



THE EDGE REPORT

October 2023



1) *Bank of Canada holds the line, points to “growing evidence” of a slowdown*

No surprise from the Bank of Canada (BoC) this morning, which held rates steady for the second consecutive meeting.

They will try to convince Canadians that further rate hikes are on the table...just to make sure a speculative mindset doesn't creep back into the real estate market...but it's clear from their language and the deteriorating economic backdrop that we are likely done with rate hikes for the cycle.

But while we've likely seen the peak, the question now is when do we see actual relief. And on that front, the Bank continues to position for a “higher for longer” environment.

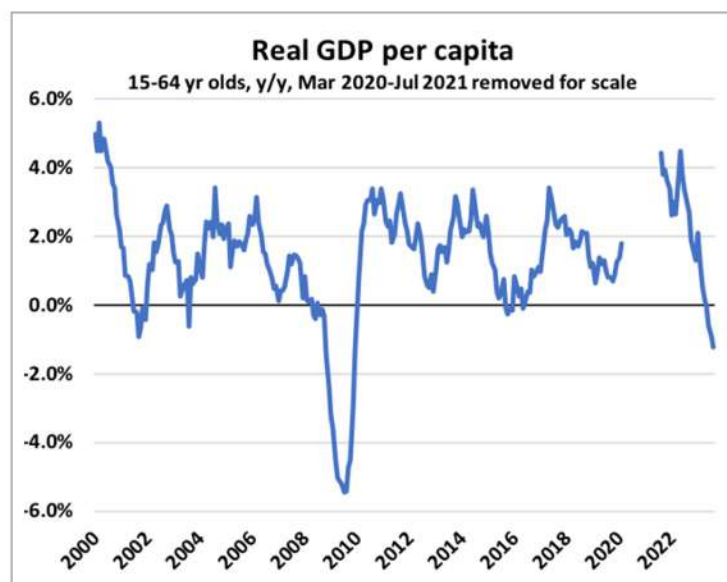
Some takeaways:

i) BoC acknowledges that recession pressures are mounting

The Bank notes that, “there is growing evidence that past interest rate increases are dampening economic activity and relieving price pressures.”

Then in the press conference, this zinger: “The path to a soft landing is narrow. In our new projection that path is narrower.”

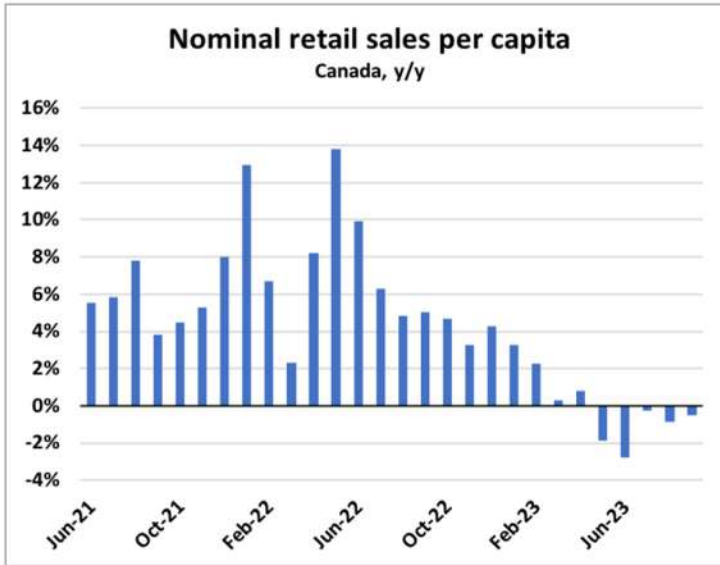
That's about as close as they are ever going to get to warning of an impending recession, and it squares with broad trends in the economy. There are so many recent data points to highlight, but consider just a couple. First off, GDP continues to trend negative once we adjust for Canada's booming population. In other words, the recession is already here in per capita terms:



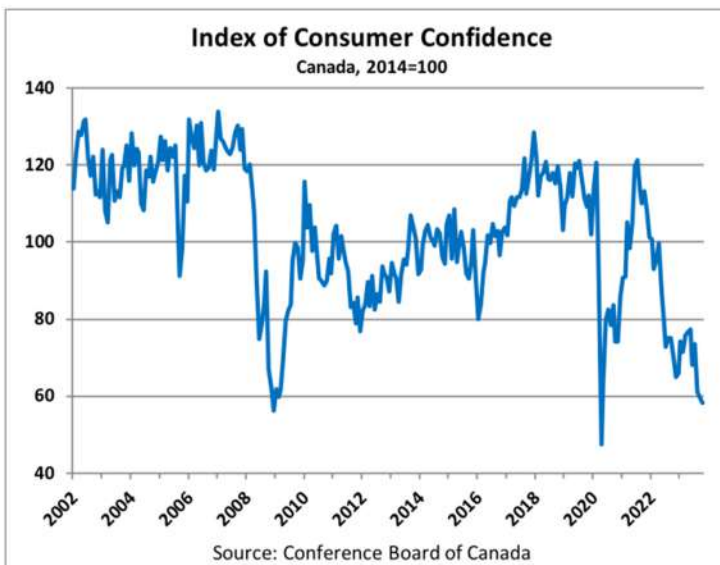
Second, retail sales are slumping. This is a key macro data point to track, because if the consumer pulls back, the economy follows.

Retail sales fell 0.6% in inflation adjusted terms last month, and are now at the lowest level of the year. Weakness is most pronounced in the cyclical components (autos, home furnishings, clothing, sporting goods and hobby stores, etc all down last month), which is exactly what you would expect to see as the economy cools.

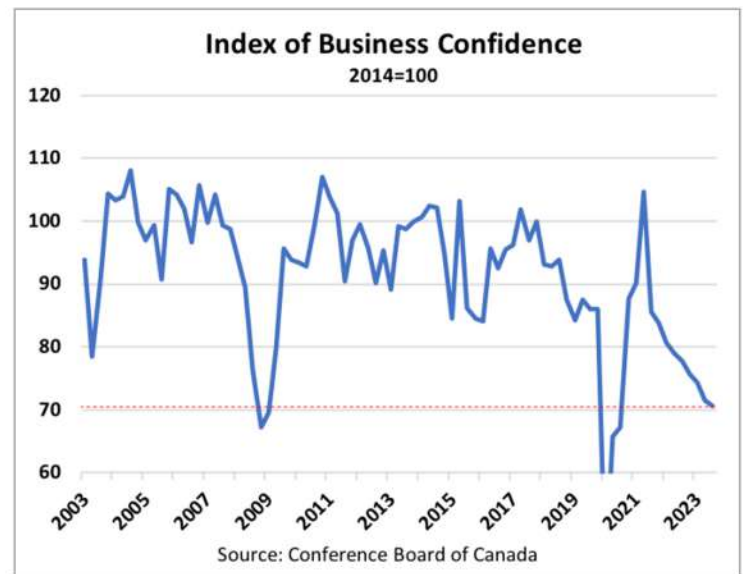
Sales in per capita terms are still negative on a y/y basis...and that's before accounting for inflation. So this too looks pretty recessionary:



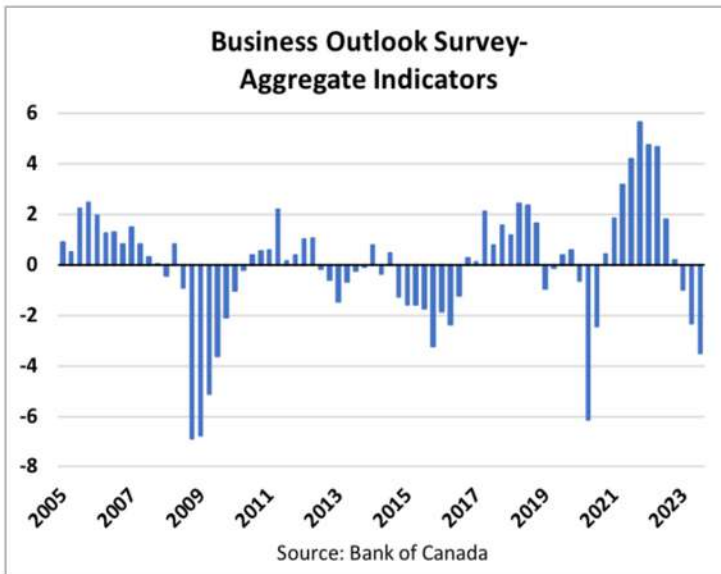
Consumers are starting to hit a wall, and we can also see that in the latest confidence readings. Consider that in the 20-year history of the Conference Board's index, it has only been below 60 for 5 months.... twice during the Financial Crisis, once in April 2020, and now in September and October 2023. And it has NEVER printed consecutive readings below 60 until the past 2 months:



It's not just consumers feeling the blues either. The Conference Board of Canada's Index of Business Confidence fell for the ninth straight quarter and is now at levels seen during the past 2 decades only during the Financial Crisis and the COVID pandemic. Nearly 60% of firms expect economic conditions to worsen over the next 6 months, a major uptick from 39.5% in July:



Also released last week was the Bank of Canada's Business Outlook Survey. The summary indicator, which aggregate measures such as future sales, investment, and employment expectations, slumped to -3.5 from -2.3 in Q2. It is currently at levels last seen in Q2 2020 and Q3 2009, and it has declined for 7 consecutive quarters:



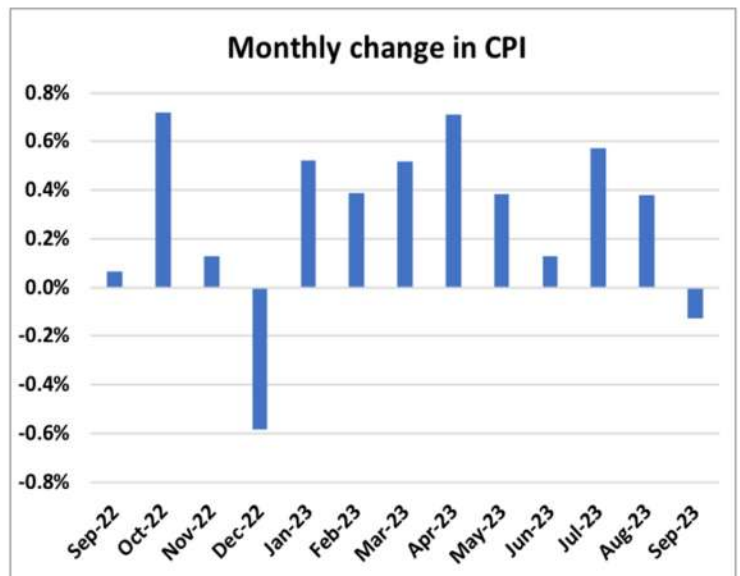
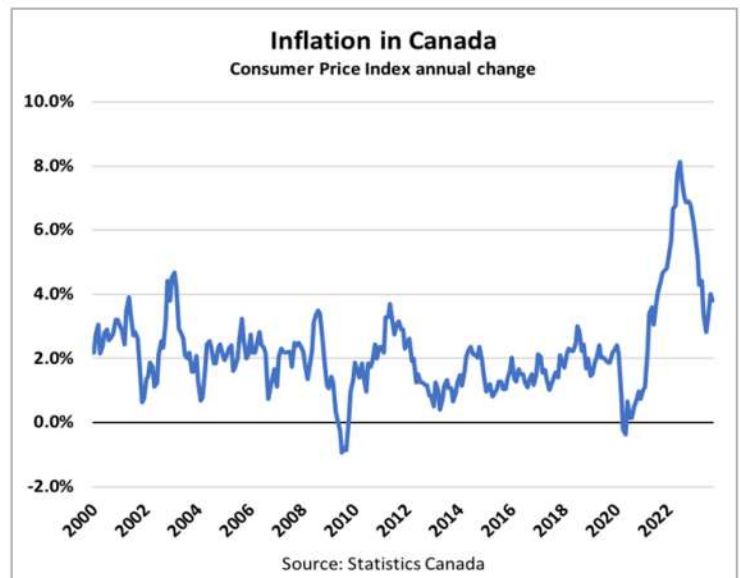
Indicators of future sales are now as low as they've been in the past 20 years outside of recessions, and a rising share of firms are citing sales/demand as a major source of concern.

When consumers and businesses lose confidence, declining spending and investment always follow. The BoC is rightfully leery to tighten further into what is a clearly deteriorating macro backdrop.

