

The Canadian Housing Industry Economic Update



Monthly Report

September 2010

Financial Market Worries

Financial markets continue to reflect concern that the economic recovery is in jeopardy. Stock markets have recovered from their early July 2010 lows but are still well below where they were in April. The S&P/TSX index is down by 4.7% from its April 2010 peak.

The search for safe-haven investments has pushed up U.S. and Canadian government bond prices and reduced yields to historic lows. The benchmark yield on U.S. 2-year Treasury notes is down to a record low of only 0.48%. Longer-term bond yields have also declined to exceptionally low levels. The rate on 10-year Treasury notes is only 2.57%. It is only 2.91% on 10-year Government of Canada bonds.

Mortgage Rates

This downward pressure on government bond yields is pulling down residential mortgage rates. The government bond markets have a much more important effect on mortgage rates than the Bank of Canada. Mortgage rates have been declining this summer despite BOC rate increases. The “special offer” rate on 1-year mortgages is now only 2.90% and the 5-year rate is 4.09%.

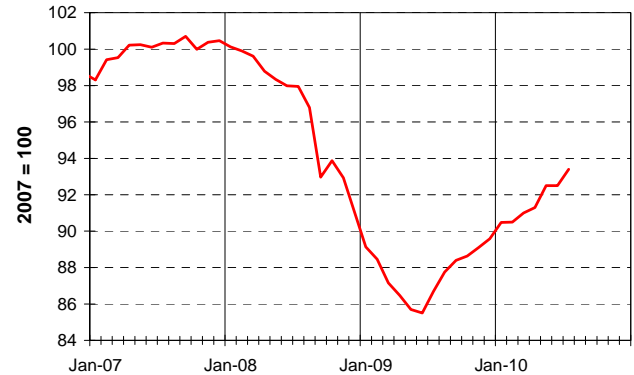
In the U.S., mortgage rates have been running at record lows for the past two months. The latest rate on 30-year fixed mortgages is only 4.42%. This has sparked a rebound in homeowner mortgage refinancing in the United States. Over time, lower monthly mortgage payments will boost household cash flow and contribute to the American consumer spending revival that we expect in 2011.

Temporary Loss of U.S. Momentum

The U.S. economy is still growing but there has been a big loss of momentum in overall economic activity. Annualized real GDP growth is estimated to have slowed down into the 1.0% to 1.7% range. The initial estimate for 2nd Quarter growth is expected to be revised down to just over 1.0% and 3rd Quarter growth will likely be below 2.0%.

In our view this is only a temporary loss of momentum. There are a number of precedents during economic recoveries. In 2002, a shift to slower growth early in the recovery also caused concern. We should also remember that double-dip recessions are rare events. The only one in living memory occurred in 1981-82. This was the result of Federal Reserve interest rate over-kill. Fed Chairman Paul Volker increased the Fed’s overnight rate to 20% in June 1981. With deflation now more of a worry than inflation, the Fed will now do everything in its power to provide monetary stimulus. If necessary this will include aggressive purchases of U.S. government bonds.

UNITED STATES
INDUSTRIAL PRODUCTION



A True U.S. Recovery in 2011

Incoming economic indicators such as industrial production and new orders for business capital equipment suggest that this is gradually changing. In contrast to GDP, U.S. industrial production is not showing any slowdown. It advanced by a full 1.0% between June and July.

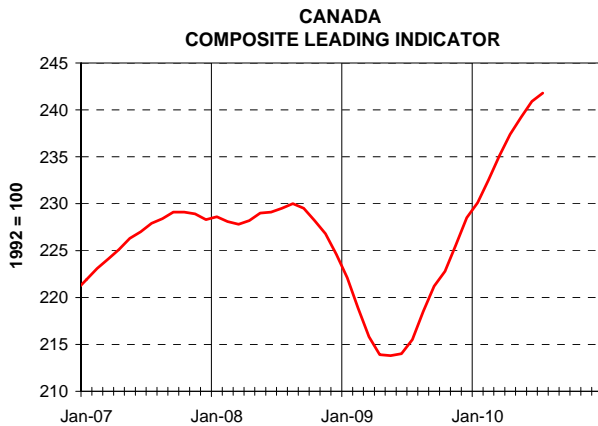
This is putting pressure on companies to increase capital spending. It will also feed into an expansion in payroll employment by next year. Non-defense capital goods orders are in a solid uptrend. Double-digit real growth in business equipment purchases is now taking place. The U.S. recovery in capital spending actually appears to be stronger than in the past two business cycles.

Credit Availability

The great recession of 2008-2009 was not the result of an interest rate squeeze. Instead, it was a balance sheet liquidity crisis triggered by a reckless expansion of debt. Emergency measures in the U.S. restored bank capital and boosted bank reserves. However, U.S. money supply is barely growing even though American banks have more than \$1 trillion in excess reserves with the Fed.

