



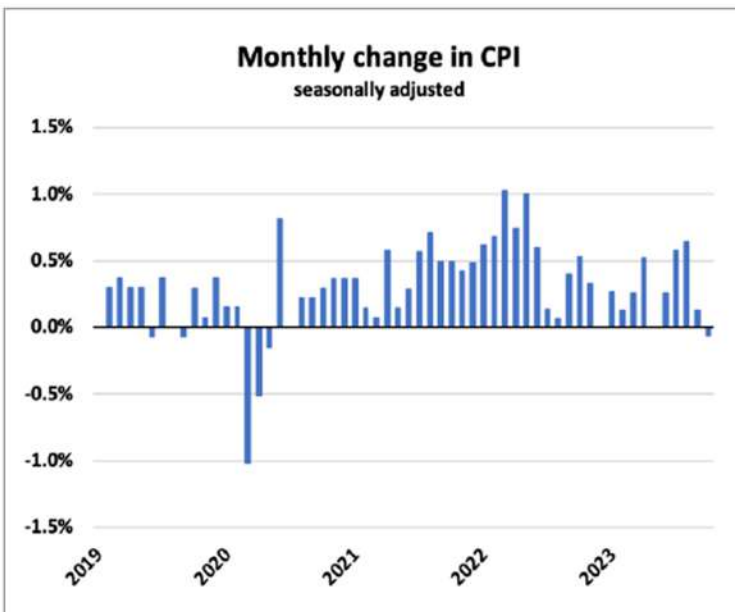
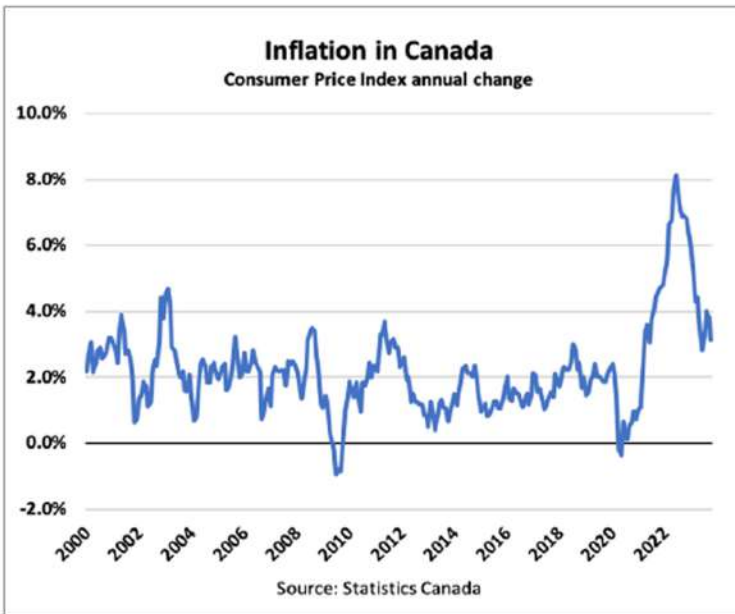
THE EDGE REPORT

November 2023

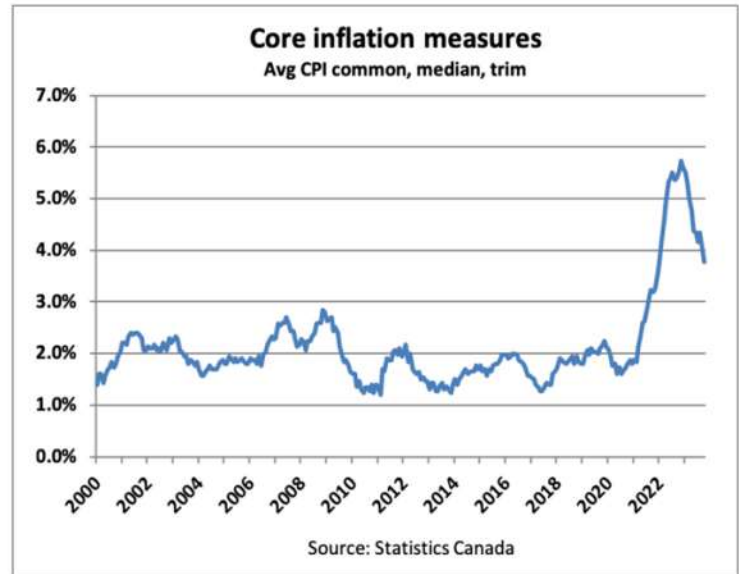


1) *Another soft inflation reading solidifies BoC pause*

The October CPI reading came in softer than expected at just 3.1% y/y (vs 3.2% expected) and the headline index actually DECLINED 0.1% m/m on a seasonally adjusted basis...the first monthly decline since the pandemic hit in early 2020.

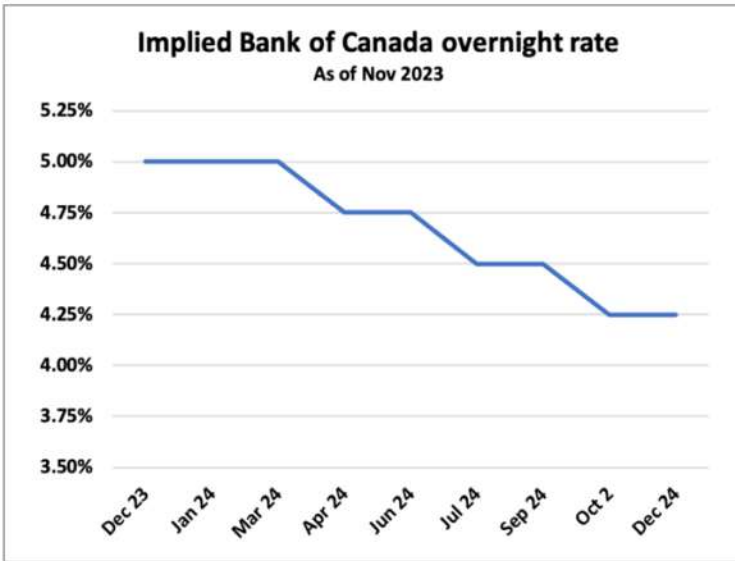


A 6% monthly decline in gasoline prices was the main driver in the monthly decline, but even when we strip that out and look at core inflation (which the Bank of Canada focuses on), we see a notable deceleration from 4.0% to 3.8%:



Falling inflation coupled with a softening labour market (the unemployment rate has risen 0.7% in the past 6 months) and weakening economic growth (Q3 is on track to be flat when reported next week) means the Bank of Canada is now very likely on hold.

In fact, market are now pricing in a pause from the Bank of Canada only until the April meeting next year before cuts begin. Earlier this month, markets weren't anticipating the first cut until into the second half of next year:



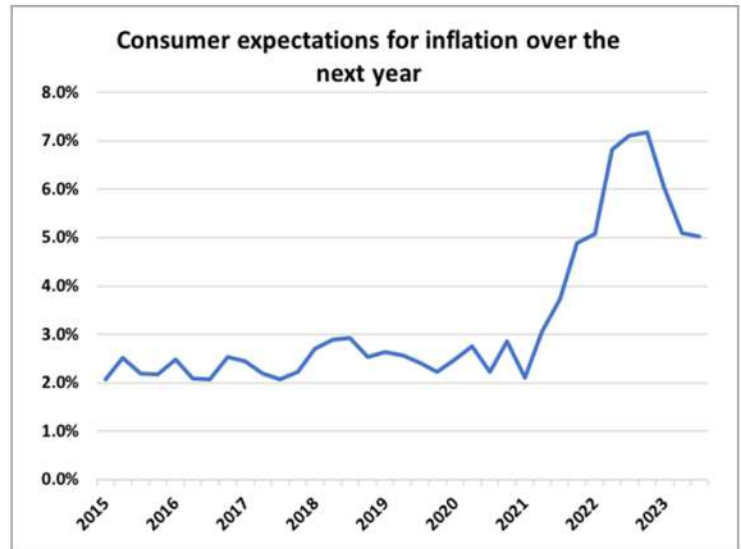
The question now is when they will cut. As I outlined last month, the Bank needs to see inflation expectations start to come down. A famous economics was once asked how they would manage their money in a high inflation environment. Their answer: Spend it! That nicely captures the gist of the issue. When people are fearful of future inflation, they spend more today... and that can risk causing the very inflation they fear.

So this remains one of the key charts to watch. Until inflation expectations get back to at least 3%, they are very unlikely to cut rates.

A lot is going to have to change at this point to get the Bank of Canada off "pause". Yes, they will talk tough, but the data is clearly not supportive of future hikes. In fact, Governor Macklem made this telling comment in a speech just this week:

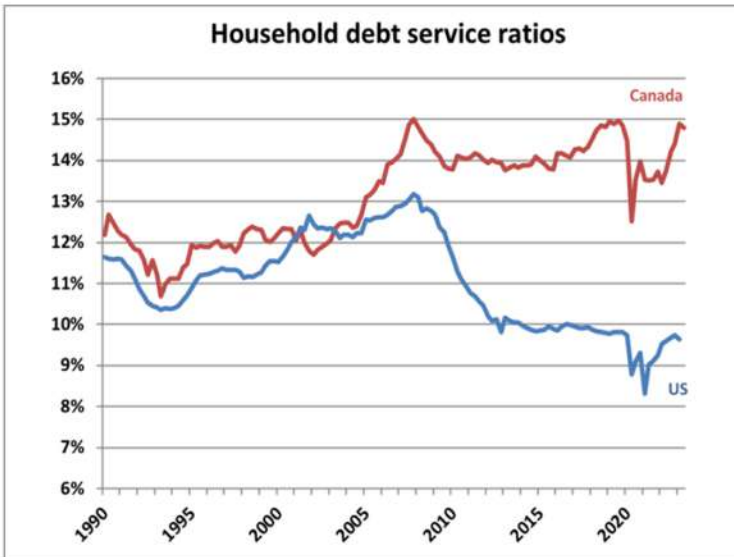
This tightening of monetary policy is working, and interest rates may now be restrictive enough to get us back to price stability.

Yes, this is the same governor who told Canadians that "you can be confident that interest rates will stay low for a long time" in late 2020, less than 18 months before starting the steepest rate hike cycle in the past 30 years. His crystal ball works no better than anyone else's, but that's not to say that we should dismiss comments like this. They are clearly on pause unless things change dramatically.



