Edge Realty
Analytics

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June 2024
Metro deep-dive: May data

Quick links:

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1) Macro commentary: The rate cuts arrive! Where do we go from here?

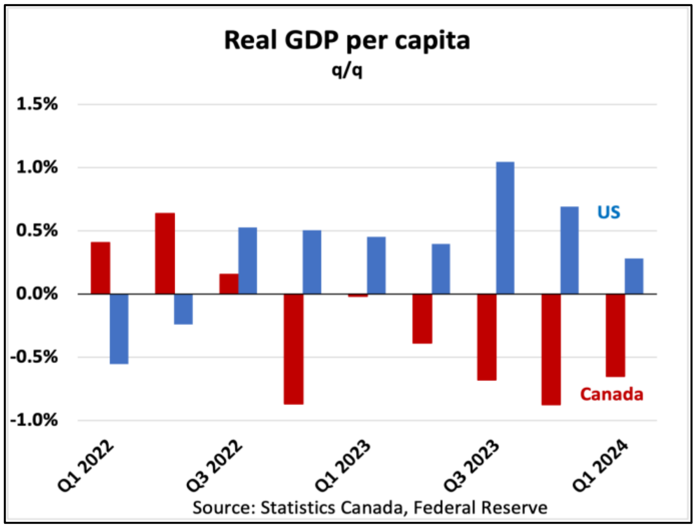
We finally got the much-anticipated rate cut last week…the first cut in over 4 years! Let's dive into what drove that decision and where we go from here.

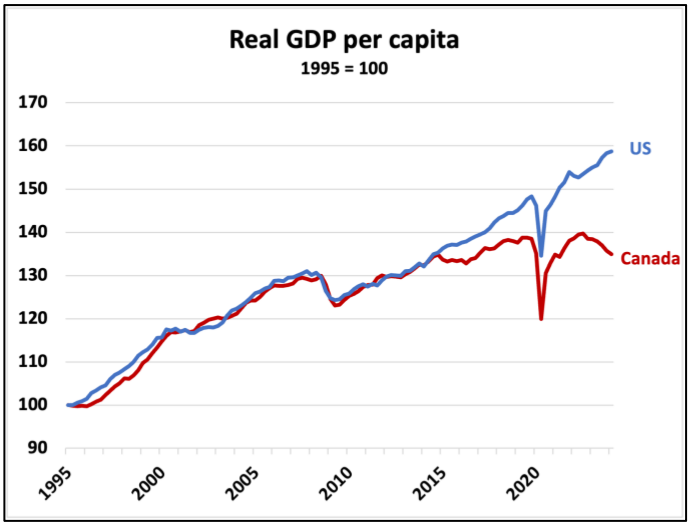
Why they finally cut

What I believe sealed the deal for the Bank of Canada was a very soft Q1 GDP report which significantly missed expectations (+1.7% annualized vs +2.3% expected) and came in well below the 2.8% the BoC had estimated in their last monetary policy report.

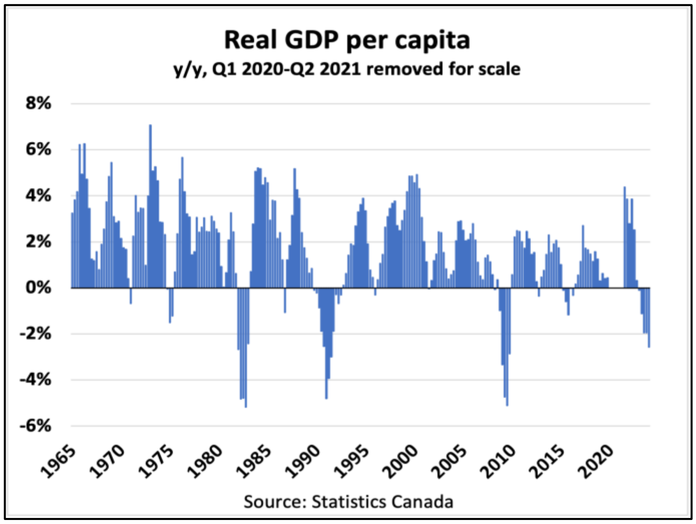
<u>But more important was a major downward revision to the Q4 data which went from +1% annualized to effectively flat and meant we saw zero GDP growth in the back half of last year. Not good!</u>

By my math, per capita GDP fell 0.7% on the quarter. The divergence in trend between Canada and the US on this measure is quite striking:





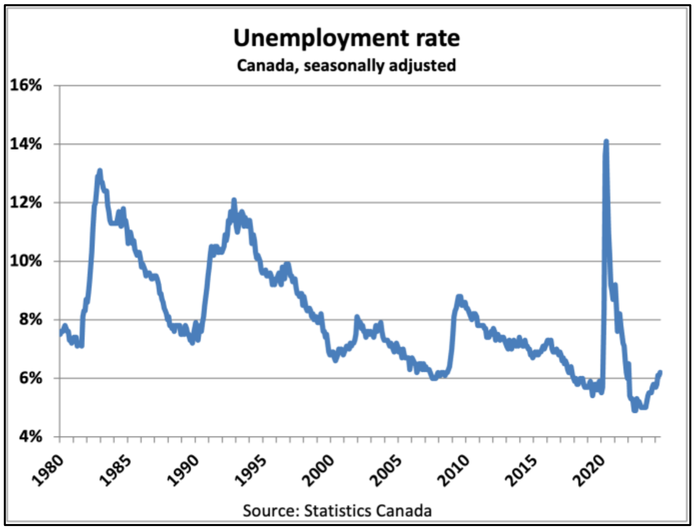
On a y/y basis, per capita GDP is down 2.6%. Outside of the COVID lockdowns, that's the steepest drop since the Financial Crisis and the early 1990s prior to that. Household consumption expenditures are also down by the steepest amount since the Financial Crisis. That just has to have the Bank of Canada more concerned than they are letting on:

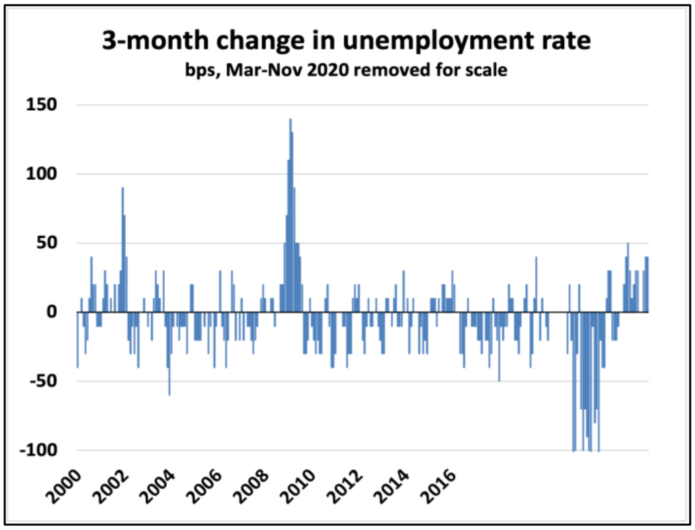


Then on top of that, the employment numbers came in a bit soft on Friday, and the Bank of Canada likely had an advanced read on that report. It wasn't terrible, but the internals were very soft.

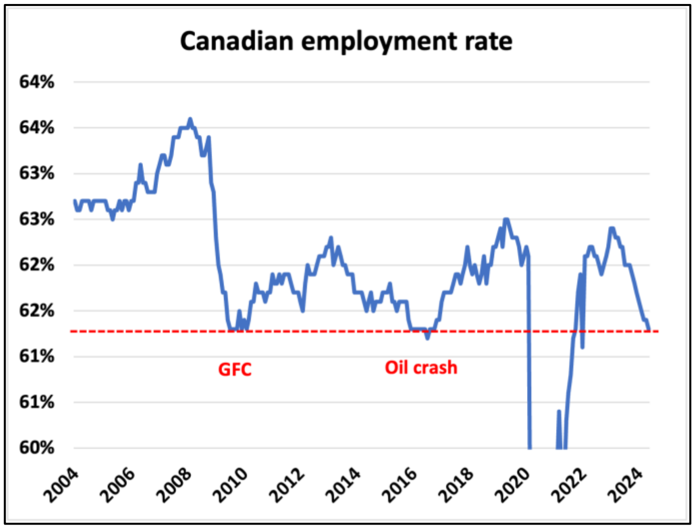
On one hand, Canada added 27k new positions, but that still lagged the growth in the labour force which expanded by 55k m/m….and that's not even counting the 36k discouraged workers who aren't currently in the labour force- the highest number since summer of 2021 when we still had rolling pandemic-related lockdowns. That's a telling data point!

Consequently, the unemployment rate rose another 10bps to 6.2% and is now up 40bps over the past 3 months:

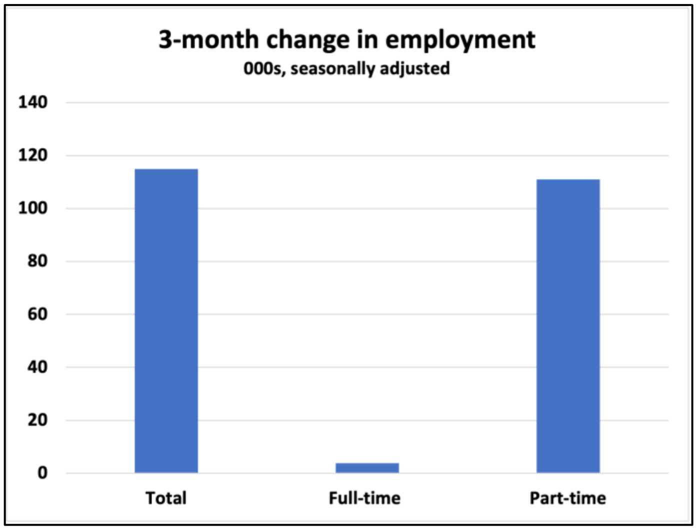




The employment rate has now fallen to 61.3%, matching the lows seen during the Financial Crisis and the oil price crash:



Making matters worse, all of the gains were in part-time employment (+62k) while full-time positions declined by 36k…the steepest decline in almost 2 years. Over the past 3 months, virtually all new positions have been in the part-time category.



Further, the involuntary part-time rate (ie the proportion of part-time workers who want full-time employment) was 18.2% in May, up from 15.4% observed 12 months earlier.

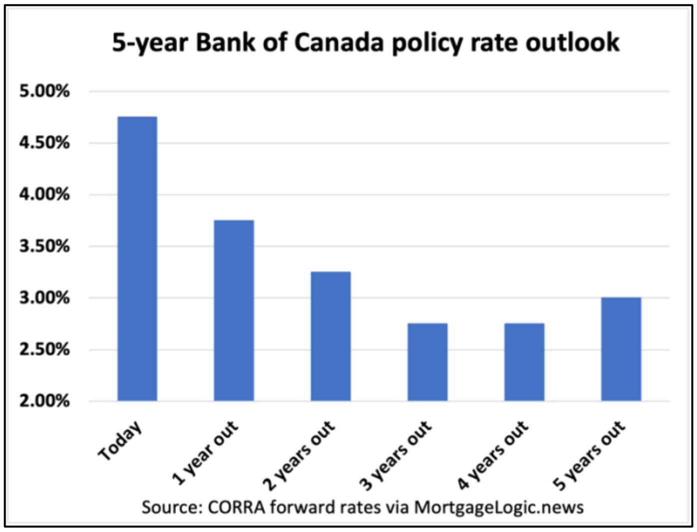
On the bright side, gains were entirely in the private sector (+18k) and the self-employed cohort (+17k) while public sector employment declined by 8k.

That brings us to the construction industry, which is often a leading indicator for the broader economy. That industry just saw the second largest monthly contraction in employment since the world shut down in April of 2020. The number of workers employed in that key industry fell by 30k or 1.8% in May, the second consecutive decline. Those payrolls are now down by a cumulative 2.2% over the past 6 months.

Markets are still underpricing rate cut odds

At time of writing, markets are pricing in only one additional 0.25% cut this calendar year. The odds of a July cut have fallen to 44%, but markets are expecting a 98% chance of a cut by September with a hold at the December meeting.

A year from now, the policy rate is expected to still be at 3.75% (down from 4% a couple weeks ago).



I think these estimates are still way too high. Barring a resurgence in inflation (which looks unlikely for now) I'm still expecting a rate cut at every remaining meeting this year, and I think we'll end the year at 4.0%. I think both the Bank

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of Canada and rate markets broadly are underappreciating the magnitude of the strain that these rates are putting on households and businesses, and I think this will be abundantly clear by the end of the summer.

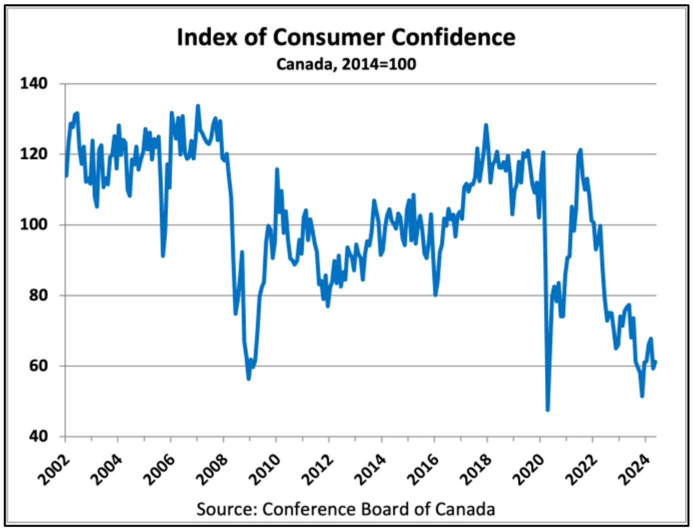
With the Bank of Canada now into an easing cycle, we turn attention to what we might reasonably expect in coming months for housing and the Canadian consumer.

