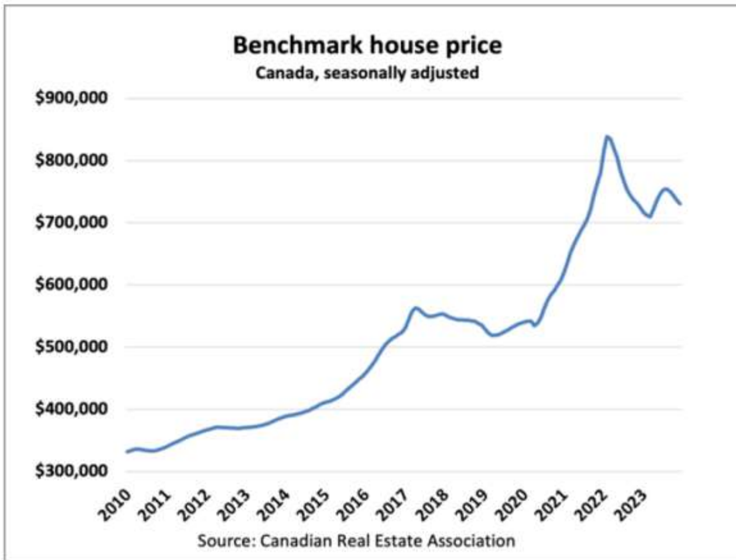
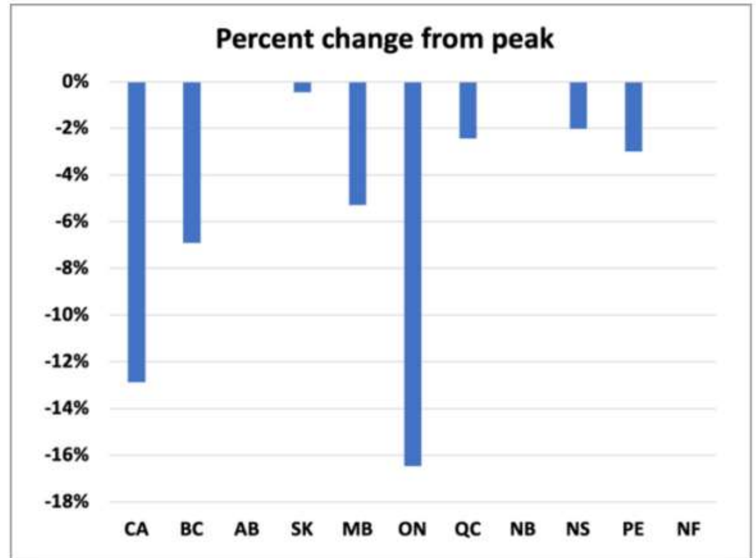
iv) Prices decline... but for how much longer

House prices continued to grind lower for now, down another 0.8% m/m in December:

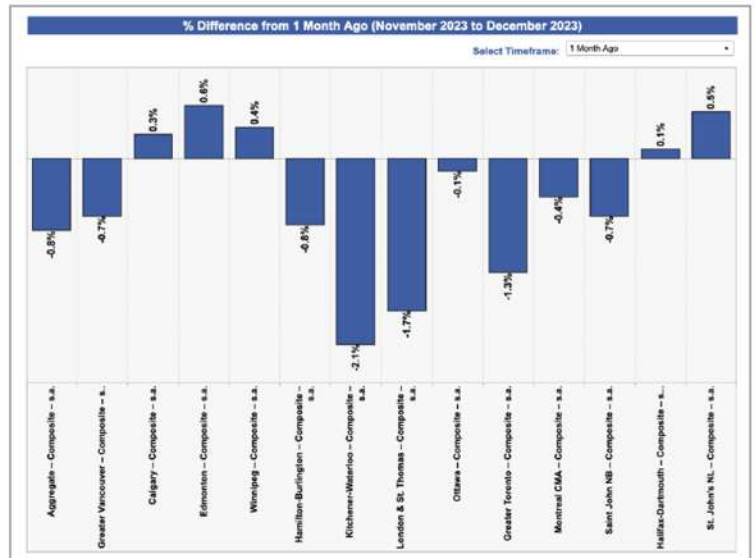




Prices nationally are now down 13% from peak levels, including nearly 17% in Ontario. Alberta and several Atlantic provinces remain at all-time highs:



Looking across the country, the bulk of the weakness in December came from the major southern Ontario metros, while the prairies and Atlantic Canada continue to see modest growth:



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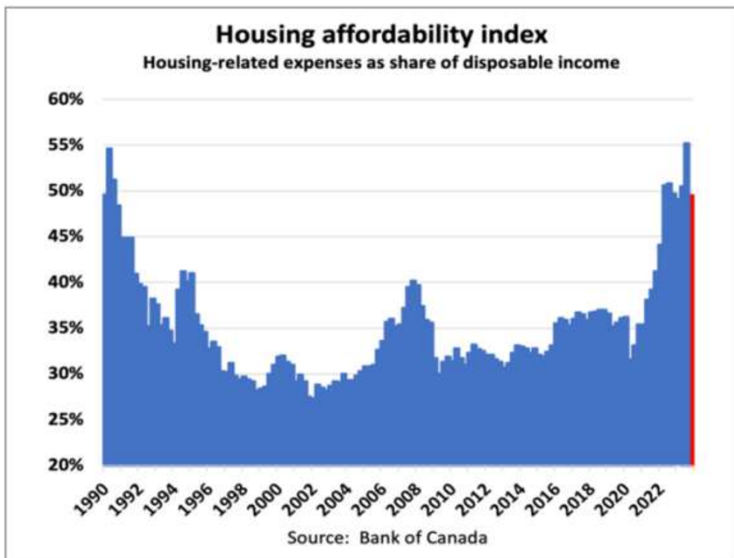
v) A long grind back to "affordable"

It appears that the worst of the affordability crisis is behind us. Q3 appears to have marked the peak, and by my math we saw a notable improvement in Q4 with affordability coming in at the best level in 6 quarters. That's not saying much when it's still close to the worse level in 30 years, but it's a start.



I still think we'll see seasonally adjusted sales rise another 20% from here heading into the spring, but we should temper expectations. The reality is that even when we model out 4% interest rates, the monthly mortgage payment needed to buy into the market is still 70% higher than it was in 2021.

That means that while sales have some room to rise from here, we'll probably be a long time returning to the crazy boom times of 2021 and early 2022.

5) *Consumer check: Retail sales still soft, but consumer sentiment jumps*

i) Disappointing retail sales

Headline November retail sales came in well below expectations at -0.2% m/m (+0.2% expected). Core sales (ie ex- autos and gasoline) were even softer, declining 0.6% m/m, the fifth decline in the past 7 months. That puts the 6- month trend in negative territory for the first time since lockdowns in 2021:

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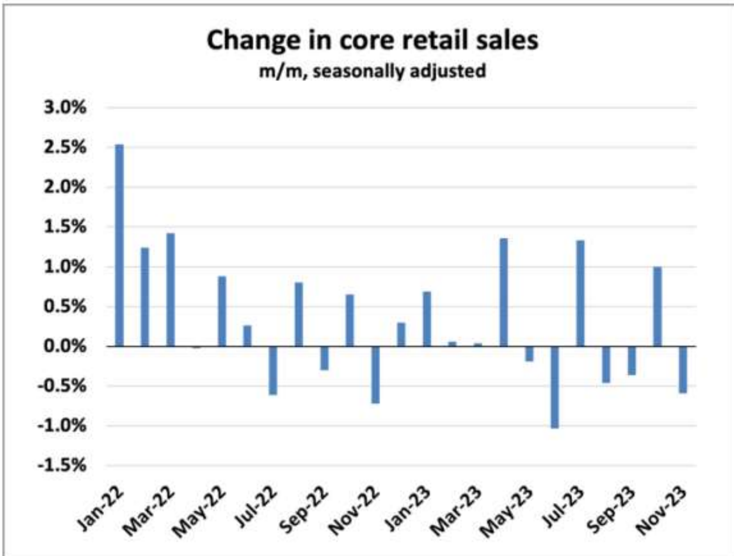
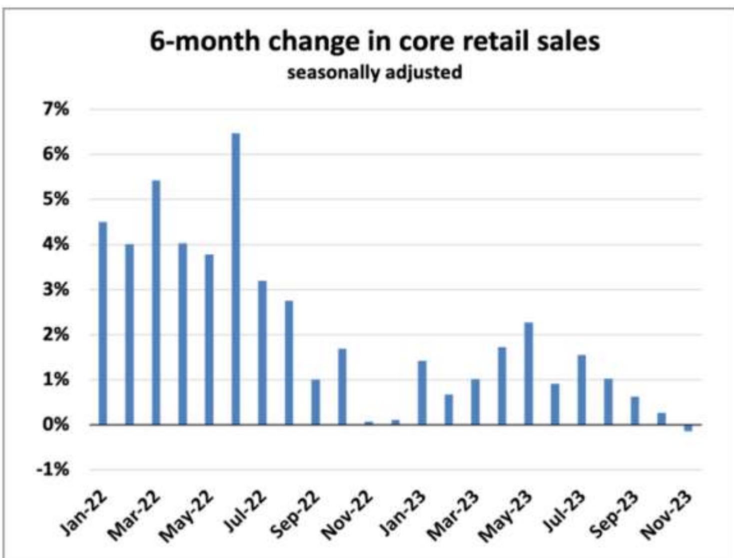
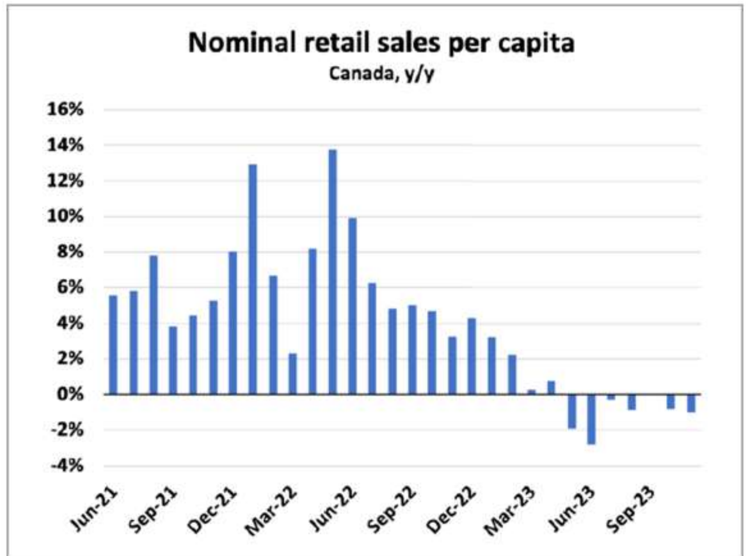