One more consideration: The Bank of Canada is in a bit of a pickle. They can't get too far ahead of the Federal Reserve in terms of rate cuts without hammering the loonie and causing another bout of inflation via more expensive imports.

This is a problem since the US consumer is showing no signs of slowing down. And why would they? They've all locked in low rates for 30 YEARS and their debt burdens overall are much lower than in Canada. The Fed can't cut rates until US households cave, and this means those pesky US consumers may end up being the ultimate arbiter of Canadian interest rates... regardless of the state of our domestic economy. That is not a comforting thought:

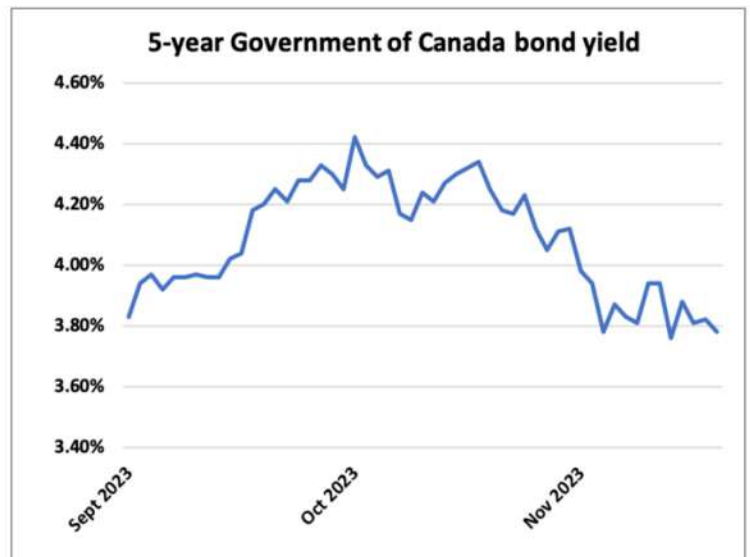


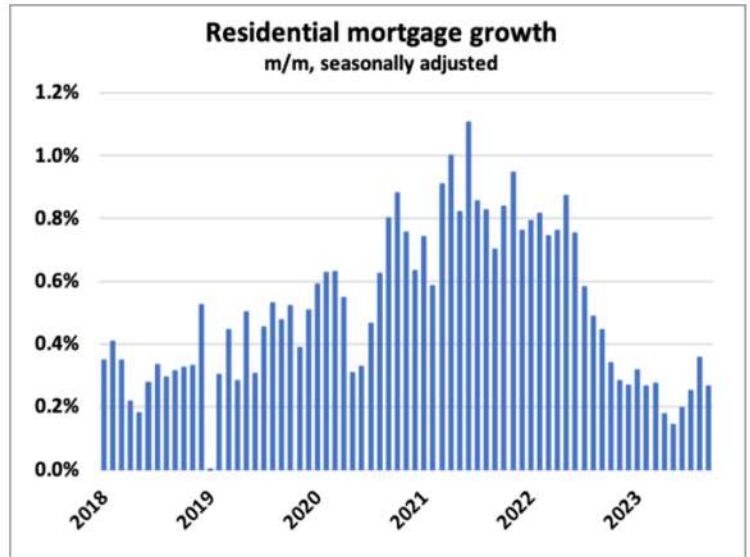
2) Mortgage market update: Fixed rates stay stubbornly high for now

i) Fixed rates barely budge

Government bond yields are a major determinant of fixed mortgage pricing. The bellwether 5-year Government of Canada bond yield is reflecting the likelihood of rate cuts in 2024 and has fallen by nearly 70 basis points or 0.7% off the early October highs. Yet deep discounted fixed rates are off only 15bps.

Lenders have a long history of quickly raising mortgage rates to match bond yields on the way up, but being slow to pass on cost savings when bond yields fall. We should expect rates to come down another 10-20bps over the next couple weeks if bond yields hold here:

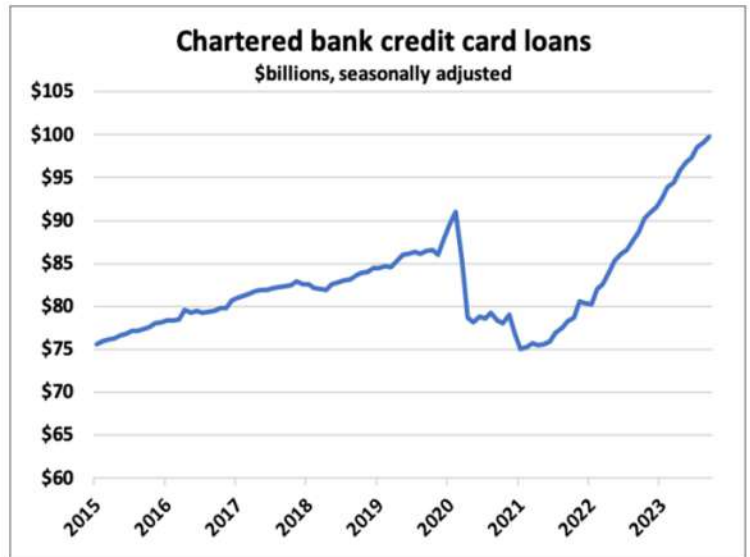
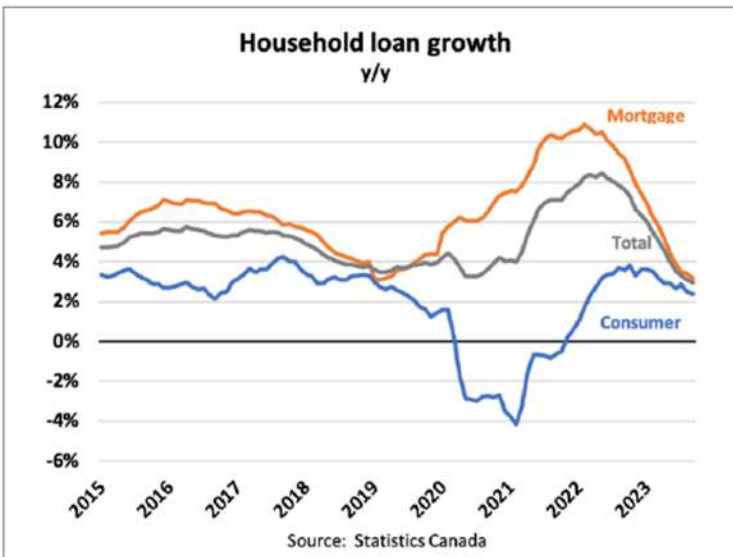


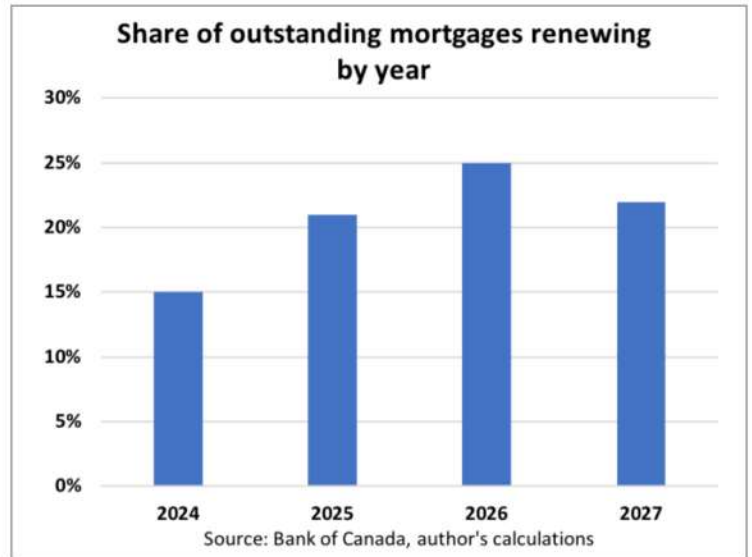
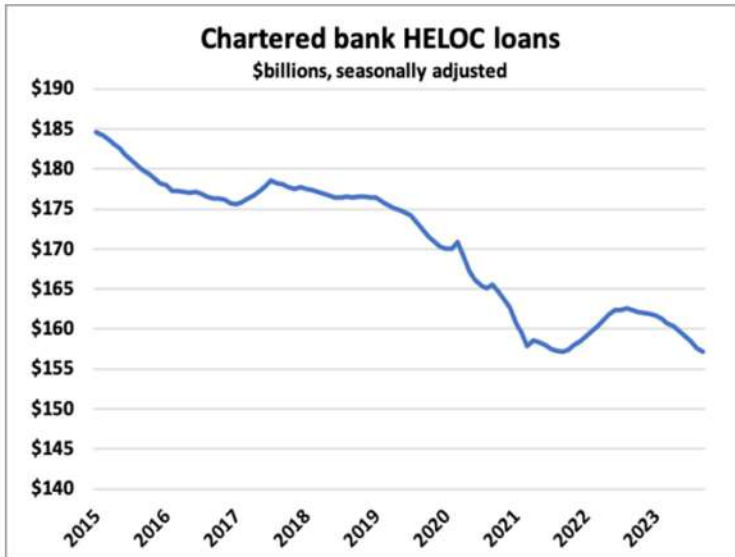


ii) Household loan growth falls below 3%

With rates still elevated, household borrowing remains tepid. Loan growth fell to just 2.9% y/y in September... the first sub-3% print since 1983. Mortgage growth slowed to just 3.2% y/y and just 0.2% m/m, and it would even lower were it not for the impact of negatively amortizing static payment variable rate mortgages at several big banks like BMO and CIBC.

Consumer loans were flat on the month, but that hides a 0.7% increase in credit card balances (up 6% in the past 6 months) and 0.3% contraction in HELOC loans (down 2.2% in 6 months).