What to expect now

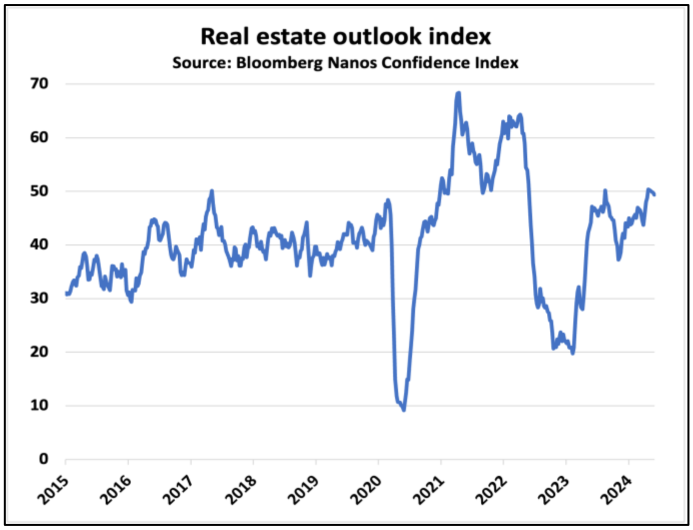
Let's be clear: 0.25% of cuts does not move the needle on the affordability or debt servicing side. But it may well affect confidence. Here's what I'm expecting:

- **A modest increase in consumer confidence**

  Household sentiment remains abysmal in Canada, with the Conference Board's measure at the lowest non-recessionary level on record. It wouldn't be at all surprising if this index perked up a bit following the cut last week:



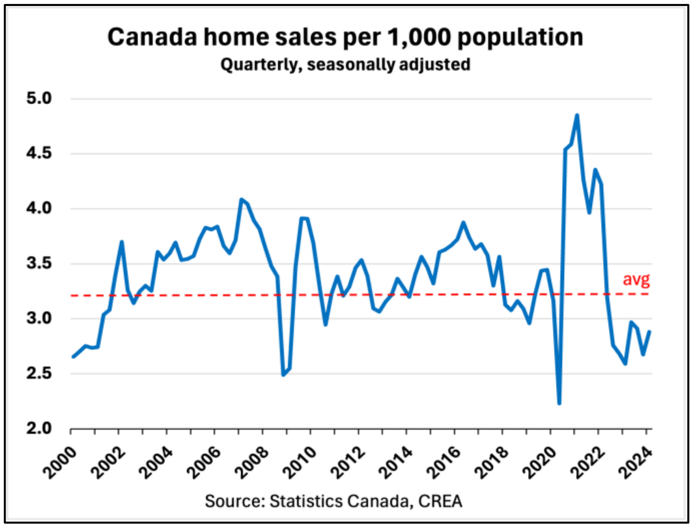
  BUT, let's remember that real estate is not what's holding sentiment down at the moment. In fact, the Bloomberg-Nanos confidence index shows the real estate outlook subindex is already back above the 2015-2020 normal range. Canadians are eternally optimistic when it comes to housing:



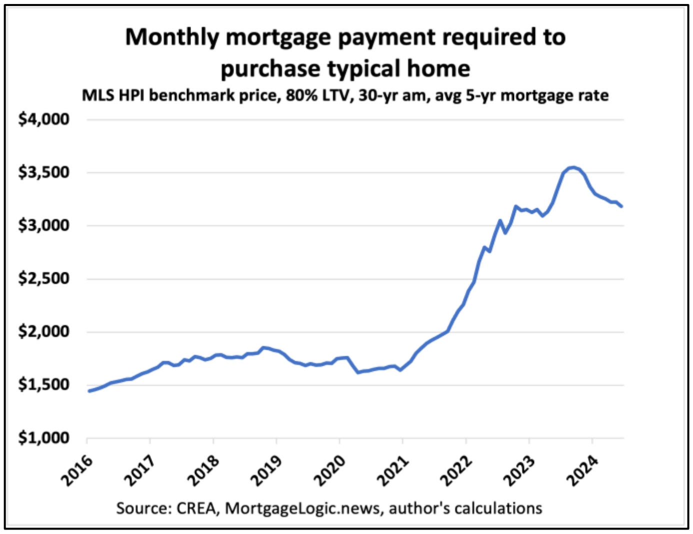
Soft sentiment is a function of deteriorating job security (highest share reporting their job is "not secure" since the onset of the pandemic) and deteriorating views on personal finances. A 25bp cut does little to change this. So maybe a small bounce, but not a return to long-term norms for a while.

- **Upward drift in home sales**

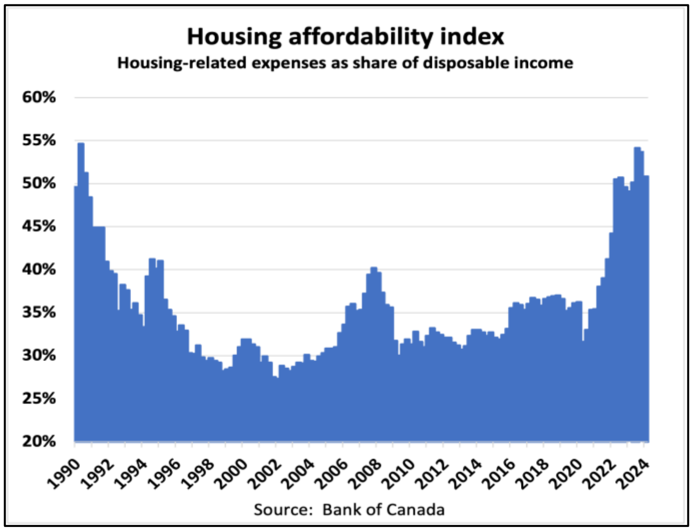
We don't have to overthink this: There is a cohort of well-qualified buyers who have been waiting on the sidelines for assurance that we won't see a repeat of double-digit mortgage rates of the late 80s and early 90s. They just got it, and we should expect seasonally adjusted home sales to drift higher through the summer. A 10% increase from current levels would not be surprising…particularly given how low transactions have been on a per capita basis since 2022:



Whatever pent-up demand will be unleashed, and I don't think it's much given where rates are currently, it will ultimately be constrained by the reality of ongoing affordability challenges. By my math, the move this week from the BoC reduced the monthly mortgage payment needed to buy into this market by $40 for a typical home. That helps at the margins, but payments are still more than double what they were in 2021.



Affordability is still a massive constraint on demand, a fact reinforced by BoC data released this week. The Bank's housing affordability index showed housing-related expenses on a new purchase dropped to 50.8% of median household disposable income in Q1, down from 53.8% in Q4. That's good, but it still leaves it at the highest level since the early 1990s…a good reminder that there's a lot of wood still to chop on the affordability front:



- **Strong supply response**

This one's counter-intuitive, but many of my trusted contacts in the real estate space are expecting a surge in listings following the Bank of Canada's cut this week. They report a growing number of owners and investors who HAVE to sell but are stubbornly holding as long as possible in the hopes of finding better resale market liquidity. After all, it's no fun having your home listed for sale for months on end….especially for Toronto residents who are used to properties selling in days or even hours. From realtor Jon Flynn:

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Jon Flynn @JonFlynnREstats

In the last few weeks I've heard more from sellers planning to list than buyer's planning to buy when the rate cut happened.

1:52 PM · Jun 5, 2024 · **14.6K** Views

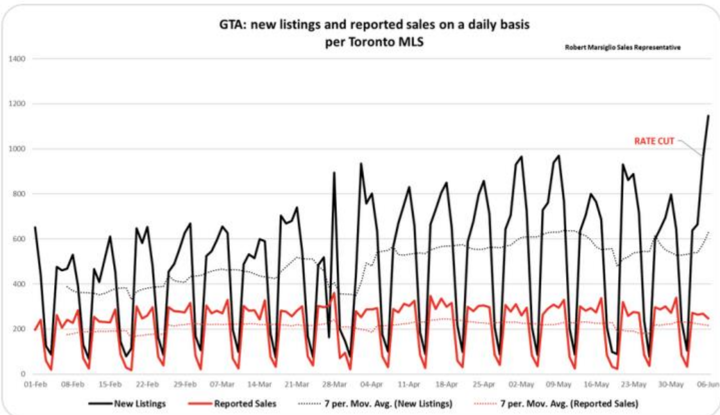
Meanwhile realtor Rob Masiglio reports that new listings have already seen a notable uptick since the cut this week:

Robert Marsiglio @rob_siglio · 3h

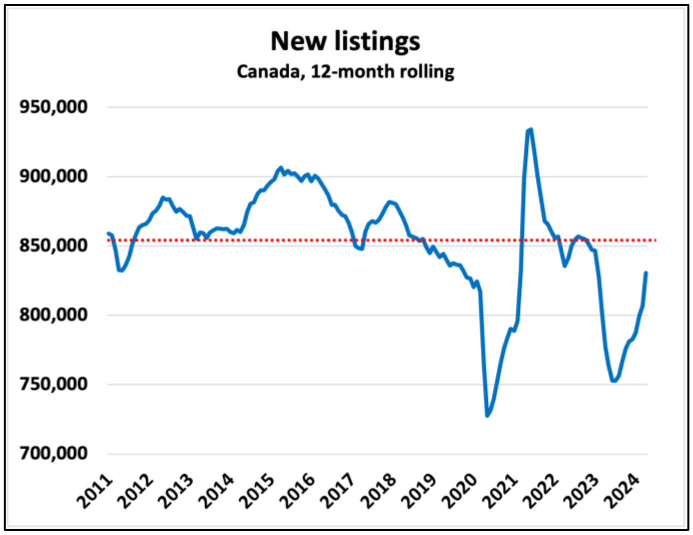
This is not a repost.

This is an update including June 6, the busiest new listing day of the year by 177.

#TORE

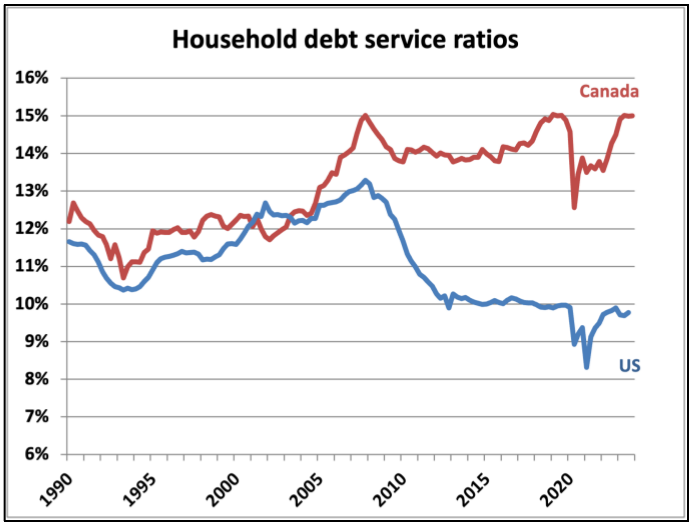


We know new listings have been kept off market since the back half of 2022 as prospective sellers have tried to wait things out. That trend is starting to reverse, but it's got a long way to go and will very likely overshoot the long-term norm on the way back up. It's not an obvious conclusion, but this week's rate cut may accelerate this trend:



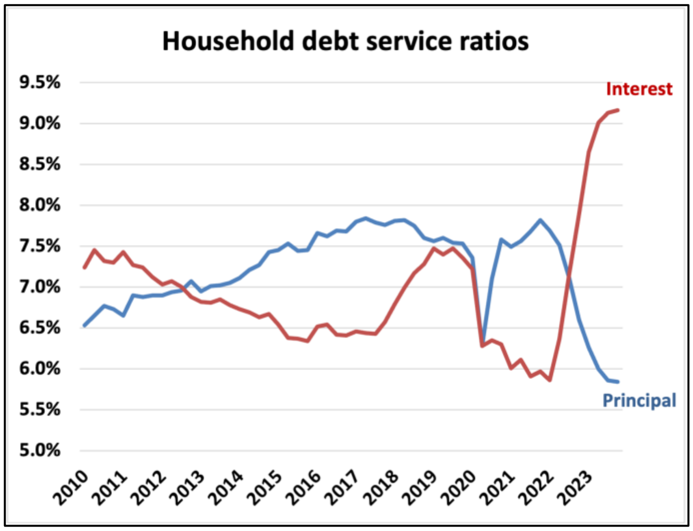
- **Debt service ratio will still make all-time highs**

  Even with interest rates now on the decline, the household debt service ratio (DSR) will not be falling any time soon and will still hit all-time highs later this year and remain elevated through 2026:



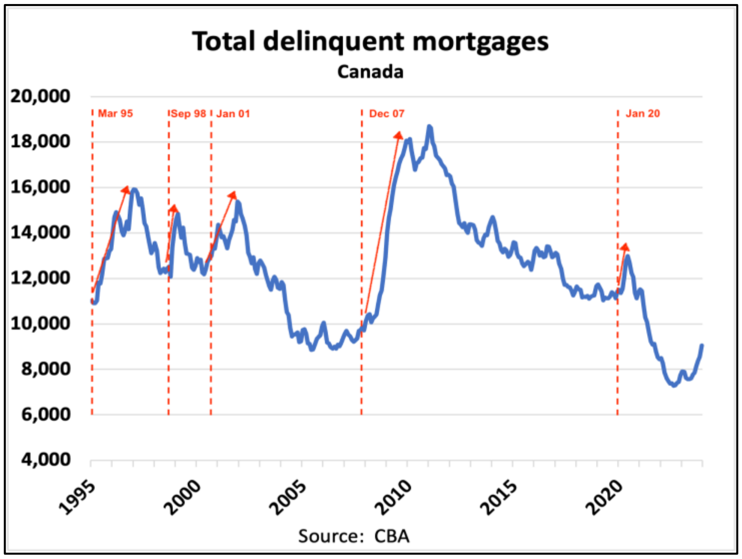
The reason is that this ratio is being artificially suppressed by declining principal repayment, entirely a function of static payment variable rate mortgages which hold monthly payments constant by reducing principal payments as rates rise.