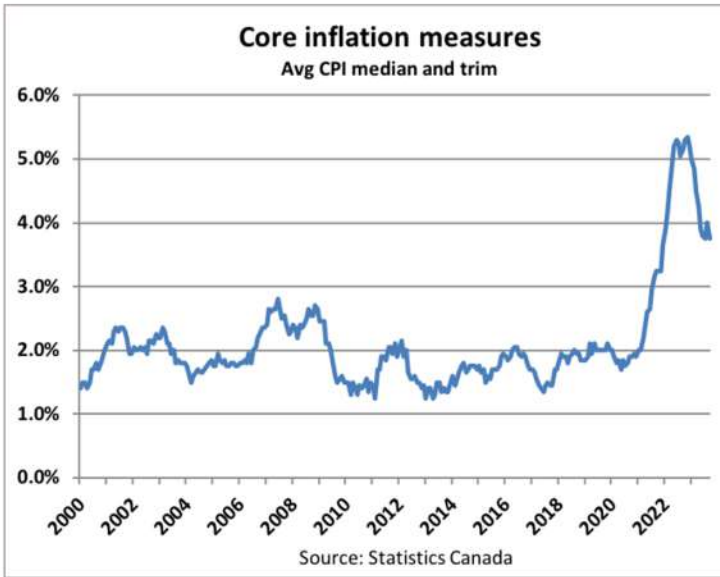
Readers may rightfully point to a still-solid labour market, but remember, jobs are the last thing to roll over in a downturn. And that's particularly true after several years where it was nearly impossible to get workers. Businesses will hold onto them until they absolutely can't. That time is coming.

ii) Price pressures are easing, but core inflation is sticky

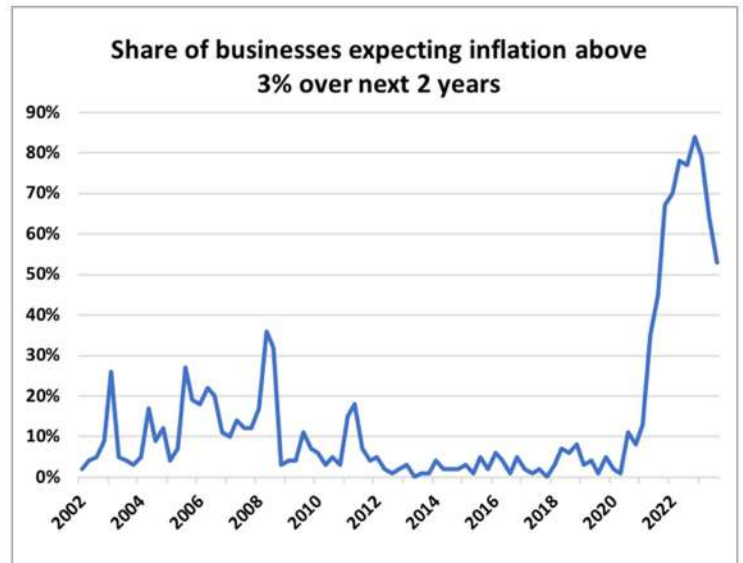
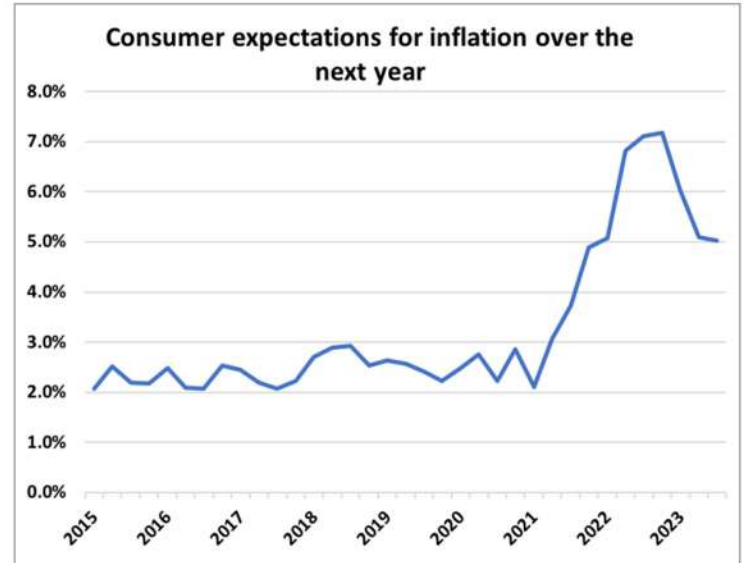
The Bank noted that price pressures are moderating, which is consistent with the latest inflation data. Last week's CPI print came in at 3.8% y/y, well under expectations of close to 4.0%. The index itself unexpectedly DECLINED on a monthly basis for the first time since December last year:



But the Bank also noted that their preferred measures of CORE inflation (ie when we strip out some of the crazy volatile components to get a better sense of underlying trends) are still stubbornly high, with their two main indicators averaging close to 4%:



Key findings: Consumers still expect inflation to be 5% over the next year, and that figure is basically unchanged from Q2. On the business side, more than half of survey respondents expect inflation to be above 3% over the next 2 years.



iii) Inflation expectations are still elevated

Remember, when people worry about inflation, they pull future spending into the present. After all, why wait and pay substantially more for something in 6 months when you can buy it today? That dynamic risks creating a self-reinforcing cycle, and it's the reason why the Bank is so focused on inflation expectations.

We got important data on this front last week from the Bank of Canada's Survey of Consumer Expectations and their Business Outlook Survey.

Here the Bank has real cause for concern, and it's one of the main reasons why we likely won't see rate cuts any time soon unless the wheels really fall off for the economy. These expectations have to fall before the BoC can start easing off on rates.

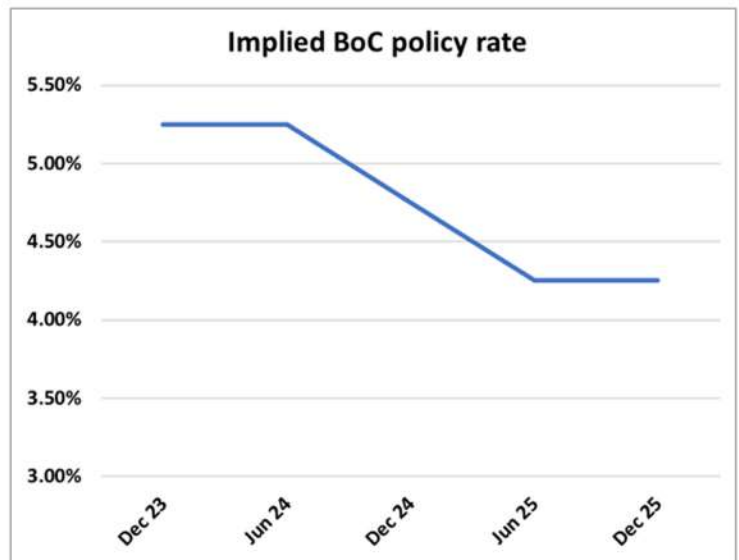
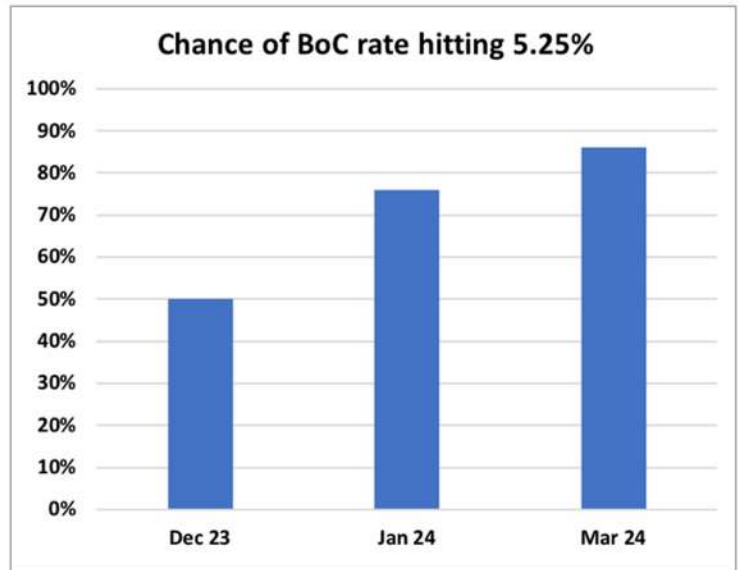
iv) What it all means

My take is that the Bank recognizes that the economy is heading for recession, but they can't acknowledge it yet as it would risk reinvigorating speculative activity across the economy, particularly in real estate. So instead they have to talk a tough game and give warnings like this:

(We are) concerned that progress towards price stability is slow and inflationary risks have increased, and (are) prepared to raise the policy rate further if needed.

Markets are starting to see through it and price in lower odds of another hike, with the December meeting down to under 50%. It was almost 100% just two months ago. The implied future policy rate based on market pricing shows one more hike by early 2024 before rate cuts begin in the middle of next year, but I would bet against that.

I may well be wrong, but I think the Bank of Canada is done. The big question now is how quickly the recession manifests and when we can begin talking about cuts.

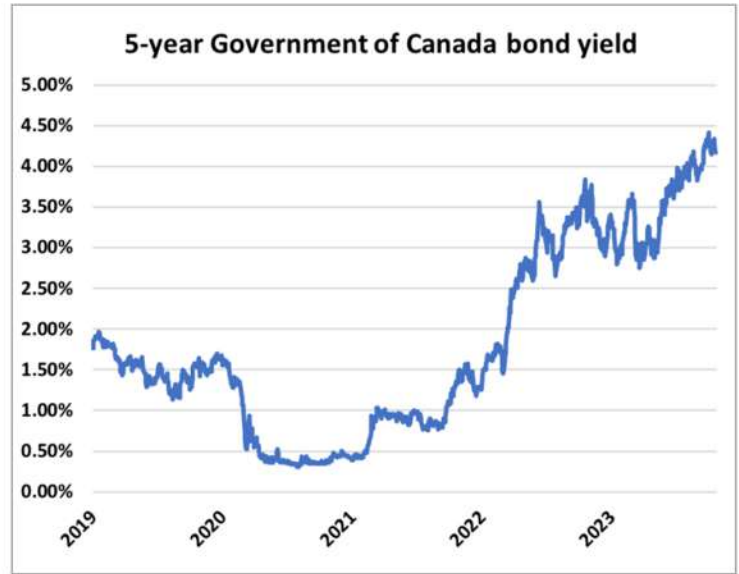


If the market is right, we'll have a bank of Canada policy rate in the low 4s towards the end of next year (and I would take the under on that bet) which means we'll likely see fixed rates back below 5%. That's not great, but let's remember that the resale market was blisteringly hot this past spring with rates in the mid-to-high 4s. If this past spring was any indication, we don't need a lot of downside in rates to get a normalization in demand.

2) Mortgage market update: Loan growth hits 40-year low, OSFI holds the line

i) Fixed rates grind higher

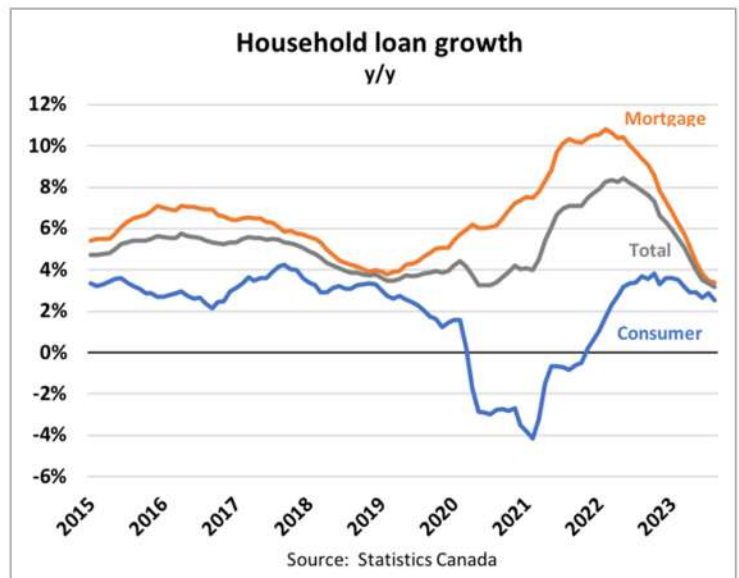
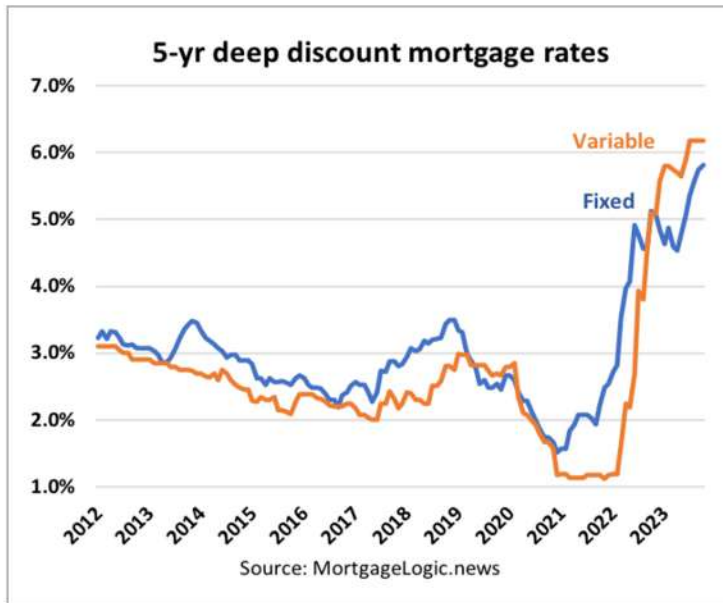
Deep discount mortgage rates have been relatively well-behaved over the past few weeks, up only 8bps since the end of September to currently sit at ~5.85%. 5-yr bond yields continue to hover around 4.3% which means limited upside from here on fixed rates.