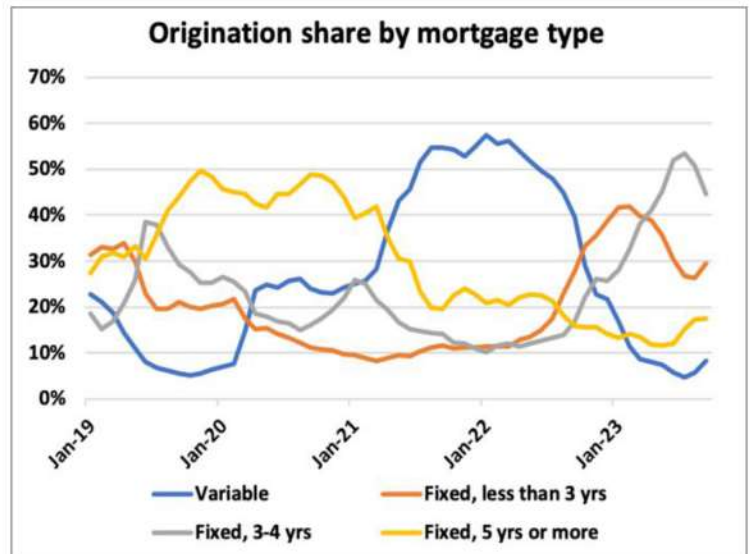
iii) Originations stabilize

Mortgage originations remain nearly 40% below peak levels, but they have stabilized over the past 5 months at what is effectively 2019 levels. The good news is that the buldge of originations from 2020 - 2024 will renew in size over the next few years.



iv) Variable originations jump

Canadian borrowers are starting to bet on a rate cut from the Bank of Canada. The latest data shows variable rate originations jumped to nearly 10% of all originations in September after hitting a low of just 5% over the summer. Ron Butler reports that it's increased even further in the past month:



Ron Butler @ronmortgageguy

What's The Fastest Growing Mortgage Term In Canada? 5 - Yr Variable

Seriously, Variable Mortgages were cursed, hated & avoided for 18 months they dropped to less than 2% of new mortgage origination

In the last 30 days they have jumped to between 10% to 13% a 550% increase

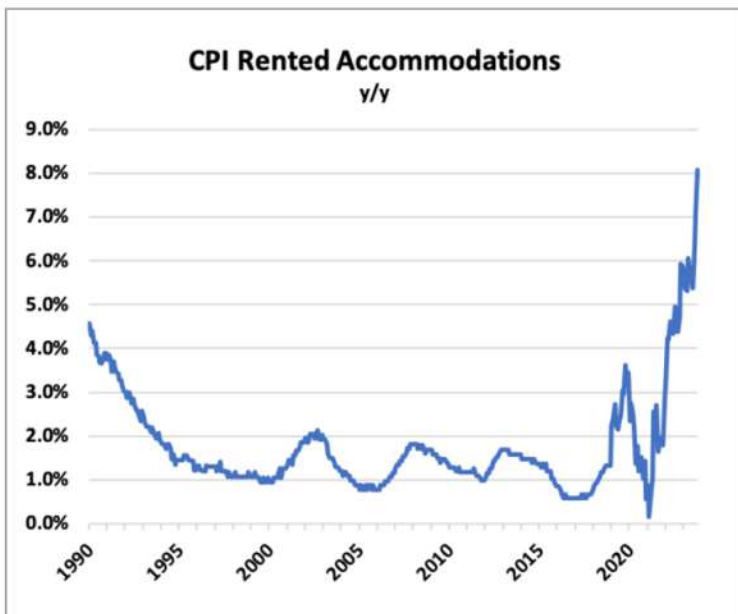
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9:02 AM · Nov 16, 2023 · 74.8K Views

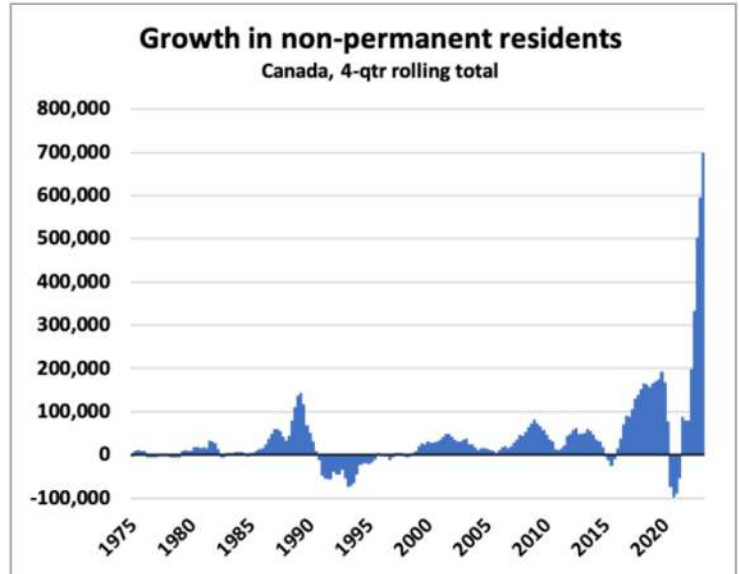
3) Supply and demand: More signs that the rental market is softening at the margins

Is the rental market finally cooling?

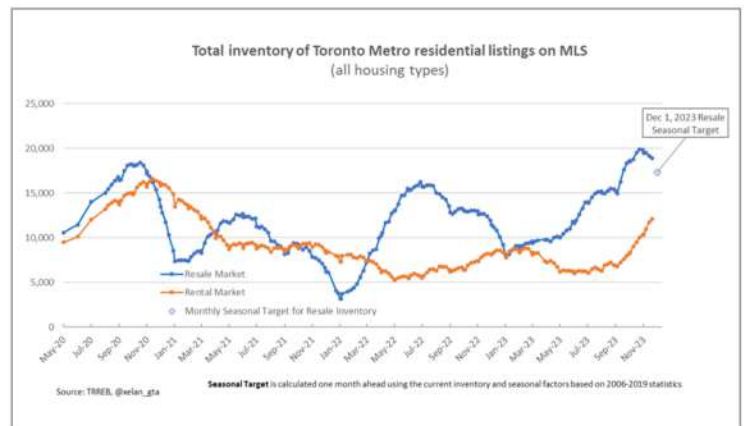
Rents in the CPI are surging at the highest rate since the 1970s. The rented accommodations index spiked above 8% in October and is now adding almost 0.6% to headline inflation:



We have a rental crisis in this country, and why wouldn't we when we've grown the non-permanent resident cohort (which is overwhelmingly comprised of renters) by a record 700,000 in the past year alone? Talk about short-sighted policies...

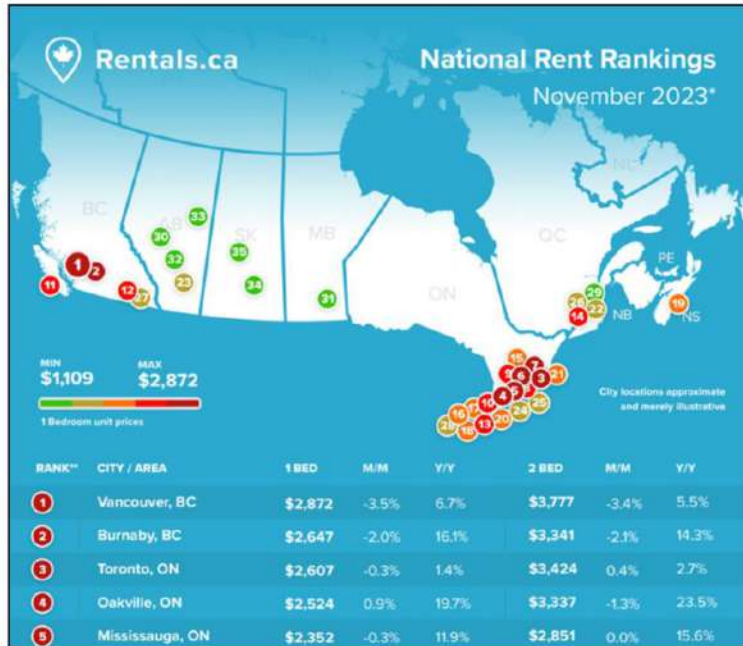


That said, I'm seeing mounting evidence that the rental market is finally shifting into a slightly lower gear. For starters, an update from my friend Alex (@xelan_gta on Twitter) who continues to report a sizeable increase in MLS rental listings in Toronto, which are now back to late-2020 levels (note the orange line below):



¹ <https://rentals.ca/national-rental-report>

We're also seeing it in the latest rental data from Rentals.ca¹ which saw average asking price for rentals decline in November in both Vancouver and Toronto:



It's also been a while since we've seen headlines like this:



RENTING

Landlords Are 'Losing Leverage' As Toronto's Rental Market Slows To A Crawl

"Slowing to a crawl" is definitely overstating things (condo leasing activity in Toronto was still up 7.8% y/y in Q3), but the supply/demand balance does seem to be shifting. From that article:

A sort of chill is setting over Toronto's rental market. Local agents say that demand is down, properties are taking longer to ease out, inventory is flooding the market, and conditions are tilting in favour of tenants for the first time in years.

Anya Ettinger, an agent with Bosley Real Estate, says that she's had two rental listings so far this month - a two-bedroom condo in the Yonge and Dundas area and a house in the Ossington area - and both have garnered very little interest from prospective tenants.

"We're really struggling to get showings and even had to reduce the price on the house. And it wasn't even overpriced; we priced slightly than what the owner got for it last year," she says. "Both of those properties six months ago or even four months ago would have been gone in less than a week. We probably would have had multiple offers and back-to-back showings."

[...] Harishan Thaskaran, an agent with Strata, notes that there's also a lot more rental inventory available right now. Investors who would have otherwise sold their properties have realized that they aren't going to get top dollar any time soon, and are opting to rent them out instead.

“But the thing is, if everyone has this mindset, we end up with so much inventory. And when there’s so much inventory, investors lose leverage,” he says. “So now the power is back to the tenant, and they can pick and choose the unit they want and the price they’re comfortable with.”

Seasonality is a factor here (it’s not unusual to see asking prices soften in late fall), but I think there’s more to this. For example, we’re now seeing the odd condo renting for less than the prior lease on sites like HouseSigma. It’s not many, but a few months ago it would have been zero.

As to what’s driving it, I think some prospective sellers are choosing not to list into a weak market and are opting to lease it out until the market improves.