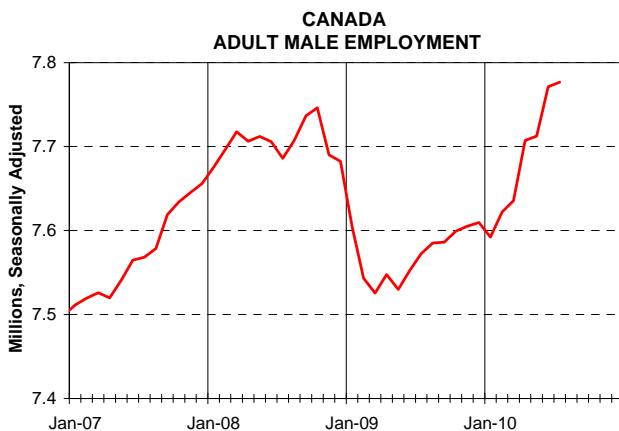
The problem has been that U.S. banks are reluctant to make loans and borrowers are focused on reducing their levels of debt. However, this is changing. The latest senior loan officers’ survey shows that banks in the U.S. have finally begun to ease standards on loans even to small businesses. Business loans by small banks have begun to increase again. This will facilitate capital spending and increased small business hiring. Next year we are forecasting stronger growth in U.S. real GDP. We are predicting annual growth of 3.5%, up from an estimated 2.5% in 2010.

Canada has not been held back by credit availability problems and its leading economic indicators are stronger.



Canada's composite leading indicator index showed a respectable 0.4% month to month increase in July. This was the 14th consecutive monthly increase in the index. While it was the smallest monthly increase so far this year, it is still consistent with a real GDP growth rate in Canada in the 3.0% to 3.5% range through the second half of this year. Canada's economy is currently growing at roughly double the rate of the U.S. economy.

Employment Growth



We have always emphasized employment growth as a key determinant of housing market health. The latest employment news is still positive for new home builders and renovators. Employment for young people has been lagging because of their lack of skills and experience. However, adult employment is on a sharp uptrend. Adult male employment continued to increase in July and the gains have been outstanding since the beginning of the year. This will provide a strong underpinning for housing market demand.

Existing home sales have continued to decline this summer, mainly as a result of monthly declines in Ontario and British Columbia. The July 1st implementation of the HST in these

provinces affected the timing of purchases. There was an incentive to take advantage of lower closing costs before the end of June. This is only a temporary effect however. Sales will be supported this fall by employment and income gains as well as by very low mortgage rates.

New House Prices

New house prices do not indicate a housing market downturn. Statistics Canada's new house price index continued to increase between May and June. Compared to the same month a year ago, the new house price index is up by 3.3%. The major centres with above average yr/yr new house price increases are Quebec City (+3.8%), Ottawa (+4.7%), Toronto (+3.5%) and Vancouver (+6.5%).

Builders in Toronto and Ottawa still report strong market conditions. Significant month to month gains were recorded in June in Toronto/Oshawa (+0.3%), Ottawa/Gatineau (+0.5%) and Montreal (+0.2%). Among smaller centres, Saint John, Fredericton, Moncton and Winnipeg all show substantial month to month increases in June.

Permits and Starts

Residential building permit approvals were granted for 17,729 new dwellings in June. This is up by 2.0% from the month before and 35% from June of 2009. A sharp increase in multiple units, which reflect high-rise construction, more than offset a decline in June in low-rise permits.

With Canada's economy now in a sustainable expansion, we can expect a recovery in condo development. In addition, Canada's position as an international safe haven for investment is attracting foreign buyers to the condo market, especially in Toronto and Vancouver. On an annualized basis, June residential approvals suggest an underlying housing start rate in the months ahead of over 200,000 units.

Housing starts are currently running at a lower rate than building permits. This could reflect the longer time lag between high-rise permits and starts. Total housing starts declined in July for a third consecutive month to a seasonally adjusted annual rate of 189,200 units.

The month to month decline was a modest 1.6%. However, this is the result of an upward revision to the previous June starts figure. The June number was initially reported to be 189,300, which is essentially the same as the latest July figure. June was revised upwards to 192,300 in the July starts report. There has been a pattern of upward revisions to monthly housing starts estimates this year.

Strength in non-residential building permits is more than offsetting a softening in residential permits. Ontario shows a rebound in the value of both commercial and institutional building intentions.

FORECAST SUMMARY

		1Q10	2Q10	3Q10	2009	2010
CPI	(% ch. from yr. ago)	1.6	1.7	2.9	0.3	2.4
PRIME RATE	(end of period)	2.25	2.50	3.00	2.25	3.50
HOUSING STARTS	(000's annualized)	198.2	198.6	190.0	149.1	194.0