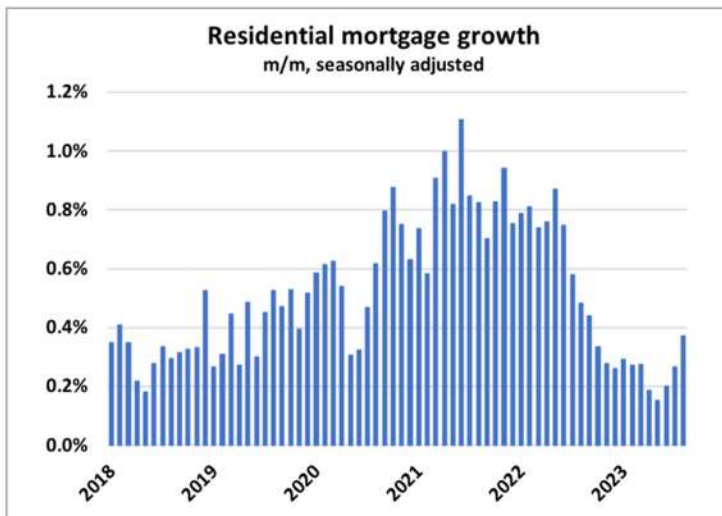


ii) Household loan growth hits 40-year lows

Canadian household loan growth fell to just 3.1% y/y in August, the lowest annual growth rate since 1983.

Mortgage growth fell to 3.3%, the lowest since 2001, but it did tick up to 0.4% m/m (seasonally adjusted), largely reflecting closing activity from the bounce in resale market activity this spring:

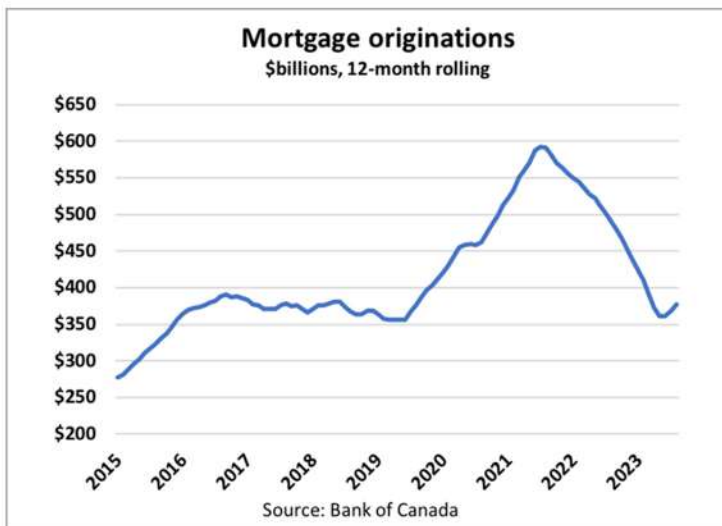




Non-mortgage consumer lending was flat on the month with declining lines of credit balances offsetting another 0.5% increase in credit card borrowing.

iii) Originations stabilize, more activity to come in 2024

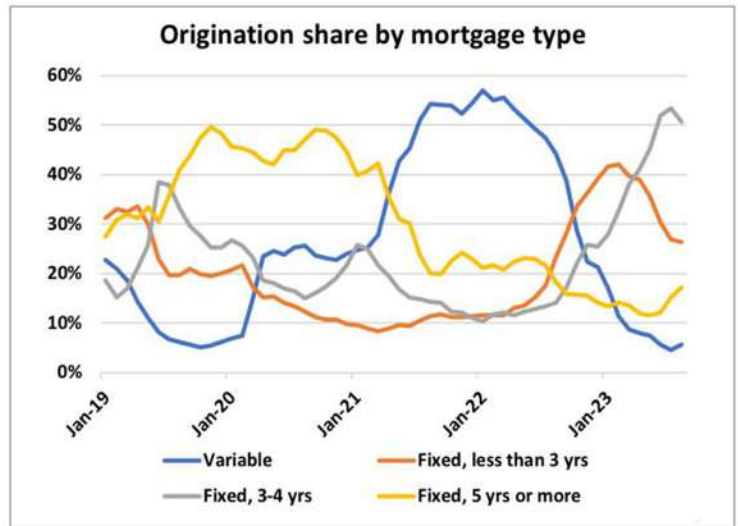
I know this hasn't been a fun time for folks in the mortgage industry, but there is a light at the end of the tunnel. We've now seen two consecutive months where originations were higher than in 2022, and we know that roughly 55% of the total mortgage stock outstanding will be renewing in 2024 and 2025. So hang in there and position now for that uptick.



iv) Variable originations bottoming

New originations are still skewed heavily to 3 and 4-year fixed terms, which still account for more than half of new loans by dollar volume. On the opposite end are variable originations which bottomed out at 5% of new loans before ticking up to 7% last month. I think we're probably seeing the lows in variable originations.

The 2-3 year fixed rate terms still seem to offer the best mix of rates and flexibility, but given my view on the Bank of Canada, I could be persuaded that variable could be a good solution for risk-tolerant clients....at least depending on the discount relative to prime.



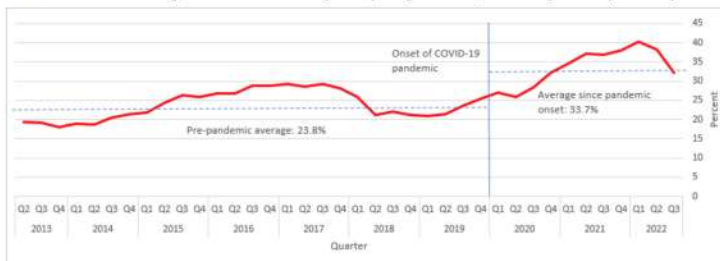
v) OSFI holds the line, opts not to materially tighten mortgage guidelines

The noise you heard last week was the Canadian mortgage industry breathing a collective sigh of relief after OSFI opted not to further tighten lending guidelines.

No Loan-to-income (LTI) or Debt-to-income (DTI) restrictions

OSFI was looking into potential portfolio-level restrictions on the share of borrowers at any lender who could have loan-to-income ratios above a certain threshold (they were fixated on 450% being a key level). This was a huge worry for the industry as roughly a third of all new mortgage loans originated since 2020 exceeded this threshold. From OSFI:

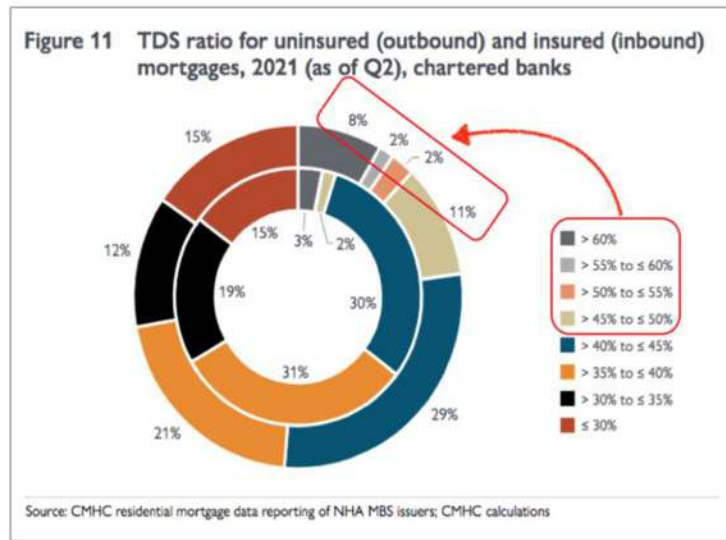
Chart 1 - Share of high loan-to-income (>4.5x) originations, industry-wide (volume)



They nixed the idea of DTI restrictions, noting that they would be “too complex to implement at this time”, and they hinted but didn’t confirm that they would abandon LTI limits as well. Regardless, they aren’t coming any time soon.

No debt service coverage restrictions

B20 guidelines are just that....guidelines. And banks have significant latitude to soften the impact of the stress test by granting debt service ratio “exceptions” on uninsured loans. This wasn’t a small dynamic either. In 2021, the most recent year for which I’ve seen data, nearly a quarter of new uninsured mortgages had DSRs in excess of bank internal stated guidelines of 44%:



This never sat well with OSFI, and they hinted at implementing hard DSR restrictions to close this loophole. Instead, they softened their stance, noting, "We agree that regulatory limits on debt service coverage should not be pursued." BUT, they left the door open to potentially forcing lenders to calculate debt servicing against shorter amortization lengths... "We believe there is merit in lenders applying an explicit, qualifying amortization limit and we will continue to evaluate this...".

So no meaningful credit tightening, which frankly makes sense with household loan growth as weak as it is.

But the announcement wasn't entirely a dud. There was some interesting language in the I press release regarding mortgage document fraud, which I maintain is a bigger issue than most realize (for those who missed it, make sure you check out CBC's undercover work on this last fall

https://www.youtube.com/watch?v=Y_wlnv5ns4I).

From OSFI:

Respondents raised other themes in their submissions, including [...] the importance of improved income verification in deterring mortgage misrepresentation.

[...] We welcome any initiative that advances our B-20 expectation that FRFIs use income sources that are independently verifiable and difficult to falsify. We and our federal financial sector partners are aware of ongoing CRA efforts in this regard.

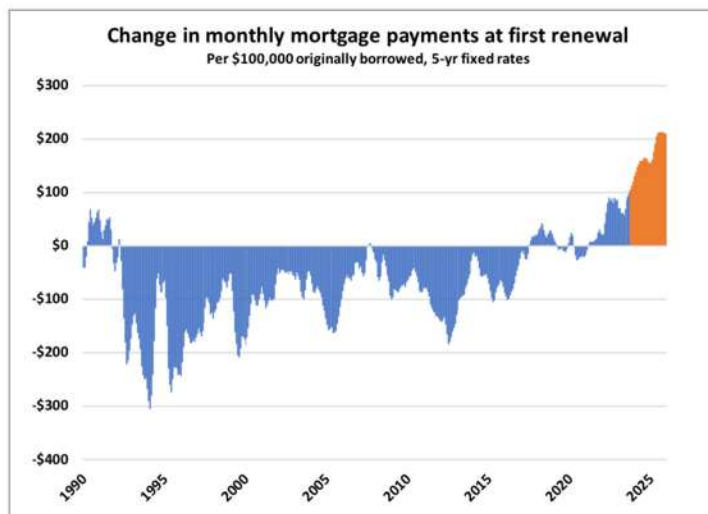
Now that is interesting! If we end up with direct income verification from Canada Revenue Agency, I believe it would represent a de facto credit tightening that could be quite material.

The mortgage industry at large may have dodged a bullet, but bad actors in the space have now been put on notice.

vi) Renewal gaps revisited

One of the most important charts for visualizing the changing mortgage landscape is the 5-year mortgage renewal gap, defined as the change in payments for 5-yr fixed rate borrowers at renewal. While the popularity of 5-yr fixed rate loans has fallen recently, they still account for 40% of all mortgage debt outstanding.

As you can see below, for most of the past 30 years, borrowers consistently saw DECLINING payments at renewal, to the tune of -\$70 per month for every \$100,000 originally borrowed. That's quite a tailwind to household consumption, among other things.



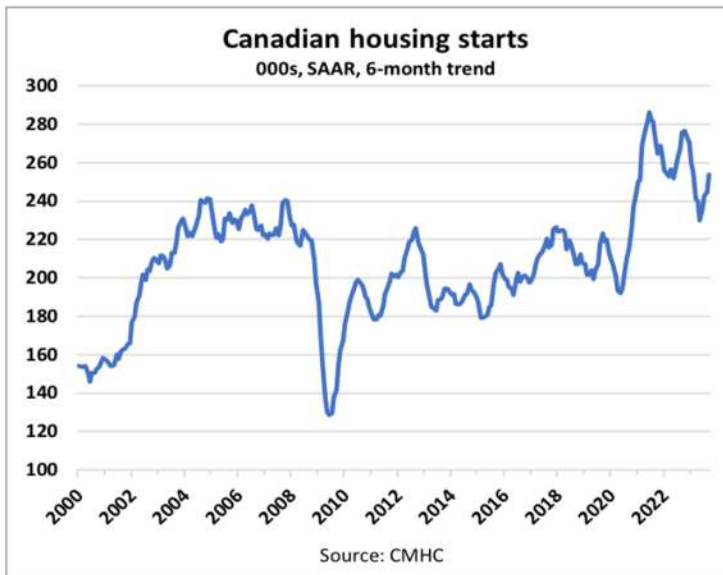
But things are changing, and we are now seeing borrowers facing roughly a \$100/month increase at renewal....assuming the opt for another 5-yr fixed term. Where things get really interesting is in 2024 and 2025 (shown in orange above). If rates stay where they are (and that's a big "if"), the payment gap will jump to \$200 per month for every \$100,000 borrowed. That will necessitate some difficult discussions and it represents a major headwind to household consumption.

