

# The Canadian Housing Industry Economic Update



Monthly Report

August 2011

## Canada Is Performing Well

Canada has lived up to our expectations of a sustainable economic recovery. However U.S. growth through the first half of 2011 has been much slower than anticipated. In Canada, real GDP growth in the 2<sup>nd</sup> Quarter appears to have continued at an above-average rate, following the hefty 3.9% annualized rate of advance recorded in the 1<sup>st</sup> Quarter.

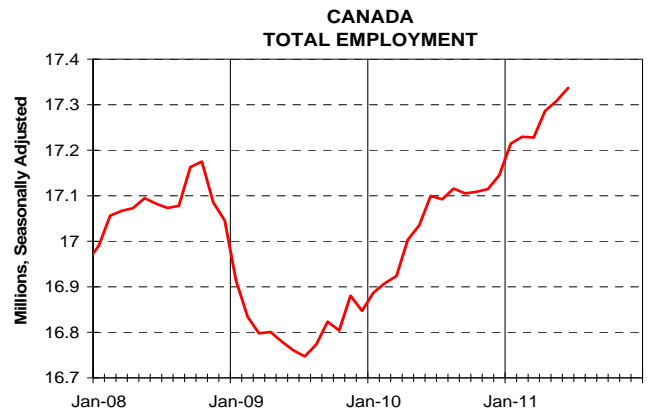
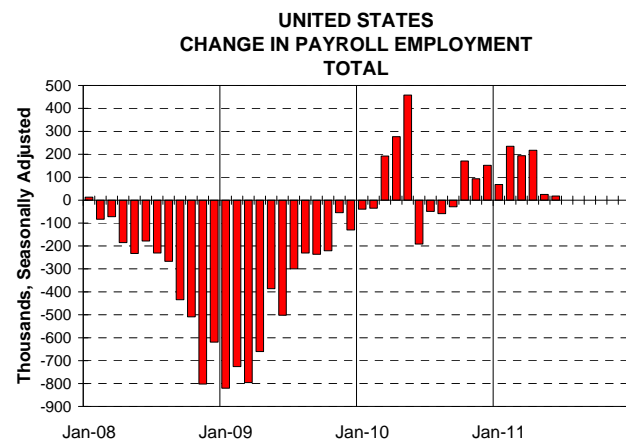
In comparison, economic growth in the U.S. has been much slower than expected, averaging only around 2.0% through the first half of the year. It has been held back by a stronger than anticipated economic shock from the Japanese disaster and spiking oil prices, which have been partly reversed.

American business confidence has been affected by uncertainty over the debt ceiling. A failure to reach an agreement would bring on an immediate recession. Despite strong earnings, favorable profit margins and record levels of cash, U.S. companies have been reluctant to hire.

## U.S. Economic Vulnerability

The missing link in the U.S. economic recovery continues to be decent employment growth. This is what is needed to produce a self-reinforcing and sustainable recovery. Corporate earnings have been strong but corporations have held back from hiring and have preferred to use their accumulating cash for mergers and acquisitions, dividend increases and stock buy-backs.

There have been some signs of improvement in the U.S. labour market. The payroll service firm ADP reported a sizeable increase in payroll jobs in June and initial jobless claims have recently edged lower. However, the June payroll report showed the weakest employment growth in the past nine months – a monthly increase of only 18,000 payroll positions. This was far below consensus expectations that had been boosted by the previous day's ADP report.



## Strong Job Growth in Canada

In contrast to the U.S., total employment in Canada is now well above its previous 2008 pre-recession peak. The recent strength in job growth is good news for Canada's new home builders and renovators. It is supporting income and confidence. It is also producing a revival in government revenues and supporting deficit reduction targets.

The seasonally adjusted unemployment rate in June 2011 stood at 7.4% - its lowest level since January 2009. The momentum in the job market is concentrated in full-time work. Over the 12 months ending in June, full-time jobs have accounted for 86% of the total employment increase.

## A Key Recovery Role for Housing

Healthy housing markets have had a big effect on Canada's ability to recover from the 2008-2009 recession. Household wealth and job market mobility have been maintained.

In the U.S., negative equity in many family homes has crippled household balance sheets. Frozen U.S. housing markets have prevented Americans from relocating in order to take advantage of job opportunities.

The avoidance of distressed housing markets has also allowed Canadians better access to credit. In the U.S., the evaluation of housing collateral is still difficult to calculate and household credit availability remains tight.

## The U.S. Debt Ceiling

The attempt to link the increase in the U.S. debt ceiling to matching spending cuts is meant to assure financial markets that America is taking steps to regain a sustainable fiscal condition. Without such a link, the U.S. will eventually run out of international financing room. The awareness of this would surface earlier, possibly by mid-decade.

It is expected that these cuts will be from spending growth and will be spread out over 10 years. A deal on the debt ceiling should boost confidence in financial markets.

