

The Canadian Housing Industry Economic Update



Monthly Report

March 2008

U.S. Recession Has Begun

The U.S. economy slipped into a recession at the end of 2007. The fall-out from the U.S. housing related financial crisis has spread through the U.S. economy. Employment is declining and consumer confidence has crashed. Companies are trimming both payrolls and capital spending plans. U.S. real GDP will probably show two consecutive declines in the 1st and 2nd Quarters of this year.

This is bad news for Canada's export-dependent economy and for Ontario in particular. Canadian exports were already declining before the U.S. recession began and we can expect much weaker export performance through the spring and summer. The economic indicators for Canada are still generally positive but it would be a mistake to think that Canada's economy, and its new housing and renovation sectors, will be immune to the U.S. downturn.

How Severe A U.S. Recession?

The optimists are calling for a mild recession in the United States. It could be over by mid-year. However, the key question is what happens in 2009, after the fiscal stimulus wears off. There will have to be some major policy moves this year by the U.S. Government to deal with the threat of rising mortgage defaults.

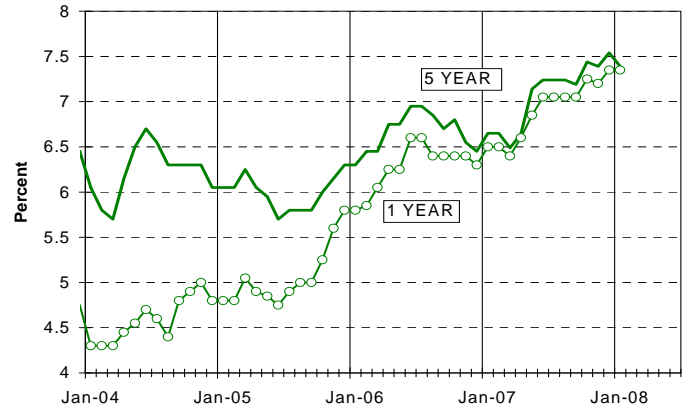
There has been an unprecedented amount of monetary and fiscal stimulus. Under Chairman Bernanke, the Fed has cut interest rates much more aggressively than it ever did under the leadership of Alan Greenspan. Additional rate cuts are expected. In addition the U.S. Congress responded very quickly with a \$150 billion stimulus package.

Tax rebates for lower and middle-income Americans will total \$100 billion. The cheques will start to arrive in May. Business incentives will take the remaining \$50 billion. Most taxpayers will receive a rebate of \$600 per person, plus \$300 per dependent child. All taxpayers below the income limit will receive a rebate of at least \$300 per person. Rebates will be phased out for taxpayers with adjusted gross incomes greater than \$75,000 (\$150,000 for couples filing jointly). This is a hefty stimulus and is capable of getting the U.S. economy growing at around a 3.0% rate in the 3rd and 4th Quarters of this year.

A More Serious U.S. Recession?

Our advice to Canadian new home builders and renovators is to play it safe. It is not a time to go out on a limb with expansion plans and big financial commitments. The U.S. recession may be more serious than we would like to think.

CANADA
MORTGAGE RATES



The basic problem of collapsing U.S. home prices and mortgage defaults and foreclosures could continue to worsen.

Instead of a 2-quarter recession, it could be a 6-quarter downturn. The economic and financial outlook has continued to worsen despite Fed rate cuts. The fiscal stimulus is a one-time effort that will wear off by early 2009. The global financial system will be the determining factor on the sustainability of the economic recovery in 2009.

It is being threatened by the possible spread of financial stress from sub-prime mortgages through to consumer debt, bond insurers, commercial real estate loans, corporate debt, hedge funds and private equity debt. The sustainability question will be particularly important for Canada, as we have enough momentum to sustain growth through to mid-2008 but not enough to last through to mid-2009.

A New Bank of Canada Governor

Bank of Canada Governor Mark Carney has chosen a particularly difficult time to start his new job. The U.S. economy is in a recession but Canada is not there yet. The first indications are that he will be willing to make significant interest rate cuts, even though Canada's job market is still tight and wage inflation is at a high level. Employment increased by 46,000 in January and the unemployment rate slipped again to a 33-year low of 5.8%. Wage inflation is running around 4.0%. Governor Carney recognizes the growing threats to the financial system though. We would not be surprised to see a 50 point interest rate cut by the Bank of Canada at its next interest rate decision date on March 4th.

Lower Mortgage Rates

Monetary policy easing is good news for mortgage rates. They are coming down. Bank of Canada rate cuts will have a

direct effect on 6-month and 1-year mortgage rates. Variable mortgage rates are coming down as well. The open 5-year variable rate is now down to 5.00% on a discounted basis.

