

The Canadian Housing Industry Economic Update



Monthly Report

October 2011

Sluggish Growth

There is no doubt that economic growth this fall in both Canada and the U.S. will be much lower than we had expected only a few months ago. Some forecasters are even putting a 60% probability on another recession in the major industrial countries within the next six months.

That is not our forecast though. At this point it looks like sluggish growth rather than an outright contraction. The threats to Canada's economy are external – weak U.S. export demand and European based financial turbulence.

No Outright Downturn

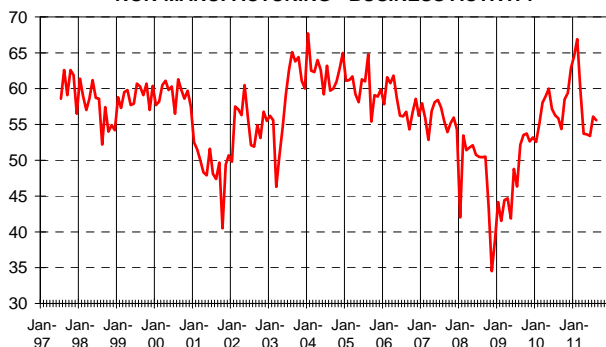
The data that cover the period after the U.S. debt ceiling and credit downgrade shocks show that the U.S. is still growing at a modest and subdued rate. We will have to wait another month for a clearer picture for sales, orders, output, income and employment. Expansion plans may be in jeopardy.

The disappointing August U.S. non-farm payroll survey was carried out in the week ending August 12th and was probably influenced by the emotions of the moment. The weeks immediately before saw the U.S. budget crisis reach a peak and the S&P downgrade was on August 5th.

Fortunately, subsequent U.S. purchasing managers' ISM reports for both the manufacturing and non-manufacturing sectors have been stronger than expected and point to continuing growth. Neither showed evidence of orders being cancelled or capital spending plans being put on hold.

The composite non-manufacturing ISM index actually increased in August, rising to an index level of 53.3 from 52.7 in July. This sector accounts for just over 80% of the U.S. economy. The survey results were published on September 3rd and are what can be considered hard data. The accompanying chart shows the business activity index. It remains higher than in either May or June.

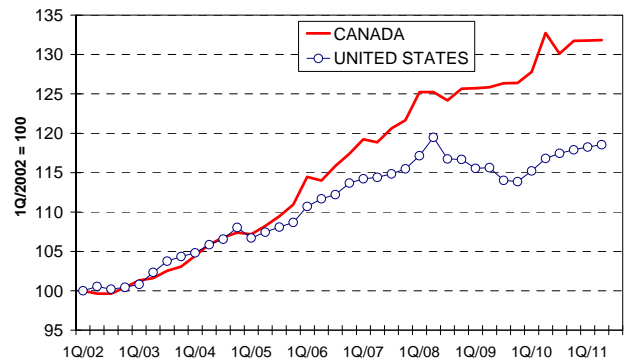
UNITED STATES
INSTITUTE FOR SUPPLY MANAGEMENT
NON-MANUFACTURING - BUSINESS ACTIVITY



A Temporary Stall-Out

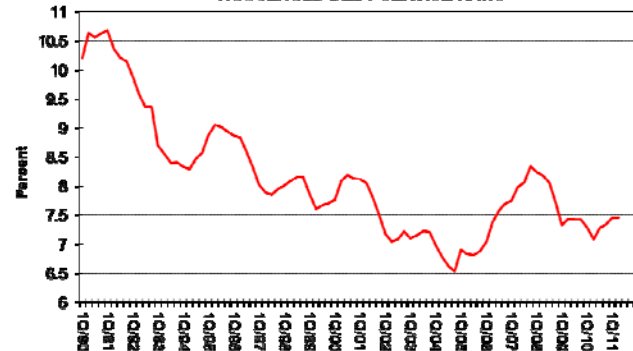
Canada's economy stalled in the 2nd Quarter, largely as a result of temporary factors. The outlook for business investment and household spending is still upbeat and economic growth will reappear in the 2nd Half.

CANADA & UNITED STATES
REAL PERSONAL DISPOSABLE INCOME INDEX



Real disposable income has held up well in Canada but has lost its previous upward momentum. The rate of advance in domestic demand is expected to moderate this fall. In the 2nd Quarter final domestic demand had been advancing at an annualized real rate of 2.8%.

CANADA
HOUSEHOLD DEBT SERVICE RATIO



High levels of household debt could also be a restraining influence on consumer spending, new home buying and renovation spending plans. However, the household debt service ratio is still at a relatively low level in Canada. On average, Canadians can still afford to carry their debt.