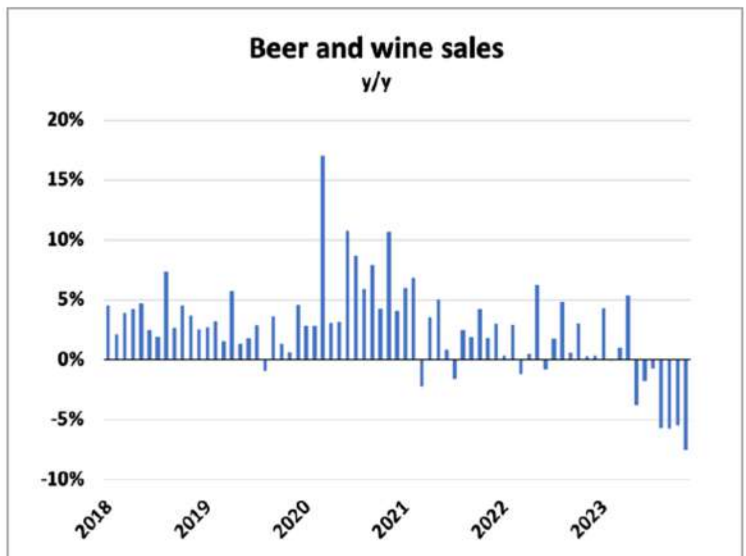


It was a mixed bag across industries with building materials (-0.1%), sporting goods and hobby retailers (-0.3%) and general merchandise sales (-1.8%... the largest decline since April '21) leading declines, but offset by gains in furniture and electronics (+1.0%) and clothing retailers (+1.5%).

Given the +0.3% monthly tailwind from population growth, the softness in retail sales is understated. Per capita sales remain negative on a y/y basis... something we haven't seen since the onset of the pandemic.



One notable trend is the continued steep slowdown in beer and wine sales which fell another 3.3% in November and are now down 7.5% yly. It's not a shift to cannabis either, weed sales fell 6.2% last month and are down 11% in the past 3. This has to be a disposable income story:



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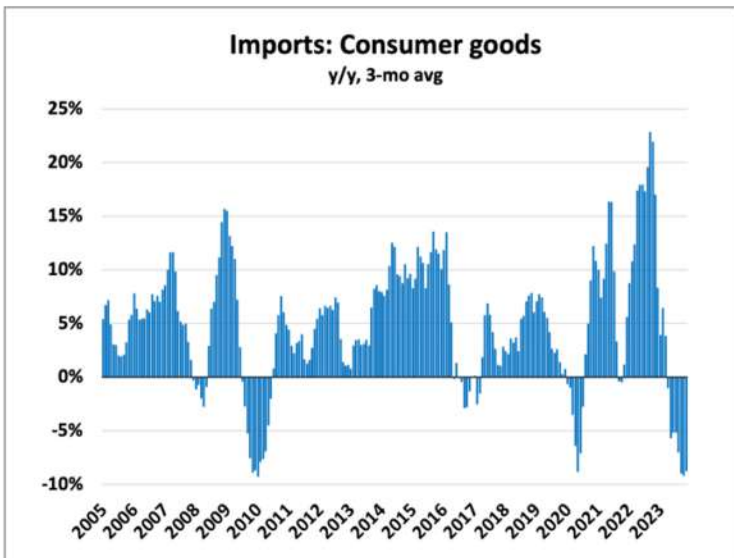
There was also an interesting tell in the latest trade data: Imports of consumer goods are plunging.

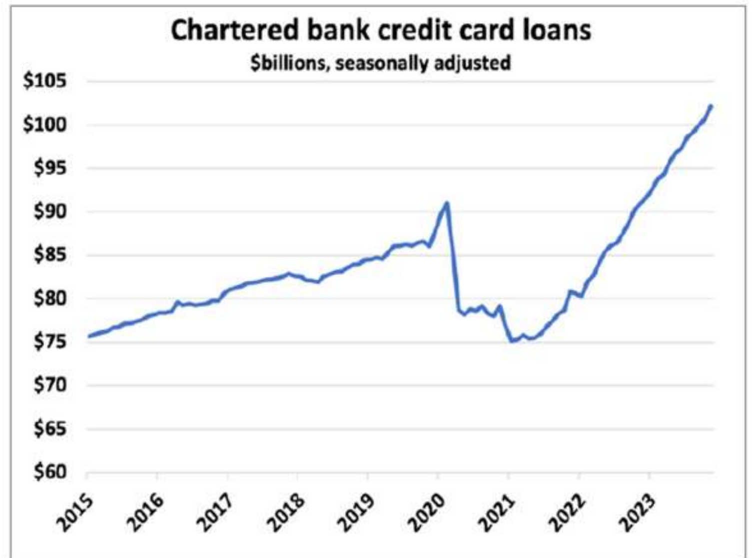
They fell 2.2% in November after a 0.4% decline in October. That leaves the y/y growth rate at levels seen in the last 20 years only during the depths of the pandemic and then the Financial Crisis prior to that.

This is not a great indicator of consumer demand in Canada:



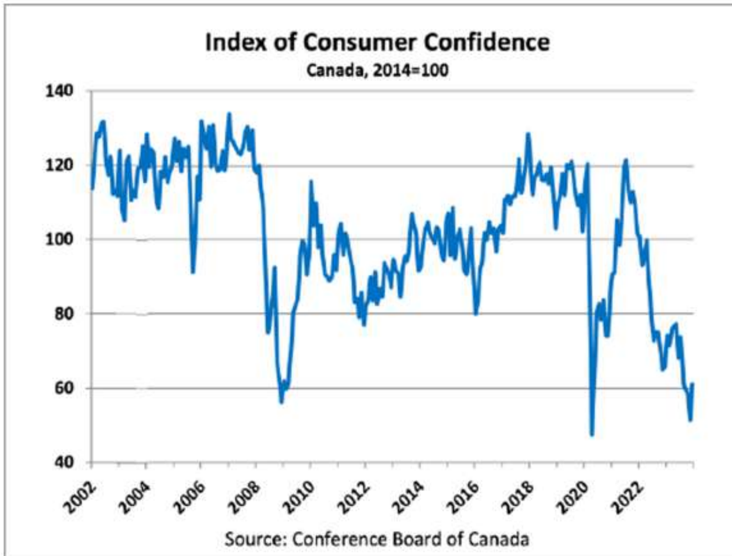
ii) Credit card balances jump

We learned this week that credit card debt jumped another 1.4% m/m (seasonally adjusted) in November -the largest monthly increase since April 2023- and balances are now 12.3% higher than one year ago. One has to wonder what retail sales look like absent this surge in credit card usage:



iii) Consumer confidence improves in December

After registering the second lowest reading on record in November, consumer confidence rebounded sharply in December according to the Conference Board of Canada. The index jumped 9.6 points, the largest increase since June of 2021. It remains at levels only otherwise seen during the depths of the Financial Crisis and the onset of the COVID pandemic:



All in all, it looks like Canadian consumers are still struggling under the weight of high rates and it's showing up in weak sentiment. That may be the story for the first half of the year until rate cuts start to bring relief.