3) Supply and demand: Housing starts jump, rental construction booms

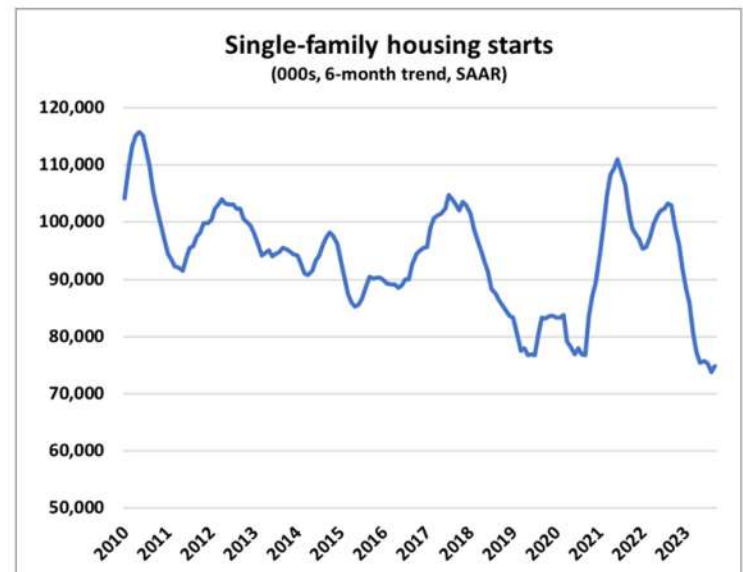
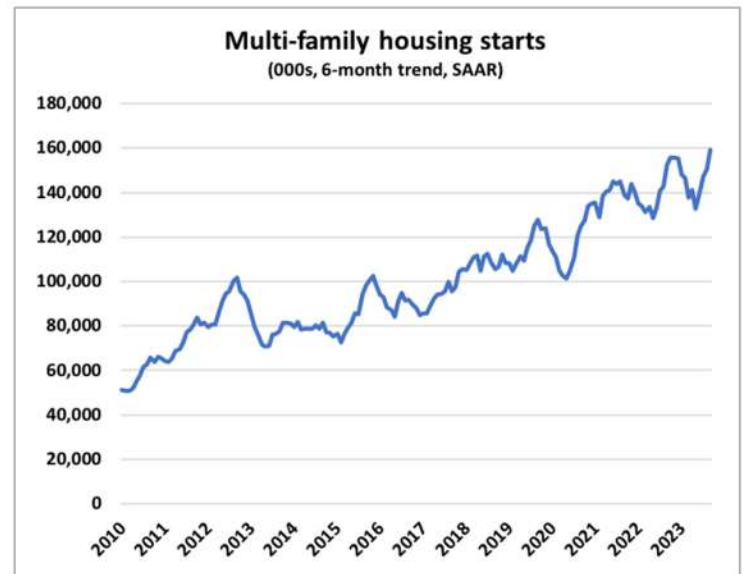
Housing starts jump, led by rentals

The last Metro Deep Dive contained a detailed discussion of the latest quarterly population trends, so I'll focus just on new supply dynamics here.

Let's start with Canadian housing starts which jumped 8.0% m/m in September to hit 270k SAAR (255k on a 6-month trend).

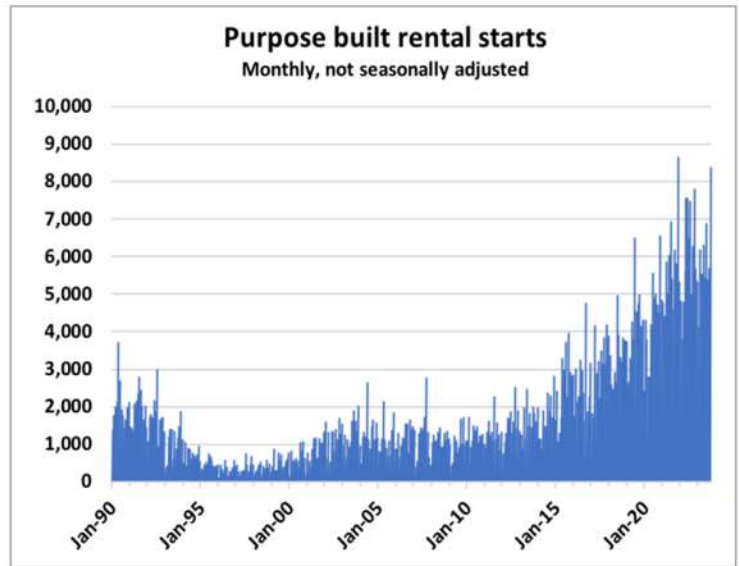


Once again, the headline figure hides more than it reveals. The majority of the increase was due to a 10% surge in the multi-family segment where the 6-month trend is back to record highs while the single-family segment continues to bump along decade lows. Short construction cycles make the single-family segment the better real-time indicator of market activity:



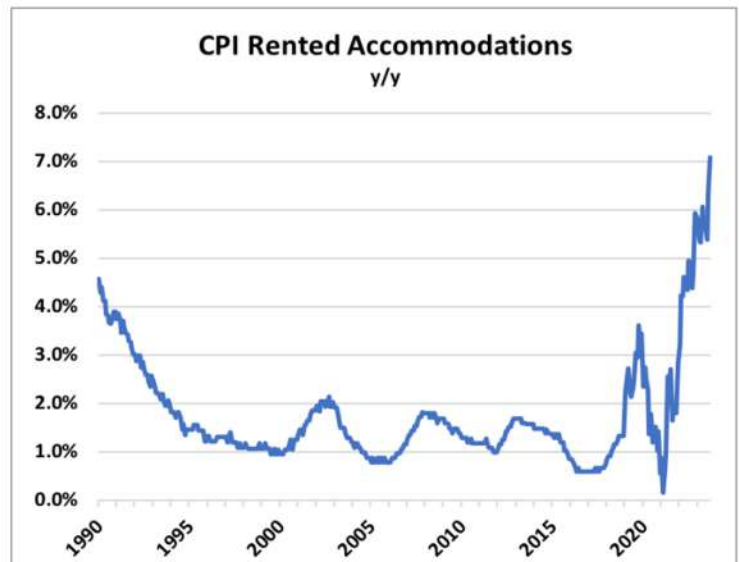
Within the multi-family segment we saw a surge in purpose-built rentals which saw over 8,000 units started in September, the second highest month on record.

Chalk this up in part to new tax measures aimed to incentivize purpose-built rentals. They seem to be working already:



We're now closing in on 130,000 rental units under construction with another 160,000 condos also in the pipeline....half of which typically enter the rental pool at completion.

That supply will help take the edge off what has been an absurdly hot rental market. Consider that the CPI rented accommodation index was up 7.1% y/y in September, the fastest annual increase in 40 years, and it contributed 0.5 percentage points to headline CPI last month:



But there are signs that things may already be cooling. Consider active MLS rental listings in Toronto (orange line below) which have surged since September and are now at the highest levels since early 2021 (data below is from my friend Alex @xelan_gta):



Anecdotes are also pointing to a softening in the rental market in Vancouver. From Steve Saretsky



On top of the that, we have the government in BC waging direct war on Airbnb operators with a major announcement last week that will no doubt force supply into the long-term rental market. The new Short-Term Rental Accommodations Act¹ will, among other things:

limit short term rentals (STRs) to principal residences only in communities of 10,000 or more (note similar legislation is already in effect in Vancouver but is poorly enforced)

compel STR platforms to share information with the province that will help establish a provincial registry that can be cross referenced against the province's vacant home tax disclosures which require residents to declare their principal residence.

create a dedicated enforcement team that can issue fines of up to \$3,000 per day for non-compliance (this is the big one that gives this law more teeth than Vancouver's)



The law is expected to be enacted this fall, with the full enforcement team up and running before the end of next year. Already we're seeing push-back in the media from STR operators:

Airbnb operator says he's facing losses of hundreds of thousands of dollars because of B.C.'s new short-term rental laws²

Steve Nguyen runs two Airbnb units in a downtown Victoria apartment building, including one decorated and paying homage to the television show "Friends." He says he's still reeling from the news he soon won't be able to operate it as a short-term rental – since he doesn't live there.

"This news is a huge, huge shock," he said Tuesday. "The equity that I've worked so hard for in these units has vanished in a day."

Ravi Kahlon, B.C.'s housing minister, who tabled the new law Monday that imposes a principal residence requirement, said the rules don't come into play for a few months.

"(The legislation) doesn't come in until May 1, so individuals do have some time, whether they want to rent them out for long-term or whether they want to sell them," said Kahlon Tuesday.

Nguyen says he makes enough by renting out his unit on Airbnb to cover its mortgage – even with interest rates spiking – but because the unit is so small (less than 400 square feet), it's not attractive for long-term rentals, and wouldn't fetch enough to cover his mortgage, which is more than \$3,000 a month. "You cannot make the numbers work – you're better off putting your money in a GIC."

As a result, he says he's forced to sell the loft unit, but plans to list it for \$150,000 less than he bought it for a year ago – its value walloped because in a matter of months, it will no longer be useable in most cases as an Airbnb,

For his part, the BC Housing Minister is entirely unmoved by the plight of local investors caught in the crosshairs:



Ravi Kahlon
@KahlonRav

The caller says that Airbnb operators: "will become reluctant residential tenancy landlords."

Good. That's the point.

Homes are for living in - they're not commodities for speculation and profit.



CFAX 1070 Victoria @cfax1070 · 22h

"I'd say my firm alone has had six calls in the last three days."

Lawyer John Alexander shares his expert perspective with @Adam_Stirling on the proposed legislation for short term rentals #YYJ #BCpoli #CDNpoli

1 <https://www2.gov.bc.ca/gov/content/housing-tenancy/short-term-rentals>

2 <https://bc.ctvnews.ca/airbnb-operator-says-he-s-facing-losses-of-hundreds-of-thousands-of-dollars-because-of-b-c-s-new-shortterm-rental-laws-1.6605986>

3 <https://www.bloomberg.com/news/articles/2023-10-17/airbnb-faces-curbs-in-canada-after-sharp-rise-in-rental-costs>

Airbnb operators are now on notice across the country. With the feds jawboning on this issue, we might reasonably expect to see higher new listings in the resale market and more long-term rental listings which will help take more froth out of the rental market.

Meanwhile, the feds are openly examining national-level curbs on STRs³

Airbnb Faces New Curbs in Canada After Sharp Rise in Rents

Canada's government is examining new measures to rein in short-term rental services such as Airbnb Inc. as policymakers try to cool inflation in apartment and house rents.

Finance Minister Chrystia Freeland said Tuesday the government is looking at what laws or regulations it can bring in to curb the use of platforms that offer rented accommodation for a few days or weeks at a time. She heaped praise on the province of British Columbia, which this week introduced a proposed law to restrict many residents from renting their investment properties on Airbnb, Flipkey and similar services.

"We know that short-term rentals through sites like Airbnb and VRBO mean fewer homes for Canadians to rent, especially in urban and populated areas of our country," Freeland said during a press conference in Ottawa. She said she has seen estimates that as many as 30,000 more homes could be made available for rent in Toronto, Montreal and Vancouver, if those platforms were restricted. "It is so important that we are examining whether there are any tools in federal jurisdiction that we could use that would make a difference in this space."

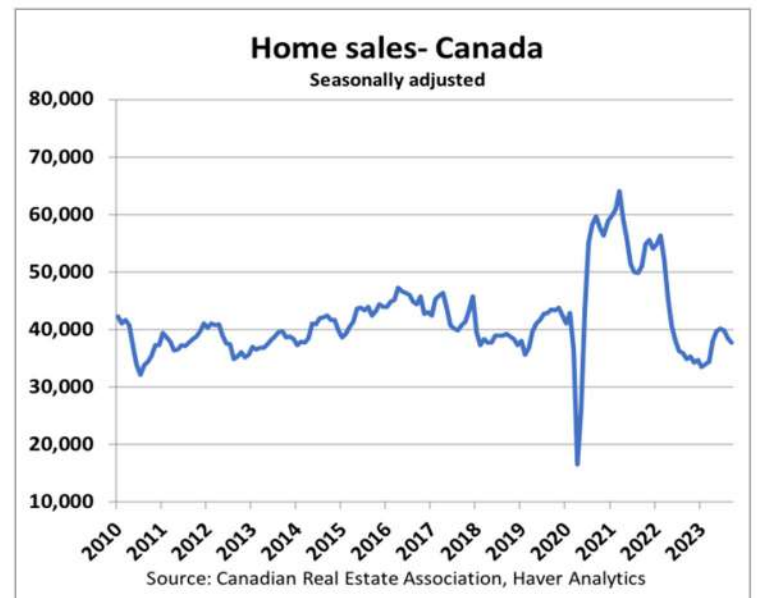
4) Ontario markets drag national averages lower in September

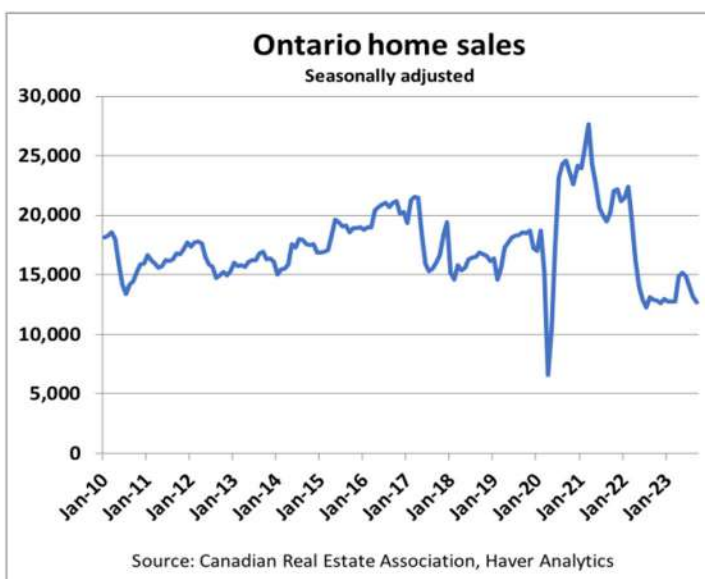
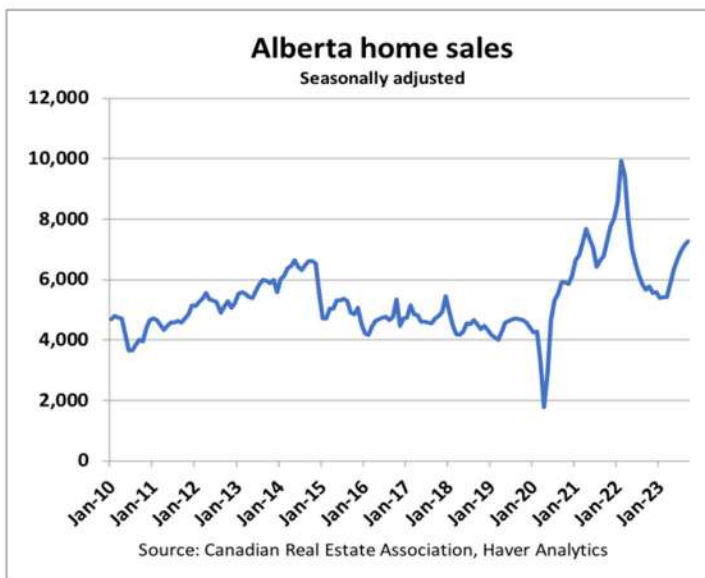
The key data from last month is summarized below.