This is not a small dynamic. For context, as these mortgages renew over the next 2 years, there will be a nearly 200bp upward drift in the principal repayment component of the household DSR as it reverts back to normal levels. That's more than enough to offset the next +100bps of cuts:



- **Arrears are only starting to rise**

  In prior easing cycles, the first cut has come near the lows in mortgage arrears, which then typically rose for another 12-18 months (remember that whole "long and variable lag" thing?)



We are much closer to the lows in delinquencies this cycle than we are to the highs. The mortgage arrears rate is still half of long-term norms at just 19bps. It will at a minimum return to normal levels and is much more likely to triple from here before finding a peak.

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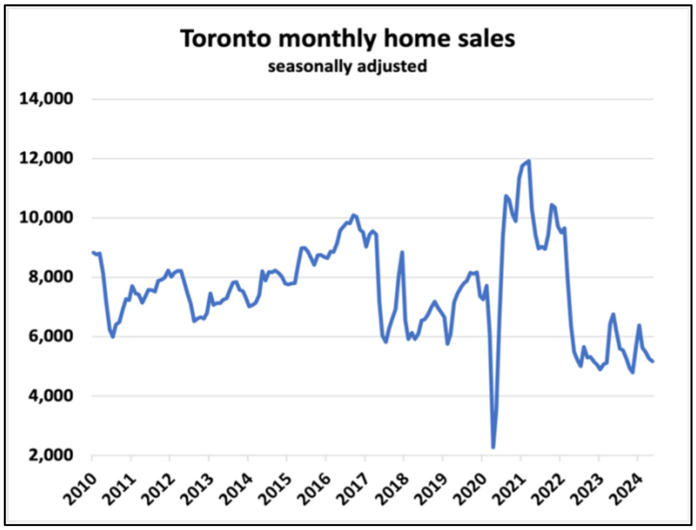
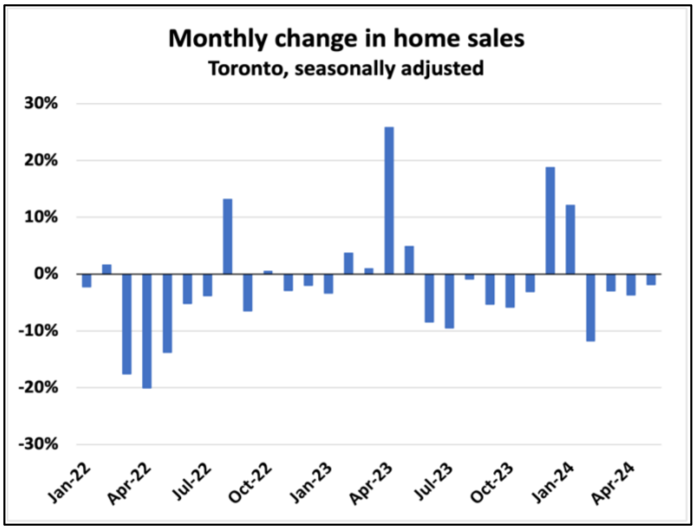
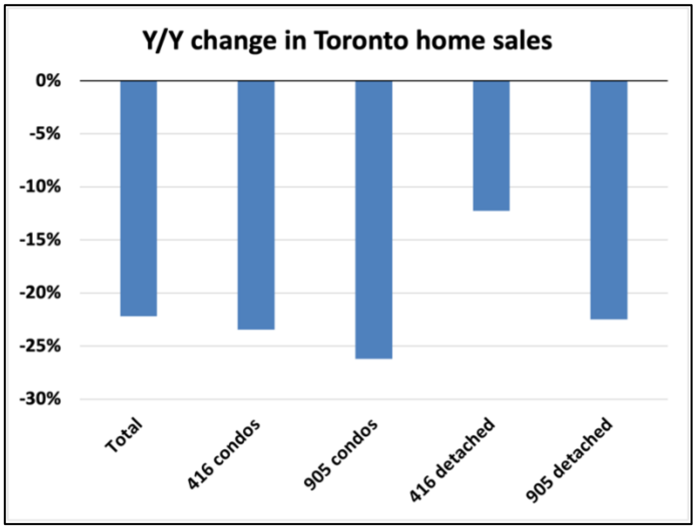
2) Toronto condo inventory hits record high in May

Sales fall in May

Seasonally adjusted home sales across the GTA fell 1.8% m/m in May but that's on top of a 1% downward revision to the originally-reported April numbers. Sales were down 22% y/y.







Sales remain near decade lows across segments:

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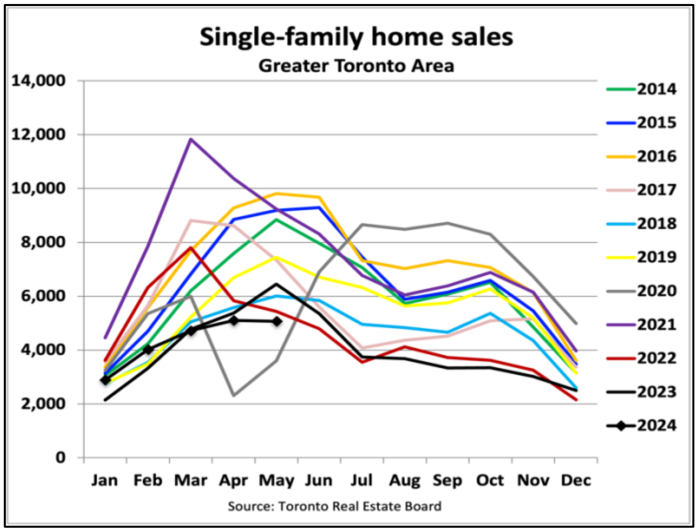
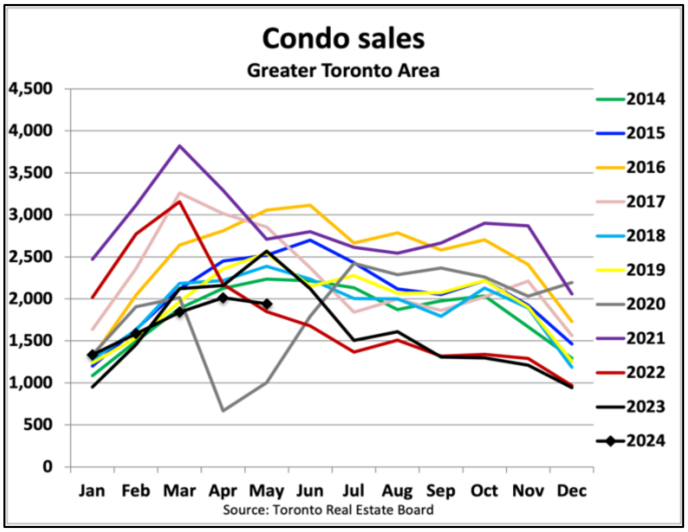
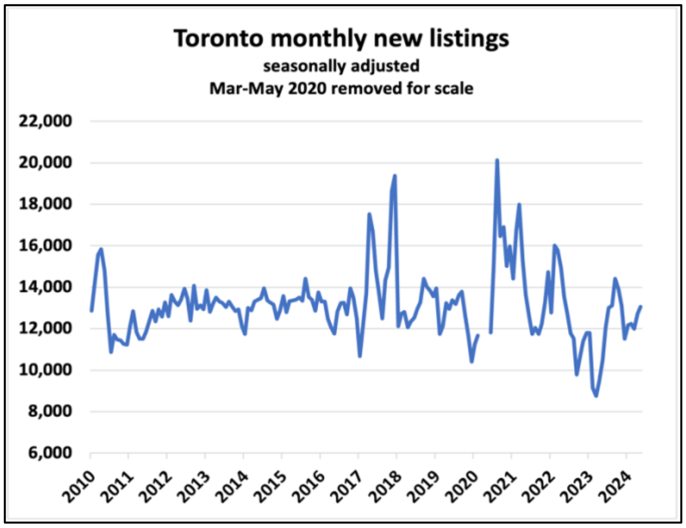
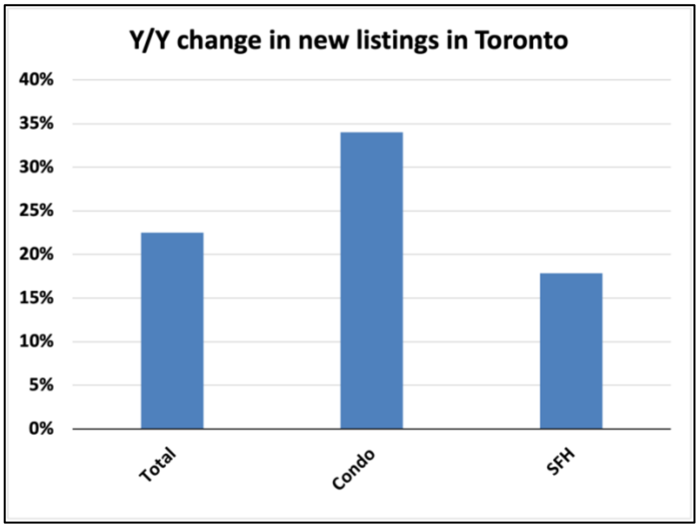




New listings tick higher

The flow of new listings coming to market accelerated in May, up a seasonally adjusted 2.6% m/m and up nearly 23% y/y.





The 12-month rolling total for new listings remains well below average. It's clear that some of the supply that was held back in the latter half of 2023 is now starting to hit the market. I expect a strong flow of new supply for the remainder of the year:

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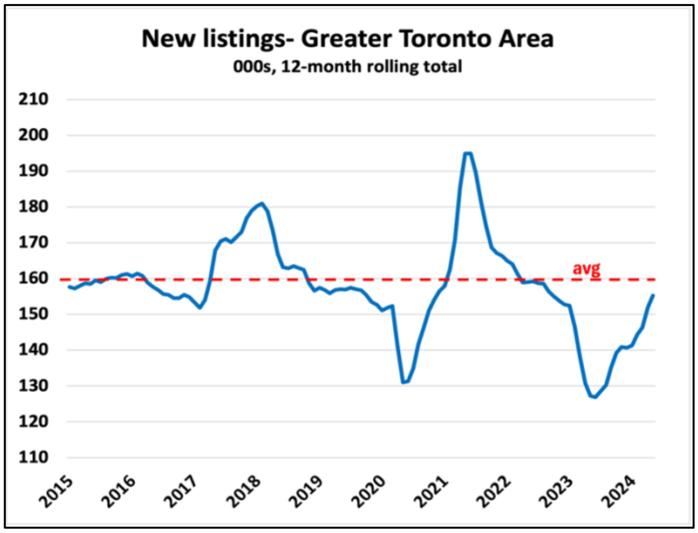
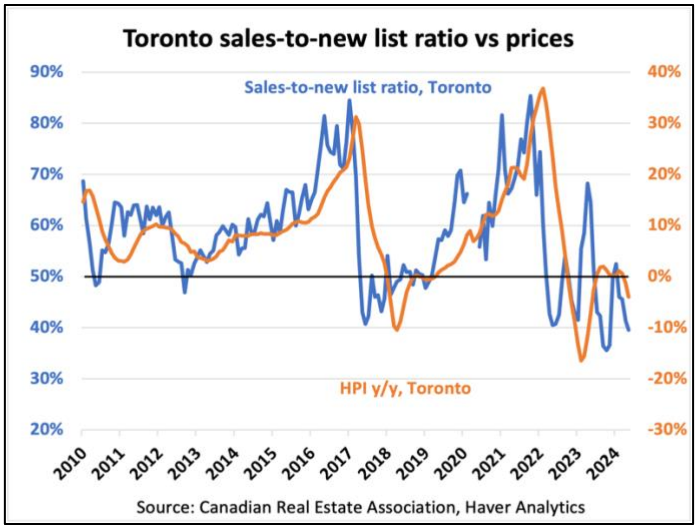