Further, short-term rental (STR) investors are feeling the policy noose tighten. The province of BC just brought in sweeping regulations that will heavily curtail STR activity, and the feds just announced a change in tax treatment on STRs in areas that already restrict them, AND they announced funding for municipalities to enforce restrictions. Consider:

Airbnb crackdown or winter lull? Furnished rentals into Vancouver’s long-term market

Two weeks after BC revealed new policies to restrict short-term rentals such as Airbnb from eating into the housing market, some rental platforms in Vancouver are seeing more furnished rentals looking for long-term tenants.

Keen Craigslist watchers report they’re already seeing more furnished units that look suspiciously like ex-Airbnbs, with fancy photos and short lease terms.

[...] Greg Park, creative content writer with liv.rent, told Daily Hive the platform is seeing an uptick in furnished rentals too, but it’s too early to say whether it’s a result of the new legislation.

“Our team has definitely noticed that some short-term rentals have been removed from the market this month; however, it’s hard to say for certain whether this is purely because of the new regulations or is the result of seasonal trends,” he told Daily Hive.

You know the BC regulations have real teeth when STR management companies put ads on Craigslist offering to pay \$500 to anyone willing to change their driver’s license to match the address of their STRs so as to bypass the new regulations. Aggressive strategy, to say the least:

\$500 for a Couple Hours of Your Time

an hour ago · Vancouver
domestic gigs

Cyzer Investments is a Short Term Rental company operating in Vancouver, managing several properties throughout the downtown area. Due to recent changes and stringent by-laws, we are forced out of business unless we can find some lucky individuals who are looking for a healthy payout for minimal work.

The requirements to be allowed to Airbnb by the municipality needs to be the primary address of the tenant. You simply go to ICBC and change your drivers license address to the address of an Airbnb selected and apply for an Airbnb approval. That is it!

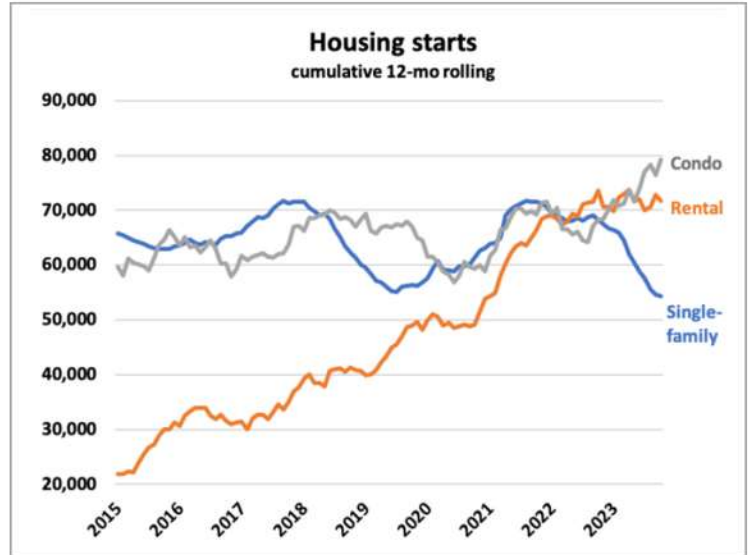
We will pay \$250 once we see you've changed your address and another \$250 once you've gotten the approval for Airbnb.

Please inquire for more questions or clarification.

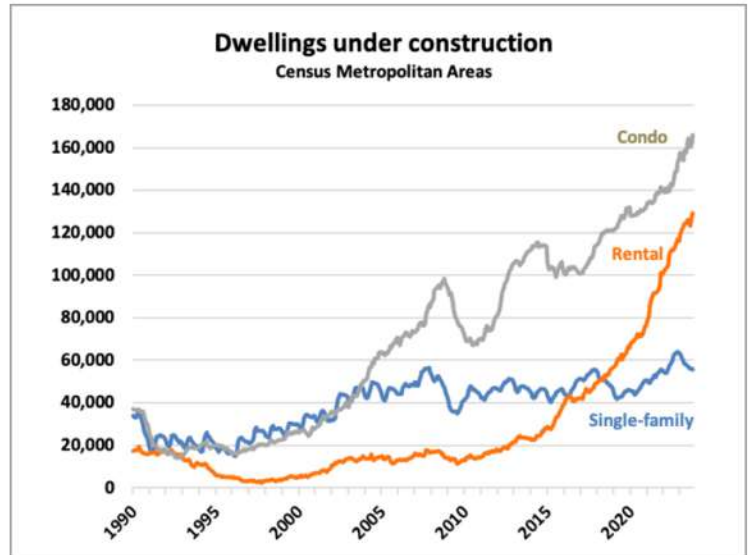
Our website for for more info: <https://cyzerinvestments.com/>

compensation: \$500

When we look at housing starts over the past year, we see a continued skew towards rentals and condos (roughly half of which end up as rentals) and away from single-family. That doesn't bode well for Canada's structural shortage of single-family homes, but it does tell us that developers are responding to the rental crisis of the past couple years:



When we look at what's under construction, it's even more striking: a record 300,000 condo and rental apartment units are currently in the pipeline.



If those complete into a backdrop of slowing non-permanent resident growth, which I expect, we'll see a lot more froth come out of the rental market in 2024. At the same time, my concern grows that we may be sleepwalking into an even worse supply crisis for coveted single-family homes when demand eventually normalizes.

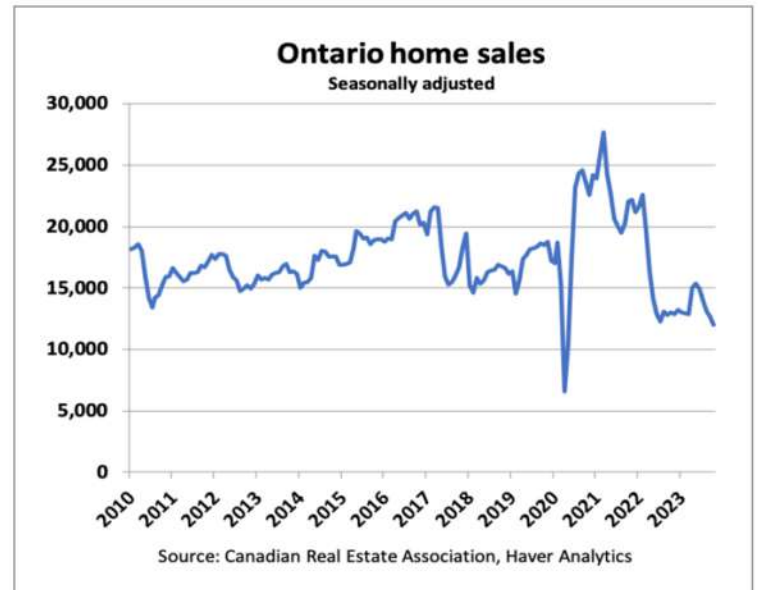
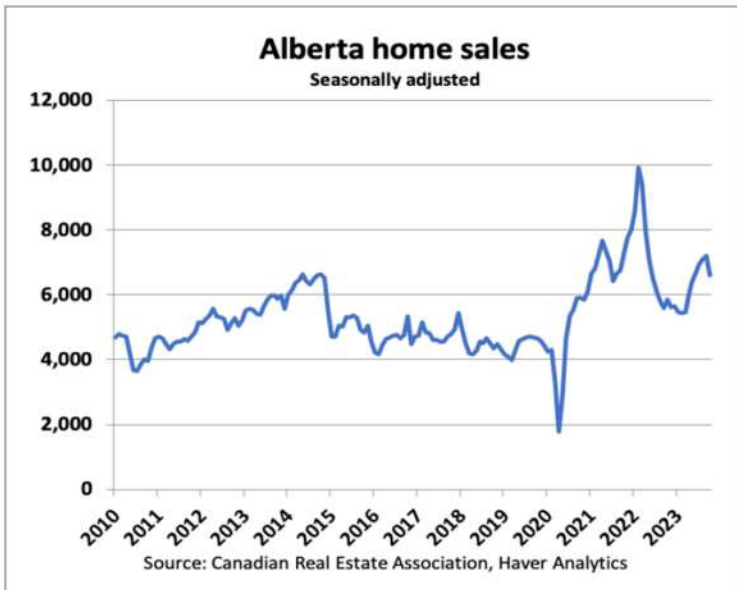
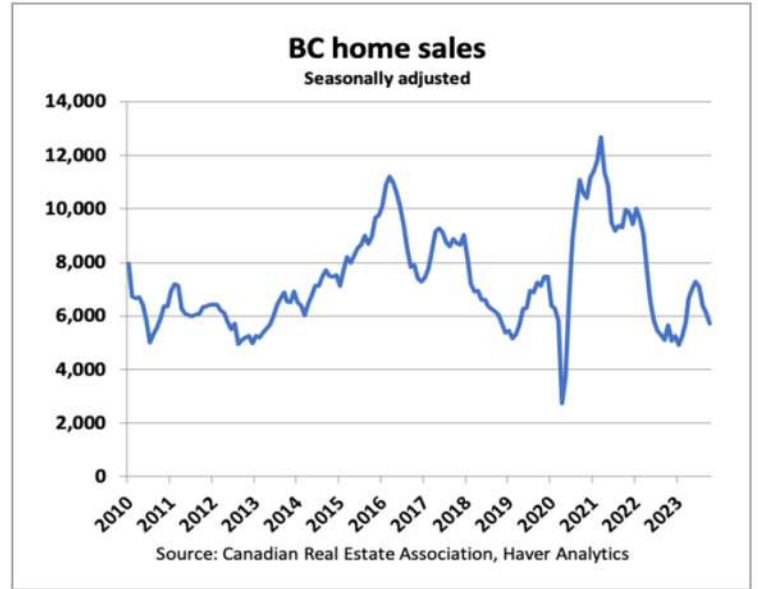
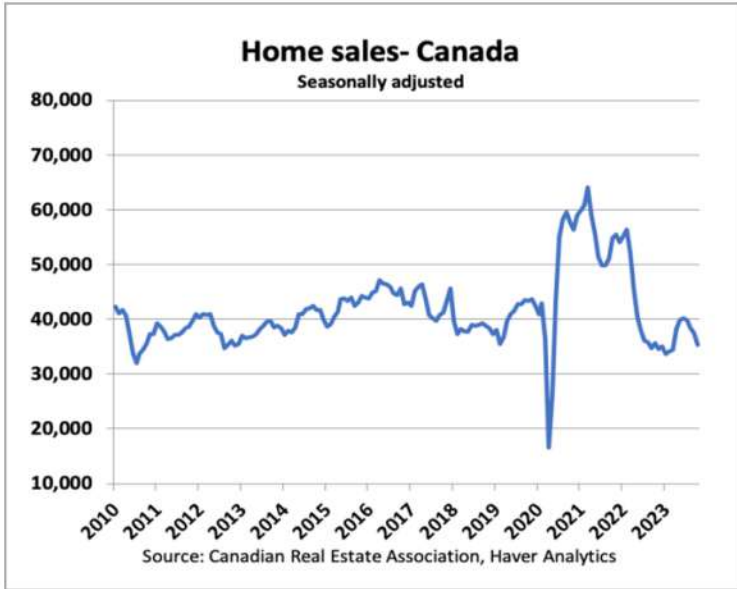
4) Ontario continues to weigh down national housing numbers

The key data from last month is summarized below.