	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	+8.1%	-1.9%	+14.9%	+6.3%	+5.7%	+4.0%	+1.0%	-0.3%
BC	+20.1%	-4.1%	+13.5%	+6.3%	+5.4%	+5.4%	+2.5%	+0.3%
AB	+28.2%	+1.9%	+5.8%	+0.2%	-18.2%	+0.3%	+5.8%	+1.0%
QN	-1.3%	-3.0%	+26.8%	+10.1%	+25.2%	+7.9%	+1.1%	-0.7%
QC	+3.2%	-0.2%	+4.0%	+0.4%	+12.5%	+2.5%	+2.8%	+0.3%

i) Home sales slide led by steep drop in Ontario

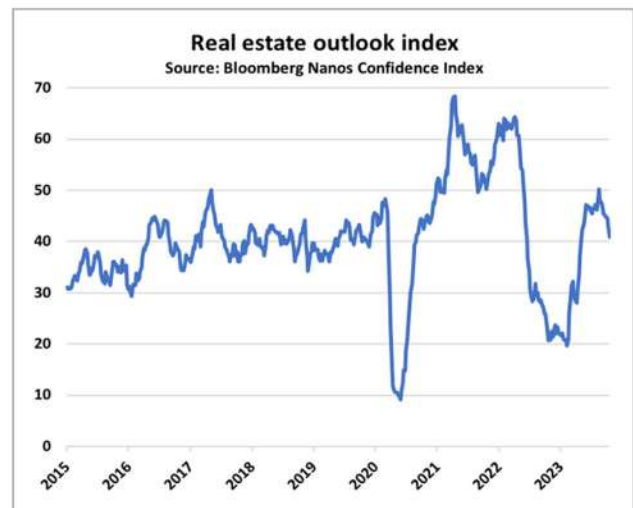
Buyers moved to the sidelines in September with total home sales down 1.9% nationally. We continue to see substantial regional variation in demand dynamics, with Ontario (-3.1% m/m) back to levels last seen on a sustained basis in the early 2000s while Alberta sales (+1.9% m/m) remain well above normal levels. BC also saw a 4.1% decline in sales last month:





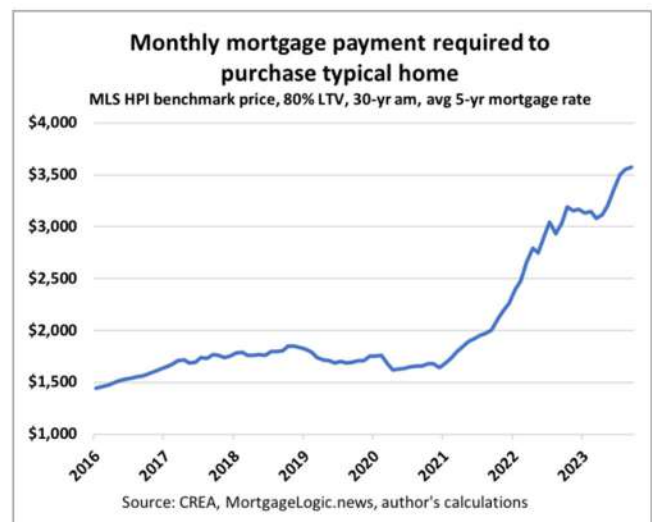
ii) Sentiment sours

The latest confidence data points to deteriorating sentiment towards real estate. The Bloomberg- Nanos Real Estate Outlook Index slipped for the 9th consecutive week last week to hit the lowest level since May:

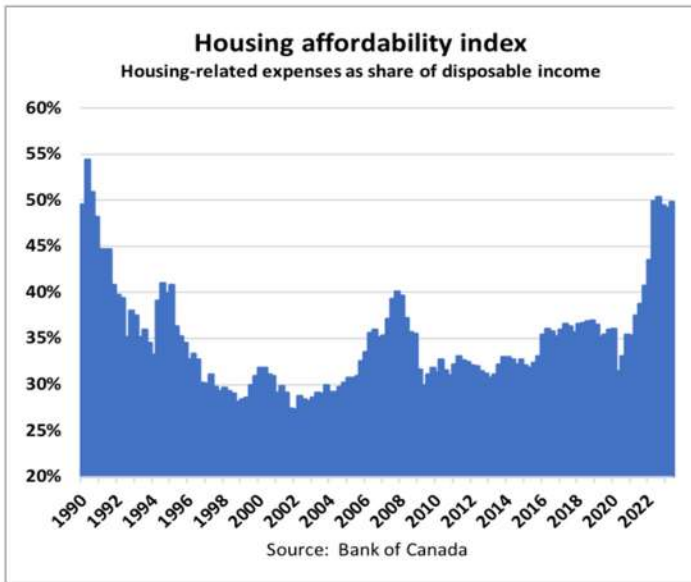


iii) Affordability deteriorates

Rising rates took another bite out affordability in September. The monthly mortgage payment needed to purchase the average home at 80% LTV rose another \$20 m/m to hit \$3,570...a stunning \$1,900 increase from where it was in early 2021:



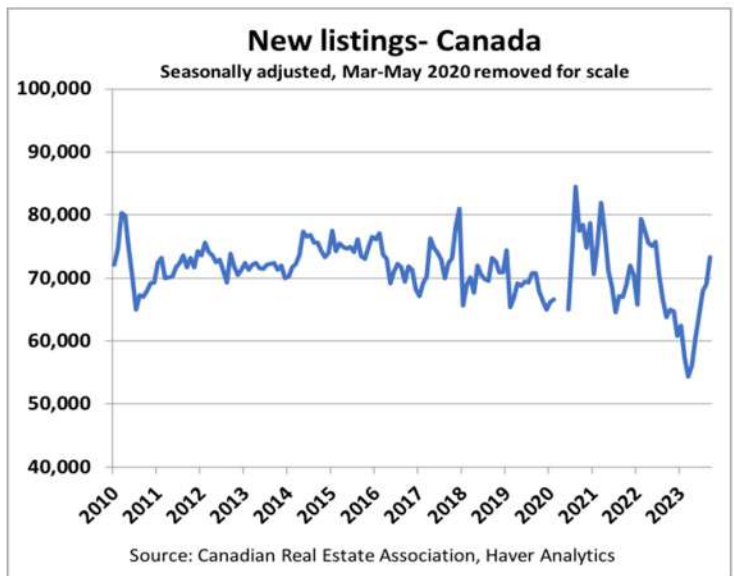
Similarly, the Bank of Canada’s latest affordability index, which measures housing-related expenses as a share of income on new purchases, deteriorated in Q2 and remains at levels last seen in the early 1990s:



Still, rising new listings into a deteriorating demand/price environment is something we have not seen on a sustained basis since at least 2008. In every other “mini downturn” in the past decade, we see an initial spike in listings into a still-strong but weakening market. Once it’s clear that prices are declining, we’ve always seen sellers move to the sidelines to wait for a stronger market. The fact that we are now seeing a significant jump in listings is a notable development that bears watching.

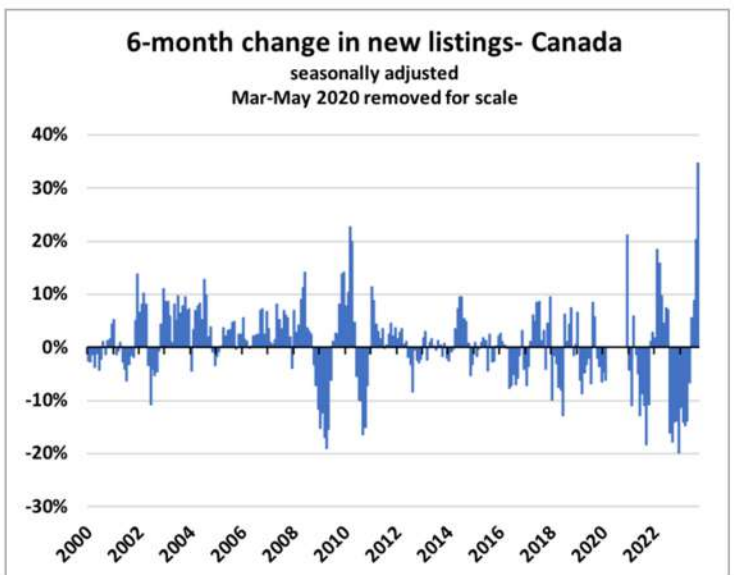
iv) New listings rise

The demand side of the equation looks pretty easy to predict at this point: Sales will be very low as long as affordability remains this constrained. That makes supply the big variable to watch.

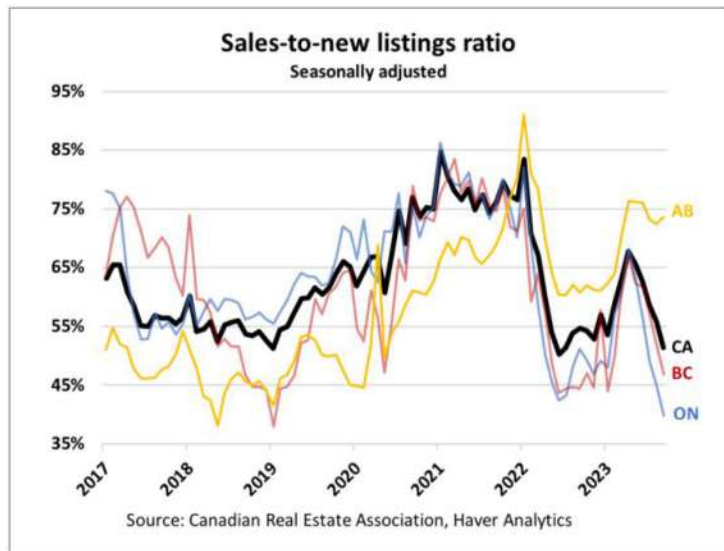


On that front, it’s notable that new listings surged 6.1% m/m in September led by 10.1% jump in Ontario where listings are up 51% over the past 6 months alone and up 21% in the past 3.

On an absolute basis, new listings aren't alarmingly high, but the trend change is striking. This is the fastest 6-month rate of increase on record....albeit off of multi-decade lows.

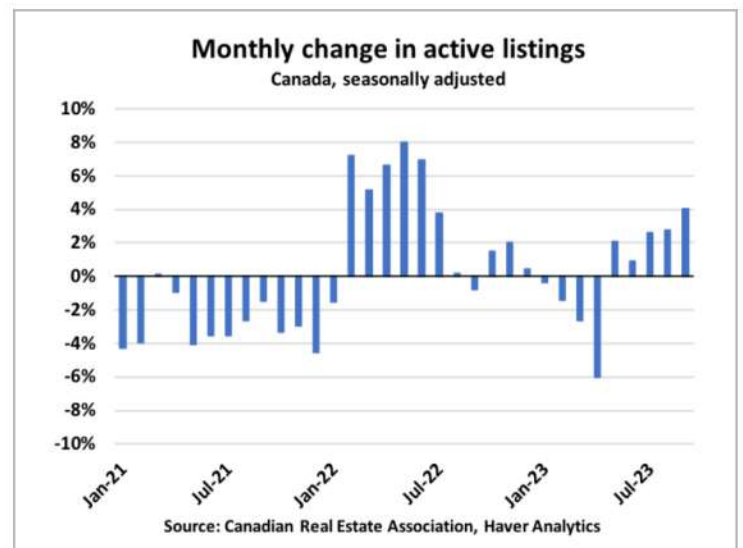
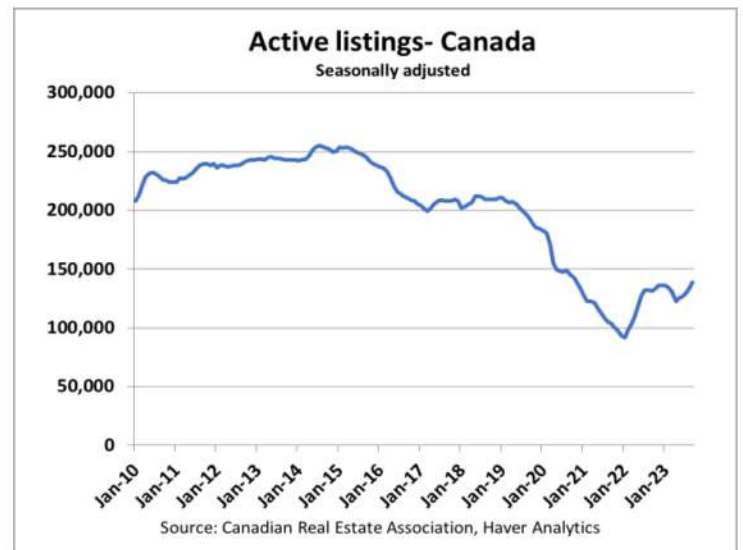


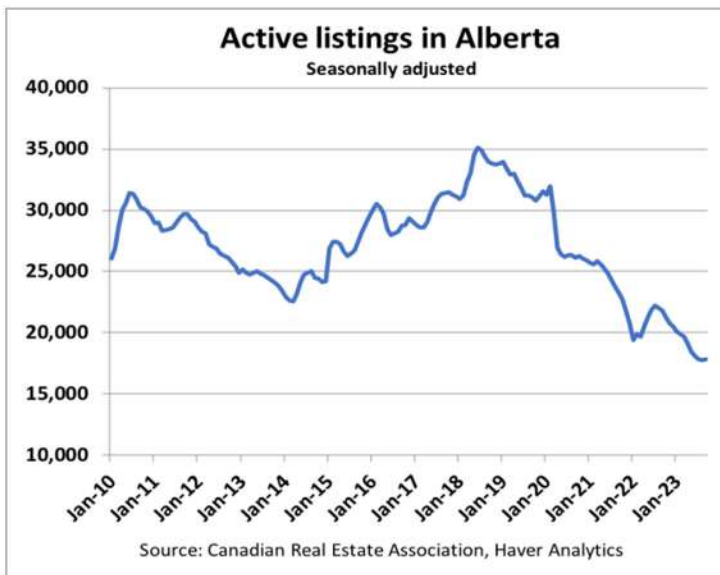
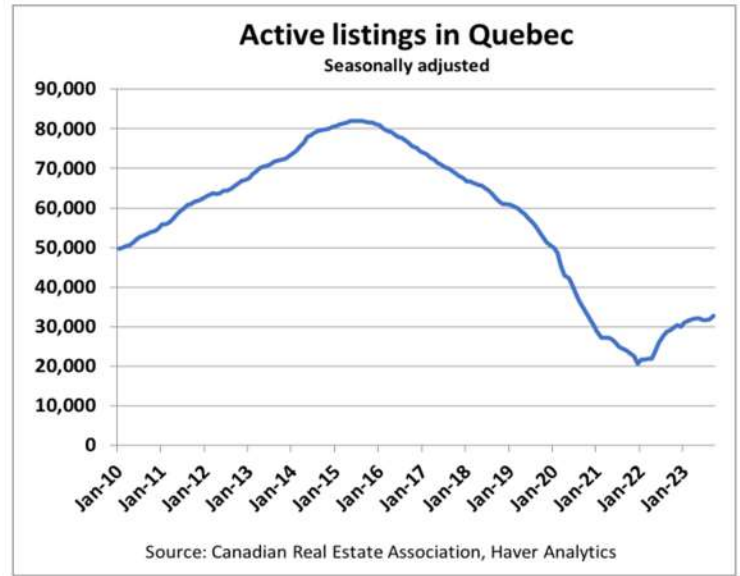
Looking across the country, we see Alberta with a sales-to-new listings ratio north of 70% (ie blisteringly hot) while in Ontario, that ratio has slid to under 40%... the lowest since the very depths of the Financial Crisis. As always, Canada is a "market of markets", and it's generally foolish to draw inferences from country-level data:



v) Inventory build accelerates

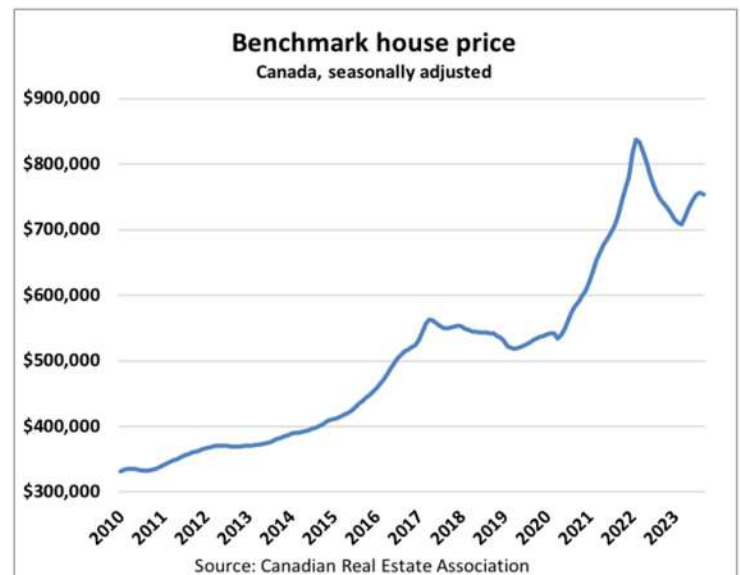
Active inventory jumped 4.0% m/m, the largest monthly build since June of last year (Ontario +7.9% m/m, BC +5.4%). Absolute inventory levels remain well below pre-COVID norms but are trending definitively higher, particularly in Ontario where seasonally adjusted active listings are up 35% in just 4 months. Every other time we've seen an inventory build on that scale in the past 20 years, it has precipitated sharp price declines in the following 6 months:

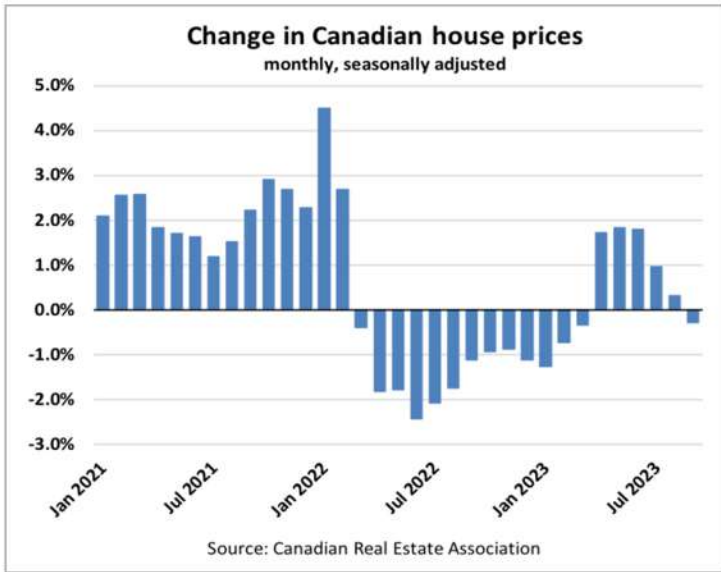




vi) Prices dragged lower by declines in Ontario

As expected, prices nationally fell in September, down 0.3% m/m....the first monthly decline since March.





Ontario led the decline with prices down 0.7% on the month. In contrast, Alberta saw prices rise 1.0%.

The composition of the index is such that it tends to understate moves in either directions at major inflections, and this time is probably no different.

One of the tell-tale signs of sharp market inflation is a rise in failed appraisals. From Ron Butler:



Ron Butler @ronmortgageguy

House Prices Fall In Ontario & It's Picking Up Steam: Appraisal Failures

What's an appraisal failure? When an appraisal on a home comes in less than the Purchase Price or when an appraisal for a refinance is less than all estimates including advanced digital analysis

2/

9:25 AM · Oct 10, 2023 · 98.2K Views

32 72 483 53



We're also seeing some major declines on same-unit sales. Consider just two from the past couple weeks. The one below left sold in early October at a 41% discount to the prior 2022 sale price!!!! The one on the right is "only" down 25% from peak, but losses of half a million dollars are something we've just never seen in any scale in Canada.



2053 Commissioners Road E
London - Jackson
Single Family Residence
Listed for: \$559,900
Sold for: \$435,000
Sold 4 days ago

3 Bedrooms 1 Bathrooms 1 Garage

Listing History

Buy/sell history for 2053 Commissioners Road E, London (Single Family Residence)

Date Start	Date End	Price	Event	Listing ID
2023-08-04	2023-10-05	\$435,000	Sold	40462648
2022-12-19	2023-01-16	\$599,900	Terminated	40359136
2022-11-28	2022-12-19	\$610,000	Terminated	40353860
2022-02-16	2022-02-16	\$738,400	Sold	40211597
2022-02-08	2022-02-14	\$624,900	Terminated	40208188



6 Chalmers Crt
Brampton - Heart Lake East
Detached
Sold: \$1,699,000
Listed: \$1,699,000
Sold 28 days ago

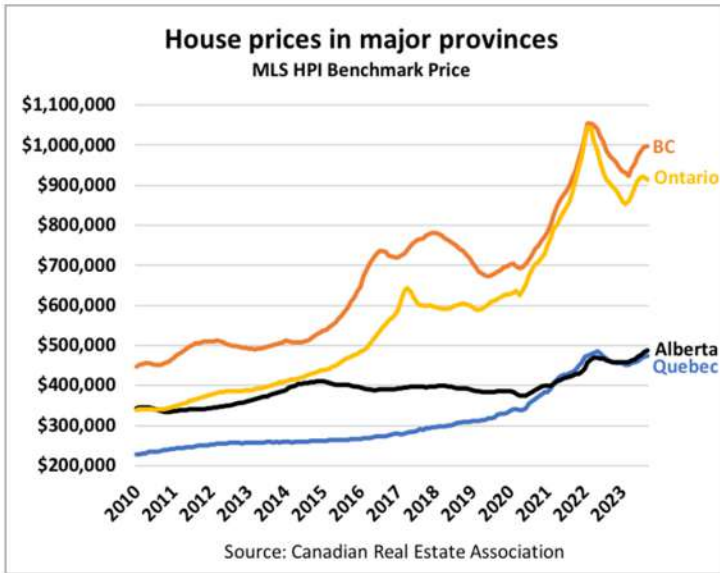
6+2 Bedrooms 4 Bathrooms 3 Garage

Listing History

Buy/sell history for 6 Chalmers Crt, Brampton (Detached)

Date Start	Date End	Price	Event	Listing ID
2023-09-18	2023-09-19	\$1,699,000	Sold	W8747028
2023-07-15	2023-08-16	\$1,710,600	Terminated	W8888954
2023-07-01	2023-07-15	\$1,599,000	Terminated	W8930670
2023-06-18	2023-06-27	\$1,789,900	Terminated	W817099
2022-07-02	2022-10-03	\$1,849,999	Terminated	W8681874
2022-02-17	2022-02-22	\$2,205,000	Sold	W5050889