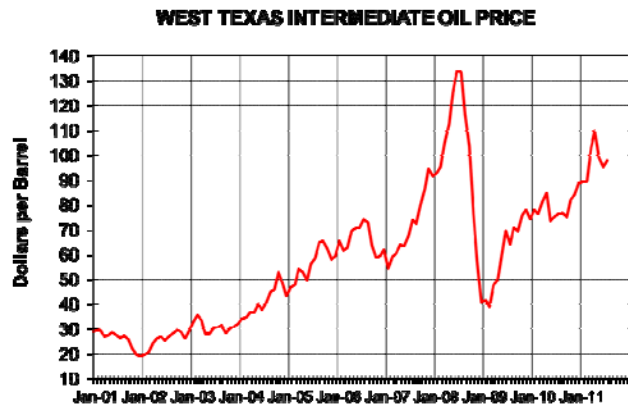
If there is not a deal, federal government spending will have to be rationed. Interest rates would soar. The economy would immediately fall into a recession. Common sense would say that this would not be allowed to happen.

The outcome of the debt ceiling negotiations will be known by early August. Common sense would say that there has to be a deal. Business confidence should therefore rebound in August and hiring should pick up again.

## A Positive U.S. Outlook

There are a number of other reasons to expect more positive economic news in the U.S. in the second half of this year. The European Central Bank and the IMF will facilitate rollovers of Greek government debt. The special factors holding back the U.S. economy this spring will dissipate.

Oil prices peaked following the co-ordinated International Energy Agency move to release strategic oil reserves. The price of West Texas Intermediate crude oil has declined from US\$106.72 per barrel at the end of March to around US\$96 at present.

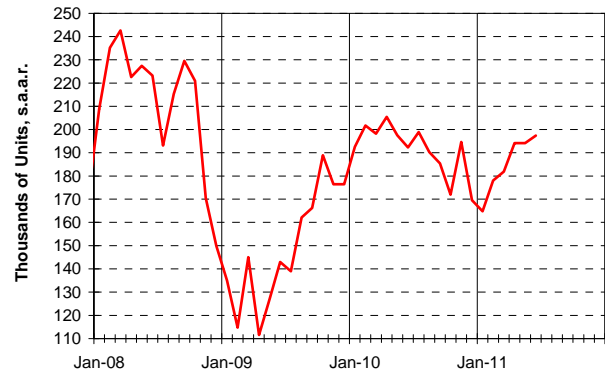


The retail pump price of gasoline has declined from a national average of almost US\$4.00 per gallon to around US\$3.65 per gallon. Same-store retail spending has already picked up in response.

The negative impact from the disaster in Japan has been greater than expected but will turn around when Japanese supply chains are re-established. Japan's economy is now rebounding.

Production and sales of autos are expected to recover this fall. In addition, the large reconstruction efforts in Japan will be partly sourced in the United States.

CANADA HOUSING STARTS

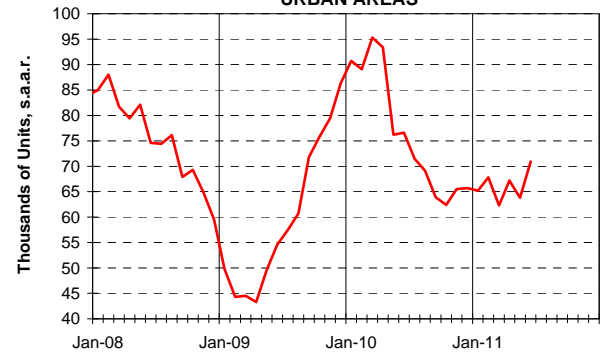


## Housing Starts

Housing starts are running at a much higher level than expected. June housing starts at a 197,400 unit annualized rate were well above expectations. In addition, the starts rate in each of the previous two months has been revised substantially higher as well.

Starts are now reported at a 194,100 unit annual rate in both April and May. This compares with initial estimates of 183,600 for May and 179,000 for April. The end result is a hefty quarterly increase in housing starts from the 1<sup>st</sup> Quarter to the 2<sup>nd</sup> Quarter. Starts averaged 174,900 units at annual rates in the 1<sup>st</sup> Quarter and 195,200 in the 2<sup>nd</sup> Quarter. This is an increase of 11.6%.

CANADA SINGLE DETACHED STARTS URBAN AREAS



The 2<sup>nd</sup> Quarter surge in housing starts was concentrated in high-rise condo construction. However, low-rise single-detached starts staged a breakout in June rising to their highest level in about 12 months.

Looking ahead, the new housing market and renovation activity will be supported by job gains and a balanced resale housing market. Existing home sales improved in June and business hiring intentions are very positive.

### FORECAST SUMMARY

		4Q10	1Q11	2Q11	2010	2011
CPI	(% ch. from yr. ago)	2.3	2.6	3.4	1.8	2.8
PRIME RATE	(end of period)	3.00	3.00	3.00	3.00	3.50
HOUSING STARTS	(000's annualized)	178.7	174.9	195.2	189.9	182.0