The longer-term mortgage rates will move with comparable bond yields. They are moving lower as evidence of a U.S. economic downturn accumulates. The benchmark 10-year Government of Canada bond yield is down by about 50 basis points from last September to a current level of around 3.82%. Canada's new home builders can therefore look forward to an improving mortgage rate environment in 2008.

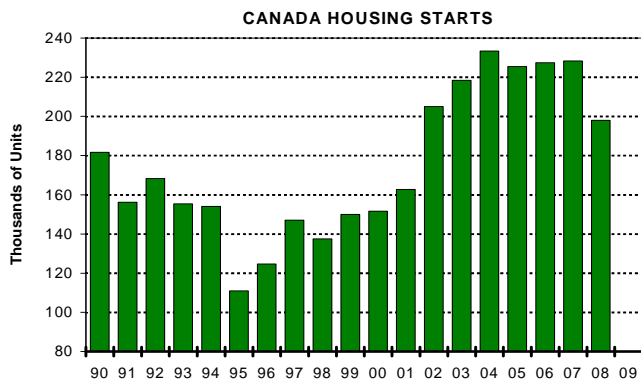
Better still, the Canadian banks will be willing to lend. This will be a big difference with the U.S., where the availability of mortgage credit has dried-up, even for prime credits.

Existing Home Sales Activity

January resale activity was below the pace of January 2007, signalling that housing demand is moderating. The resale market is always a good indicator for conditions in the new home market. The cooling in existing home sales is particularly noticeable in Calgary and Edmonton. The resale market remains very strong in Saskatchewan though. New listings are up sharply, suggesting that vendors are sensing a turn in the market and want to sell while market conditions are still generally favourable. In Ontario, existing home sales were particularly weak in Durham Region and St. Catharines.

Housing Starts

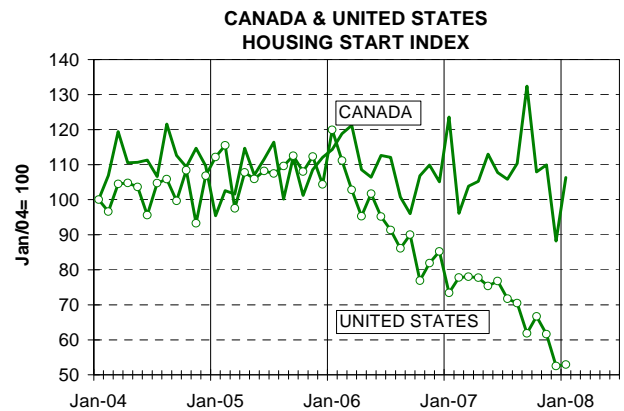
Forecasts for Canadian starts are pointing to a down year in 2008. Projected declines range from 7% to 14%. In recent years though, forecasts for Canadian housing starts have tended to be too low. The actual numbers have consistently exceeded the earlier forecasts. This may be influencing forecasts for 2008, keeping them at a relatively high level. Our forecast of 198,000 starts in 2008 is at the lower end of the forecasting range. It is based on our view that the U.S. recession will have an impact on confidence in Canada.



Regional Developments

Economic performance in Ontario will be a key determinant of homebuilding activity in 2008. Ontario's economy is currently under pressure because of the elevated Canadian dollar as well as declining demand for Canadian exports in the United States. The overall Canadian economy could avoid the U.S. recession that has just begun. However, Ontario is the most exposed and is currently on the brink. This indicates, even in a best case scenario, employment weakness, rising unemployment rates and declining consumer confidence in Ontario.

As a result, we expect housing starts in Ontario to show another significant decline in 2008. Hopefully we are wrong. However, new home builders should be aware of the risk. Even with a 10% decline in Ontario starts in 2008, Canada's housing sector will still continue to out-perform its U.S. counterpart by a wide margin.



House Prices

House prices are giving a completely different message in Canada, compared to the United States. The average Canadian new house price edged higher between December and January and stands 6.2% above January of 2007. However, the big run-up in prices seems to be over. A number of cities (Halifax, Quebec, Montreal, Ottawa-Gatineau, London, Edmonton, Vancouver and Victoria) showed no price increase between December and January. Windsor is the only market showing a yr/yr decline (-1.1%) in new house prices. The Toronto-Oshawa region shows a 3.4% yr/yr increase; Calgary, 6.0%: and Vancouver, 6.4%.

Building Materials Costs

The strong CAD and the U.S. housing slump should be producing price declines for imported building materials. However, the price of copper has soared over the past month and crude oil and gasoline prices are surprisingly strong.

FORECAST SUMMARY

		3Q07	4Q07	1Q08	2007	2008
CPI	(% ch. from yr. ago)	2.1	2.4	1.9	2.1	1.6
PRIME RATE	(end of period)	6.25	6.00	5.25	6.25	4.75
HOUSING STARTS	(000's annualized)	243.7	214.0	214.0	228.3	198.0