	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	-0.7%	-5.6%	+9.7%	-2.3%	+9.2%	+4.4%	+1.1%	-0.8%
BC	+1.0%	-6.9%	+3.0%	-4.0%	+9.0%	+5.8%	+3.2%	-0.1%
AB	+13.0%	-8.3%	+4.6%	-1.0%	-15.8%	+0.4%	+7.2%	+0.9%
QN	-7.8%	-5.5%	+18.2%	-3.1%	+32.2%	+7.5%	-0.5%	-1.4%
QC	-1.0%	-5.1%	+7.3%	+0.7%	+13.3%	+4.1%	+3.7%	+0.3%

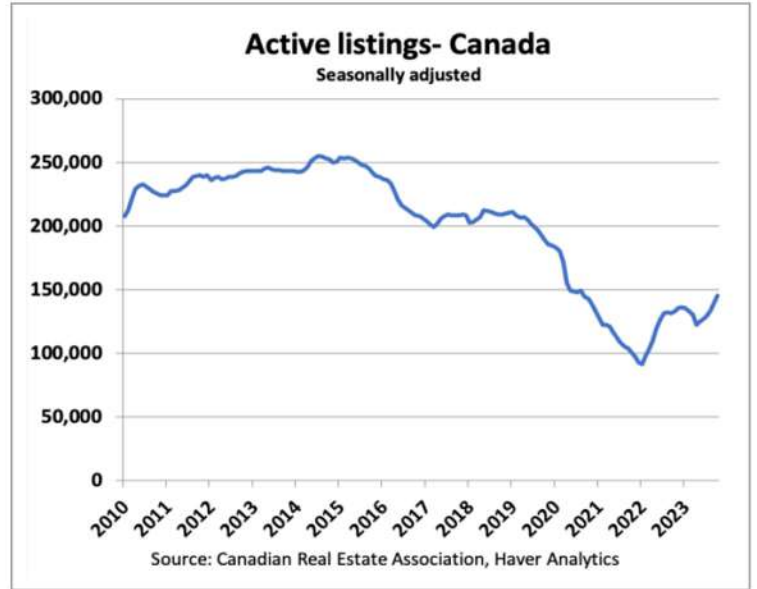
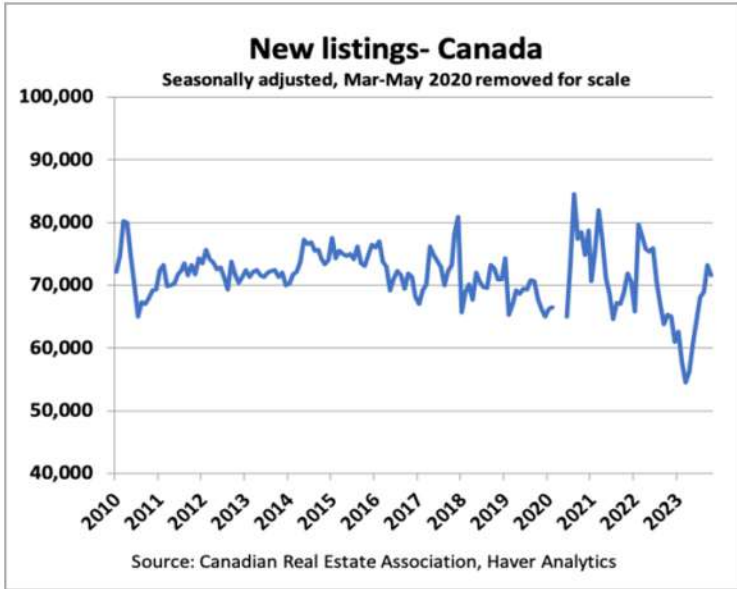
i) Home sales tumble

Seasonally adjusted home sales nationally posted the largest monthly decline since June of last year, falling 5.6% m/m in October. All big provinces posted substantial declines led by Alberta (-8.3%) and BC (-6.9%). Ontario saw a 5.5% decline while Quebec saw sales drop 5.1%.



ii) Inventory jumps

New listings ticked down 2.3% m/m in October. This is something worth watching as I'm now hearing from realtors that some prospective sellers are pulling listings with the intention of selling next spring.



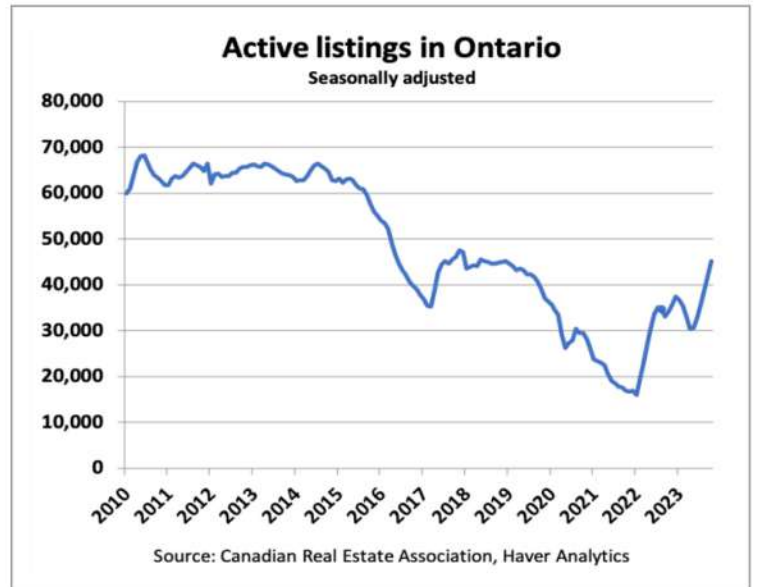
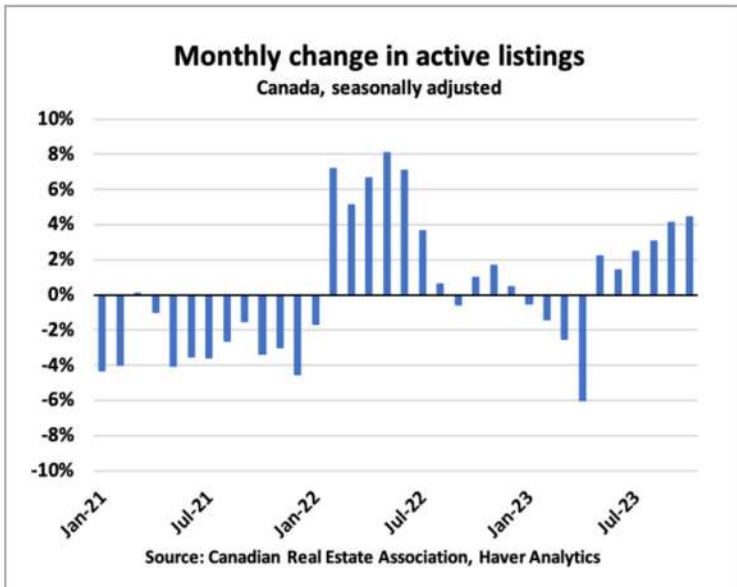
Steve Saretsky @SteveSaretsky

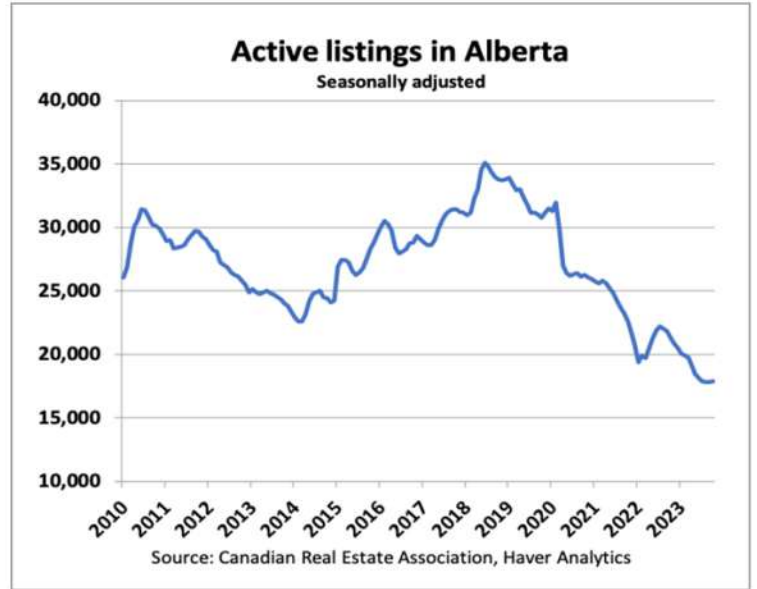
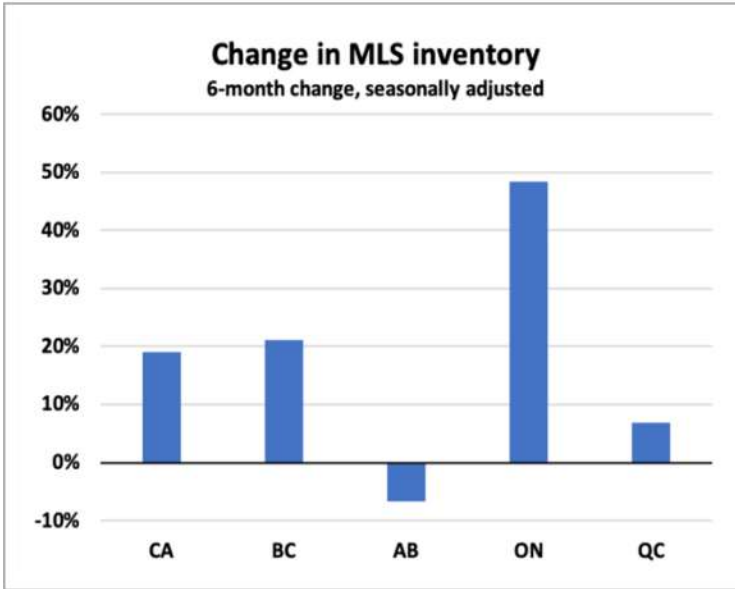
Sellers not getting their price these days. Many opting to pull the listing and try again in the spring. Hope springs eternal they say! This is especially true in the Vancouver Real Estate market.

9:35 PM · Nov 15, 2023 · 38.4K Views

Rising inventory levels nationally are primarily due to surging supply in Ontario where active listings jumped 7.5% last month and are now up nearly 50% in the past 6 months:

Seasonally adjusted active inventory was up another 4.4% m/m, the sixth consecutive monthly increase.

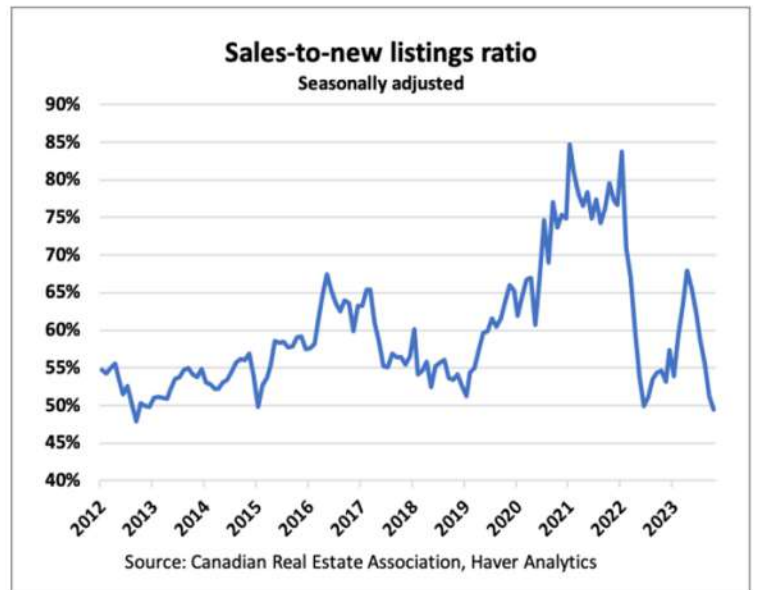
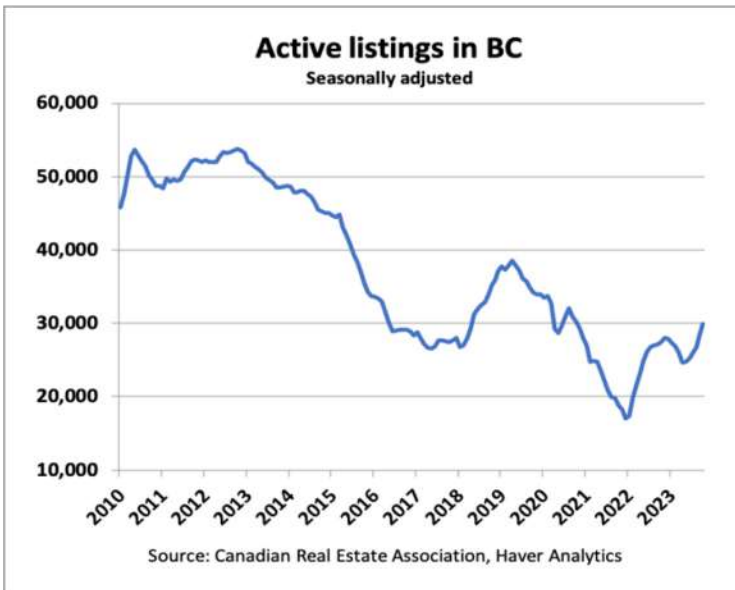




Things are not quite as dramatic in BC and Alberta where inventory levels are still well below normal in the former, and arguably at crisis lows in the latter:

iii) Market balance skews further to buyers

Months of inventory nationally is now back above 4 for first time since May 2020. And in Ontario, it's at 8-year highs outside of April 2020... both clear signs that the market is shifting further in favor of buyers:



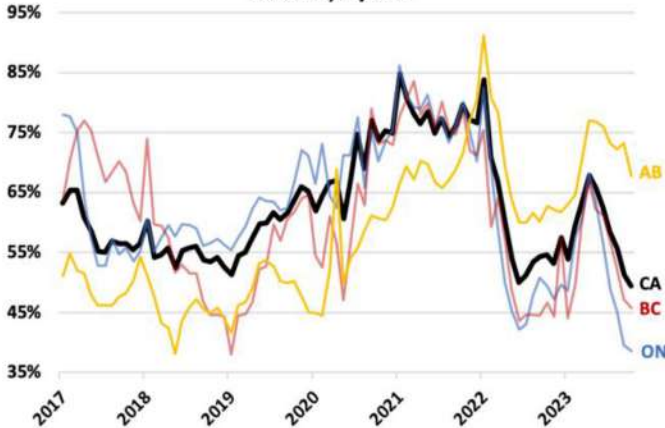
Months of inventory- Ontario
Seasonally adjusted



Source: Canadian Real Estate Association, Haver Analytics

Meanwhile the sales-to-new listings ratio fell to 49% in October, the first sub-50 print since 2012. It's even worse in Ontario where it came in at 38%, the lowest since the very depths of the Financial Crisis. This signals a deep buyer's market and portends even further price declines over the winter.

Sales-to-new listings ratio
Seasonally adjusted

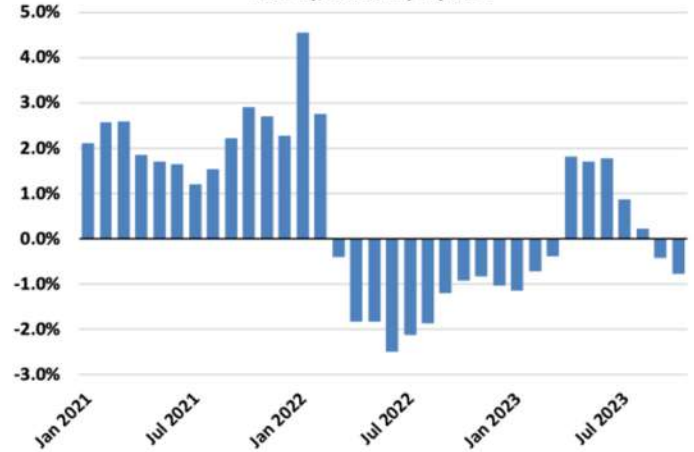


Source: Canadian Real Estate Association, Haver Analytics

iv) Price declines gain momentum

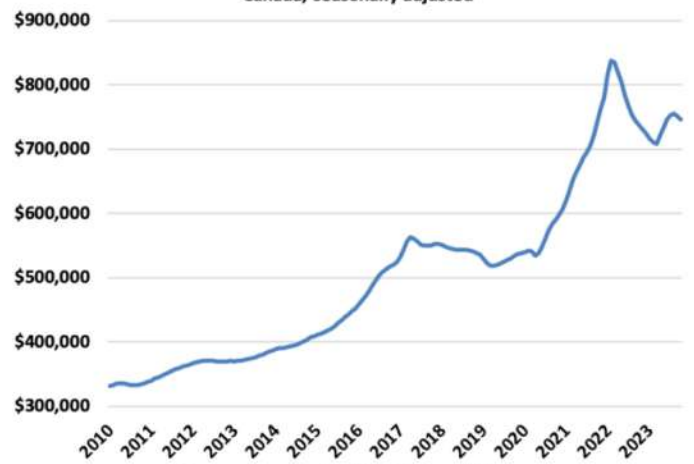
House prices nationally declined 0.8% m/m in October, building on the 0.4% decline in September.

Change in Canadian house prices
monthly, seasonally adjusted



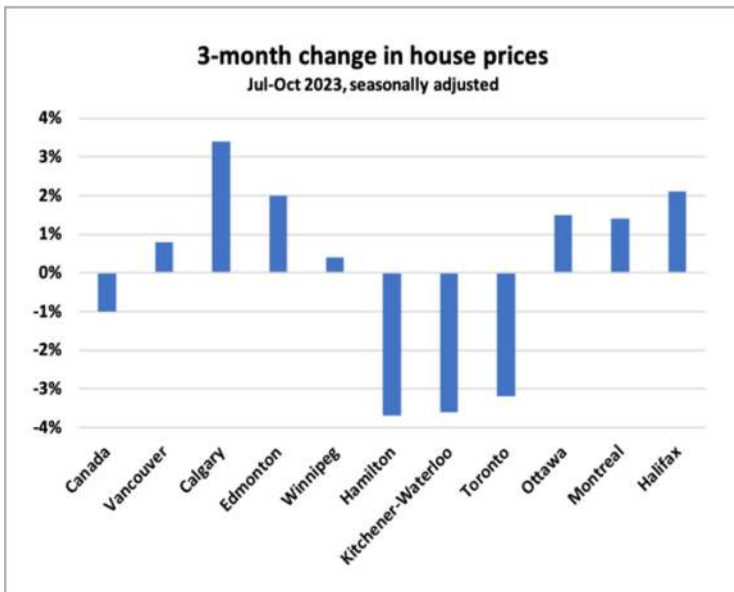
Source: Canadian Real Estate Association

Benchmark house price
Canada, seasonally adjusted



Source: Canadian Real Estate Association

Here once again the weakness is almost entirely from the big southern Ontario metros like Toronto (-1.7% m/m) while Alberta and the Atlantic provinces continue to see prices advance. And if we step back and look at the 3-month change, it's even more clear that this is entirely a southern-Ontario problem... for now:



One word of caution: Be careful with average prices right now. Several news outlets ran headlines highlighting the increase in average prices over the past few months. The culprit is an unusual increase in average prices in Toronto since the summer:

Aug: \$1,082,960
 Sep: \$1,119,428
 Oct: \$1,125,987

The explanation is that buyers of “luxury” homes are front-running a higher land transfer tax set to come into effect in 2024 on homes sold above \$3 million. From the Globe and Mail ²:

² <https://www.theglobeandmail.com/real-estate/toronto/article-coming-luxury-tax-and-a-flurry-of-toronto-home-sales>

A coming ‘luxury tax’ - and a flurry of Toronto home sales

A number of properties in the affluent Toronto enclaves of Rosedale, Forest Hill and the Bridle Path have found buyers in recent weeks.

The city’s “luxury tax”, set to come into effect in 2024, may have something to do with the flurry of sales.

In September, Toronto’s city council approved an increase to municipal land transfer tax rates for homes valued at \$3-million and above.

The new graduated rate will be applied at closing starting Jan 1.

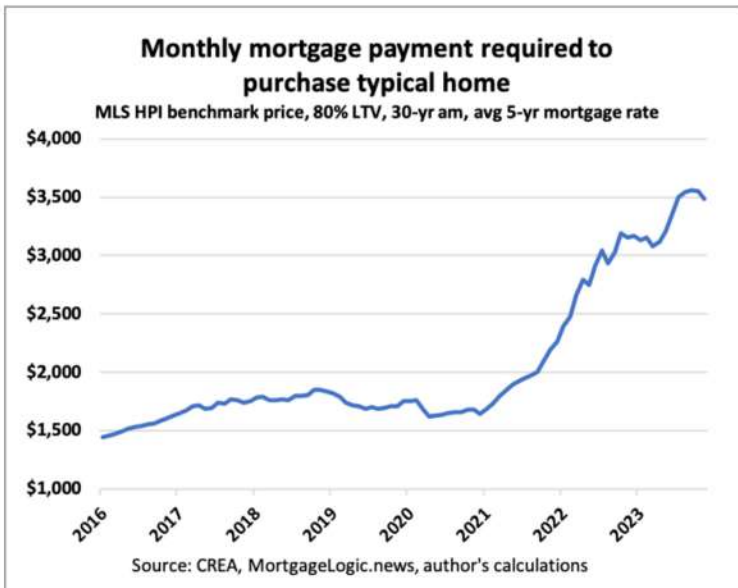
[...]“A lot of these deals that are \$10-million plus are, all of a sudden, having quick closings,” says Andre Kutyan, broker with Harvey Kalles Real Estate Ltd.

Mr. Kutyan says it’s unusual to see houses closing in December because the holidays tend to be busy time for families. In other cases, people are travelling or don’t want to risk moving during a blizzard in the winter months.

Best to focus on the MLS House Price Index, which adjusts for these changes in composition. But the HPI is not without its own limitations. The primary issue is that it strips out 'outliers' and smooths data, which means it tends to understate price changes at sharp inflections, which I believe is happening right now. I think price declines over the past 3 months are considerably larger than the index suggests, at least in Ontario.

v) Required mortgage payment decline

If there's good news in all of this, it's that the monthly mortgage payment needed to buy into this market fell \$59 last month. A buyer looking to purchase a 'typical' home in Canada and financing it at 80% LTV at current rates is now looking at a monthly mortgage payment just under \$3,500... still a dramatic increase from just over \$1,600 in 2021, but a sequential improvement nonetheless:



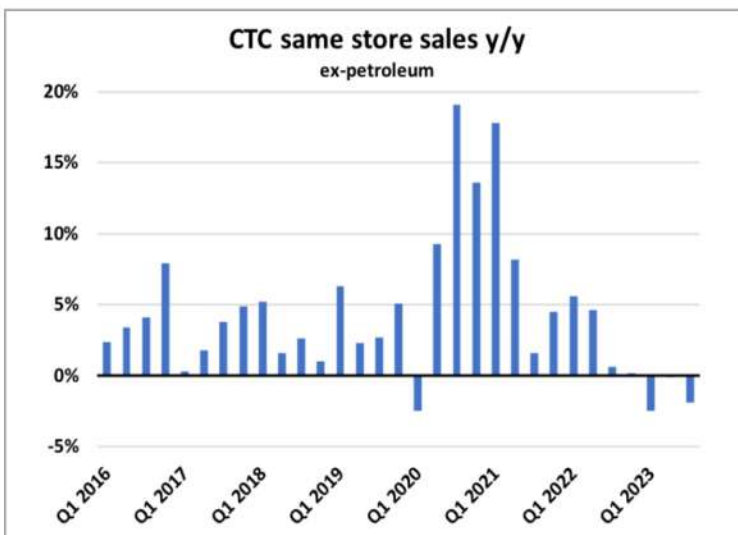
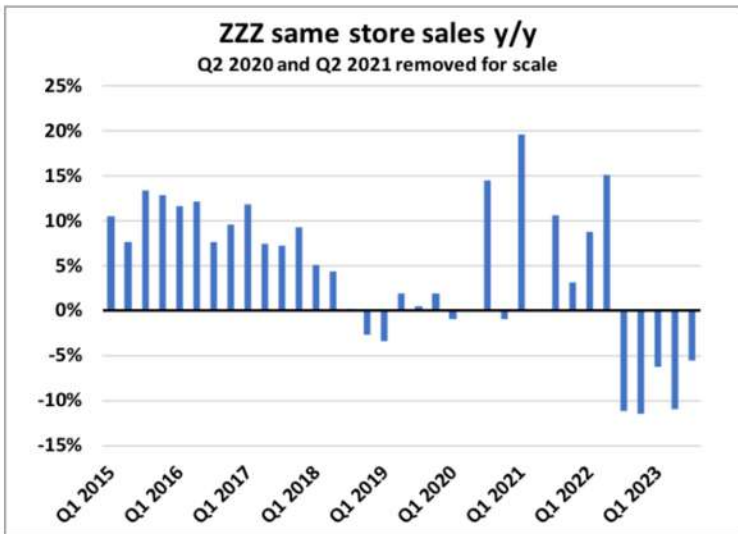
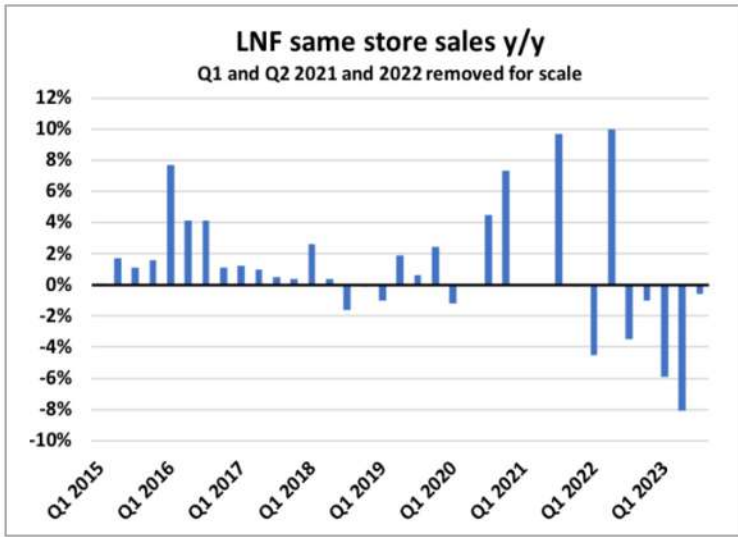
5) *Consumer check: What weak holiday spending means for mortgage arrears*

i) Weak consumer spending a warning sign for mortgages

Remember, no one wakes up one day and just defaults on a mortgage. There's an order of operations that happens once a borrower gets into financial stress:

- First, tighten the budget and cut discretionary spending
- Second, max out credit lines
- Third, default on unsecured credit and maybe autos
- Fourth, if nothing improves, 6 - 12 months later there's a default on a mortgage

We're now at the point where there's been a very clear slowdown in discretionary spending and a run up in credit card utilization. Consider the same-store at a harmful of Canadian retailers this past quarter. Shown below are Leon's Furniture (LNF), Sleep Country (ZZZ) and Canadian Tire (CTC):

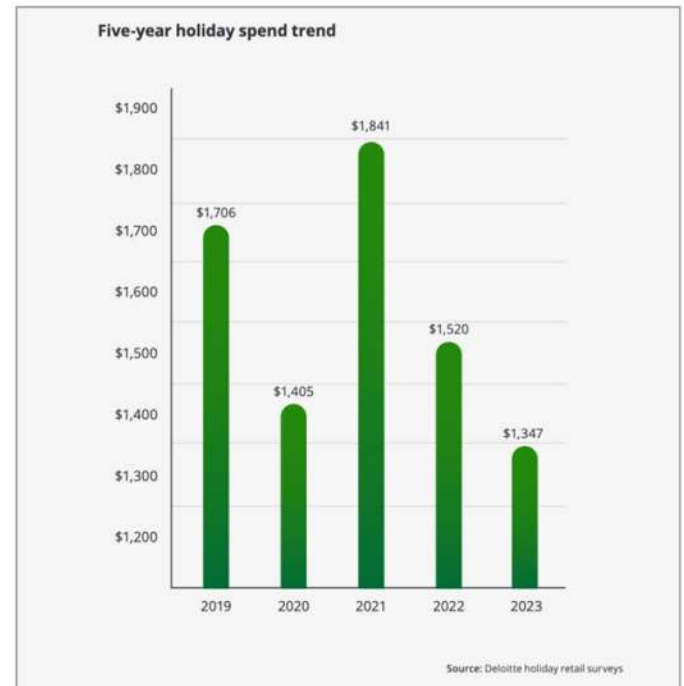


And there were some notable tidbits on Canadian Tire conference call:

- “Consolidated comparable sales were down 1.6% as a result of softening customer demand, especially in Ontario and B.C. and we saw a continued performance bifurcation between essential and discretionary categories.”
- “We saw that the discretionary softness is coming from more indebted households, most notably in Ontario and BC.”

Two other data points this week. First off, from the annual Canadian Holiday Outlook from PWC which found that anticipated holiday spending is set to fall to 5-year lows:

Canadian consumers intend to spend less this holiday season (-11% than 2022), for an average of \$1,347. They’ll be spending less on gifts (down 18%), gift cards (down 14%), and charitable donations (down 40%).