The sales-to-new listings ratio dropped back below 40% in May and remains in deep buyer territory and at levels that historically are consistent with prices declining at a 10% annual rate if things hold here:



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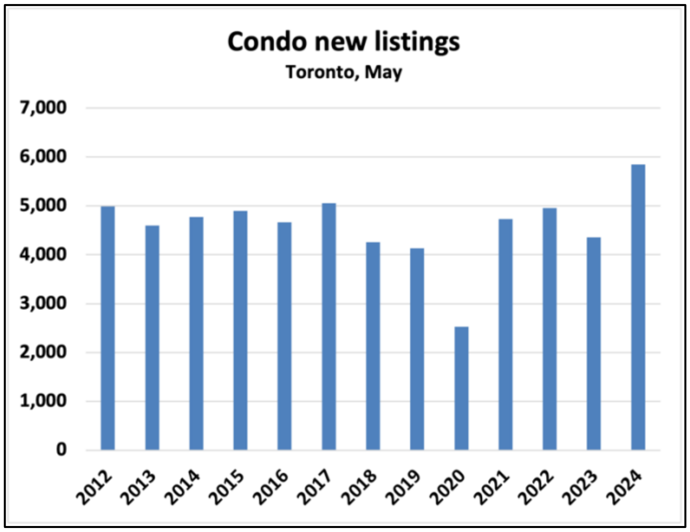
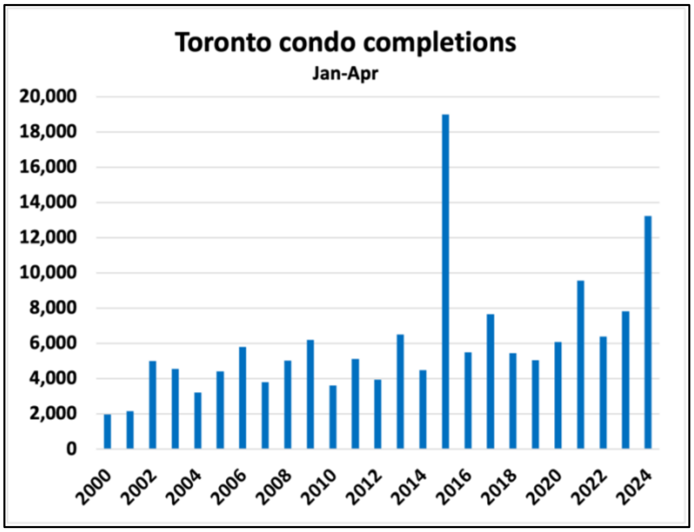
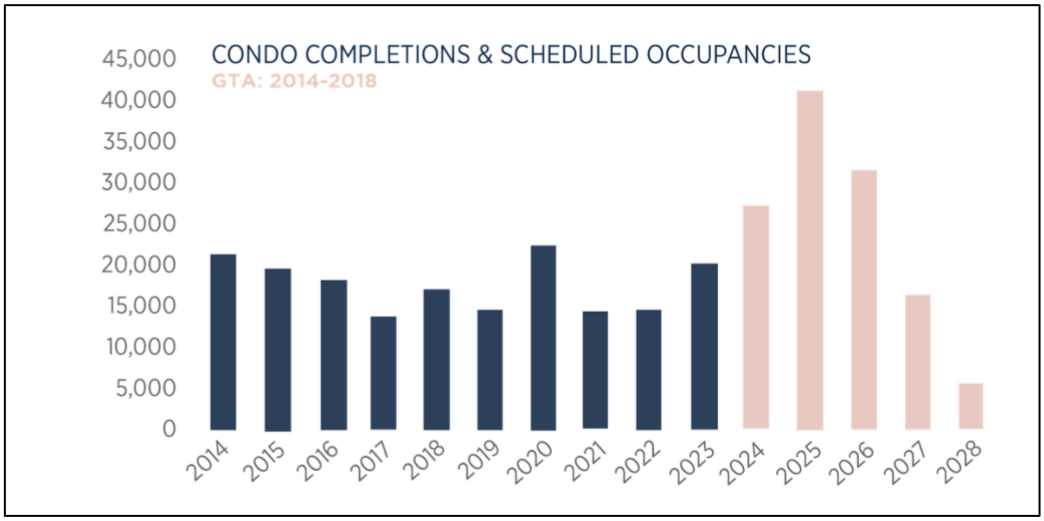
New listings for condos hit new record

Of note, we just set a record for new condo listings for the month of May. Anecdotally I'm being told that some investors are starting to trim their holdings, and that may account for some of the surge in supply. The other reason that supply has been strong lately is that new completions have surged to start the year. We've seen nearly 14,000 condo completions year-to-date through April across the GTA according to CMHC. In the past 30 years, only 2015 saw more completions in that same period:





There's plenty more still to come. The chart below is from ReMax Condo Plus showing their estimated completions out to 2028:



That surge in new completions is also adding considerable supply to the rental market where average rents for condos were down 4% y/y in May. The good news is that with rates and condo prices trending lower, we're starting to see cash flows on new purchases improve slightly. By my math a resale condo purchased at current prices, financed at current rates and achieving current rents would see negative monthly cash flow of roughly $500 AFTER principal repayment was accounted for:

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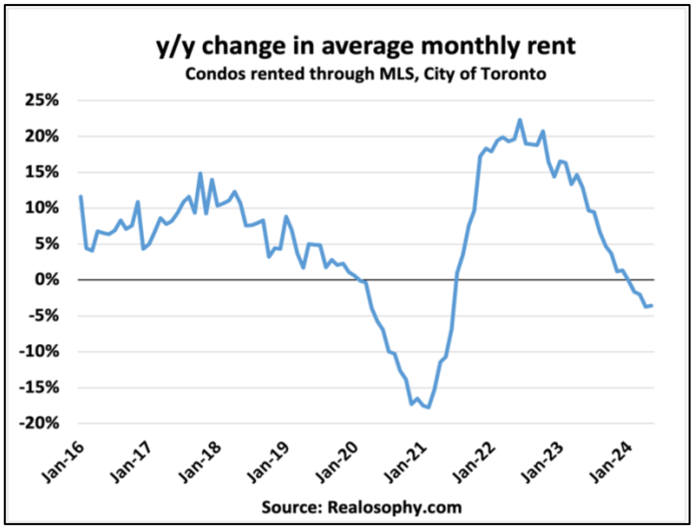
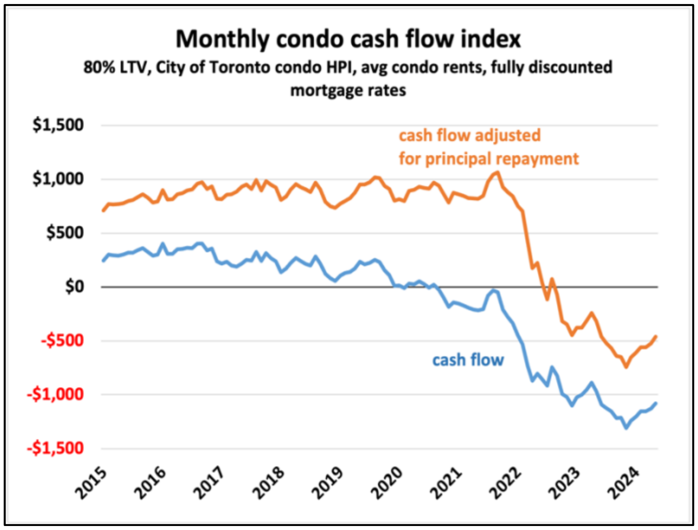
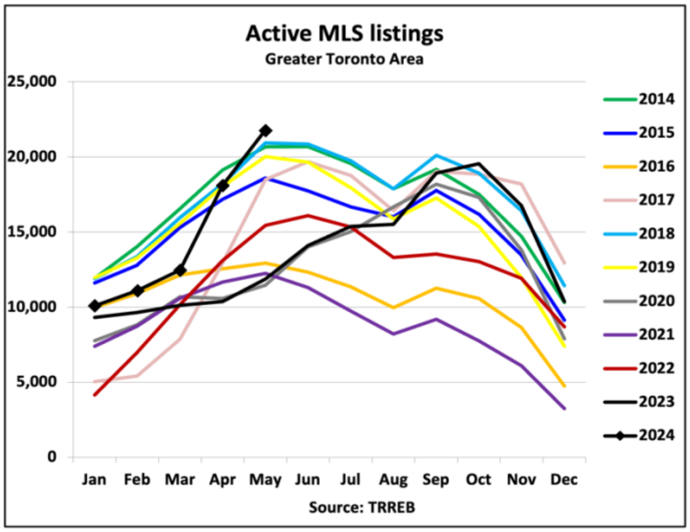
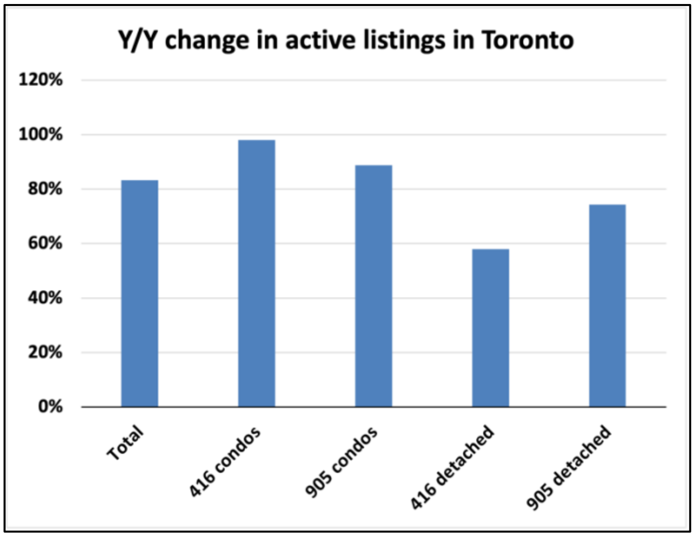




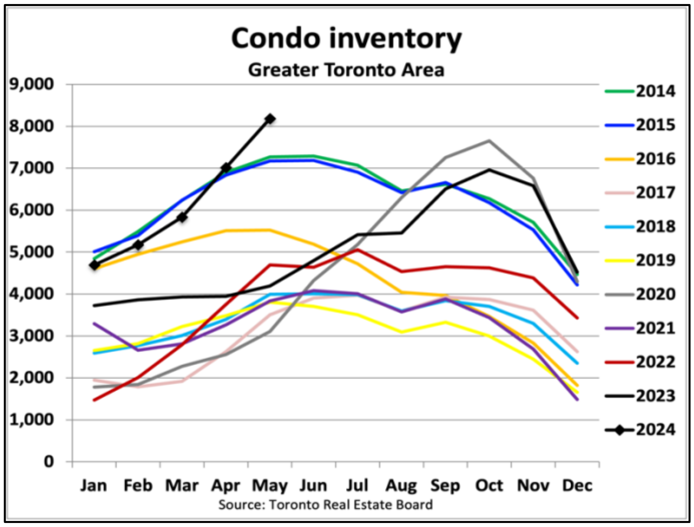
Major resale inventory build

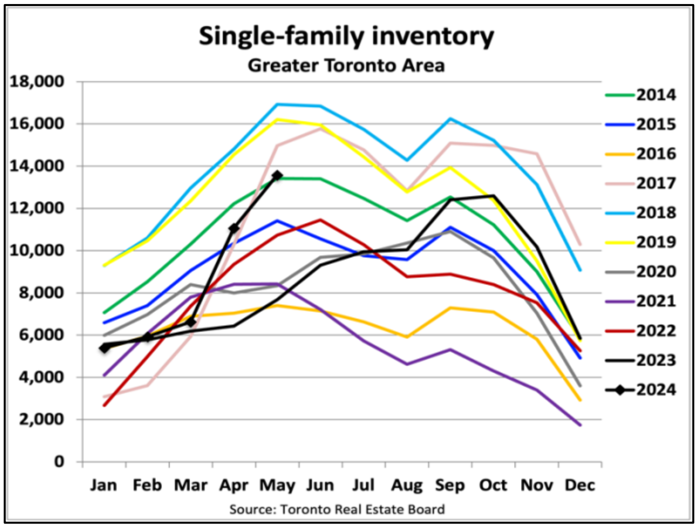
The big story last month was the surge in resale inventory which was up 82% y/y and nearly 100% for condos in the 416. <u>Resale listings just hit the highest levels in a decade and have now risen 75% in just 2 months:</u>





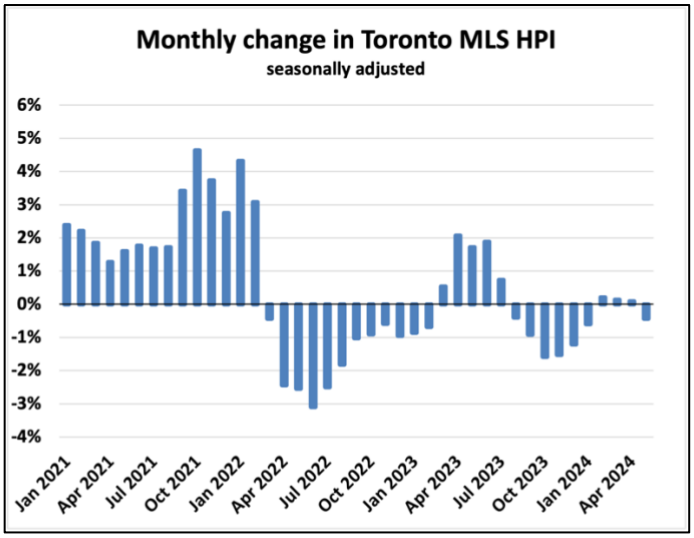
Condos set a record for the highest number of units for sale last month, but the single-family segment has seen the more dramatic increase in the past 2 months, with inventory levels more than doubling in that period. There's certainly seasonality at play, but this is still the second steepest inventory build for this time of year, next only to 2017:

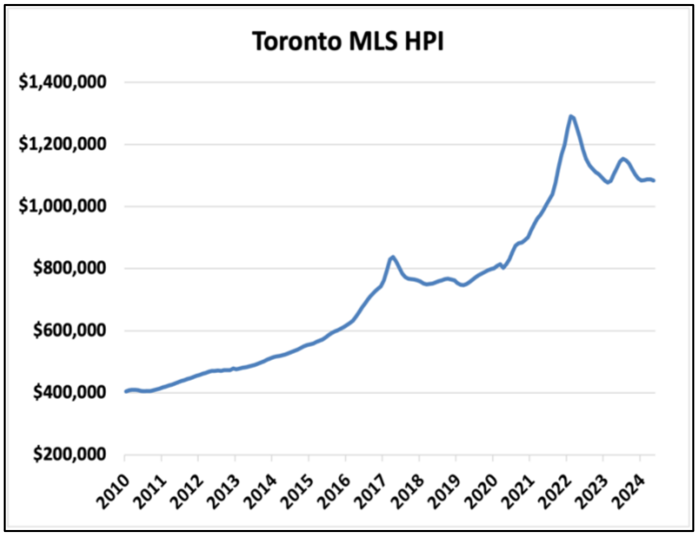




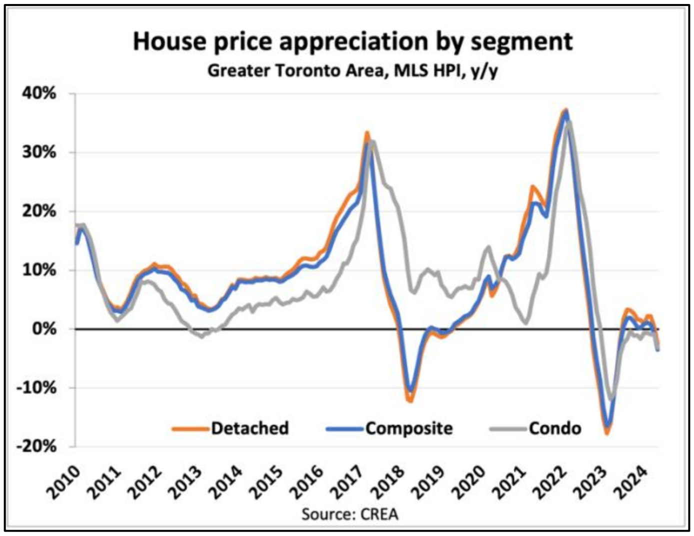
Prices turn lower

Given the magnitude of the inventory build over the past couple months, it's no surprise that the seasonally adjusted House Price Index are trending lower. The MLS HPI was down 0.4% in May, the first decline in the past 4 months:



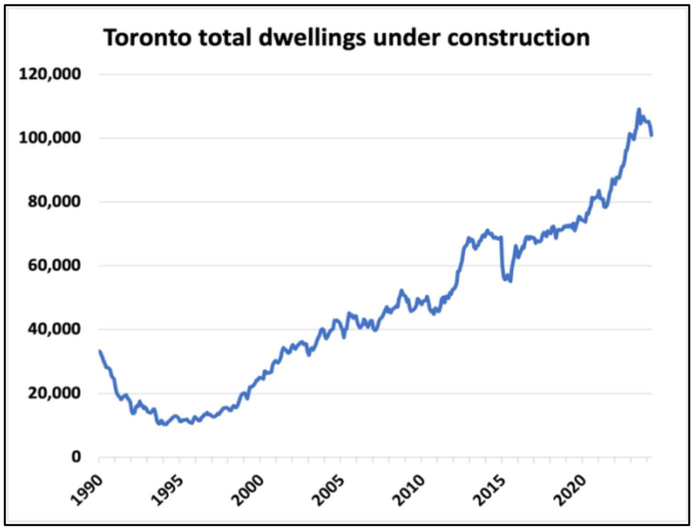


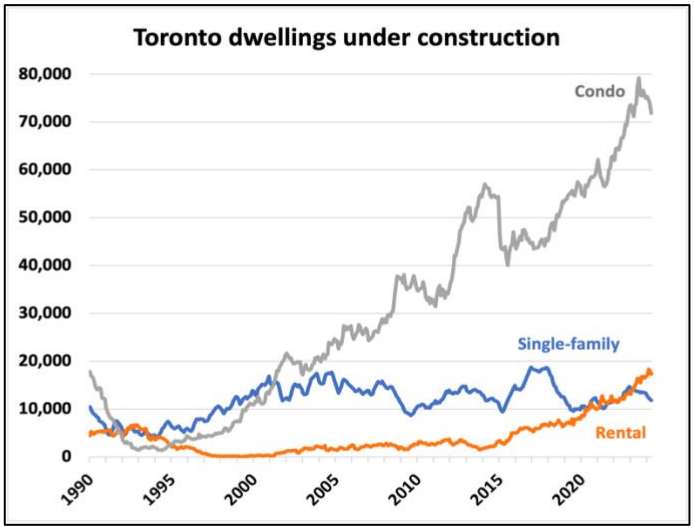
That same index was down 3.5% y/y in May:



Construction activity posts sharp decline

The number of dwellings under construction across the GTA has now fallen in 5 of the past 6 months after declining a sizable 2.8% in April. We are now at the point where new completions are outpacing housing starts, which means dwellings under construction are declining. I expect this will continue for much of the next couple years:





The reason I think dwellings under construction are set to slow sharply is that new condo sales continue to hover near 20-year lows, but housing starts have not yet reflected that dynamic. That's because CMHC doesn't count a "start" until development is back above grade. For big condo developments, that means that "starts" today reflect projects where foundation work has been underway for well over a year and where the presales that drove the development happened as far back as 2021. It hits with a big lag, but the slowdown IS CERTAINLY coming:

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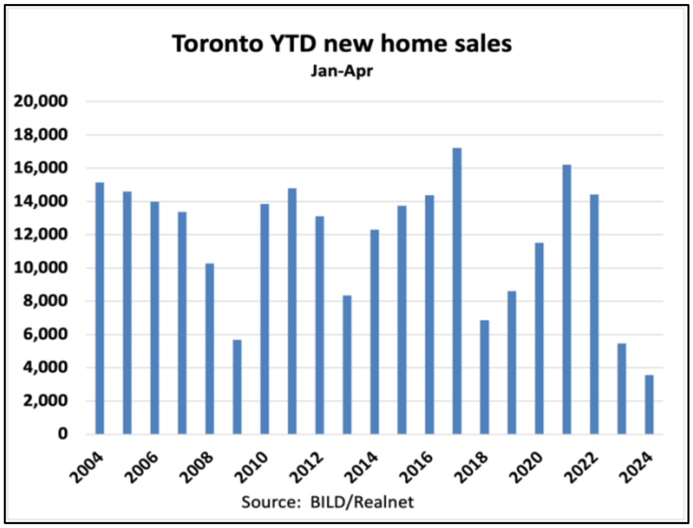
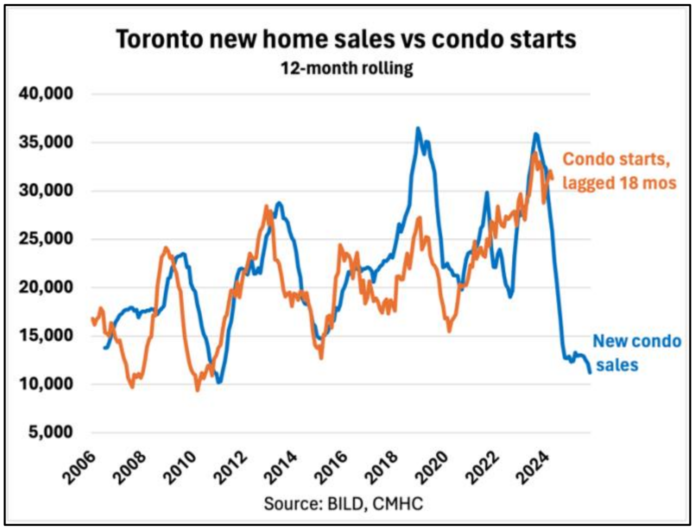
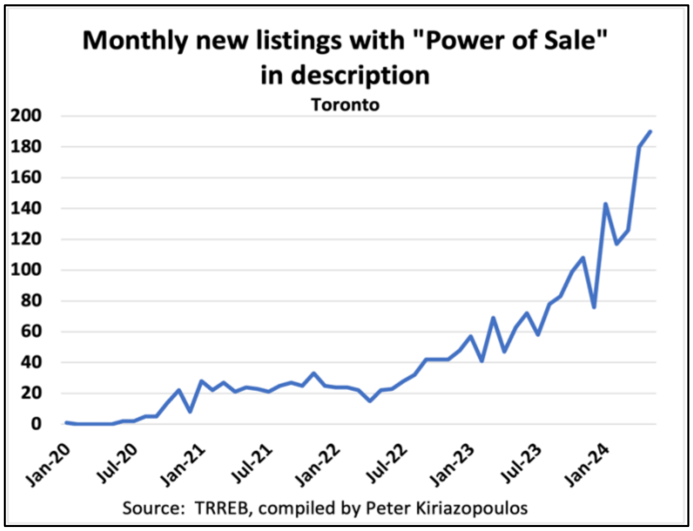




What this means is that Toronto will see 3 years of very high completions, but 2028 and beyond will see exceptionally low new supply. This will tighten the resale market again, and you can bet that prices will react accordingly. That's the opportunity, but we've got some pain to wade through between now and then.

Power of sale listings rise

Thanks to good friend of Edge Analytics, Peter Kiriazopoulos, for the ongoing power of sale data. Just under 200 new listings had that term in the description last month. A drop in the bucket compared to total new supply, but the trend can't be more clear:



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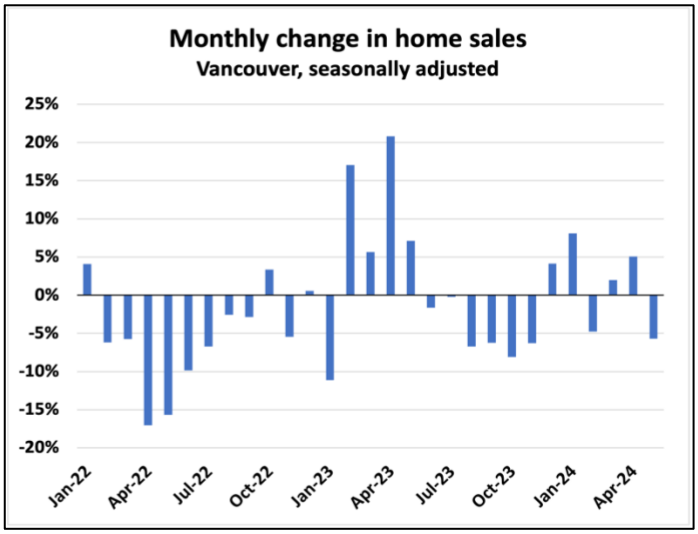
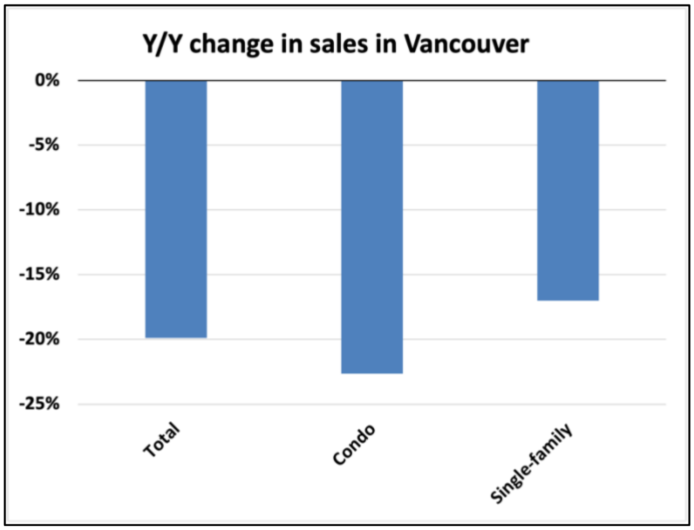
3) Vancouver house prices tick up