Europe Has to Contain Its Crisis

We had thought earlier that Europe's financial crisis was being contained. We were wrong. This is the single largest threat for the Canadian and U.S. economies. European policymakers will have to show that they are able to handle

their fiscal and financial problems. There is an urgent need for additional major policy moves.

Sovereign debt refinancing has to be assured and the liquidity of the European banking system has to be protected. The government bail-out vehicle – the European Financial Stability Facility – does not yet have adequate size or political clout. Also, the European Central Bank has not worked hard enough to calm banking system insolvency fears. Money markets show sharply rising risk awareness and reluctance of European banks to lend to each other.

More Stimulus Is Needed

With the North American economy struggling to maintain recovery momentum more economic stimulus is clearly needed. The obvious place to look for help is in the United States. President Obama’s package of tax cuts, infrastructure spending and direct aid to state and local governments is big – about \$450 billion. It will not be easy to get Congressional approval for all of it but many of the proposals appear to have bipartisan Congressional support

It is a short-term stimulus plan aimed at 2012. It has to be matched with a credible long-term deficit reduction plan. The design of U.S. fiscal policy in the coming months will be vitally important to Canada’s new home builders and renovators. Canada is highly vulnerable to its export linkages with the U.S. economy. We are not calling for a U.S. recession but the risk of one happening within the next six months has risen to its highest level since 2009.

The policy emphasis on job creation in the U.S. also enhances the likelihood that the U.S. State Department will approve the Keystone XL pipeline project by the end of the year. This would give an important confidence boost to Alberta’s oil sands industry.

Bank of Canada

The Bank of Canada has indicated that it will not be increasing its overnight rate target anytime soon. There is even a possibility that it might opt for a rate cut before the end of this year. This would have an immediate impact on the banks’ business prime lending rates as well as on short-term mortgage rates. The remaining Bank of Canada interest rate announcement dates are October 25th and December 6th.

Longer-term interest rates have declined sharply in response to expectations of low growth and stable inflation. Bond yields plunged in September, reaching new all-time lows. Foreign investors regard Canada as an international safe-haven and capital inflows have played an important role in pushing bond yields lower. Longer-term mortgage rates are influenced by bond market trends and could decline further.

New home builders and renovators therefore face a friendly interest rate environment this fall.

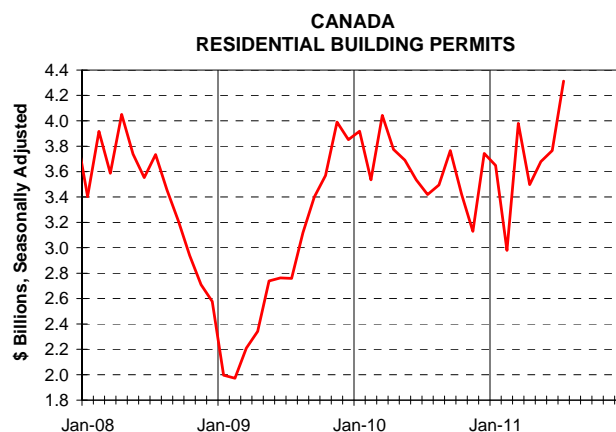
Housing Demand

There was an increase of 25,700 in full-time employment in Canada in August, compared to the month before. This is a healthy increase. The slight decline in total employment reflected a decline in the part-time category. Full-time job growth will support new housing demand this fall.

Resale housing markets have been stable this summer and show a healthy balance of demand and supply. High-rise condo demand is strong in Ontario and sales of new low-rise homes have picked up. New home prices show modest month to month increases. The Toronto/Oshawa Region showed a pronounced monthly new house price increase in July in response to strong market conditions. In contrast, Calgary showed a significant new home price decline in July.

Construction Trends

New housing construction spending in Canada rose sharply in real terms in the 2nd Quarter, putting it back in line with, and actually somewhat above, its average 2010 level. Housing starts declined to an annualized rate of 184,700 units in August from 204,500 in July but building permits point to a continuing high level of starts this fall. The July surge in permits mainly reflected high-rise construction intentions in Ontario. Permits are at their highest level since 2005.



Residential renovation spending increased by 10.1% in constant dollar terms in 2010, compared to the year before. Renovation spending continued to increase in Canada through all of the recent recession. By the 1st Quarter of 2011, it had reached a new all-time high and it moved sideways at this elevated level in the 2nd Quarter. In nominal dollar terms, residential renovation spending amounted to \$45.3 billion in 2010 and new housing construction, \$49.1 billion.

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	3.00
HOUSING STARTS	(000's annualized)	178.7	177.8	192.8	189.9	182.0