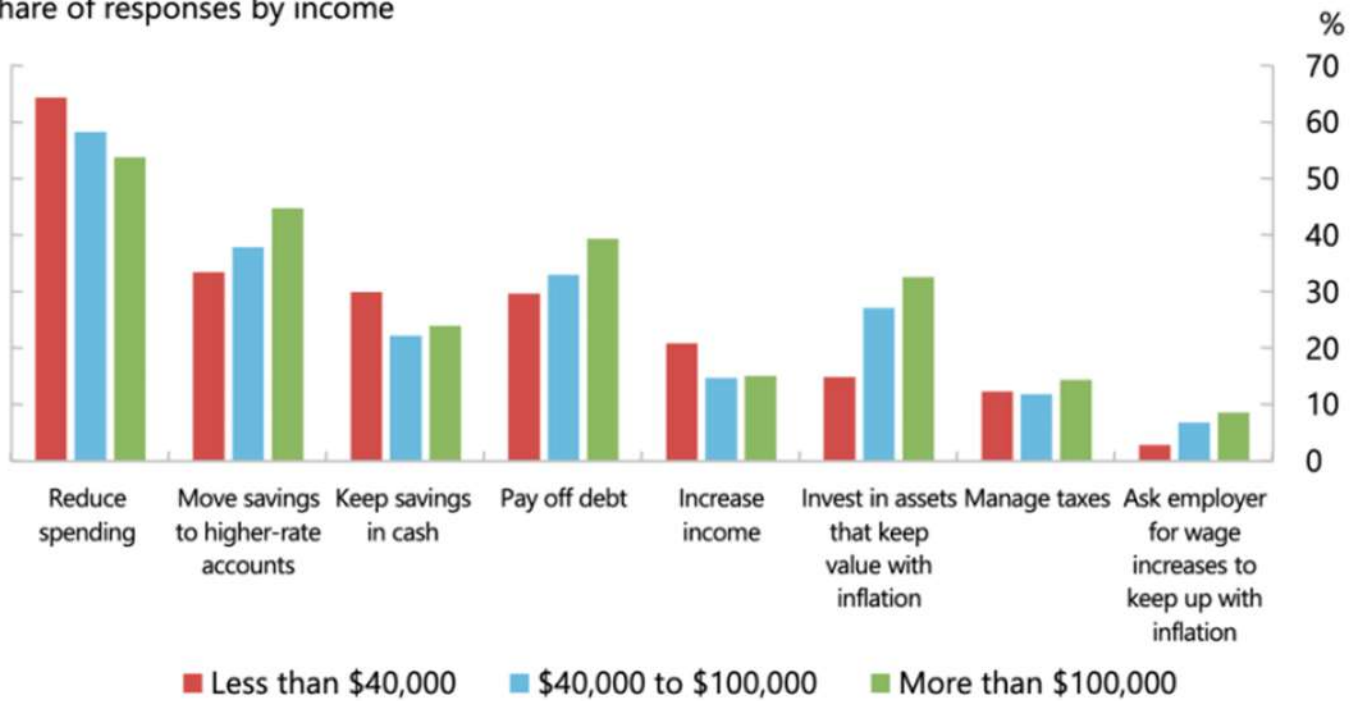


Yikes! Secondly, comments this week from Bank of Canada Governor Tiff Macklem contained this tidbit:

Chart 5: Many Canadians are reducing spending, especially those with low incomes

What actions are you taking to protect yourself against inflation?

Share of responses by income

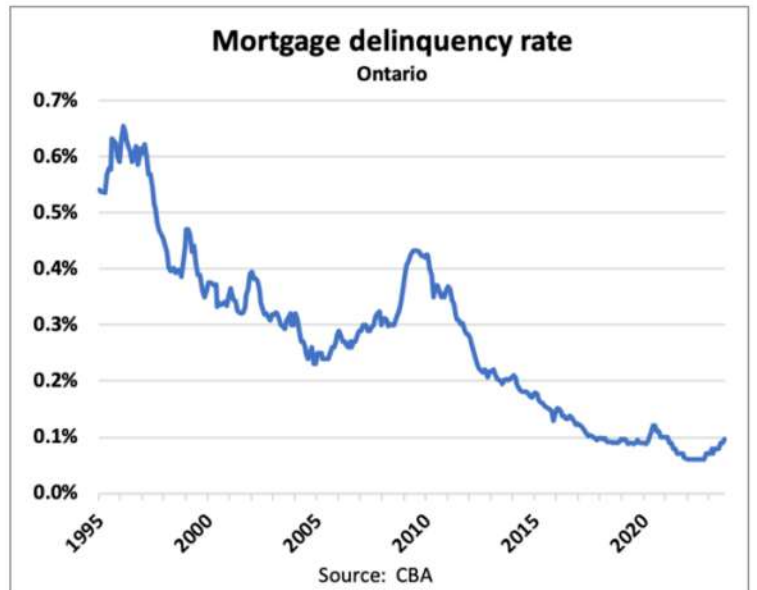
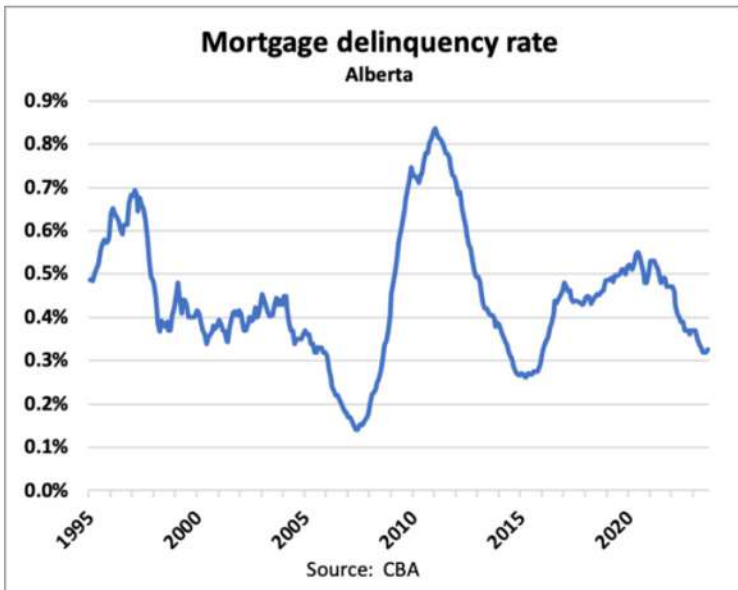
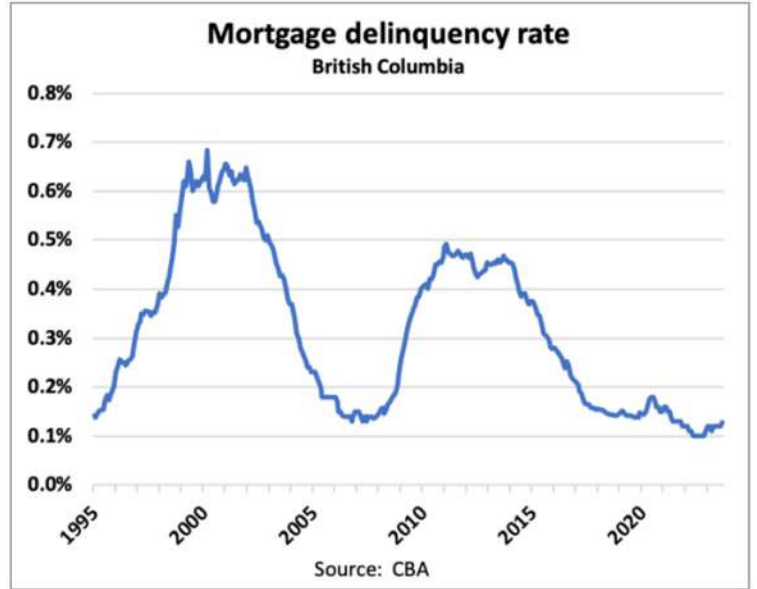
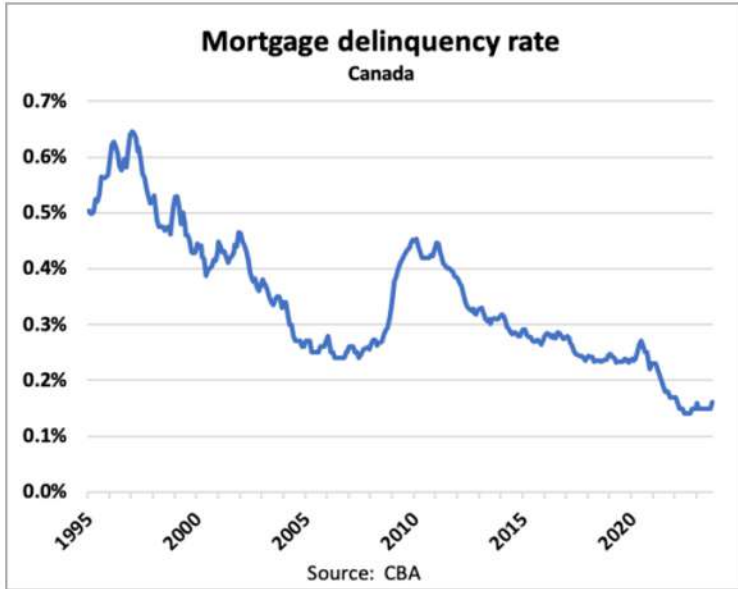


Note: Data are from the Canadian Survey of Consumer Expectations.
 Source: Bank of Canada
 Last observation: 2023Q3

What this tells us is that we are now on the road towards a significant rise in delinquencies start to rise more rapidly (they are only now back to pre-pandemic levels), and then by Q2 next year it should be abundantly obvious that mortgage delinquencies are well on their way to normalizing.

ii) Arrears tick up slightly

Notwithstanding the clear signs that consumers are stressed, there are still remarkably few official arrears. Yes, they ticked up in October... to a whopping 0.16%... still less than half the long-term average:



The signs are now there that stress is building among a sizable minority of Canadian borrowers.

We should expect a doubling in the arrears rate in 2024.