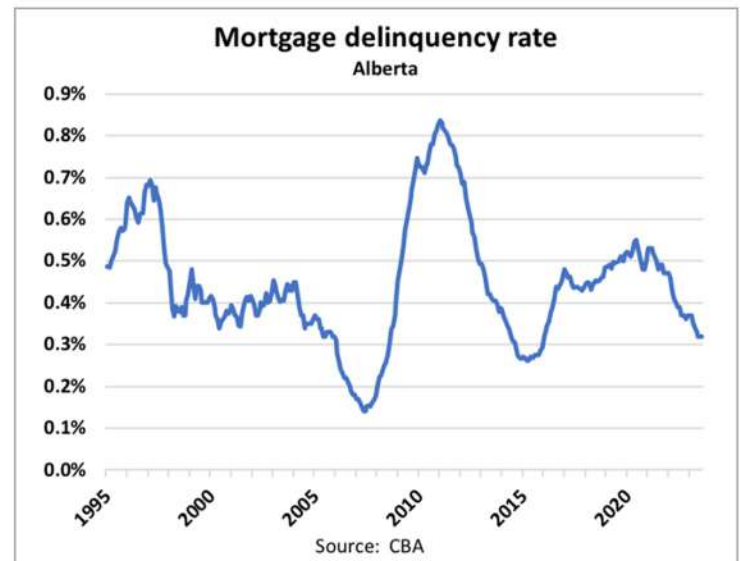
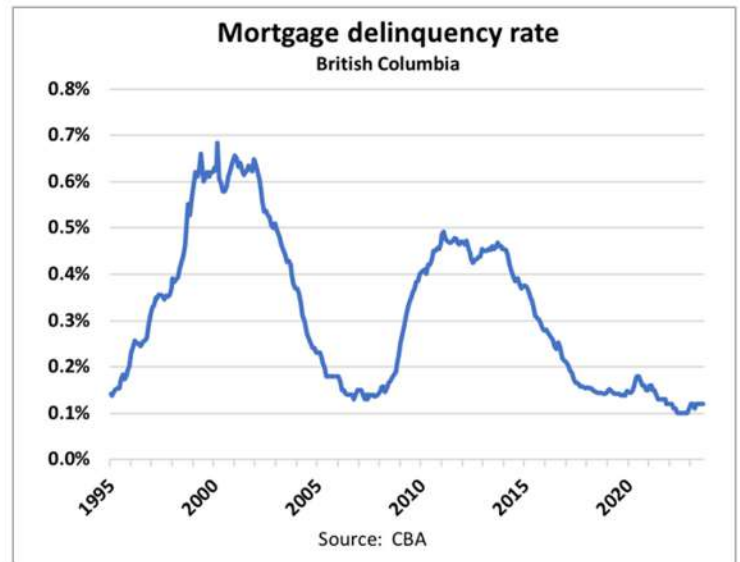
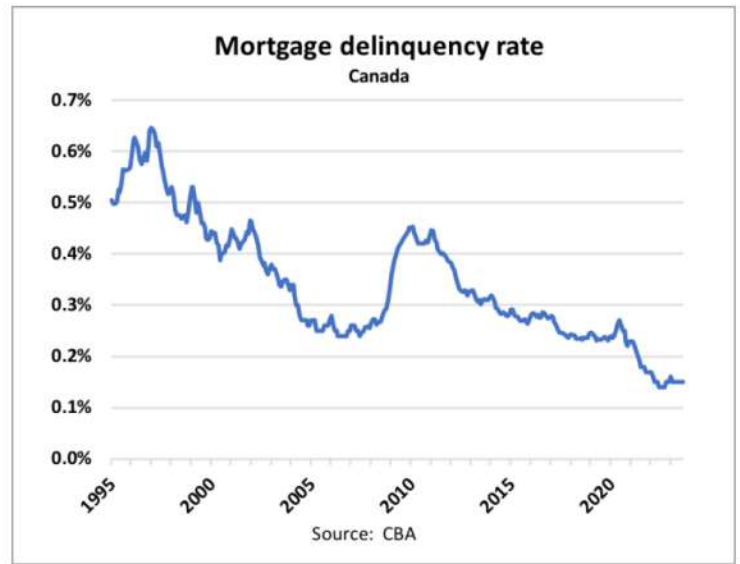
Ontario was the only province that saw declines. All other major provinces saw positive prices, albeit with slowing momentum:

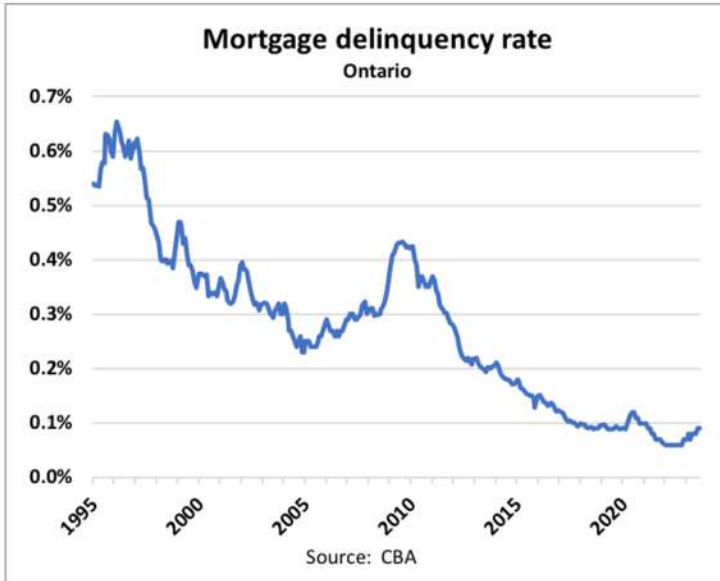


5) *Consumer check: Arrears still at low levels, but insolvencies keep ticking higher*

i) Arrears still at rock bottom levels... for now

Mortgage arrears remain shockingly low at just 0.15% in August, the third consecutive month at that level. They are starting to tick higher in Ontario, but it's hard to get worked up about arrears at 9 basis points or 0.09%!

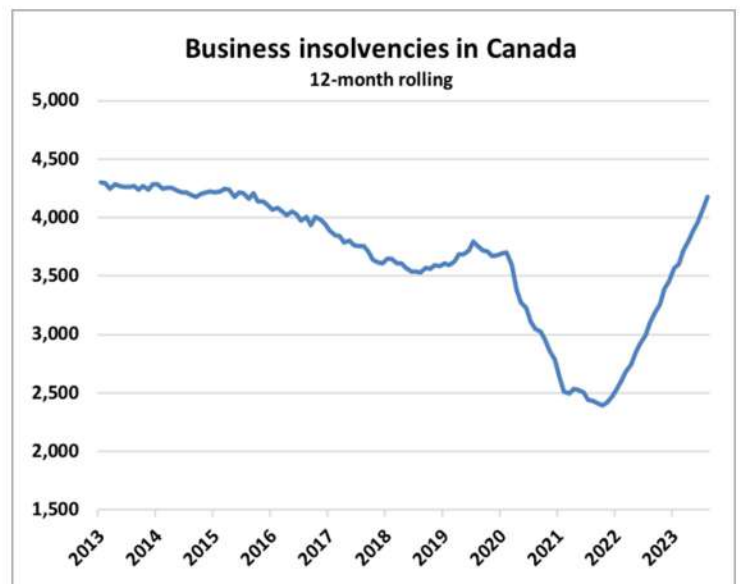
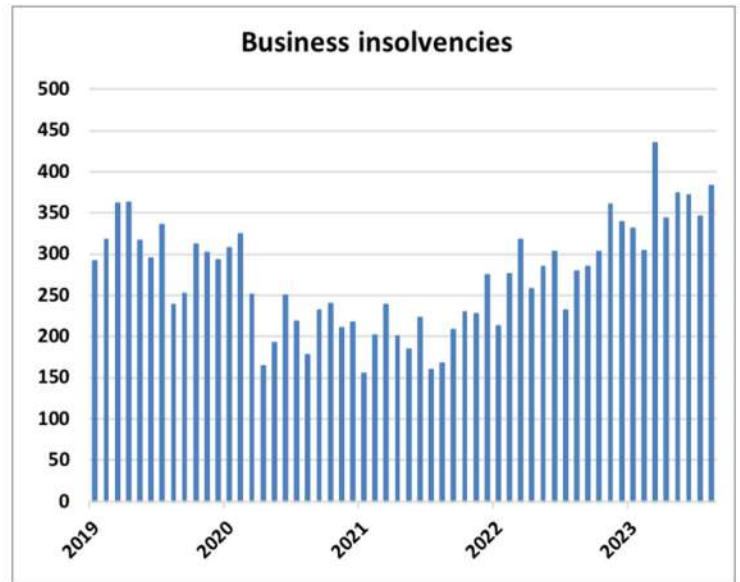




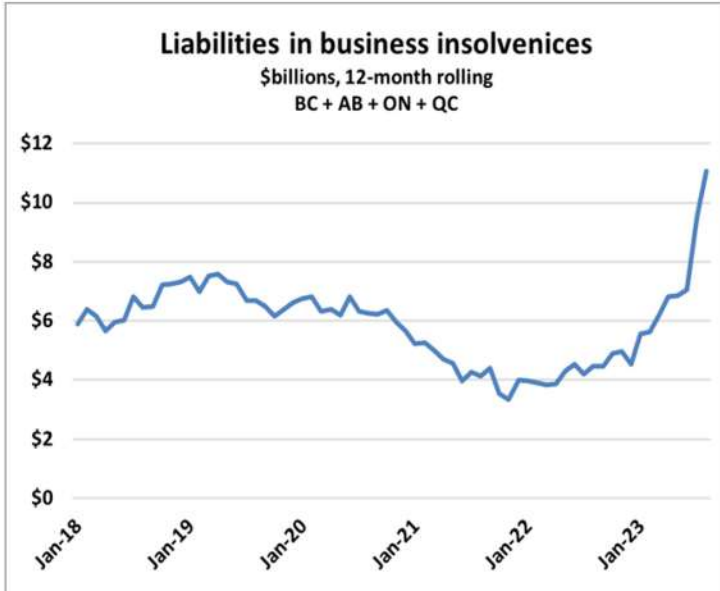
It's just not reasonable to expect arrears to stay at these low levels given the rise in rates and weakening economic backdrop. My call remains for arrears to double over the next year....which admittedly sounds like a lot, but it would leave us at 30bps nationally, more or less in-line with long-term norms.

ii) Insolvencies up again in August

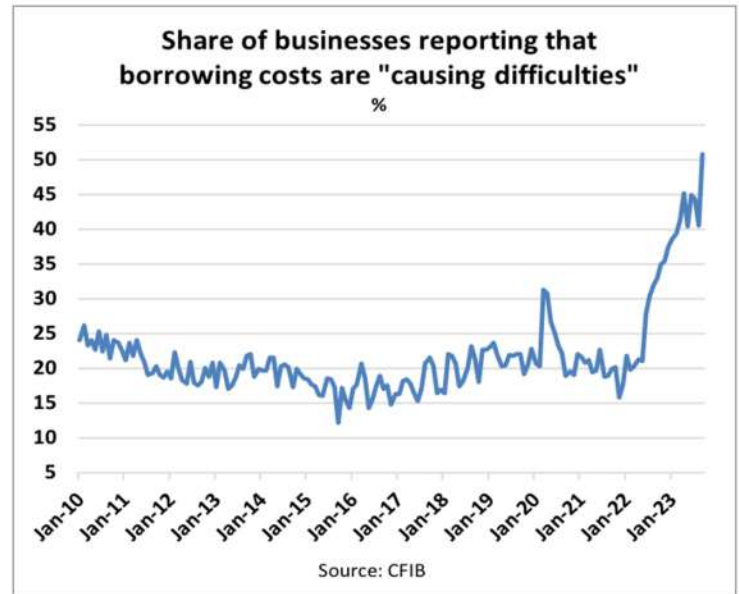
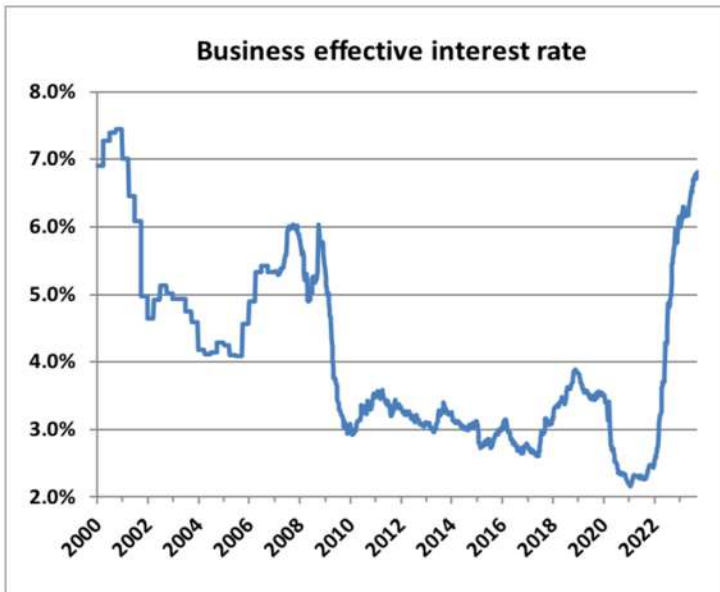
I have long argued that business insolvencies would lead in this cycle, and we're now seeing that play out. August saw a 37% increase in business filings, and we're now back to levels seen in 2015:



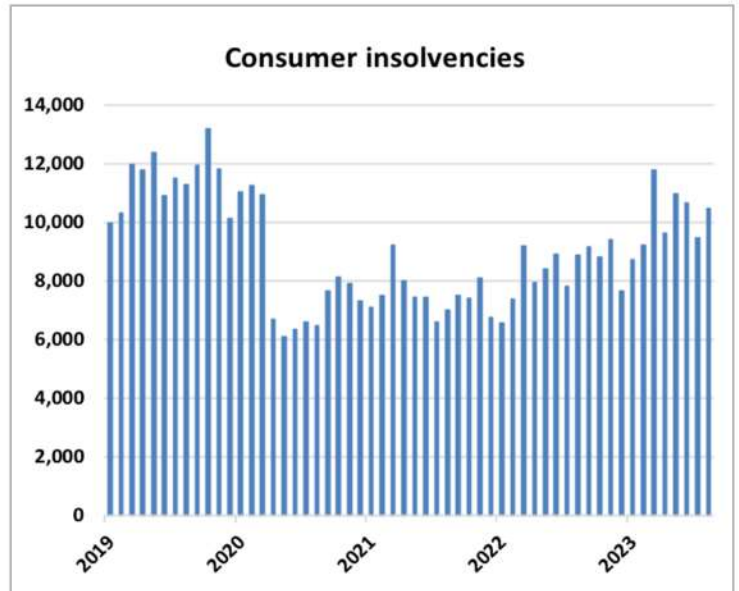
It's even more concerning when we look at the trend in liabilities in those filings, which are starting to go vertical:

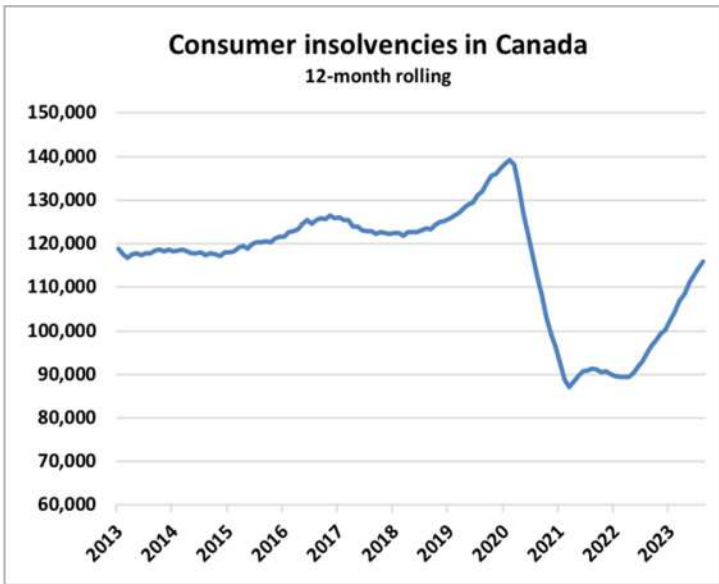


We don't have to overthink this: Rising rates are starting to crush businesses. The effective rate for businesses is closing in on 7%, and we now have over 50% of respondents in CFIB's Business Barometer suggesting that high borrowing costs are "causing problems"....a survey record high by a wide margin:

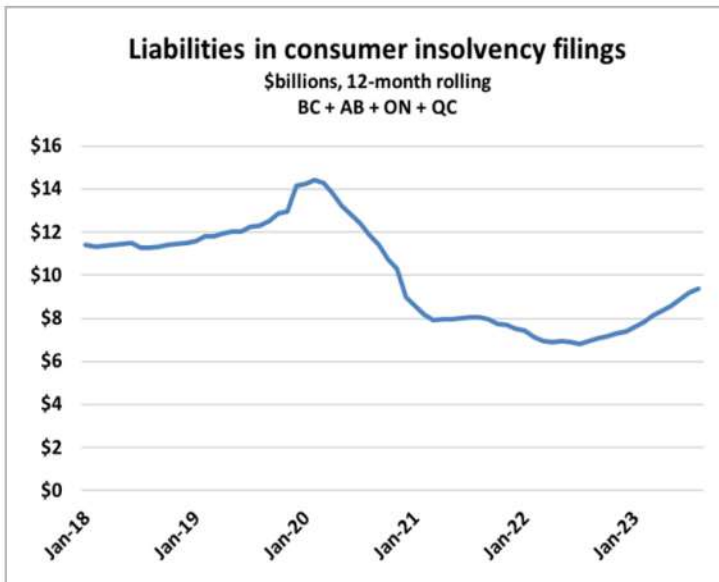


Meanwhile consumer insolvencies are tame by comparison, up 18% y/y in August but still not back to pre-COVID levels.



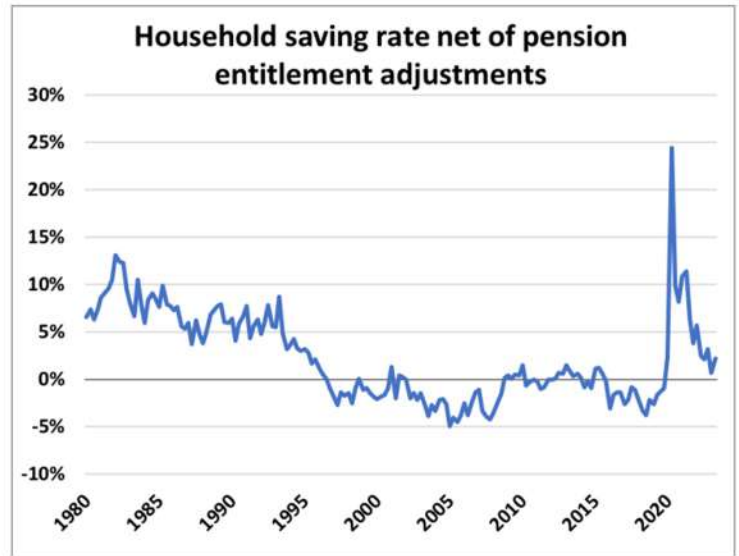


That’s particularly true when we look at liabilities in those filings which have a long, long way to run from here to get back to 2019 levels. Barring a miracle, we’ll smash those levels in coming quarters:

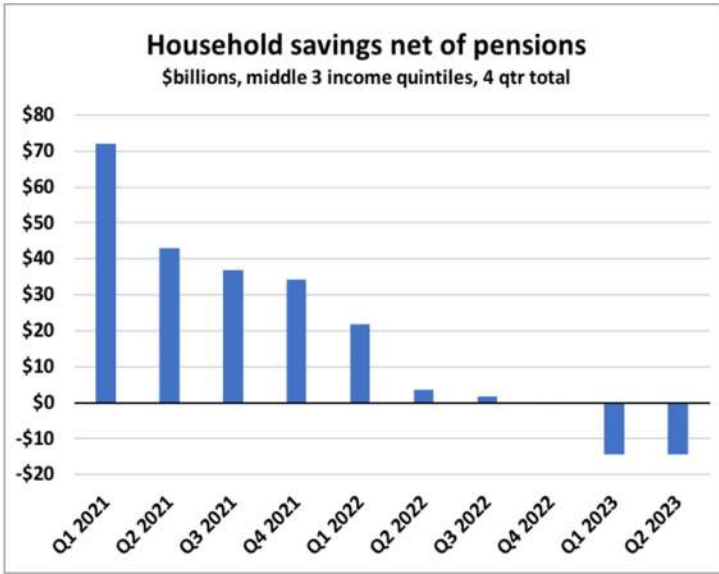


iii) Where are savings accumulating?

Statistics Canada released detailed income and savings data by earlier this month. As a reminder, the household savings rate net of pension adjustments was 2.2% overall in Q2, but that figure hides as much as it tells us:

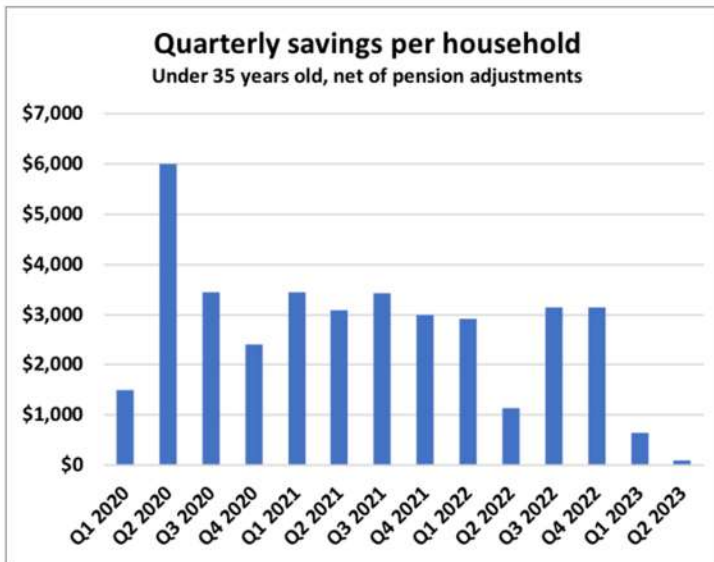


For starters, let’s remember that it’s typically not the top or bottom income quintiles that drive consumption trends. The poorest quintile never has disposable income and the richest always has it. What moves the needle is the trend among the “middle class”, very loosely defined here as the middle three income quintiles. When we look at household savings net of pension adjustments (ie active, liquid savings) for these 3 cohorts, we see a sharp decline in the past 2 quarters. In other words, the middle class is burning through their pandemic savings at a petty sharp pace:



Roll that forward and it has all sorts of implications on consumer spending and overall household credit performance once consumers are out of dry powder.

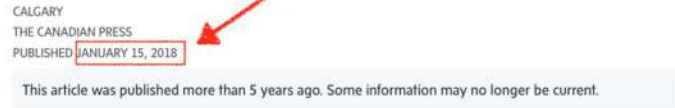
The other interesting takeaway is what's happening with household savings in the under-35 cohort. This cohort saw quarterly savings rates evaporate to nearly zero per household in Q2. And it wasn't much better in Q1. Since this is the cohort that has to build up down payments to enter homeownership, it doesn't bode well for housing demand going forward:



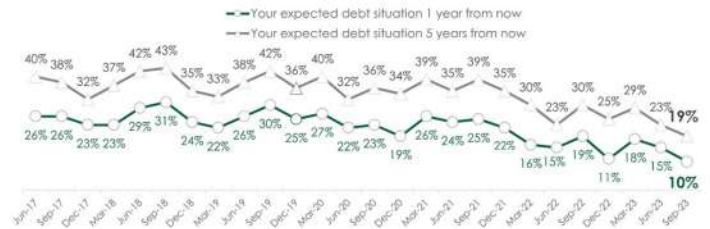
iv) Debt angst on the rise

Always take survey data with a grain of salt, and that seems to be particularly true for MNP's Debt Outlook Survey which for years now has pushed out clickbait headlines suggesting that a shocking share of Canadians are teetering on the verge of bankruptcy. Consider this from 2018:

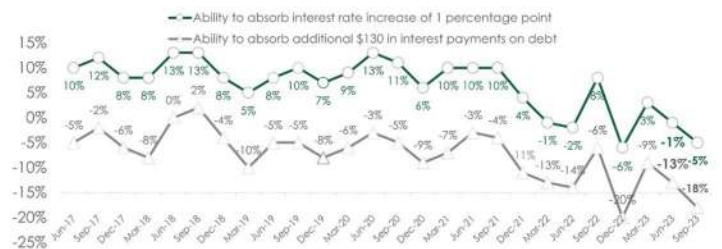
One-third of Canadians can't pay monthly bills as interest rates set to rise, survey suggests



If there's a signal here, it's clearly not in this headline number but rather in the underlying trends. Consider the balance of opinion on future finances which have fallen to survey lows⁴.



Similarly, the balance of opinion on consumers' ability to absorb future payment shocks has fallen to near record lows.



⁴ <https://mnpdebt.ca/en/resources/mnp-debt-blog/canadians-debt-outlook-reaches-lowest-point-in-five-years>

These are indirect measures of consumer confidence, and they square with what we've seen from other confidence surveys recently. More than an imminent credit default indicator, I think these speak to the extent to which consumer spending will slow in coming months.

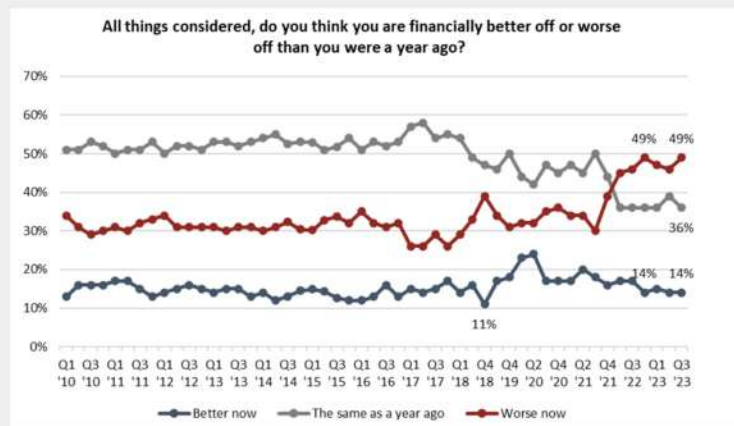
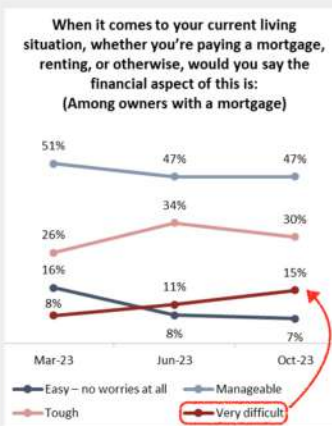
It also speaks to a general trend I've been hearing since early September: I believe consumers finally hit a wall last month, and it will be abundantly clear when we start to get that official data in coming months. Consider:



Perhaps more pertinent to the credit side is a new Angus Reid survey released this week that looked at how Canadians are managing the strains of rising interest rates. Some key findings⁵:

[...] the number of mortgage holders struggling with their monthly payment growing in recent months. One-in-six (15%) in this group say they find the financial aspect of their mortgage “very difficult”, a figure that has doubled from data seen in March.

Overall, Canadians are more down than usual on their financial situation and prospects. Half (49%) say they are in a worse financial position than they were last year, while 35 per cent expect to be in a worse position a year from now. Both figures tie records seen in more than 13 years of tracking data from the Angus Reid Institute.



That seems like a much more credible estimate of households that are feeling the pinch. Remember, only 35% of households have a mortgage at all, so when it says that 15% are finding it “very difficult”, that’s only about 5% of all Canadian households. With rates where they are, I think that’s entirely believable.

⁵ <https://angusreid.org/mortgage-rates-variable-fixed-canada-increases-economic-optimism-pessimism/>