Sales pull back

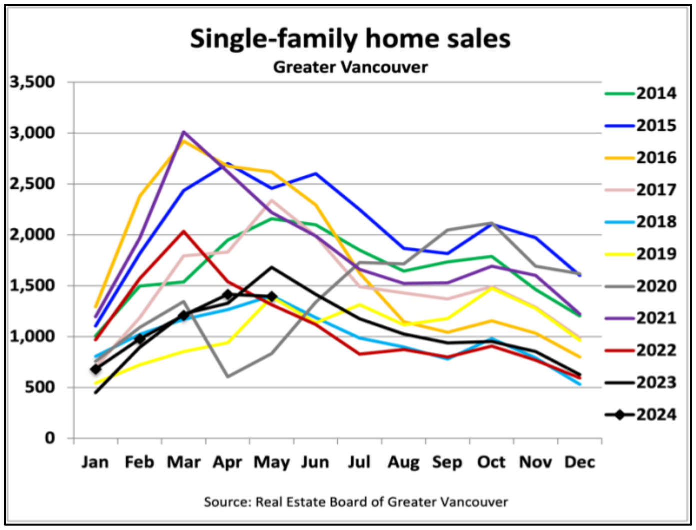
By my math, Vancouver saw a 5% pullback in seasonally adjusted home sales last month, the sharpest decline since Q4 of last year:

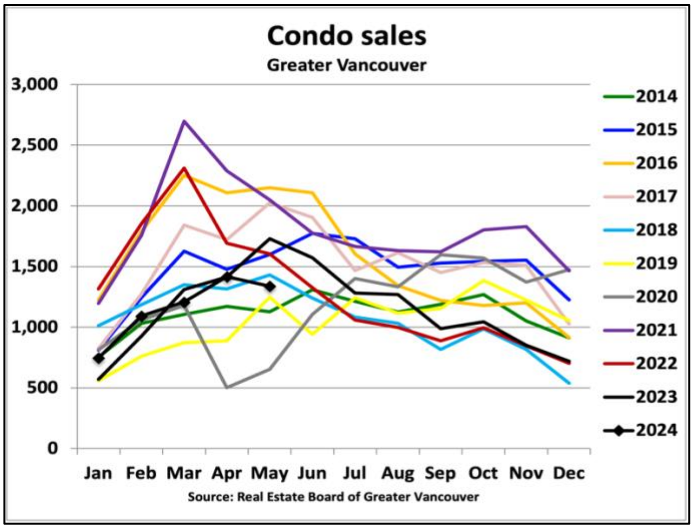


That left sales down 20% compared to last year at this time, and down closer to 23% for the condo segment:



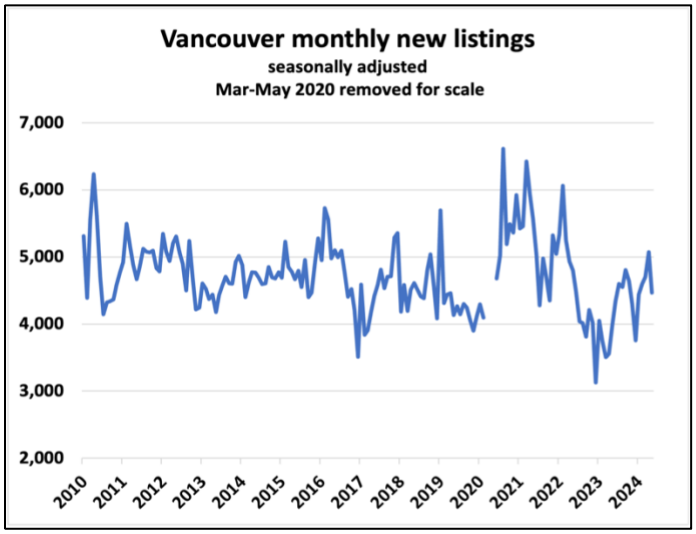
Single-family sales remain relatively weak at 15% below decade norms, but condo sales are only slightly off the "normal" rate:

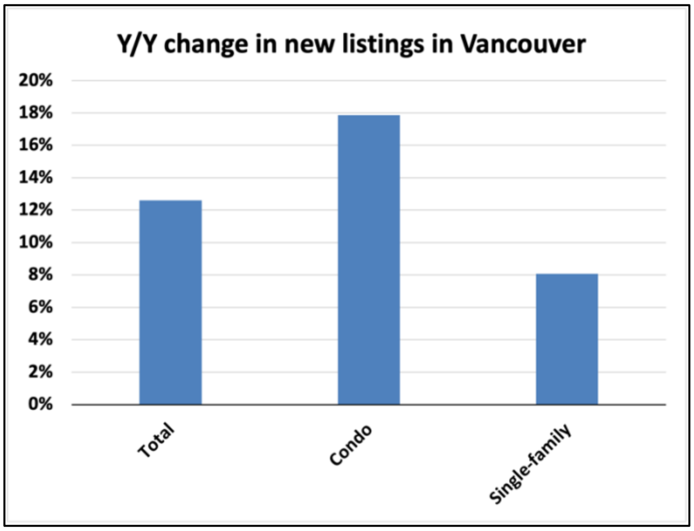




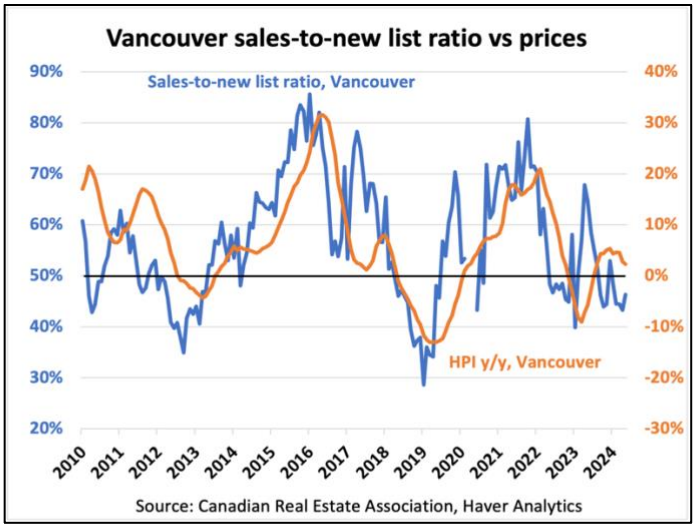
New listings tumble

After a big spike in new listings in April, sellers cooled their jets last month. New listings fell an estimated 10% m/m but were still nearly 13% higher than last year at this time:



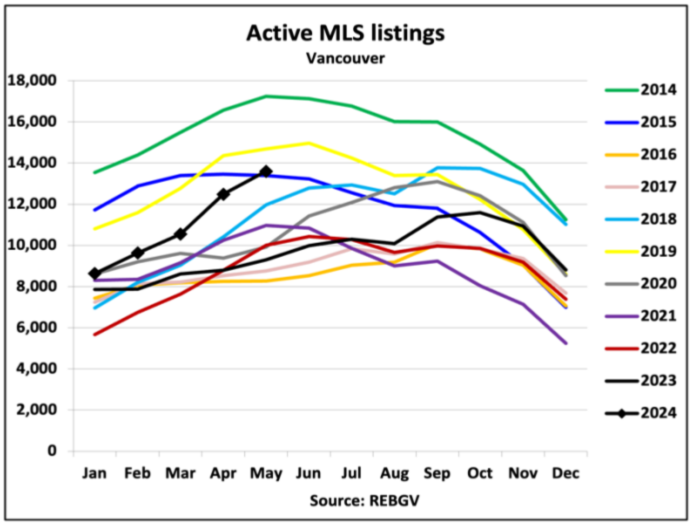


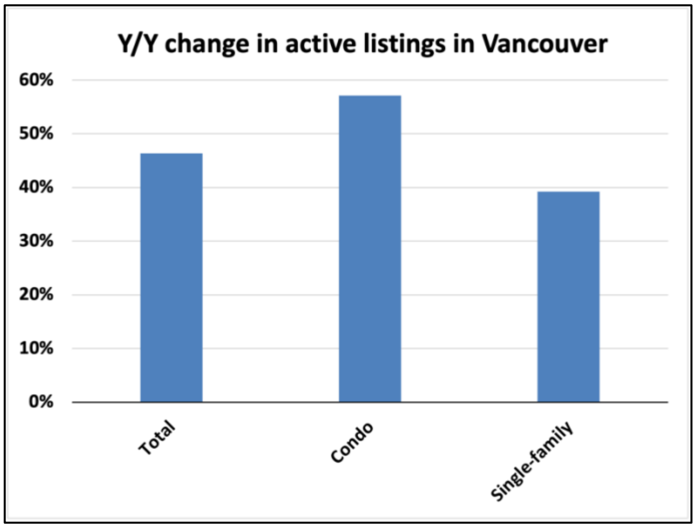
Market balance tightened slightly, but the sales-to-new listings ratio is still in the mid-40% range, a level consistent with slightly declining prices if these levels hold for any length of time:



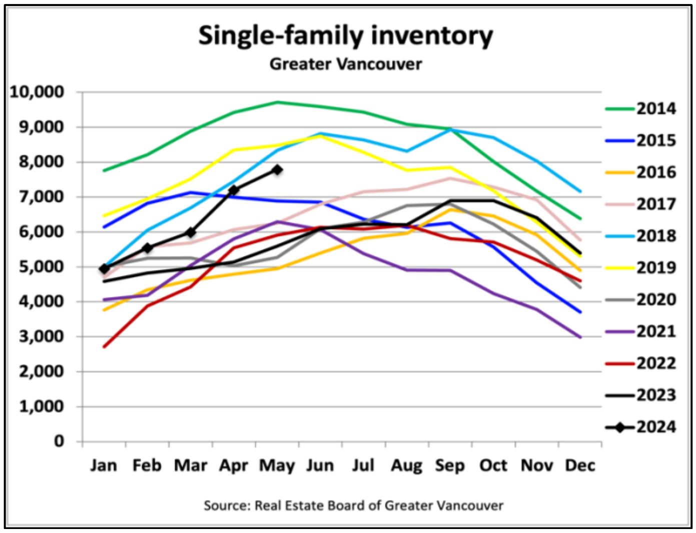
Inventory rises

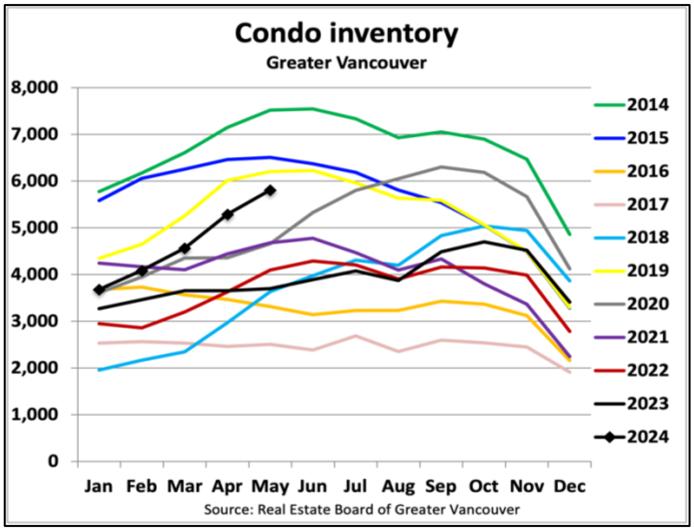
Active listings continue to trend higher and were up 46% y/y overall and up a whopping 57% for condos:





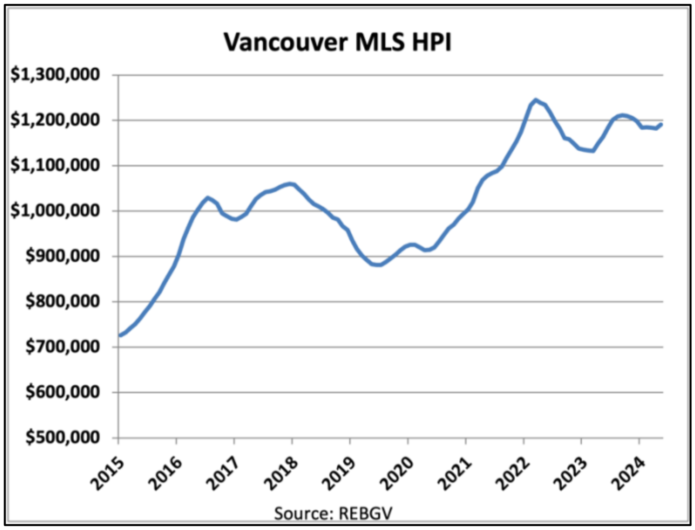
Note below that the inventory build is particularly large in the condo segment, although both remain only about 20% above "normal" levels:

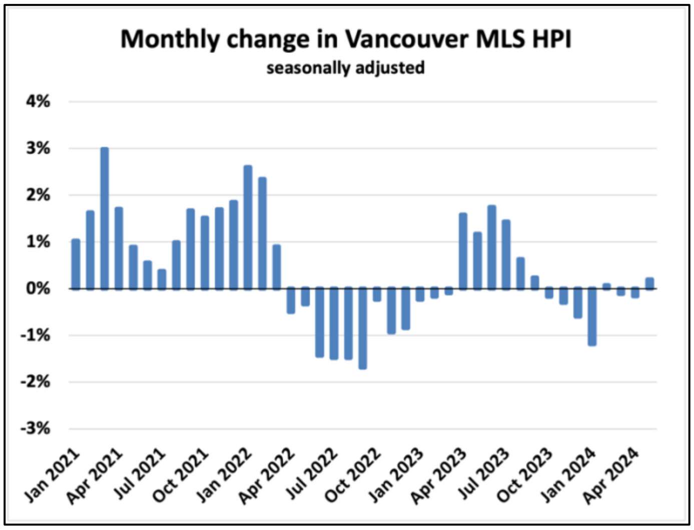




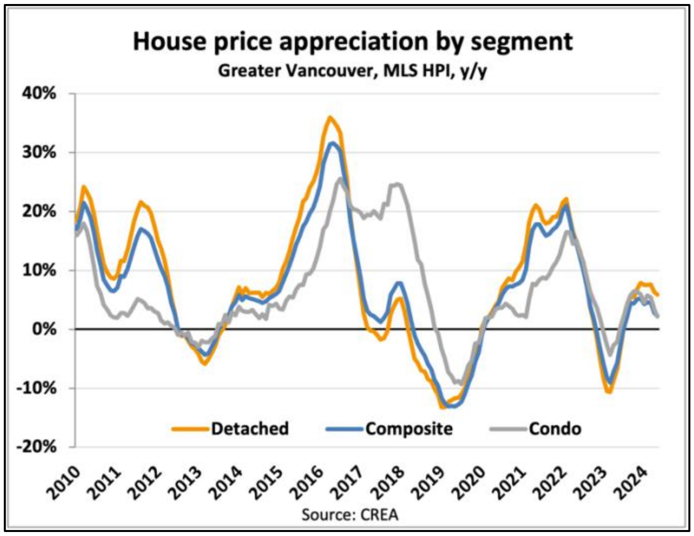
House prices rise

The seasonally adjusted MLS HPI appears to have posted a 0.2% monthly increase in May, but those gains are unlikely to hold if the market doesn’t tighten in coming months:



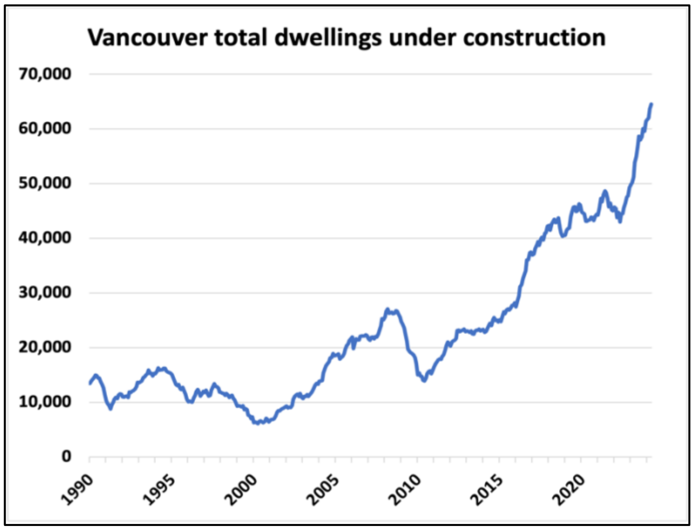


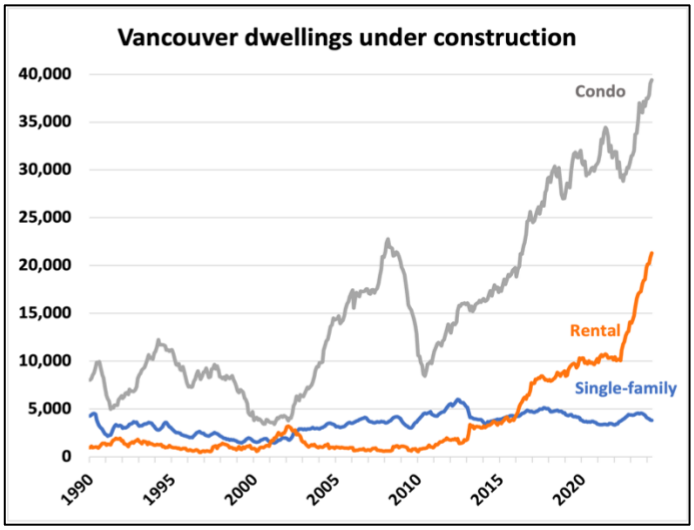
Prices across segments are still above year-ago levels, but gains are slowing sharply, particularly in the condo segment:



Construction activity continues to surge

Unlike in Toronto where dwellings under construction are declining, Vancouver continues to see a construction boom. Total dwellings under construction were up another 1.4% m/m in April and are now up 8.4% in the past 5 months led by a boom in condo and rental construction. The single-family segment, on the other hand, is seeing a slowdown in construction activity:



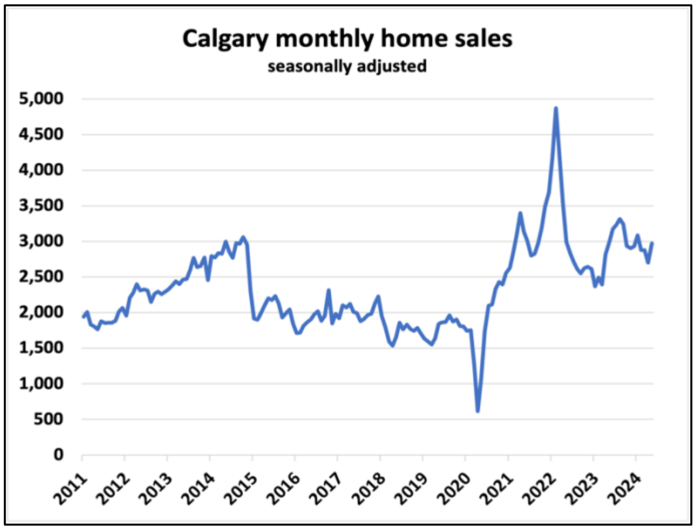


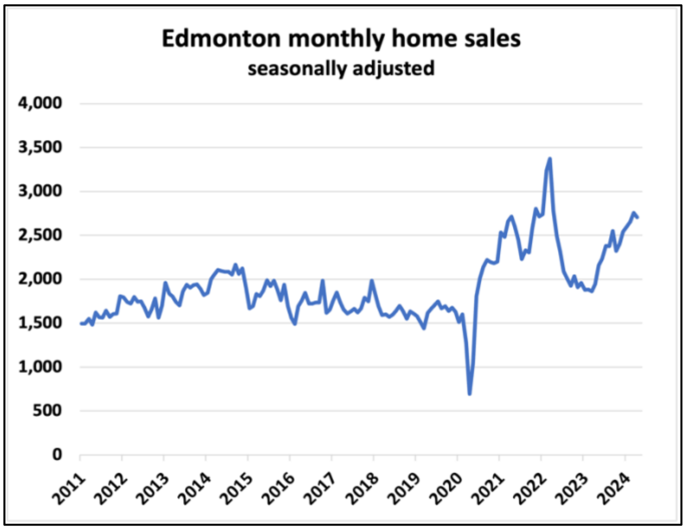
Prepared For:

4) Calgary stays hot but Edmonton starting to catch up

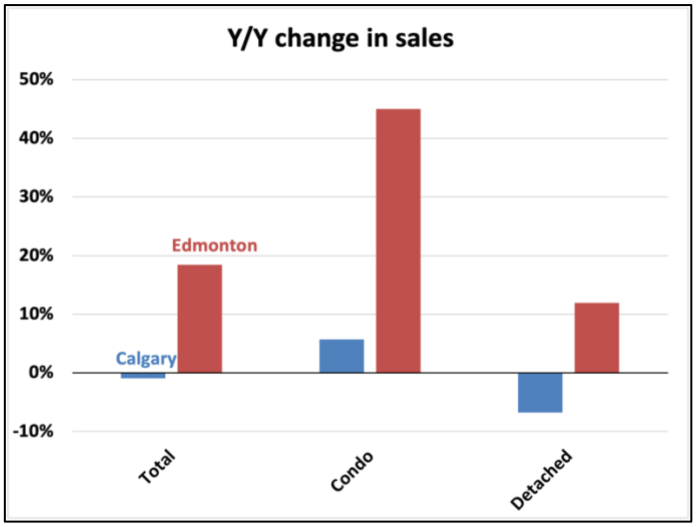
Demand remains solid

Seasonally adjusted home sales appear to have ticked up roughly 8% m/m in Calgary and were basically flat in Edmonton:



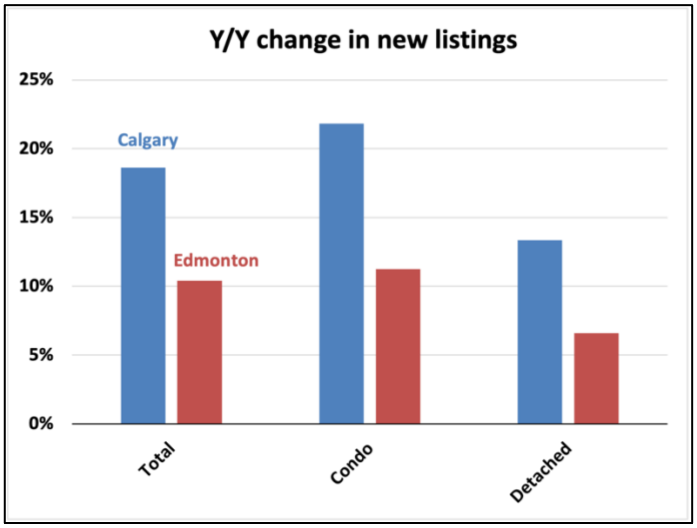


But the y/y trend is where things are very interesting. Calgary is seeing sales DOWN slightly, led by a 7% y/y decline in single-family sales, while Edmonton is UP nearly 20%.

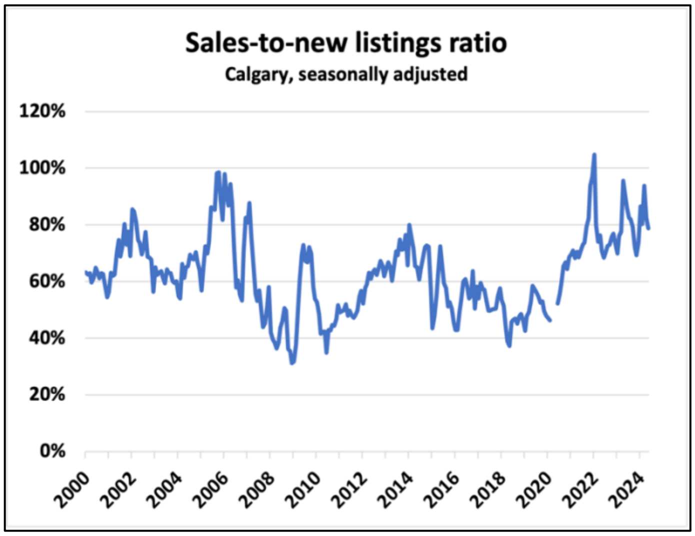


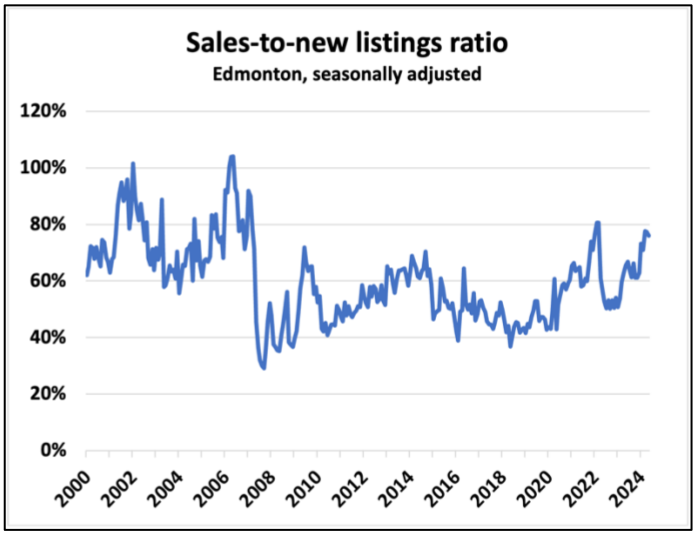
New listings tick up

New listings were also significantly higher on a y/y basis in Calgary…+18% y/y vs +10% in Edmonton:



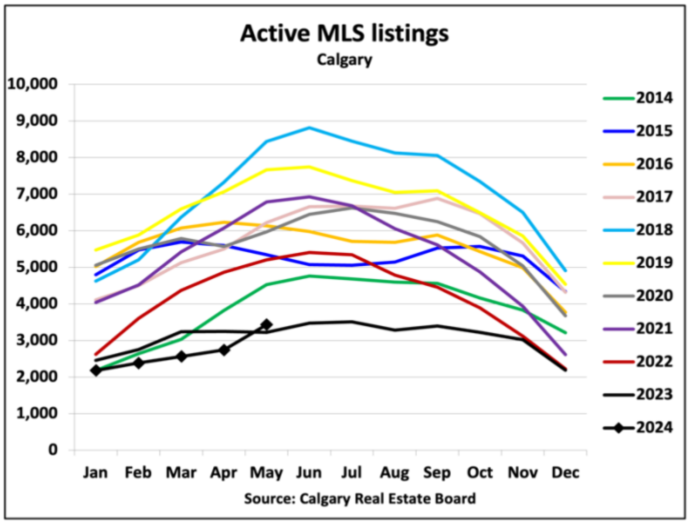
The sales-to-new listings ratio continues to hover near the 80% range in both metros, which a rip-roaring market by the standards of ANY Canadian city:

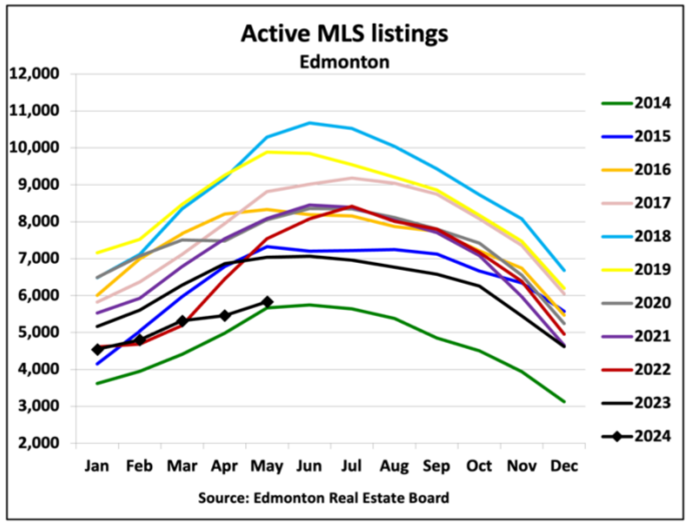


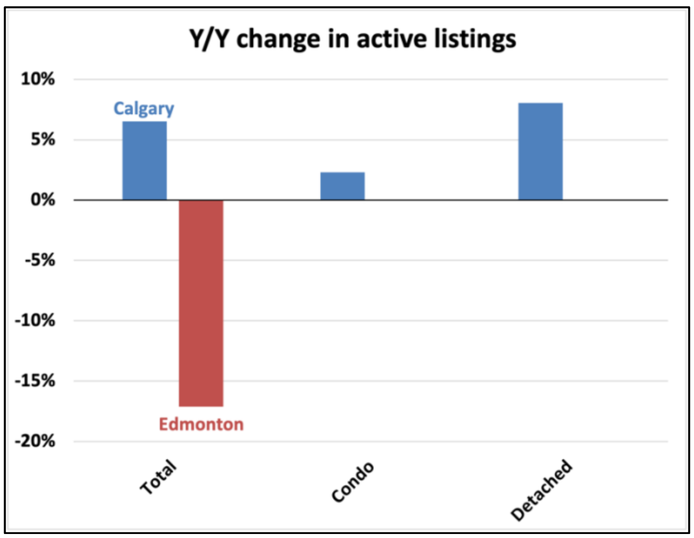


Inventory levels RISE in Calgary

Now here’s something we haven’t been able to say in over 3 years: Inventory levels in Calgary were higher in May than they were 1 year prior while in Edmonton, inventory was 17% lower:



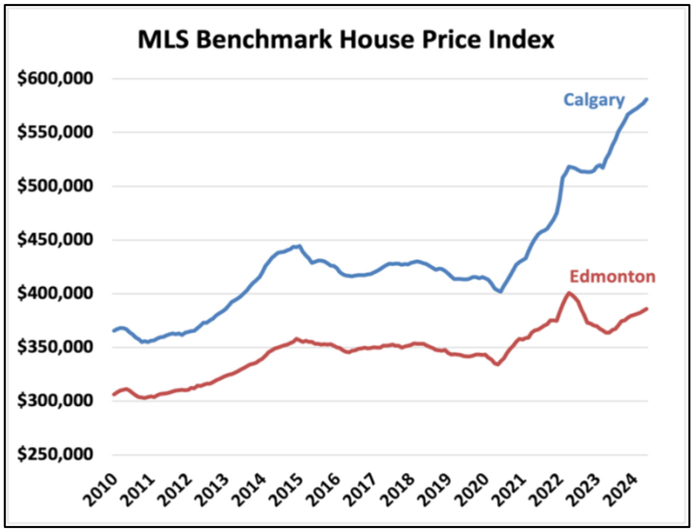


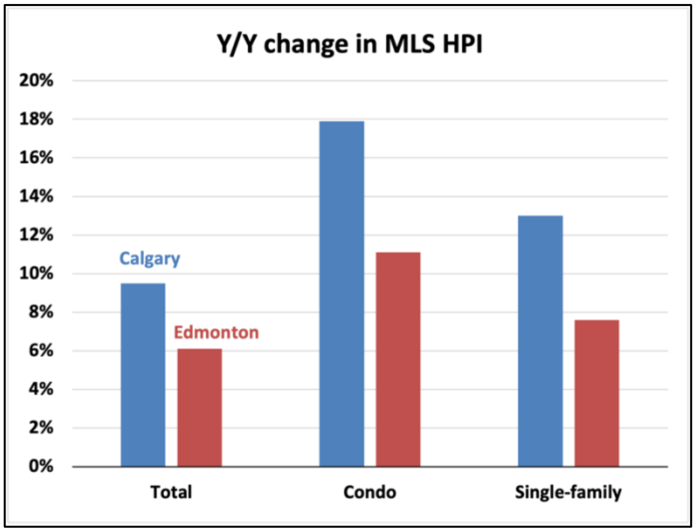


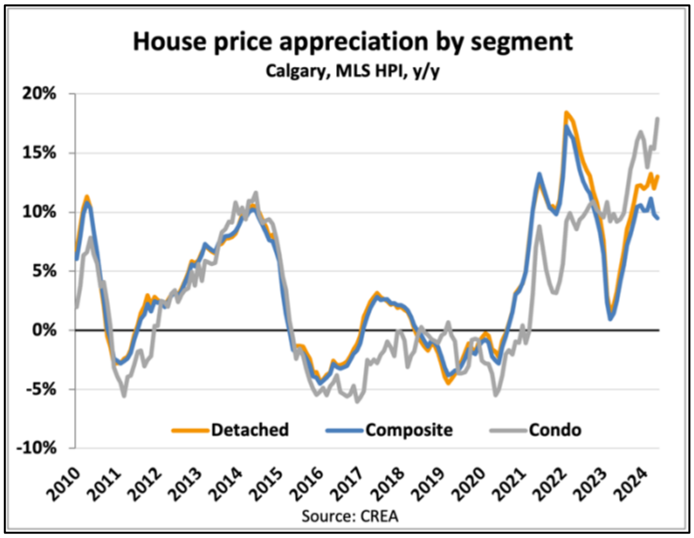
Prepared For:

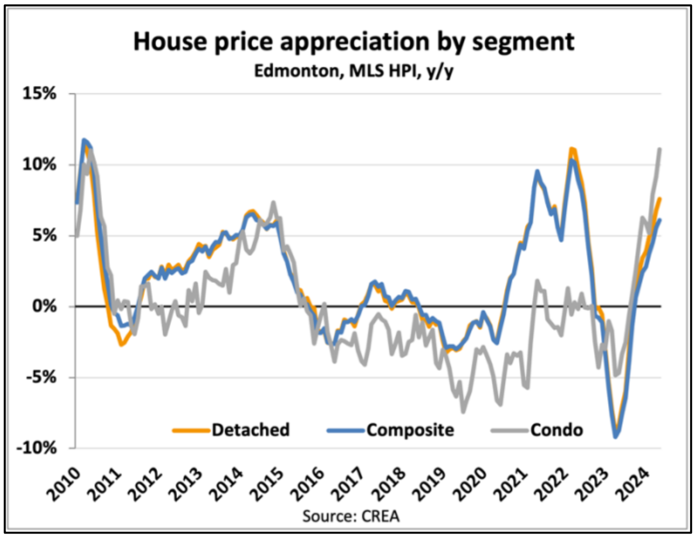
House prices rise

Price continue to surge higher in both Calgary (+9% y/y) and Edmonton (+6% y/y), but given that we're now seeing the sales and inventory trends shifting more positively in the latter, my call remains unchanged: It's Edmonton's time to take the crown from Calgary for Canada's best-performing major metro:





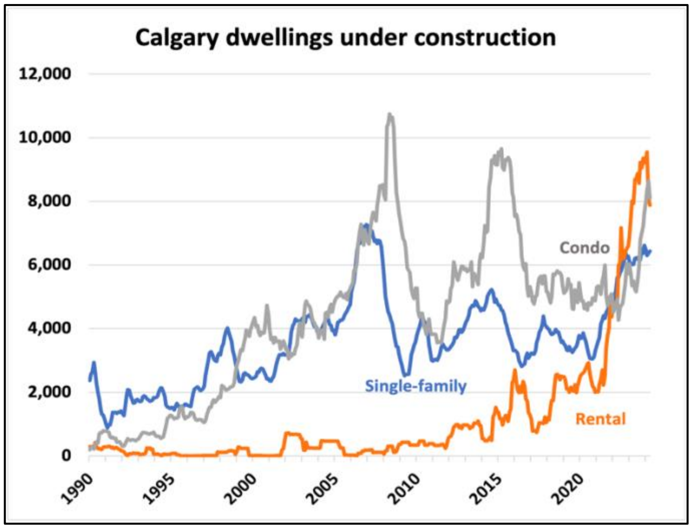


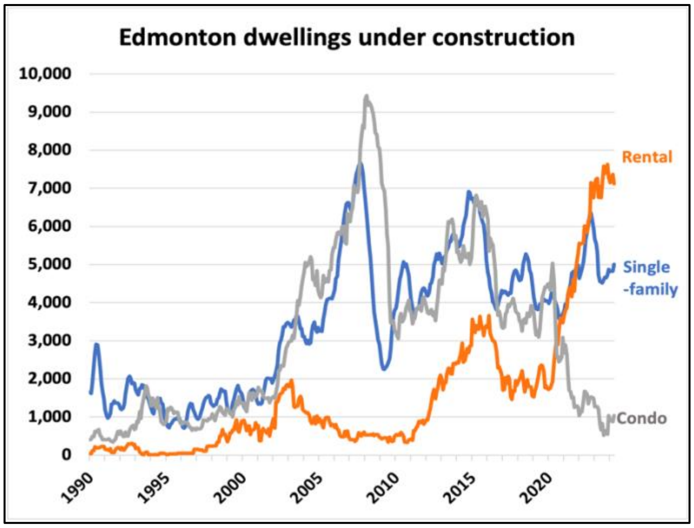


Construction activity declines in Calgary

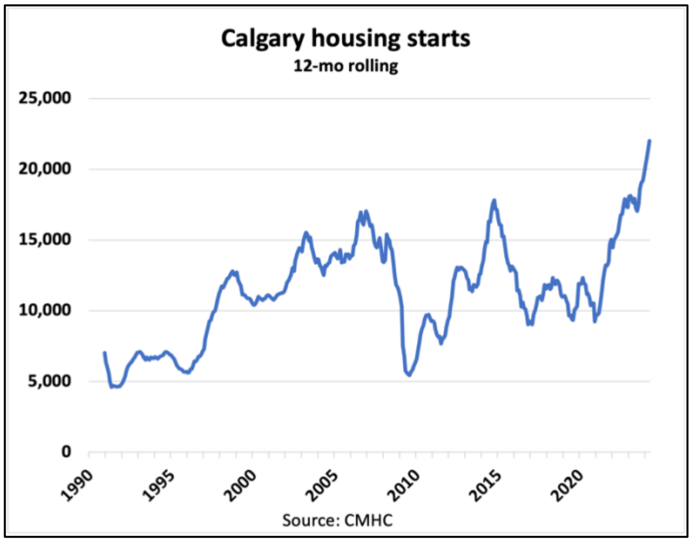
The number of dwellings under construction across Calgary fell 3.0% in April after declining a whopping 4.5% in March. The culprit is a big decline in rental construction due to a high number of completions over the past couple months.

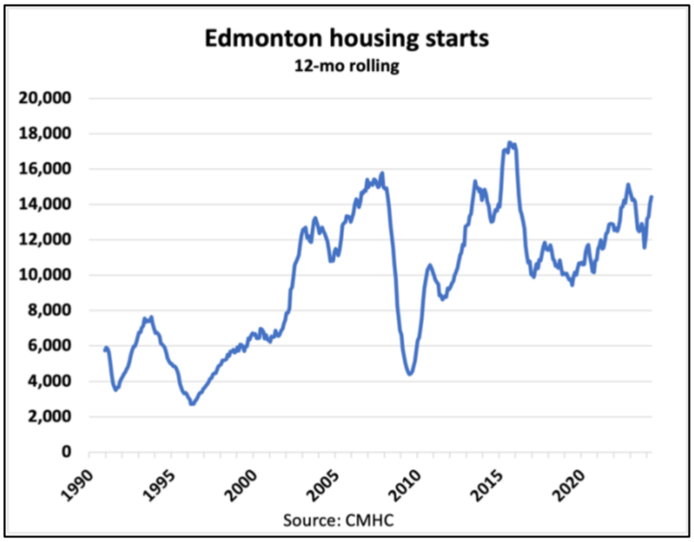
Over in Edmonton, construction activity ticked up 0.7% m/m:





Housing starts continue to remain at record levels in Calgary while in Edmonton they have not recaptured the prior cycle highs in spite of very tight resale market conditions.





So to reiterate: I remain bullish on both but very, VERY bullish on Edmonton for now.

Have a great day!
Ben

Prepared For: